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Arizona Corporation Commission Public Comment Form

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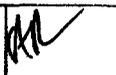
Step 1

This form should be used for public comments pertaining to a specific pending case only. Please be sure to reference the appropriate docket number so your comments are filed in the docket promptly. Please use the Consumers Services Assistance Form for complaints, inquiries or general inquiries.

Step 2

YOUR NAME D. Blake Wheatley	DATE 11/5/2004
YOUR ADDRESS 2530 North 491st Avenue, Tonopah, AZ 85354	YOUR PHONE NUMBER (636) 532-2200
DOCKET YOU WISH TO COMMENT ON:	DOCKET NUMBER E-01345A-03-0437
CASE OR UTILITY NAME Arizona Public Service Company	YOUR POSITION ON THIS DOCKET PRO <input type="radio"/> CON <input type="radio"/> OTHER <input checked="" type="radio"/>
YOUR E-MAIL ADDRESS bwheatley@lspower.com	

Step 3

ENTER YOUR COMMENTS HERE: Comments are included in the attached letter.	
Arizona Corporation Commission DOCKETED NOV - 5 2004 DOCKETED BY 	
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Step 4

*This form may be completed electronically, printed and mailed to:
Arizona Corporation Commission, Consumer Services Section, 1200 W. Washington St.
Phoenix, Arizona 85007; or*

*You may save the completed form and e-mail it as an attachment to:
mailmaster@cc.state.az.us*

New Harquahala Generating Company, LLC

2530 North 491st Avenue
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Phone (928) 372-3200
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November 5, 2004

Electronically Filed and Hand Delivered

Brian C. McNeil
Executive Secretary
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007-2996

RE: IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND FOR APPROVAL OF PURCHASED POWER CONTRACT
Docket No. E-01345A-03-0437

Dear Mr. McNeil:

New Harquahala Generating Company, LLC ("NHGC") hereby submits public comments on the Proposed Settlement of Arizona Public Service Company's ("APS") request for a rate increase and request for approval of its acquisition of generation resources owned by its affiliate, Pinnacle West Energy Corp. ("PWEC").

The proposed settlement ignores the crucial principles embodied in the Commission's Track A and Track B Orders. As those well-reasoned orders underscore, the Commission can most effectively protect Arizona ratepayers by requiring that the reasonableness of any proposed asset acquisition be first demonstrated by its selection as the best choice resulting from an independently monitored RFP. The Track A and B Orders recognized that anything short of an RFP, including any effort to create a proxy-RFP in an attempt to demonstrate that, if APS were to issue an RFP, no supplier other

than PWEC would respond with a more attractive offer, is a poorly conceived regulatory substitute for competitive bidding.

Just as important, an independently monitored RFP is the only way to ensure that competition is not harmed by foreclosing the opportunity of market participants such as NHGC from the opportunity to supply APS's long term power supply needs. Arizona has many competitive wholesale generation suppliers which stand ready to compete to meet APS's needs. Unless PWEC competes head-to-head with other supply sources, it cannot be concluded that the asset acquisition is the least cost alternative and will not harm ratepayers and competition. In addition, the asset acquisition will require approval of the Federal Energy Regulatory Commission (FERC), an approval that is unlikely without an RFP because FERC's clear policy is that affiliate arrangements must be priced consistent with market alternatives and FERC has a strong preference for determining such market alternatives through an RFP.

A competitive solicitation is the best way to ensure that Arizona ratepayers are being served at least cost. The most effective means to determine that APS meets the long-term resource needs of Arizona ratepayers reliably and at the lowest cost is to let competition work and evaluate the reasonableness of the proposed asset acquisition against the results of an RFP. In fact, this Commission's own Track A and Track B orders came to this very conclusion. Those orders, which received broad support from, among others, APS, independent power producers and the Residential Utility Consumer Office (RUCO), clearly determined that an RFP is the best way for Arizona customers to get the best deal. In its Track A order, the Commission found:

that requiring some power to be purchased through the competitive procurement process developed in Track B will encourage a phase-

in to competition, encourage the development of a robust wholesale market for generation, and obtain some of the benefits of the new Arizona generation resources, while at the same time protecting ratepayers. Track A Order at 30, lines 13-15.

The Track A Order specifically noted that APS intended to acquire affiliate assets, and directed that “[i]f APS wishes to pursue this issue, it should file the appropriate application (s) by September 15, 2002. The results of the proceeding on such issue *shall not* affect the amount, timing and manner of the competitive procurement process.” *Id.* at 31, lines 9-12 (emphasis added). Finally, the Commission held:

IT IS FURTHERED ORDERED that upon implementation of the outcome of Track B, APS shall acquire at a minimum, any required power that cannot be produced from *its own existing assets*, through the competitive procurement processes as developed in the Track B proceeding. The minimum amount of power, the timing, and the form of procurement shall be determined in the Track B proceeding. *Id.* at 33, lines 6-9 (emphasis added).

