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BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

Arizona Corporation Commission

DOCKETED

DEC 31 2002

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IN THE MATTER OF THE GENERIC) DOCKET NO. E-00000A-02-0051
PROCEEDING CONCERNING ELECTRIC)
RESTRUCTURING ISSUES)

IN THE MATTER OF ARIZONA PUBLIC) DOCKET NO. E-01345A-01-0822
SERVICE COMPANY'S REQUEST FOR)
VARIANCE OF CERTAIN REQUIREMENTS)
OF A.A.C. R14-2-1606)

IN THE MATTER OF THE GENERIC) DOCKET NO. E-00000A-01-0630
PROCEEDING CONCERNING THE ARIZONA)
INDEPENDENT SCHEDULING)
ADMINISTRATOR)

IN THE MATTER OF TUCSON ELECTRIC) DOCKET NO. E-01933A-02-0069
POWER COMPANY'S APPLICATION FOR A)
VARIANCE OF CERTAIN ELECTRIC)
COMPETITION RULES COMPLIANCE)
DATES)

**NOTICE OF FILING POST-HEARING REPLY BRIEF OF
RELIANT RESOURCES, INC.**

Reliant Resources, Inc., by and through its attorneys, hereby files its
Post-Hearing Reply Brief.

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RESPECTFULLY submitted this 31st day of December, 2002.

MARTINEZ & CURTIS, P.C.

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POST-HEARING REPLY BRIEF

OF

RELIANT RESOURCES, INC.

DECEMBER 31, 2002

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1 I. INTRODUCTION

2 Reliant Resources, Inc. ("Reliant"), in compliance with the instructions of
3 Administrative Law Judge Teena Wolfe ("ALJ Wolfe" or the "ALJ"), files its Post-
4 Hearing Reply Brief addressing the Opening Briefs filed in Track B of this
5 proceeding in the context required by Decision No. 65154. In that Decision the
6 Commission recognized that market power/market abuse issues are real and should be
7 addressed (p. 21, l. 17); that the proper market structure and regulatory framework are
8 needed for consumers to benefit from wholesale competition (*Id.*, p. 22, ll. 14-15);
9 that more protections are needed against self-dealing and inappropriate affiliate
10 transactions (*Id.*, ll. 20-21); that investigations are ongoing into market manipulations
11 and improprieties (*Id.*, ll. 21-22); and that proposed new generation may be canceled
12 if it is not able to find a market (*Id.*, l. 20). The Commission further found that
13 "requiring some power to be purchased through the competitive procurement process
14 developed in Track B will encourage a phase-in to competition, encourage the
15 development of a robust wholesale market for generation, and obtain some of the
16 benefits of the new Arizona generation resources, while at the same time protecting
17 ratepayers." (*Id.*, p. 30, ll. 12-15). To assist in achieving these goals, the Commission
18 directed the parties "to continue their efforts in Track B of this proceeding to develop
19 a competitive solicitation process that can begin by March 1, 2003." (*Id.*, p. 33, ll. 14-
20 15). Importantly, the Commission expressly ordered both APS and TEP "upon
21 implementation of the outcome of Track B . . . [to] acquire, *at a minimum*, any
22 required power that cannot be produced from its own existing assets, through the
23 competitive procurement process as developed in the Track B proceeding. The
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1 minimum amount of power, the timing, and the form of procurement shall be
2 determined in the Track B proceeding.” (Emphasis added.) (*Id.*, p. 33, ll. 6-14).

3 In summary, by Decision No. 65154, the Commission expressly recognized the
4 need to develop the framework for a competitive procurement process to encourage
5 further development of a robust wholesale generation marketplace and to permit TEP
6 and APS consumers to obtain some of the advantages from the existing marketplace
7 immediately. The Track B decision, then, must establish the foundation upon which a
8 robust competitive generation marketplace can flourish, even though aspects of the
9 competitive procurement process approved in Track B may, over time, be refined or
10 altered. It is critical for the Commission, through its Track B decision, establish a
11 fair, open and transparent competitive procurement process that will serve to
12 encourage further development of the competitive wholesale marketplace, now and in
13 the future, and thereby permit TEP and APS consumers to obtain the advantage of a
14 robust competitive wholesale marketplace over the long-term. While the Staff Report
15 provides the basic structure of such a competitive procurement process, some fine-
16 tuning is required, as set forth in the comments below.

