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

DOCKET NO. E-00000A-02-0051

E-01345A-01-0822

14 IN THE MATTER OF ARIZONA PUBLIC)
15 SERVICE COMPANY'S REQUEST FOR)
16 VARIANCE OF CERTAIN REQUIREMENTS)
17 OF A.A.C. R14-2-1606

~~DOCKET NO. E-01345A-01-0822~~

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

DOCKET NO. E-00000A-01-0630

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

DOCKET NO. E-01933A-02-0069

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

DOCKET NO. E-01933A-98-0471

**SUMMARY OF DIRECT AND
REBUTTAL TESTIMONY OF
ARIZONANS FOR
ELECTRIC CHOICE
AND COMPETITION**

42 Arizonans for Electric Choice and Competition (AECC) hereby submits the

43 Summary of the Direct and Rebuttal Testimony of Kevin C. Higgins in the "Track A"

44 portion of the above-captioned proceedings.

1 RESPECTFULLY SUBMITTED this 18th day of June, 2002.

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15 Original and eighteen (18) copies of the foregoing
16 filed this 18th day of June, 2002, with:

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18 Docket Control Division
19 Arizona Corporation Commission
20 1200 West Washington Street
21 Phoenix, Arizona 85007
22

23 Copies of the foregoing were mailed/delivered this 18th day of June 2002 to the attached
24 service list.

**SUMMARY OF TESTIMONY
KEVIN C. HIGGINS**

Direct Testimony

In my direct testimony I make the following points:

1. On behalf of AECC, I was closely involved in the negotiations that resulted in the APS and TEP Settlement Agreements.
2. AECC reaffirms its strong support for the APS and TEP Settlement Agreements, which provide both short-term and long-term benefits for Arizona customers.
3. AECC recognizes that, these agreements notwithstanding, the Commission must be assured that, on a going-forward basis, the structure of the Arizona power market is in the public interest.
4. In my view, the most critical public interest issue to be addressed on a going-forward basis is that of potential market power, which I believe can and should be addressed within the context of the Settlement Agreements.
5. Market power in the Phoenix, Tucson, and Yuma load pockets is addressed in the "must-run generation" protocol of the Arizona ISA – as directed by the Commission in the Electric Competition Rules. This stakeholder-negotiated, FERC-approved protocol requires that during load pocket conditions, generation owners inside the load pocket must sell to scheduling coordinators, on a cost-of-service basis, sufficient generation beyond the amount of the transmission import constraint to serve load inside the load pocket.
6. After the Arizona ISA is replaced by an RTO, responsibility for mitigating market power in load pockets should be addressed by the RTO tariff in a manner that protects retail customers while providing transmission owners and generators the necessary long-term incentives to alleviate the load pocket problem. The load pocket treatment filed at FERC by WestConnect is similar to that of the Arizona ISA, but allows local generation owners to sell at market prices (established outside the load pocket) during load pocket conditions and attempts to establish a framework for creating proper incentives for generation to be constructed inside the load pocket.
7. The approaches to mitigating load-pocket market power provided in both the Arizona ISA Tariff and the WestConnect filing are reasonable and well-balanced mechanisms.
8. The Commission and other Arizona stakeholders should become actively involved before FERC to ensure that rigorous procedures are put in place to test for and, if necessary, to mitigate any wholesale market power that might arise in a post-divestiture Arizona. While FERC's past record in addressing horizontal market power issues has been controversial and the target of significant criticism, market power is now clearly a "front-burner" issue at FERC, and it is receiving, and will continue to receive, a great deal more scrutiny.
9. FERC has moved toward more rigorous testing of market power potential, namely the Supply Margin Assessment (SMA) test, which indicates the presence of

market power if a single seller controls an amount of generation that exceeds the market's supply margin (generation in excess of load) during peak demand.

10. My recommendation is that a similar, but more comprehensive test, called the Residual Supply Index (RSI) screen, should be applied to APS and its affiliates and TEP and its affiliates, with respect to each utility's territory. The RSI screen calculates, for each hour of the year, the ratio of residual supply (total supply minus the capacity of the supplier in question) to system demand (load plus reserve). When the RSI is significantly above 100 percent, there is sufficient supply in the market to support competitive prices even if the supplier in question withholds all of its capacity. However, if the RSI is below 100 percent (or not significantly above 100 percent), then potential market power is indicated for the supplier in question, and mitigation measures are in order.
11. If the RSI screen (or other appropriate test) indicates that generalized market power is present in either the APS or TEP territories, then some type of capped pricing – either tied to cost-of-service or an external market index – combined with a “must-offer” obligation, should be required for the hours in which market power was indicated.
12. Because power markets are dynamic, it is important that potential market power be subject to continuous scrutiny by an entity with region-specific expertise. FERC will require this market monitoring function to be performed by RTOs. I recommend that the Commission become closely involved in the development of the market monitoring procedures of WestConnect (or alternative RTO with responsibility for Arizona) to ensure that potential market power in Arizona is carefully monitored and appropriately mitigated.

Rebuttal testimony

In my rebuttal testimony, I offer the following points of rebuttal to the direct testimony of TEP witness James S. Pignatelli:

1. Mr. Pignatelli's proposal to exclude all customers with loads of 3 MW or less from direct access should be rejected. His proposal would abrogate TEP's commitments under its Settlement Agreement, which ensures direct access rights for *all* TEP customers.
2. In addition to direct access rights, TEP customers are assured of stable rates through the end of 2008 by virtue of the Settlement Agreement.
3. Mr. Pignatelli's proposal to abrogate direct access rights for the vast majority of TEP customers is a blatant attempt by a signatory to an agreement to advance its pre-settlement objectives in contravention of its settlement commitments, while offering absolutely nothing in exchange.
4. If AECC were to emulate TEP's strategy of lobbying for after-the-fact changes to the settlement, AECC would seek changes in the “Adders” used in the determination of the shopping credit in TEP's territory. As it is, these Adders are open to reconsideration in 2004. I view Mr. Pignatelli's proposal to eliminate direct access of most of its customers to be an opportunistic, preemptive strike against having the Adders adjusted upward in 2004.

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