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BEFORE THE ARIZONA CORPORATION COMMISSION RECEIVED

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3 WILLIAM A. MUNDELL
4 Chairman
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6 Commissioner
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8 Commissioner
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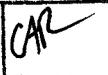
Arizona Corporation Commission

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10 IN THE MATTER OF THE GENERIC
11 PROCEEDINGS CONCERNING
12 ELECTRIC RESTRUCTURING ISSUES

Docket No. E-00000A-02-0051

14 IN THE MATTER OF ARIZONA PUBLIC
15 SERVICE COMPANY'S REQUEST FOR
16 A VARIANCE OF CERTAIN
17 REQUIREMENTS OF A.A.C. R14-22-1606

Docket No. E-01345A-01-0822

19 IN THE MATTER OF THE GENERIC
20 PROCEEDING CONCERNING THE
21 ARIZONA INDEPENDENT
22 SCHEDULING ADMINISTRATOR

Docket No. E-00000A-01-0630

24 IN THE MATTER OF TUCSON
25 ELECTRIC POWER COMPANY'S
26 APPLICATION FOR A VARIANCE OF
27 CERTAIN ELECTRIC COMPETITION
28 RULES COMPLIANCE DATES

Docket No. E-01933A-02-0069

30 IN THE MATTER OF THE
31 APPLICATION OF TUCSON ELECTRIC
32 POWER COMPANY FOR APPROVAL
33 OF ITS STRANDED COST RECOVERY

34
35 **TRACK B REPLY BRIEF OF THE**
36 **LAND AND WATER FUND OF THE ROCKIES**
37

38 The Land and Water Fund of the Rockies' (LAW Fund) recommendations in this
39 proceeding are simple and direct: the Arizona Corporation Commission (Commission) in
40 its Track B order should initiate separate proceedings to develop Commission policy on
41 demand-side management (DSM) and environmental risk management. The LAW Fund
42 is *not* asking the Commission to adopt specific DSM or environmental risk management

1 policies in its Track B order or to apply specific policies to the initial competitive
2 solicitation; rather, the LAW Fund is requesting the Commission now establish the
3 *process* for analyzing and developing Commission policy on these issues, to be applied to
4 second and subsequent solicitations.

5 Notwithstanding the straightforward nature of the LAW Fund's
6 recommendations, the post-hearing briefs of Staff, Arizona Public Service Company
7 (APS) and Sempra Energy Resources (Sempra) indicate some confusion as to exactly
8 what the LAW Fund is requesting that the Commission do in its Track B order. To dispel
9 any remaining confusion, this reply brief repeats the LAW Fund's recommendations,
10 followed by a discussion of why the objections of Staff, APS and Sempra are misplaced.¹

11 **Overview of LAW Fund's Recommendations**

12
13 Dr. David Berry, testifying on behalf of the LAW Fund, recommended that the
14 Commission initiate *separate* proceedings to develop Commission policy on DSM and
15 environmental risk management. Those separate proceedings would consist of a series of
16 stakeholder workshops, followed by Commission hearings leading to the development of
17 Commission policy on these issues. *See* Berry Direct, Exhibits DB-2 and DB-3
18 (LAW-1). He suggested that the Commission consider these issues in separate
19 proceedings in order not to slow down the first round competitive solicitation. He
20 encouraged the Commission to start the process quickly, though, so that DSM and
21 environmental risk management policies can be comprehensively reviewed and
22 completed in time to be applied, as inputs, to the second and subsequent rounds of

¹ Sempra raises the same objections as Staff on DSM and environmental risk management in its post-hearing brief. Sempra's objections should be rejected for the reasons discussed herein with respect to Staff's comments.

1 competitive solicitations, taking into account the time needed to refine the solicitation
2 process for the second round. *See id.*, at pp. 2-5; Tr. (Vol.IV), pp. 821-822.

3 Staff's argument – that, given the tight time frame governing the initial
4 solicitation, the issues of DSM and environmental risk management are beyond the scope
5 of this proceeding – misinterprets the LAW Fund's recommendations (Staff Initial
6 Closing Brief, at p. 9). The LAW Fund recognizes the Commission's desire to conduct
7 the first round solicitation expeditiously, and it does not seek to slow down the first round
8 solicitation. Accordingly, the LAW Fund's recommendations do not affect the timing or
9 the substance of the first round solicitation. Rather, the LAW Fund is recommending that
10 a separate process be established now to ensure that DSM and environmental risk
11 management policies are in place in time for inclusion in the second and subsequent
12 solicitations.

