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November 19, 2002

Docket Control
Arizona Corporation Commission
1200 W. Washington
Phoenix, Arizona 85007

RE: ARIZONA PUBLIC SERVICE COMPANY'S SUMMARIES OF TESTIMONY IN THE MATTER OF THE
GENERIC PROCEEDING CONCERNING ELECTRIC RESTRUCTURING ISSUES.
DOCKET NO. E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-0630 and E-01933A-02-0069

Dear Sir or Madam:

Pursuant to the Procedural Order dated October 9, 2002, Docket No. E-00000A-02-0051, et al., Arizona Public Service Company is hereby filing the written summaries of previously filed direct and rebuttal testimony for Mr. Steven W. Wheeler, Mr. Peter M. Ewen, Mr. Thomas J. Carlson and Mr. Thomas Glock.

If you or your staff have any questions, please feel free to call me.

Sincerely,

Jana Van Ness
Manager
Regulatory Compliance

Attachment

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Arizona Corporation Commission

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Summary of Steven W. Wheeler Direct Testimony

My testimony will respond to certain sections of the Commission's Utilities Division Staff ("Staff") Report in this proceeding dated October 25, 2002 ("Staff Report"). I also suggest certain modifications to that Staff Report.

It is the Company's understanding that Staff wishes the Commission to formally adopt and approve the Staff Report. APS fully endorses the stated goals of the Staff Report and supports much of the substance. Moreover, the Company appreciates Staff's willingness to assist in the Track B procurement process through active involvement and advice. But as is often the case, the devil is in the details.

I am concerned both about the practicality of the Staff Report's proposed timeline for this Track B procurement and that certain substantive proposals in the Staff Report may prove counterproductive and could frustrate the goals of a workable competitive procurement. Either concern could lead to higher power costs for APS and its customers. Therefore, I ask the Staff and the Commission to consider modifying the Staff Report in a manner that will (1) encourage more robust participation by sellers in the Track B procurement process; (2) reduce the regulatory uncertainty facing buyers, including APS, from this process; and (3) improve the objectivity and transparency of the Track B procurement process. These modifications include the following:

- Commission approval of the results of the Track B procurement.
- Commission assurance of full cost recovery of power acquired through any Commission-mandated procurement.
- Refinement of the role of both Staff and the independent monitor during and after the Track B solicitation to bring finality to the process.
- Modification of the "price to beat," both in concept and in application.
- More careful and precise definition of the actual scope and objectives of the required "Standards of Conduct" to avoid unintended counterproductive consequences.
- Assurance by the Commission that confidential information will indeed be kept confidential through the bidding process.

Summary of Steven W. Wheeler Rebuttal Testimony

My rebuttal testimony will respond to certain accusations by Panda/TECO witness Dr. Craig Roach concerning the Company's motives and past actions. I hope also to put the overall APS rebuttal case into some perspective. Finally, I address Reliant witness Curtis L. Kebler's comments regarding possible standards of affiliate conduct for the present Track B competitive solicitation, as well as certain of the recommendations of Residential Utility Consumer Office ("RUCO") witness Dr. Richard A. Rosen, Law and Water Fund ("LAW Fund") witness Dr. David Berry, and Wellton-Mohawk witness Robert W. Kendall.

APS is proud of its successful efforts to manage risk, control cost and reduce customers rates during perhaps the most difficult years in the electric utility industry since the late 1970s. And the Company does not apologize for any of the filings it has made with this Commission. Whether Dr. Roach's client agreed with them or not, APS has always tried to act in the interests of its customers and is doing so in this proceeding.

Second, although Mr. Carlson and Mr. Ewen will rebut specific criticisms of their pre-filed written testimony, I believe that once you get past the invective and the semantic debate over whether a particular need is more or less properly characterized as "reliability," "economy," "reliability must-run," etc., there are significant areas of agreement between APS and some of the merchant intervenors. We agree that APS should procure its needs for purchase power from the competitive market through a process that is reasonable and prudent.

Third, the specific recommendation of Reliant concerning standards of conduct for the upcoming Track B solicitation could, if interpreted literally, eliminate one of the largest of Reliant's (and the other merchant generators') competitors before the solicitation even started. I am, of course, speaking of Pinnacle West Capital Corporation ("Pinnacle West") and its Marketing and Trading division ("M&T"). This is hardly in the interests of APS and its consumers and is not needed to implement a reasonable, fair and open competitive power procurement in Track B.

