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Arizona Corporation Commission
DOCKETED
APR 27 2004
DOCKETED BY

Commissioner Kristen Mayes
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Dear Commissioner Mayes:

I received your April 16, 2004 letter regarding UES' RFP process and thank you for recognizing the efforts that we undertook in issuing the RFP. Overall we were pleased with the participation. It is interesting to note that twice the number of bidders participated in this RFP than in TEP's much publicized Track B RFP last year. As explained in the April 2, 2004 Progress Report summarizing the RFP results, the current market conditions do not provide a better supply option than the existing PWCC contract. However, we feel this process has provided a good baseline of data and information that we will use in assessing future supply options for UES.

I have addressed your specific questions and concerns below.

Frozen Bid

In order to allow time to analyze bids against each other and other alternatives, it is necessary to freeze the bids for the evaluation period. Since most of the bids received were index-priced bids (the electricity price is based on future spot gas prices) there is little risk to these bids since the bidder is not offering a "fixed price". The risk primarily lies with bidders who offer a fixed price product and bear the risk that energy prices for their bid period change during the evaluation period. In order to mitigate this risk and encourage bidders to participate, UES emphasized, in both our RFP documentation and Bidders' Conference call, that "Fixed price bids will be treated as indicative in nature and the prices of such bids will be finalized in the negotiation process". Given this ability to "refresh" bids and the participation in the RFP, we do not believe bidders were discouraged from participating and did not receive any feedback from the bidders to the contrary.

Incremental Amounts of Power

UES required a minimum bid of 10 MW in this RFP. UES preferred bids in increments of 25 MW for standard products (6x16 and 7x24) for two main reasons 1) it is the standard contract size in forward electricity markets and would increase the amount of bids due the higher liquidity of the product and 2) it would limit the complexities associated with negotiating with so many parties to serve a load ranging from 350 MW in 2004 to 500 MW in 2014.

UES communicated to the parties in both the RFP documentation and the Bidders' Conference call that we were open to alternative products and flexible in evaluating any product (including term, delivery point, contract size, etc.). For example, the RFP stated,

> "The four Products listed are the preferred Products however other Products may be considered."

and

> "UNSE prefers to take delivery at the aforementioned locations but will consider deliveries at other local delivery points. Bidders can utilize the transmission paths listed above or arrange for transmission themselves. Other points will be considered in the process with the Bidder responsible for establishing that an alternative delivery point will serve UNSE's needs".

Given this background and the RFP flexibility, we do not believe smaller stated increments would have provided better bids.

ACC Review and Approval

The requirement for Commission approval in the RFP states:

> "UNSE may require Master Agreement entered into by UNSE and Seller to be subject to and contingent upon ACC approval and authorization. UNSE will notify Seller of any such contingency prior to the signing of the Master Agreement."

Given the risk to UES associated with restructuring the PWCC supply agreement or entering into alternate supply agreements, we feel it would be necessary for the Commission to review and approve any such structure.

UES discussed this requirement with the bidders during the Bidders' Conference and clarified that any contingency for ACC approval would be known during subsequent negotiations and prior to signing any agreements. We did not receive any negative feedback from the bidders relating to this requirement and do not believe it dissuaded any from participating. We further do not believe that participants submitted higher bids to account for the risk since they would have opportunity to address the risk during negotiations or submit index priced bids to mitigate the risk.

Local Power Plants

Southpoint (through Calpine Energy Services), Griffith (through Duke Energy and PPL EnergyPlus) and Blythe (through FPL Energy) power plants all submitted proposals in the RFP. These three generators are located near UES' Mohave County load.

Separate RFP's for Mohave and Santa Cruz

The small nature of Santa Cruz County's load (~55 MW) and limited local resource alternatives (unlike Mohave) make it more beneficial to include it as part of the larger 300+ MW Mohave load. Although Mohave and Santa Cruz County loads are many miles apart, the transmission receipt points (Pinnacle Peak and Saguaro, respectively) are much closer together and are both on WAPA's system providing some economies of scale for potential bidders. While we believe issuing the single RFP

actually encouraged more bids for the Santa Cruz load we are aware that this may not always be the case and will analyze the use of separate bids in future RFP's.

FERC Negotiation Process

We have discussed the FERC mediation process with our outside legal counsel. These discussions have led us to the conclusion not to pursue the FERC mediation process. We believe FERC would analyze whether the contract was within a zone of reasonableness, where the prices are neither less than compensatory, no excessive. Based upon the results of this RFP, and the Company and Staff testimony in the acquisition hearing, we believe that the current contract is within a zone of reasonableness. Nonetheless, we will continue to seek alternatives to provide lower cost power to our customers.

Transmission

Currently, there is sufficient transmission capacity to serve the UES Electric load in both Mohave and Santa Cruz Counties. This includes transmission under long-term contracts with WAPA and short-term summer transmission purchases to provide the additional required capacity to Mohave County. The long-term contractual transmission service delivers the power from the receipt points under the PWCC contract (Saguaro and Pinnacle Peak) to the UES load. The short-term summer purchases or alternative solutions to meet the demand in Mohave county, such as local generation, requires agreement from PWCC. UES is currently evaluating several different options to meet the future needs in Mohave County with additional transmission and/or generation.

The radial 115kV circuit serving the UES Santa Cruz County load will soon reach its capacity limits. New transmission infrastructure or additional local generation will be required in the very near future to meet the growing demand in Santa Cruz County. The single transmission feed into Santa Cruz County also presents service reliability issues. The planned South Loop to Gateway 345kV Project will satisfy both the transmission capacity and reliability issues for Santa Cruz County.

There are no direct transmission paths from the Palo Verde hub to the UES load areas. Palo Verde energy requires at least one wheel to interconnect to UES' existing transmission rights on WAPA's system. Under the existing PWCC contract, PWCC provides the transmission to UES' WAPA interconnects via a network transmission service agreement with APS.

As seen in this RFP, suppliers have the ability to transfer power directly to UES load or its receipt points on WAPA's system. The need for additional transmission lines or rights to serve UES load will depend on the location of the generation supply relative to the load. Additional transmission infrastructure will be reduced if existing or new plants near the UES loads in Mohave County are utilized to serve the load or new generation is sited in transmission constrained areas. UES is currently evaluating the long-term transmission and supply options using the results of this RFP and possible future supply options as a backdrop. The purpose of this evaluation is to develop a supply and transmission strategy that will provide long term, stable, reasonably priced service in Mohave and Santa Cruz Counties.

PWCC Meeting

The discussions around resource additions are to provide the general background for future opportunities that may present themselves to UES. While no particular alternatives have yet presented themselves, we intend these discussions to generally include possible asset purchases or contracts from generation units that come up for sale or local generation in areas that would increase reliability and/or reduce the UES dependence on future short-term transmission purchases. These discussions are primarily aimed at increasing the flexibility of UES to take advantage of opportunities which may present themselves with a rather short timeframe for negotiation and decision-making.

If you would like to discuss any of these matters further, please do not hesitate to call me.

Sincerely,

James S. Pignatelli

JSP:lhk

cc: Chairman Spitzer
Commissioner Mundell
Commissioner Gleason
Commissioner Hatch-Miller
Brian McNeil
Earnest Johnson