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RE: ARIZONA PUBLIC SERVICE COMPANY'S TESTIMONY IN THE MATTER OF THE GENERIC PROCEEDING CONCERNING ELECTRIC RESTRUCTURING ISSUES.
DOCKET NO. E-00000A-02-0051, ET AL.

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 direct testimony of Mr. Steven M. Wheeler.

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

Sincerely,

Jana Van Ness
Manager
Regulatory Compliance

Attachment

JVN/vld

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Service List

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DIRECT TESTIMONY OF STEVEN M. WHEELER

On Behalf of Arizona Public Service Company

Docket No. E-00000A-02-0051, et al.

November 12, 2002

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1 Division Staff ("Staff") Report in this proceeding dated October 25, 2002 ("Staff
2 Report"). I also suggest certain modifications to that Staff Report.

3
4 II. SUMMARY

5 Q. **WOULD YOU PLEASE SUMMARIZE YOUR DIRECT TESTIMONY?**

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

12
13 I am concerned both about the practicality of the Staff Report's proposed
14 timeline for this Track B procurement and that certain substantive proposals in
15 the Staff Report may prove counterproductive and could frustrate the goals of a
16 workable competitive procurement. Either concern could lead to higher power
17 costs for APS and its customers. Therefore, I ask the Staff and the Commission
18 to consider modifying the Staff Report in a manner that will (1) encourage more
19 robust participation by sellers in the Track B procurement process; (2) reduce
20 the regulatory uncertainty facing buyers, including APS, from this process; and
21 (3) improve the objectivity and transparency of the Track B procurement
22 process. These modifications include the following:

- 23 • Commission approval of the results of the Track B
procurement
- 24 • Commission assurance of full cost recovery of power
25 acquired through any Commission-mandated procurement
- 26 • Refinement of the role of both Staff and the independent

1 monitor during and after the Track B solicitation to bring
2 finality to the process

- 3 • Modification of the “price to beat,” both in concept and in
4 application
- 5 • More careful and precise definition of the actual scope and
6 objectives of the required “Standards of Conduct” to avoid
7 unintended counterproductive consequences
- 8 • Assurance by the Commission that confidential information
9 will indeed be kept confidential through the bidding process

10 III. THE TENSION BETWEEN GOALS AND PROCESS

11 Q. **DOES APS AGREE WITH THE STATED GOALS OF THE STAFF
12 REPORT?**

13 A. Absolutely. At pages 1 and 3 of the Staff Report, Staff endorses a transparent,
14 open, flexible and understandable process that seeks reliable power at
15 reasonable prices. Although the Staff Report goes on to make other statements
16 concerning how it believes its goals can be accomplished, the overall objectives
17 of transparency and consumer benefit are something APS can heartily endorse.

18 I also wish to thank Staff for its use of an open collaborative process in
19 developing the Staff Report. I believe that Staff listened to our comments and
20 concerns even if they did not always agree with or adopt APS’ position in the
21 final Staff Report.

22 Q. **COULD YOU THEN PLEASE EXPLAIN WHY YOU ARE CONCERNED
23 THAT THE STAFF’S PROPOSED TRACK B SCHEDULE AND
24 PROCESS MIGHT BE IN CONFLICT WITH THIS OVERRIDING
25 GOAL OF TRANSPARENCY AND CUSTOMER BENEFIT?**

26 A. There are several aspects of the Staff proposal that may not contribute to a
“transparent process.” Indeed, they could add significant uncertainty for both
buyers and sellers—uncertainty that could discourage at least some potential

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sellers and add to the costs of procurement, thus thwarting an important part of Staff's overarching objective—reasonable costs for customers.

Specifically, I am first referring to the absence of clear Commission, or even Staff, acceptance of the results of a power procurement process that Staff designed and that will be closely overseen by Staff and its independent monitor. This creates great uncertainty as to the eventual recoverability of costs incurred by APS through a process that represents such a significant change from its current procurement strategy—something of concern to both APS and potential sellers of power to APS.