The critical underpinnings of the Track A and Track B Orders are as valid today as they were then. NHGC maintains that APS must market test its proposed acquisition in order to prove that its purchase is prudent. As Greg Patterson of the Arizona Competitive Power Alliance then observed:

Competitive solicitations are essential to achieve the best deal for ratepayers in terms of price, risk, reliability and environmental performance.¹

NHGC believes that it cannot be determined whether Arizona customers are being served at least cost if the acquisition of 1800 MW is not competitively tested and, for this reason, urges that the Commission require an RFP before ruling on the settlement proposal².

¹ Greg Patterson, Arizona Competitive Power Alliance, Comments on Solicitation Process, November 13, 2003 at page 1.

²NHGC notes that it is a member of the Arizona Competitive Power Alliance (the “Alliance”), and that the Alliance participated in settlement negotiations regarding this matter, and that the Alliance ultimately

Many wholesale suppliers stand ready to compete to serve Arizona customers. There is little doubt that many potential competitive suppliers exist in Arizona and, therefore, that an RFP will produce many competing proposals. It is a matter of public record that, in the initial Track B solicitation, APS received more than 175 bids from 10 different suppliers totaling over 2,750 MW of on-peak capacity for 2003 and over 4,000 MW for 2004.³ The Independent Monitor evaluated the solicitation and concluded that it was a success, producing competitive prices for Arizona customers.⁴ Similarly, in the RFP that resulted in the selection of the PPL Sundance facility, APS received 13 proposals from 9 different merchant generators and power marketers for both asset purchases and purchased power agreements (PPA) with a cumulative total of about 6,800 MW.⁵ There should be little question that an RFP seeking long term supply, the majority of which is to be delivered at Palo Verde, will generate significant interest.

There is simply no reason to sidestep an RFP or to guess at the extent and terms of the competing offers that APS will receive. All APS need do is issue an RFP and the

supported the settlement. However, at no time was NHGC involved in these settlement negotiations or did it ever indicate its support for the settlement. In fact, the Alliance itself expressly recognized that it did not necessarily represent the views of all of its members. As noted in Greg Patterson's Direct Testimony submitted on behalf of the Alliance, "The positions contained in this filing represent the views of the Alliance as an organization, but not necessarily the views of any particular member with respect to any issue. Any individual Alliance member may take different positions with respect to any issue (September 27, 2004, at page 2).

³ Independent Monitor's Final Report on Track B Solicitation, May 27, 2003), (Final Report) at page 23.

⁴ Final Report at page 4.

⁵ Direct Testimony of William Gehlen, Utilities Analyst, Utilities Division Arizona Corporation Commission, September 17, 2004, at page 4.

answer will be known. Prior solicitations have saved Arizona ratepayers millions of dollars⁶, and an RFP now can do so again.

References to other RFPs where PWEC did not participate are meaningless as support for the acquisition. The way to demonstrate the proposed acquisition is prudent and is the lowest cost to Arizona customers is through subjecting it to the litmus test of an RFP where PWEC must compete together with all market participants to serve APS's long-term power supply needs. Reference to other RFPs where PWEC did not compete serve as no gauge for concluding that this acquisition is the best deal for ratepayers. For example, APS's most recent RFP did not propose to meet anything near 1800 MW of its needs and there is no basis to conclude that market participants would respond in the same manner now as then. The only way to ensure least-cost is a head-to-head competition for similar products and PWEC should not be selected unless it withstands the rigor of such a competitive challenge. This is particularly relevant in NHGC's case because its Harquahala facility is of similar technology, size and location to PWEC's Redhawk facility. Ratepayers suffer no harm if APS is required to conduct an RFP since they will either save money through the acquisition of cheaper resources or the affiliate resources will be confirmed as the least cost alternative. Either way, the end result is ratepayers being assured of the best deal.

In contrast, the failure to rely on an RFP will have long term effects on the wholesale market in Arizona and, thus, on ratepayers because it will harm competition by signaling generators that contestable load can be simply awarded to utility affiliates without even giving competitors the chance to respond with more attractive offers.

⁶ See, Final Report at page 6, noting APS's estimate that the Track B solicitation yielded about \$70 million in savings.

NHGC recognizes that the Proposed Settlement provides that APS will not self-build a facility with an in-service date prior to January 15, 2015, without authorization from the Commission. However, the 1800 MW acquisition from PWEC represents a significant amount of APS's resource needs through 2015. The fact remains that, awarding 1800 MW to PWEC forecloses market participants such as NHGC from an opportunity to supply APS's long-term needs. This will discourage development of merchant generation and ultimately raise costs to Arizona ratepayers above competitive levels, if the acquisition is not doing so directly.