Finally, although Dr. Rosen, Dr. Berry and Mr. Kendall's testimony on resource planning, demand-side management ("DSM") and the Environmental Portfolio Standard ("EPS") raise some important issues, I cannot support definitive Commission resolution of these matters in this Track B proceeding. There is simply insufficient time to properly consider and implement these proposals in a manner benefiting APS customers. Some aspects of their recommendations are better considered in separate proceedings already mandated by the Commission, or would be impacted by external events going on at the federal level, the outcome of which cannot be predicted at the present time.

Summary of Peter M. Ewen Direct Testimony

My testimony will explain and document the methods by which APS has estimated its unmet needs for capacity and energy for the period 2003 through 2012. It was that estimated need that will serve as the basis for Mr. Thomas Carlson's testimony on the Company's proposed procurement plan.

APS's unmet needs for capacity and energy are derived from a comparison of the expected energy and peak demand requirements over the next ten years with the availability of APS resources to meet those needs. As would be expected for a utility having a system load factor in the low 50% range, our unmet capacity needs far exceed our unmet energy needs. That is, the number of hours for which we require additional supply beyond that which our own resources and firm contracts can provide is relatively low, which means that the amount of energy that accompanies the additional capacity is also low. Specifically for 2003, I estimate that we need to acquire approximately 1,400 MW of capacity (22% of peak requirements) and some 650 GWH of energy, from the competitive wholesale market to meet the reliability needs of the APS system. Meeting these reliability needs means that APS has enough resources to meet the single hour of highest peak demand each year plus a reserve amount to protect against unforeseen plant outages and unanticipated demand, and that all of our customers' energy needs can be served as well. Virtually all of this capacity and energy is needed during the third quarter of 2003 (July, August and September). Capacity needs grow by roughly 6.0% per year, reaching 1,877 MW by 2007, or 25% of peak requirements. In contrast, energy needs grow by 25% per year to 1,940 GWH by 2007. See Attachment PME-1.

These figures are based on the definition of unmet need set forth in Staff's Final Report on Track B Issues ("Staff Report") dated October 25, 2002. See Staff Report at 35, lines 4 - 8. Such definition follows directly from the Commission's order in Track A. See Decision No. 65154 (September 10, 2002). This includes some small modifications to address the Commission's Environmental Portfolio Standard ("EPS") requirements and reliability must-run ("RMR") issues, both of which are described later in my testimony. See also Staff Report at 6, lines 9 - 14. Specifically, we took our most current load and energy forecasts for the years 2003 through 2012 and added a 15% capacity reserve requirement for APS generation and non-firm purchases. We then subtracted out the following:

- (1) capacity and energy that can be met from generation resources owned by APS as of September 1, 2002 and included in APS retail rates;
- (2) capacity and energy that can be met from wholesale contracts with non-affiliated suppliers that were entered into prior to September 1, 2002;
- (3) a calculation of RMR that necessarily must come from non-APS resources; and
- (4) the EPS grid-connected resources that APS has or will acquire during these years assuming continuation of present funding for the EPS.

Summary of Peter M. Ewen Rebuttal Testimony

My rebuttal testimony will respond to certain assertions made in this proceeding by Panda/TECO witness Dr. Craig Roach and National Energy Group ("NEG") witness Mr. Thomas Broderick. Specifically, I will provide additional explanation of my calculation of unmet needs, address the accuracy of the October 2002 APS load forecast, and provide additional clarification regarding the determination and treatment of reliability must-run ("RMR") requirements, as well as reserve margin calculations.

As I explained in my direct testimony, I derived APS's unmet needs for capacity and energy from a comparison of APS's expected energy and peak demand requirements with the availability of APS resources to meet those needs. I calculated this amount by following the definition set out by the Commission in Track A and adopted in the October 25, 2002 Staff Report ("Staff Report"). See Decision No. 65154 (September 10, 2002); see also Staff Report at 4. In essence, this calculation simply affirms that APS's procurement of power from the wholesale market will be done under two separate processes – a formal solicitation process for our reliability needs and an economy energy procurement process. My rebuttal testimony further demonstrates both how accurate APS's forecasts have been and that the estimate of unmet needs provided and explained to the merchant Intervenor at the November 6 workshop is the appropriate estimate to use.

Summary of Thomas J. Carlson Direct Testimony

My testimony will describe a proposed APS procurement plan for what APS witness Pete Ewen has determined to be the Company's reliability-driven capacity and energy needs that cannot be met by the Company's existing generation and purchase power contracts, which I believe is the subject of Track B. I then discuss the potential acquisition through a separate but parallel process of what are presently classified as "reliability must-run" (RMR) needs of the Company. I also address competitive short-term purchases for both economic and reliability reasons that would fall outside the broader Track B procurement.