I am also concerned about the “price to beat” concept. It is unclear how such a “price to beat” will be developed or how it will be applied. To the extent it will represent some mysterious “black box” number that will surface only after purchase power agreements will be executed, “price to beat” contributes to uncertainty rather than transparency.

The role of Staff and the independent monitor during the solicitation appear to contemplate numerous opportunities for the bidders to attempt to negotiate “around” the utility to influence the process or suggest new procurement protocols to enhance their position at either the expense of other bidders or the buyer, or both. See, e.g., Staff Report at 8, lines 11 through 15; and 9, lines 11 through 14. I suggest that all discussions should be directly between bidders and the utility, with the participation of Staff and/or the independent monitor.

1 The apparent opportunity for significant post-bidding "negotiation" of issues
2 that should be resolved during the pre-solicitation process is also not helpful to
3 the cause of transparency. See Staff Report at 23, lines 26 through 28. It may
4 also prove impractical. The timeline shown on page 29 of the Staff Report
5 allows barely two weeks for post-bid evaluation and post-bid negotiation. If this
6 process requires evaluation of numerous non-conforming bids suggesting
7 alternative credit criteria, alternative products, or alternative transmission
8 delivery points, there is simply insufficient time to do so in a manner that
9 effectively protects the interests of APS customers. Knowing that the utility may
10 be pressured to make a hurried analysis and decision, bidders may be tempted to
11 engage in bid gaming. They could do so by confusing the process with a myriad
12 of non-conforming bids and other variations in hopes of creating an overly
13 complex and subjective process that could translate into higher customer costs.

14 **Q. DO YOU HAVE ANY OTHER COMMENTS ABOUT THE STAFF**
15 **REPORT'S PROPOSED TIMELINE?**

16 A. As I discussed above, the post-bidding timeline is extremely short. In addition to
17 the two-week window for evaluation and negotiation, which is further impacted
18 by the requirement for extensive monitor and Staff involvement in this process,
19 there is the need to await the monitor's report and any Commission approval of
20 such report before any contracts can actually be executed. And if one or more of
21 the unsuccessful bidders challenges the monitor's report, or if the Commission
22 otherwise decides to review the solicitation process (see Staff Report at 12, lines
23 5 through 10), contract execution could be even more significantly delayed.

24
25 As it is, the schedule contemplates awarding contracts for reliability needs at the
26 end of April for deliveries that will start barely two months later. Mr. Carlson,

1 head of APS Procurement, tells me that this is simply too close for comfort.
2 Many otherwise interested bidders may have already sold forward their capacity
3 for 2003 by this time, or market prices may have turned unexpectedly higher.
4 APS would normally have secured or significantly hedged its third quarter of
5 2003 supplies well in advance of the beginning of the second quarter. That is
6 why APS had proposed last July a 2003 bid based on a plan to be approved and
7 in place by September 2002. That proposal was rendered moot by the
8 Commission's Track A order.
9

10 **IV. ROLE OF STAFF AND THE COMMISSION**

11 **Q. WHAT ROLE WOULD APS RECOMMEND FOR STAFF AND THE**
12 **COMMISSION IN THIS AND ANY FUTURE TRACK B**
13 **SOLICITATION?**

14 A. Because Staff understandably wants to be heavily involved in the Track B
15 solicitation process, Staff should be an active partner with a clearly defined role
16 and commensurate responsibilities. At each stage of the pre-solicitation process,
17 Staff should be able to comment on the assembly of the bid package and the
18 identification of potential bidders. APS could either accept such comments or
19 reject them, but Staff would be thereafter precluded from raising additional
20 issues concerning pre-solicitation. The same process would then be used during
21 the solicitation and the post-solicitation review and evaluation. Given the
22 intense supervision of this entire process by Staff and the independent monitor, I
23 would hope (as a matter of simple fairness) that comments and criticisms could
24 be offered contemporaneously. This would provide the utility an opportunity to
25 address such concerns while at the same time continuing on with the solicitation.
26 After the evaluation is complete, and provisional contracts awarded to the
winning bidders, the Commission should either affirmatively approve such