18 II. ISSUES ADDRESSED

19 In this Reply Brief, Reliant will set forth Reliant’s position on the following
20 issues:¹

- 21 1. Use of Auctions. Reliant recommends the Commission require APS
22 and TEP solicit at least one-third of their contestable load through an
23

24 ¹ In its Opening Brief, Reliant addressed only the issues that it directly advocated at hearing,
25 reserving the right to address in its Reply Brief any issue raised by another party or which other
26 parties failed to raise in their Opening Briefs.

1 auction process. Such a requirement not only ensures that the utilities
2 receive the lowest price for the product being solicited, but also ensures
3 that all competitors are offered a fair opportunity to participate and that
4 the Commission is provided a complete array of potential responses.
5 Reliant further supports the Commission requiring adoption of APS'
6 proposal for an auction to solicit the utilities' economy energy needs;

7
8 2. **Prompt Prudency Review.** Reliant recommends that the Commission
9 not dismiss the benefits of a prompt prudency review simply because
10 this is the first ACC-adopted competitive solicitation, as Staff contends.
11 The process developed since Track A encompasses numerous checks
12 and balances and opportunities for the Commission, Staff, the
13 Independent Monitor, and other participants to review and respond to
14 the solicitation plans of the utilities. These measures enable the
15 Commission to explore and modify the solicitation "up front",
16 incorporating a prudency determination of the process, products, and
17 outcome in a prompt, efficient, and effective manner. Reliant, therefore,
18 recommends that the Commission provide prompt (within 5 to 30 days)
19 regulatory review of the offers accepted through the Commission
20 approved competitive solicitation process;

21
22 3. **Unmet Needs.** Reliant recommends the Commission accept the
23 suggestion of Staff and several other parties that APS and TEP be
24 required to use the approved competitive solicitation process to secure
25 all load and energy requirements not served *economically* by generation
26

1 owned by the utility and included in the utility's rate base, or supplied
2 by FERC or Commission approved contracts, or from sources from
3 which the utility must purchase power as a result of law or regulation.
4 As a compromise for the 2003 solicitation, Reliant recommends that the
5 Commission accept the utilities' calculation of their "unmet needs",
6 while requiring the approved competitive solicitation process be used by
7 the utilities to solicit, at a minimum, the energy and capacity levels
8 recommended by Staff. As noted by Panda Gila River, L.P., there is an
9 important distinction between the load that is "contestable" (i.e., it must
10 be subjected to the competitive marketplace) and the amount of power
11 that must actually be accepted. The latter is a function of the offers that
12 are received, while the former may be established by the Commission in
13 its Track B decision;
14

15 4. **Integrated Resource Planning.** Reliant recommends that the
16 competitive solicitation not be put on hold to conduct the Integrated
17 Resource Planning ("IRP") suggested by RUCO. Reliant agrees with
18 Staff that RUCO's suggestions are beyond the scope of this proceeding,
19 but is supportive of APS' proposal that, to the extent the Commission
20 wishes to consider the issue further, additional workshops be scheduled
21 to address it; and
22

23 5. **Code of Conduct.** Reliant recommends the Commission require APS
24 to adopt a Code of Conduct prohibiting its affiliates that intend to
25 participate in the solicitation from handling system dispatch, risk
26

1 management or contract management for APS or receiving information
2 from APS (directly or indirectly) that would advantage them in the
3 solicitation process.

4 **III. AN AUCTION FOR A SIGNIFICANT PORTION OF THE UTILITIES'**
5 **CONTESTABLE LOAD WILL BRING BENEFITS TO ARIZONA'S**
6 **CONSUMERS**

7 Throughout both the Track A and Track B process, Reliant has supported an
8 auction process for Arizona's utilities' competitive solicitation. The policy reasons
9 for this are clear: there are significant benefits for Arizona's consumers as a result of
10 an auction. First, an auction is the most open, transparent, and auditable process for
11 the benefit of the Commission, utilities, and suppliers. Second, an auction induces
12 vigorous competition for standard products and determines the efficient competitive-
13 market price for a particular product. Finally, the open process and competitive
14 nature of an auction will mean efficient, and ultimately lower, prices for Arizona's
15 consumers. Arizona's abundant supply of generation leaves the parties with the
16 reasonable expectation that consumers will be able to realize significant savings as a
17 result of the competitive solicitation.