13 Staff's contention (Staff's Initial Closing Brief, at p. 9) that DSM and
14 environmental risk management are outside the scope of these proceedings is inconsistent
15 with the Administrative Law Judge's (ALJ) Third Procedural Order on Track B Issues in
16 this docket. In that Procedural Order, at p. 8, the ALJ specifically stated that the hearing
17 should cover the issues identified by the parties, including DSM and management of
18 environmental risk as proposed by the LAW Fund. Further, Commissioner Spitzer
19 questioned RUCO's counsel during opening statements about the benefits to ratepayers
20 of DSM and about the environmental consequences of utility resource acquisition
21 decisions. Tr. (Vol.I), pp. 40-43. Thus, the LAW Fund's recommendations on DSM and
22 environmental risk management are properly within the scope of this proceeding.

1 APS also appears to misapprehend what the LAW Fund is asking the Commission
2 to do in its Track B order. APS recommends against the adoption of the LAW Fund's
3 recommendations because the record is not adequately developed. *See* APS Post-Hearing
4 Brief, at p.22. Yet, as stated previously, the LAW Fund has not requested that the
5 Commission adopt specific policies on DSM or environmental risk management in its
6 Track B order. Rather, the LAW Fund requests that the Commission initiate workshops
7 and hearings precisely in order to create the extensive record necessary for the
8 development of thoughtful Commission policy on these issues. *See* Tr. (Vol.IV), at
9 p.823. APS does state that, if the Commission wishes to consider these issues, it would
10 not oppose further workshops. *See* APS Post-Hearing Brief, at p.23. The LAW Fund is
11 encouraged by APS's willingness to participate in workshops on these issues (or, at a
12 minimum, its lack of opposition to them), and would look forward to working with APS
13 and other parties at the workshops to develop sound DSM and environmental risk
14 management policies.

15 **Environmental Risk Management**

16
17 Dr. Berry submitted testimony on the public interest in the environmental aspects
18 of utility resource acquisition.² He also gave several examples of the types of
19 environmental risk management policies that could be considered at the workshops and
20 hearings the LAW Fund has proposed.³ However, the LAW Fund is not proposing a
21 specific environmental risk management policy for adoption or requesting that the

² The public interest in the environmental aspects of utility resource acquisition include a) the Commission's previous statements on environmental matters; b) the recovery, through rates, of the costs of meeting environmental targets and requirements; and c) the environmental externalities of power production imposed on society and the ecology of the state. *See* Berry Direct, at pp. 6-9.

1 Commission adopt a specific policy on environmental risk management in its Track B
2 order.⁴ Rather, Dr. Berry's testimony provides the evidentiary basis for the Commission
3 to conclude in its Track B order that it is in the public interest to develop an
4 environmental risk management policy. Based on this conclusion, the Commission, in its
5 Track B decision, should order that separate proceedings be initiated to develop an
6 environmental risk management policy, to be applied to second round and subsequent
7 solicitations.

8 Staff's acknowledgment (Staff's Initial Closing Brief, at p. 9) that bidders are
9 free to submit bids that include environmental risk mitigation is an inadequate substitute
10 for the Commission taking explicit, proactive steps to establish an environmental risk
11 management policy. Dr. Berry submitted testimony on the public interest to ratepayers
12 of managing environmental risks and proactively addressing the environmental
13 implications of utility resource acquisition decisions. Berry Direct, at pp. 6-9. Dr. Berry
14 warned that competitive solicitations arising from Track B would accomplish these
15 public interest objectives only by happenstance unless the Commission directly addresses
16 environmental issues. *Id.* at p. 8. He reasoned that, without explicitly considering the
17 environmental impacts of resource alternatives, it is unknown what the effect would be
18 on environmental performance, but that it is entirely possible that environmental
19 performance might deteriorate. Tr. (Vol.IV), at p. 827, lines 19-25.

³ Examples include shadow prices or adders to reflect environmental impacts or costs of compliance with future regulatory requirements, environmental performance goals, and the allocation of environmental risks among utilities, ratepayers and power producers. See Berry Direct, at DB-3; Tr. (Vol.IV), at pp. 828-829.

⁴ The LAW Fund does request that the Commission require explicit consideration of the risk of future climate change regulations at the workshops and hearing. Again, the LAW Fund is not requesting that the Commission adopt a specific policy on climate change in its Track B order, only that the Commission require consideration of climate change issues at the workshops and hearing.