Without an RFP, FERC approval is unlikely or, at the very least, will require lengthy litigation. FERC has recently announced new generic guidelines for evaluating affiliate transactions⁷ and APS's acquisition will be subject to those guidelines. These are the identical guidelines that FERC has historically applied to PPAs among utilities with captive customers, such as APS, and affiliated power suppliers, like PWEC.

Ameren holds that affiliate acquisitions will be subject to the FERC's *Edgar* standard⁸ which requires a demonstration that the acquisition is reasonably priced when compared to alternatives in the market. This standard can be met by: (1) evidence of direct head-to-head competition through a well-structured, open and transparent RFP with independent third-party oversight, (2) evidence of prices which non-affiliated buyers were willing to pay PWEC for the assets; or (3) benchmark evidence showing that the purchase price is in line with what non-affiliated buyers and sellers have negotiated for similar assets.

As a result, FERC approval will require that APS demonstrate that the acquisition is the result of a competitive solicitation providing for direct head-to-head competition or

⁷ *Ameren Energy Generating Company, et al.*, (Ameren), 108 FERC ¶ 61,081 (2004).

⁸ *Boston Edison Company re: Edgar Electric Co.*, 55 FERC ¶ 61,382 (1991).

that the acquisition is at terms equivalent to what non-affiliates would have agreed upon for similar assets at the same time as the acquisition. Simply put, APS cannot rely on head-to-head competition because there was none. And, try as it may, APS will not likely succeed in justifying the transaction on a benchmark analysis given the many wholesale generation suppliers in Arizona and the level of participation in prior RFPs. This is precisely the reason that FERC has made clear its strong preference to avoid the time-consuming and wasteful litigation of developing a record on substitutes for an RFP:

Because the market for generating assets is not nearly as liquid as the market for PPAs, a competitive solicitation through a formal RFP in future section 203 cases is likely to be the most effective way to show that an affiliate transaction is not marred by affiliate abuse.⁹

These very principles are what lead this Commission to the conclusion it reached in its Track A and B Orders.

FERC also laid out specific guidelines for RFPs involving affiliate assets.¹⁰

Those guidelines provide that a good RFP must have four core attributes:

- Transparency: the competitive solicitation process should be fair and open
- Definition: the products should be clearly defined
- Evaluation: the evaluation criteria should be standardized and applied to all bids and bidders
- Oversight: an independent third party should oversee the design of the solicitation, the administration of the bidding and the bid selection

These guidelines closely follow the RFP process developed through the Track B workshops and hearings, yet are conspicuously absent from the proposed acquisition

⁹ *Ameren* at P 67.

¹⁰ *Ameren* at P 72-84.

from PWEC. Implementing these guidelines has already provided Arizona ratepayers significant savings and would no doubt do so again were they to be used to market-test the APS acquisition of affiliate assets. Without a well-designed, transparent and open RFP that possesses the above attributes, FERC approval is unlikely.

Given this, NHGC urges the Commission to require that APS issue a competitive solicitation. Absent such an RFP, the acquisition will severely harm competition by allowing APS to rate base its affiliate's merchant generation. This safety net does not exist to generators who are not affiliated with APS, is a disincentive for merchant generators to invest in new facilities, and creates a barrier to entry which harms competition and raises prices to customers in the long run. FERC clearly recognized this in *Ameren*:

A franchised public utility is generally a major purchaser of generation resources in a region and thus may have some degree of buyer market power, or monopsony power. Purchase of an asset through a utility procurement to serve the utility's franchised load may be the best opportunity in some regions for a power plant investment to succeed or, in the event of failure, to recover its investment. In a less concentrated buyer's market (less monopsony power), a firm seeking to exit a particular market would sell its assets to other market participants for a fair market value. However, if a franchised utility has buyer market power, the price that the exiting firm will recover is likely to be less. This increased proportion of total costs likely to be unrecoverable by an exiting firm is a barrier to entry.¹¹

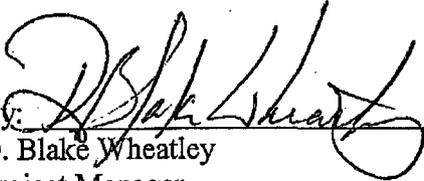
APS has a substantial retail load that it must supply and, without the ability to compete in an RFP, market participants like NHGC are foreclosed from the market and will suffer competitive harm.

In conclusion, NHGC requests that the Commission direct an RFP pursuant to which PWEC must compete head-to-head with all market participants. This is the best

¹¹ *Ameren* at P63 (footnote omitted).

way to protect both ratepayers and Arizona's competitive wholesale market. Absent an RFP, the acquisition creates significant competitive harm to NHGC and APS ratepayers.

Sincerely,
New Harquahala Generating Company, LLC,
By: LSP Services, LLC, authorized signatory

By: 
D. Blake Wheatley
Project Manager