18 APS has endorsed an auction for up to 50% of its economy energy needs in the
19 first year of the competitive solicitation. Reliant supports APS' proposal and
20 recommends Commission adoption of this process. If the auction process provides
21 Arizona's consumers the benefits desired by the Commission, Reliant recommends
22 the Commission consider it as its policy for Arizona and possible future expansion
23 beyond 50% of the economy energy needs.
24
25
26

1 In its Initial Brief, APS states that the company should not be required to
2 acquire economy energy through the Track B process. (APS Brief, p. 11, ll. 17-18).
3 However, the company does propose a quarterly economy energy auction
4 commencing in 2003 and continuing through 2004. Reliant supports Commission
5 approval of APS' auction proposal and further recommends such approval incorporate
6 a future formal review of the process for the express purpose of developing
7 modifications and enhancements to the auction process based on lessons learned,
8 similar to what Reliant anticipates is likely for the remainder of the Track B process.
9 Reliant recommends the quarterly auction procedure be continued until further order
10 of the Commission.
11

12 The Commission should further require the utilities to conduct an auction for at
13 least one-third of their capacity needs in this initial competitive solicitation. The
14 benefits of an auction have been discussed in great detail by Reliant witness Mr.
15 Curtis Kebler and no opposition has been presented by any party in this proceeding.
16 In fact, Panda proposes an independent, yet very similar concept in their Initial Brief.
17 (Panda Brief Exhibit-1, p. 11, ll. 1-7). The capacity products described by both APS
18 and TEP in this proceeding appear tailor-made for the auction process. Specifically,
19 the utilities have described products that are either already standard products or can be
20 easily standardized for procurement from today's wholesale electric markets. The
21 Commission will encourage vigorous competition for the contestable load of each
22 utility by supporting the procurement of standard products through an auction. Such a
23 competitive environment will lead to efficient market prices that represent the lowest
24 possible price for Arizona's consumers. Additionally, an auction will also benefit the
25
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1 Commission as it considers alterations to the competitive solicitation in the future.
2 The experience gained from an auction process will provide the Commission the
3 ability to compare implementation, ease of use, evaluation techniques, and outcomes
4 from auctions and other solicitation methods utilized by APS and TEP.

5 APS asserts it should have the discretion to determine which solicitation
6 method(s) it utilizes. (APS Brief, p. 18, ll. 22-24). While Reliant agrees that the
7 utilities should have leeway in their procurement plans, Reliant suggests it is
8 reasonable to set a threshold in this proceeding of at least one-third of the utilities'
9 contestable load to be procured via auction. Such a threshold provides the utilities
10 ample opportunity to address their unmet needs in an efficient manner, and protects
11 the interests of the Commission and Arizona's consumers in the long term.

12
13 **IV. PROMPT PRUDENCY REVIEW IS IN ARIZONA'S CONSUMERS**
14 **BEST INTEREST AND INHERENT IN STAFF'S EVALUATION**
15 **DESCRIPTION**

16 The Staff contends that the Commission should have as much flexibility as
17 possible in determining whether the process, products, and outcome of the
18 competitive solicitation are prudent. (Staff Brief, p. 6, ll. 27-28). The Staff states that
19 its lack of experience in evaluating this kind of procurement supports its contention.
20 Staff's assertion, however, fails to adequately consider the benefits gained through the
21 workshop and hearing process undertaken in this proceeding over the last six months.
22 This collaborative process has resulted in the development of numerous safeguards
23 proposed in the Staff Report and supported by participants in this proceeding. Such
24 safeguards include the omnipresent role given the Independent Monitor with a
25 significant list of responsibilities, including but not limited to evaluating the adequacy
26

1 of all solicitation materials, advising Staff and the utilities regarding issues affecting
2 the integrity of the solicitation, status reports to the Commission and Staff regarding
3 the solicitation (including any deficiencies), and submitting a final report after the
4 solicitation of findings and observations. (Staff Report, pp. 9-11). No party to this
5 proceeding has argued against Staff's proposed role for the Independent Monitor or
6 against any of its proposed responsibilities. Reliant believes that with Commission
7 approval of such safeguards, it is reasonable for the Commission to also provide
8 prompt consideration of completed solicitations.
9