1 Staff would have the Commission passively leave it up to individual bidders to
2 decide whether to include environmental risk management in their bids. Naturally,
3 bidders whose prices would increase if they took into account the cost of offsetting or
4 avoiding environmental impacts will not consider or report those environmental impacts
5 if bids are to be selected on the basis of price alone. Nor would utilities have any reason
6 to consider the environmental impacts of their resource choices if they expected that they
7 would be penalized for selecting higher priced but cleaner resources. The result will be
8 increased environmental risks to ratepayers and/or greater environmental impacts on
9 Arizona. Staff's proposal is also deficient because the information upon which to
10 compare resource alternatives would be incomplete, and the Commission would have no
11 policy in place on how to evaluate the relative merits of competing bids based on their
12 environmental risks and impacts or on the weight that should be attributed to
13 environmental factors. Finally, the Commission would not have a policy in place on the
14 retirement of "environmentally undesirable plants." Cf. Decision No. 65154, at p. 23,
15 note 8. Staff's proposal would accomplish environmental improvements only by
16 happenstance, if at all.

17 **Demand-Side Management**

18 Dr. Berry testified on the public interest in utility acquisition of DSM.⁵ He also
19 identified several components to an effective DSM policy.⁶ However, the LAW Fund is

⁵ Dr. Berry testified that cost effective DSM is a resource that can help meet the demand for electric energy services at lower cost than conventional generation resources. Thus, the public interest in DSM is to ensure that consumers' electric energy services bills are as low as possible. In addition, because DSM displaces electricity generation and generally has a stable cost, it helps consumers and utilities avoid fluctuations in the price of electricity and natural gas used to generate electricity. Further, DSM may reduce or eliminate the need for more transmission or distribution capacity, may avoid transmission constraints, and can reduce the environmental impacts of electricity consumption, including compliance costs with future environmental regulations. See Berry Direct, at p. 2.

1 not proposing a specific DSM policy for adoption or requesting that the Commission
2 adopt specific DSM requirements in its Track B order. Rather, Dr. Berry's testimony
3 provides the evidentiary basis for the Commission to conclude in its Track B order that
4 cost-effective DSM acquisition is in the public interest. Based on this conclusion, the
5 Commission, in its Track B decision, should order separate proceedings to develop
6 Commission policy on DSM.

7 In his testimony, Dr. Berry discussed several aspects of current DSM policy in
8 Arizona as justification for why workshops and a hearing on DSM are warranted. He
9 explained that current utility DSM programs fall well short of capturing the full cost-
10 effective DSM potential in Arizona. He also testified that DSM should be acquired
11 separately from supply-side resources rather than through an all-source solicitation. A
12 separate DSM acquisition process is desirable in order to attract DSM vendors and to
13 reflect the different attributes of the two resource types. *Berry Direct*, at p. 4. The
14 Commission should reject Staff's passive approach which contends that the Commission
15 need not address the LAW Fund's recommendation because bidders are free to include
16 DSM in their bids (*Staff's Initial Closing Brief*, at p. 9). Staff wrongly assumes that an
17 all-source solicitation process with no direction regarding DSM will magically result in
18 the lowest cost mix of supply-side and demand-side resources. It will not. To develop a
19 process that will more realistically result in the lowest cost mix of resources, the LAW
20 Fund suggests that the structure of a DSM solicitation process be one of the issues
21 discussed at the LAW Fund's proposed DSM workshops and hearing. *See Berry Direct*,
22 Exhibit DB-2.

⁶ Those components include a solicitation process separate from supply-side solicitations, target levels of cost effective DSM (kW and kWh savings), and implementation timetables for APS and TEP.

1 APS states that it has long supported cost-effective DSM, but it correctly notes
2 that there currently is no funding mechanism in place for DSM, nor is there a regulatory
3 process in place for evaluating the cost-effectiveness of DSM. APS Post-Hearing Brief,
4 at p.22. Yet, APS' concerns, while valid, do not provide a basis for objecting to the
5 LAW Fund's recommendations; rather, they point towards the need for additional
6 proceedings on DSM. Recognizing this, the LAW Fund has proposed workshops and a
7 hearing on DSM precisely for the purpose of evaluating the types of issues raised by
8 APS. *See* Tr. (Vol.IV), at p. 822, line 25 – p.823, line 9. Indeed, on cross-examination,
9 APS witness Steven Wheeler acknowledged that the issues raised by APS could be
10 addressed in the context of the workshops and hearing recommended by the LAW Fund.
11 *See* Tr. (Vol.III), p. 640, line 11 – p. 641, line 12.

12
13 *WHEREFORE*, the LAW Fund requests that the Commission establish separate
14 proceedings on DSM and environmental risk management, and that it adopt the LAW
15 Fund's recommendations concerning the Staff Report.

16
17 RESPECTFULLY SUBMITTED this 30th day of December 2002.

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