I say "proposed" procurement plan not just because the Commission may require a different plan, but also to emphasize the evolving nature of the procurement process itself. APS has already made significant changes to the procurement proposal outlined in its July 2002 filing in the proceeding (and discussed during the workshops). No doubt further refinements will occur between now and the actual 2003 Track B procurement as a result of these proceedings and continued dialogue with Staff and other parties. However, our goals, and I believe those expressed by Commission Staff in its final report of October 25, 2002 ("Staff Report"), are unchanged—to acquire the unmet needs of APS customers in an economic and reliable manner through a fair and open process. APS's proposed plan calls for a multi-layered procurement effort. The first part will be a request for proposals ("RFP") to be issued no later than the end of February 2003 seeking three basic products:

- (1) capacity only (the right to capacity at a fixed or floating price with no obligation to take energy) from a specific generator or group of generators;
- (2) capacity plus some minimum level of energy taken from a specific generator or group of generators during specified months and hours; and
- (3) physical "call" options having the same general characteristics as the first product except physical call options are usually exercised at specific fixed or "strike" prices.

Contract lengths will be as short as one quarter and as long as four years. The percent mix of the listed product types that APS will procure in the initial RFP will be determined by then-existing market conditions, credit quality, deliverability, and other relevant factors.

The intent is to request bids for 100% of the unmet reliability needs for 2003, 2004, 2005, and 2006 through this process. But APS may elect to acquire more or less than these amounts during any year or in total depending on the actual responses to this RFP and then existing or forecasted market conditions. APS could also reject all the bids if they do not satisfy the Company's needs or are unreasonable in terms of price, reliability, etc. To the extent that APS unmet needs cannot be economically and reliably met through the initial RFP, or as stated above, any part of such need goes "uncovered" in the initial RFP solicitation, those uncontracted and still unmet reliability needs would be addressed either by short-term market purchases (for 2003) or in a subsequent formal procurement. Such procurement would likely take place in early 2004, depending on the results of the RFP and may in 2004 switch to a descending clock auction process, which remains a long-term procurement option .

RMR needs from non-APS resources will be handled somewhat differently. APS will separately but concurrently solicit proposals for such needs. If a proposal is received that can demonstrate to the Company's satisfaction deliverability on reasonable terms within the Phoenix load constraint, APS will consider it on the same price, credit-worthiness, reliability of both supply and delivery, etc., criteria as will be applied to the more general Track B solicitation.

Finally, short-term and economy purchases (e.g., balance of month, day ahead, and real time) would be made much as they are today, as is recommended in the Staff Report. Maximum flexibility in making these purchases has benefited and should continue to benefit APS customers. Short-term purchases have been a critical part of prudent power procurement for many decades and are necessary to match a changing market with changing load requirements. APS is studying an expanded role for independent brokers and/or electronic trading platforms to determine whether these or other steps are necessary for affiliate

transactions, but will not unnecessarily burden the procurement process with red tape and prescriptive rules at the expense of customer benefits.

A last part of my testimony, although intertwined with the rest, is a discussion of risk management. In other words, how will APS manage the risks of this Commission-ordered procurement to best protect its customers? This encompasses both the traditional risks of commodity availability and commodity price, and also the relatively new world of counter-party risk. It also addresses the risks newly created by the Track B process itself. Although it would be inappropriate to discuss in any detail APS risk management tools in a public forum involving prospective bidders, it is today evident that counter-party risk is a dominant consideration in determining the length of power agreements in the current financial climate. Establishing strong credit requirements at the outset of the contract is a first line of defense. Periodic collateral call provisions are the next layer of credit protection, although they are of limited value when needed most. In a world where strong A-rated companies can fall all the way to junk status in a year or less, only resource diversity and/or shorter term transactions or some combination can provide that final layer of protection for our customers.

Summary of Thomas J. Carlson Rebuttal Testimony

My rebuttal testimony will respond to criticisms of the proposed APS power procurement program, and of APS itself, by Panda/TECO witness Dr. Craig R. Roach, National Energy Group ("NEG") witness Thomas Broderick, Wellton/Mohawk witness Robert W. Kendall, and to a lesser extent Sempra witness E. Douglas Mitchell and Reliant witness Curtis L. Kebler. These witnesses have either misunderstood that program or are attempting to mischaracterize that program to the Commission. They are attempting to both increase the size of the procurement and focus the scope of the procurement on what these sellers would like to sell rather than what APS and its customers need to buy. They have also drawn precisely the wrong conclusions from the California experience in 2000-2001, and not surprisingly, therefore, have proposed a "solution" that is more likely to replicate that experience in Arizona than prevent it.