10 Reliant witness Mr. Kebler, as well as witnesses or representatives for APS,
11 TEP, Panda, and PPL have all described why it is in the best interest of Arizona's
12 consumers to provide prompt prudency review. (See, Reliant-1, p. 10, ll. 4-14; APS-
13 3, p. 6, ll. 25-26; APS-3, p. 7, ll. 1-11; Panda-3, p. 9, ll. 9-11; TEP-2, p. 11, ll. 2-9; Tr.
14 v. I, p. 28, ll. 14-25; Tr. v. I, p. 29, ll. 1-9). These reasons include reducing regulatory
15 uncertainty on the part of the utilities and suppliers such that bids for power supplies
16 are lower. It also provides the opportunity for the utilities to rapidly return to the
17 market or otherwise address any finding of imprudence. Finally, prompt prudence
18 review is consistent with the Commission's intentions in its Track A Order to
19 "encourage a phase-in to competition, encourage the development of a robust
20 wholesale market for generation, and obtain some of the benefits of the new Arizona
21 generation resources, while at the same time protecting ratepayers" in Arizona.
22 (Decision No. 65154, p. 30, ll. 13-15).
23

24 Staff has further argued that Arizona's consumers remain unprotected by a
25 "pre-approval or expedited approval." (Staff Brief, p. 6, ll. 22-23). First, no party has
26

1 proposed that the results of the procurement automatically be found prudent because
2 they were simply part of a competitive solicitation. Rather, it is the sum of
3 opportunities for review, both in this proceeding and during the solicitation itself that
4 provides the opportunity for a prompt review. Therefore, it is inappropriate to
5 describe prompt prudency review as "pre-approval." Furthermore, Staff infers that
6 prompt prudency review does not allow the Commission to give due consideration to
7 the process, product, or outcome of the competitive solicitation. Such an assertion
8 ignores this Commission's directive in its Track A Order which states: "the
9 minimum amount of power, the timing, and the form of procurement shall be
10 determined in the Track B proceeding." (Decision No. 65154, p. 33, ll. 6-14).
11 According to the Track A Order, some of the major issues that would be part of a
12 typical prudency review will, in fact, be determined by the Commission in this
13 proceeding. With the extensive participation by Staff, the Independent Monitor, and
14 other participants throughout this process, the Commission will already have access to
15 and knowledge of all facets of the solicitation by the time procurement takes place.
16 Only the outcome of the solicitation(s) will be needed for the Commission to have all
17 the necessary information to be able to determine the prudency of the solicitation.
18 Once the solicitation is complete, a prompt prudency review is possible without
19 putting Arizona's consumers at risk. The Commission should adopt the timelines
20 proposed by Reliant for prudency review.²
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² Panda also provides a reasonable outline for prudency review in its Closing Brief. (Panda Brief Exhibit-1, p. 17, ll. 8-12).

1 **V. THE COMMISSION SHOULD REQUIRE APS AND TEP TO USE THE**
2 **APPROVED COMPETITIVE SOLICITATION PROCESS TO**
3 **SOLICIT, AT A MINIMUM, THE LEVEL OF CAPACITY AND**
4 **ENERGY ADVOCATED BY STAFF**

5 Much of this docket involves identifying the level of capacity and energy APS
6 and TEP must solicit through the approved competitive solicitation process. APS and
7 TEP express concern that overstating their respective levels of unmet need creates
8 negative implications in their financial ratings. They also argue that including RMR
9 related capacity and energy is unnecessary and goes beyond the scope of Decision No.
10 65154. It is Reliant's position that the contestable load should be set at a level to
11 ensure the power needs of APS and TEP are tested in the competitive wholesale
12 market through the Commission approved competitive solicitation process. If there is
13 no economic alternative to the utility's RMR or existing generation, then no offer will
14 be accepted. On the other hand, if a lower cost alternative is offered—all else being
15 equal—the utility and its customers will benefit. There is simply no compelling
16 reason not to use the numbers advocated by Staff. (*See also*, PPL Opening Brief, p. 8,
17 “in order to maximize value for Arizona's ratepayers, the utilities should bid more
18 than the economic unmet needs”.)

19 In order to address APS' concern that the use of Staff's numbers will
20 unnecessarily imply greater needs and thus create adverse financial impacts, Reliant
21 suggests that the Commission either (1) accept APS and TEP numbers as an
22 approximation of their respective unmet needs or (2) clearly state that the level of
23 contestable load is set to maximize the potential beneficial results from the
24 competitive solicitation process and should not be interpreted as a precise
25 quantification of the utilities unmet need.
26

1 Reliant also generally agrees with Panda, Sempra and PPL that the decision in
2 Track B should encourage APS and TEP to solicit a variety of products with varying
3 terms. (See, Panda Brief, p. 11, ll. 7-9; Sempra Brief, p. 11; PPL Brief, p. 8).
4 However, Reliant agrees with Staff, APS and TEP that the utilities should determine
5 the actual products to be solicited in the competitive process. Therefore, Reliant does
6 not support Panda's suggestion that the Commission require specific products to be
7 solicited, but Reliant does recommend the Commission require at least a third of the
8 solicitation be conducted through auction for the reasons set forth above.
9

10 **VI. A RETURN TO THE FORMAL INTEGRATED RESOURCE PLAN IS**
11 **UNNECESSARY AND INCONSISTENT WITH THE DIRECTION OF**
12 **THE COMMISSION IN THIS PROCEEDING**

13 RUCO has suggested returning to the formal Integrated Resource Plan ("IRP")
14 process to evaluate competitive solicitation bids. (RUCO Brief, pp. 5-6, ll. 24, 1-3).
15 This is unnecessary and should be considered a step backwards in the Commission's
16 desire to "encourage a phase-in to competition, encourage the development of a
17 robust wholesale market for generation, and obtain some of the benefits of the new
18 Arizona generation resources, while at the same time protecting ratepayers."
19 (Decision No. 65154, p. 30, ll. 13-15).

20 To implement such a proposal will cause unnecessary delay and ignores the
21 tremendous volume of work done to date by the parties to this proceeding. Reliant
22 agrees that the competitive solicitation should result in a least-cost mix of supplies for
23 the benefit of Arizona's consumers. However, it is the utilities' responsibility to
24 determine this mix and does not need to be part of a time consuming IRP process.
25 Reliant agrees with Staff that RUCO's suggestion is beyond the scope of this
26

1 proceeding. (Staff Brief, p. 9, ll. 14-16). If the Commission wishes to examine the
2 issue further, then, Reliant supports APS' suggestion that the concept be explored in
3 workshops. (APS Brief, p. 23, ll. 2-4).

4 **VII. THE CODE OF CONDUCT MUST ENSURE THAT AFFILIATES ARE**
5 **NOT ALLOWED AN UNFAIR COMPETITIVE ADVANTAGE**

6 Staff (Brief, pp. 8-9), Panda (Brief pp. 13-22); PPL (Brief, p. 10), and HGC
7 (Brief pp. 6-8) all recognize the need to ensure that an affiliate is not unfairly
8 advantaged. Reliant recommends the Commission require the adoption of a Code of
9 Conduct prohibiting its affiliates that intend to participate in the solicitation from
10 handling system dispatch, risk management or contract management or from
11 receiving information from APS (directly or indirectly) that would advantage them in
12 the solicitation process. The recommendations of Panda, PPL and HGC regarding the
13 Code of Conduct issue appear consistent with the position of Reliant. Reliant is
14 generally supportive of Staff's position, except to the extent it could be construed as
15 allowing APS and Pinnacle West to share services related to system dispatch, risk
16 management or contract management. These areas provide access to information that
17 creates an unfair competitive advantage to the affiliate and must not be permitted, if
18 the affiliate wishes to participate in the competitive solicitation.
19

20 **VIII. THE COMMISSION SHOULD ADOPT RELIANT'S**
21 **RECOMMENDATIONS AS DESCRIBED IN ITS OPENING AND**
22 **REPLY BRIEFS**

23 Reliant has been an active participant in the competitive solicitation process
24 since the beginning of the Track B process. Many issues have been resolved toward
25 establishing an open and transparent competitive solicitation that benefits Arizona's
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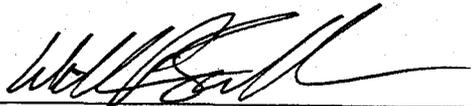
1 consumers. To ensure these benefits are realized, Reliant urges the Commission to
2 implement the recommendations set forth in the Reliant's Opening Post-Hearing Brief
3 and set forth above. In addition, Reliant recommends the Commission adopt the
4 amended description of the Texas competitive process provided by Reliant in its
5 Opening Brief to more accurately reflect the situation in Texas.

6 **IX. CONCLUSION**

7
8 The parties in the Track B proceeding have worked during the past six months
9 toward achieving agreement on the framework for the initial competitive solicitation
10 in Arizona. Reliant has proposed reasonable solutions for specific contested items,
11 which benefit Arizona's consumers and that support the Commission's stated goals in
12 this proceeding. By adopting these recommendations, the Commission will ensure
13 these benefits are captured on the consumers' behalf.

14 RESPECTFULLY submitted this 31st day of December, 2002.

15 MARTINEZ & CURTIS, P.C.

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