Second, I will describe a specific proposal for the procurement of short-term economy energy needs that brings some of the thoughts expressed in my direct testimony into more focus. Although I am still opposed to using the same formal Track B process as is contemplated for securing our reliability needs, APS is willing to consider a compromise to satisfy the concerns expressed by some parties. Specifically, a system of quarterly "mini-Track B" procurements could be implemented for a significant portions of our estimated economic energy needs.

APS today benefits from one of most sophisticated and innovative power procurement programs in the United States. It has allowed the Company to successfully manage risk and control costs during extremely turbulent and volatile market conditions. The proof is in seven straight years of rate reductions. To criticize APS for not having experience in formal power auctions or RFPs for "asset-backed" unit contingent products is like criticizing a New Yorker for not knowing how to milk a cow or a modern PC-owner for not using a main frame or understanding Fortran. In the case of the former, it is a skill-set of little value given the New Yorker's circumstances and needs. For the latter, you have a somewhat antiquated method of computing that has been superseded from both a hardware and software perspective.

The "APS economy energy proposal" (Testimony of Dr. Craig R. Roach at 5) is not just an APS proposal. It is the same approach to economy energy and other short-term purchases apparently used by Tucson Electric Power Company ("TEP"), which Dr. Roach uncritically accepts, and embraced by TEP witness David Hutchens. It flows directly from the language used in the Staff Report, which in turn comes directly from the Commission's language in the Track A order, Decision No. 65154 (September 10, 2002).

Our (and I presume TEP's) short-term procurement program is the polar opposite of the mandatory real-time purchase scheme used in California. Indeed, it is the Panda/TECO proposal for an RFP process seeking largely unit-backed contingent power that is eerily reminiscent of Gray Davis' California. It could lock APS and its customers into 365 days a year capacity costs during the next couple years to meet a less than 90 days a year capacity need.

There may be a significant risk to our customers in entering into 10 or 20-year agreements (except under special circumstances, which I discuss in my rebuttal testimony), as is recommended by some of the witnesses in this proceeding. Regional Transmission Organizations ("RTOs") and some manner of FERC-mandated Standard Market Design ("SMD") are coming and could significantly affect the relative economics of differing generators. Retail access may be down, but it would be foolish to assume it is dead. Credit problems plague the electric power industry, and it is difficult to know who will be in business 10 or 20 months from now, let alone 10 or 20 years. Power markets will remain soft for at least the next year or two, and may well get softer before they firm up. Although APS will consider any serious offer from a credit-worthy supplier, there is simply no need for APS and its customers to be forced into accepting long-term contracts today.

APS does use least cost evaluative criteria, including dispatch simulation and forward pricing models, over the period for which it is primarily soliciting bids, which is the period 2003 through 2006. Although it is important to simultaneously evaluate the impact of major transmission additions on longer-term proposals, this can be done, as proposed by Dr. Richard Rosen in this proceeding, through a less-software driven iterative process. Moreover, no such transmission additions are planned until after 2006, and the Company is leery of most long-term purchase power commitments for the reasons set forth above.

Summary of Thomas Glock Rebuttal Testimony

I will respond to the claims of some intervenors, including Mr. Thomas Broderick, Mr. Curtis L. Kebler and Mr. Robert W. Kendall that relate to Reliability Must Run ("RMR") issues and transmission import limitations in serving load-constrained areas such as the Valley and Yuma.

Some of the merchant generator intervenors suggest that transmission deliverability and RMR should either be ignored or that the risk of any transmission limitations should be placed on APS rather than the seller. This is not the appropriate way to address RMR and deliverability. Instead, the RMR studies that were directed in the Track A order and discussed in the Biennial Transmission Assessment are the appropriate vehicles to quantify and resolve RMR issues.

Wellton-Mohawk goes further, and recommends that all load in the Valley and Yuma areas be contestable. This clearly exceeds the direction given in the Track A order and makes little sense given APS' existing transmission and rate-based generation resources. Wellton-Mohawk's criticisms of APS' resource planning for meeting load serving requirements in Yuma are likewise misplaced.