1 contracts within 15 days or alternatively, deem them as being approved if the
2 independent monitor's report (Staff Report at 11) concludes that the solicitation
3 was effective and fair. In either event, Commission approval should constitute a
4 finding that the utility acted prudently and reasonably in entering into the
5 approved contracts, both individually and collectively. Such finding should also
6 provide for full and timely cost recovery, either through a purchase power
7 adjustment mechanism or some similar procedure. Commission and Staff
8 assurance of cost recovery is especially appropriate given that the Commission
9 has mandated this procurement through a formal process and on a schedule not
10 entirely of the Company's choosing, and which is in contrast to the flexibility
11 allowed in the current version of A.A.C R14-2-1606 (B).

12 **Q. WHAT ARE THE ADVANTAGES OF THESE SUGGESTIONS?**

13 A. During the solicitation and pre-solicitation process, it affords the utility an
14 opportunity to address and rectify actual or perceived flaws in the solicitation.
15 At the end of the solicitation, it provides certainty to the buyer and seller that the
16 awarded contracts will be honored and receive full rate recognition. This should
17 reduce or eliminate any regulatory risk premium being added to the bids and
18 encourage buyers to be more aggressive in accepting bids, especially those that
19 do not meet Staff's "price to beat" or those for quantities above the needs
20 described at page 4 of the Staff Report. Finally, the contemporaneous approval
21 of Track B contracts prevents the later potential application of impermissible
22 hindsight in evaluating utility prudence and will remove a potentially
23 contentious issue in future rate proceedings

24 **V. PRICE TO BEAT**

25 **Q. WHAT IS THE COMPANY'S REACTION TO THE "PRICE TO BEAT"**
26 **CONCEPT?**

1 A. APS has no objections to the general "concept" of "price to beat" or similar
2 "safe harbor" provisions in the solicitation. However, the Staff Report says little
3 about how the "price to beat" will be determined, although what it does say
4 causes me some concern. It is also clear that the utility will not be told of the
5 "price to beat" until it is too late. A "safe harbor" does little good if the location
6 of the harbor is hidden until after the ship has already foundered.

7
8 **Q. WHEN SHOULD STAFF DISCLOSE THE "PRICE TO BEAT" TO THE
UTILITY AS PART OF THE BID EVALUATION PROCESS?**

9 A. The relevant "price to beat" should be revealed to the utility on a confidential
10 basis after the bidding is complete and during the evaluation process. It should
11 certainly be revealed prior to any contracts being signed. Such disclosure would
12 not affect the bidding in either this Track B solicitation or in future solicitations.

13
14 **Q. WHY SHOULD THE "PRICE TO BEAT" BE DISCLOSED TO THE
UTILITY PRIOR TO CONTRACT EXECUTION?**

15 A. If Staff's evaluation indicates that a bid or set of bids is, in some sense, too high,
16 I would strongly argue that the public interest would best be served by so
17 informing the utility before contractual commitments are made that could
18 impose unnecessarily higher costs on customers. The proposal to keep "price to
19 beat" as a Staff secret that would be revealed at some unknown future moment
20 to support disallowance of power costs for which the utility was already
21 contractually committed was a change in the final Staff Report from earlier
22 drafts. Yet, I fail to see any public policy purpose in not disclosing "price to
23 beat," or for that matter other specific Staff concerns, before such contractual
24 commitments are made.

25
26 **Q. WHAT ARE YOUR CONCERNS ABOUT THE ACTUAL
DETERMINATION OF "PRICE TO BEAT"?**

1 A. The Staff Report seems to contemplate a single price or price forecast for a
2 given product. This implies a degree of precision that is likely unobtainable and
3 assumes a superior ability in price forecasting that is difficult to demonstrate
4 except with hindsight. This benchmark price would appear especially difficult to
5 apply if the bid price were indexed to, for example, the price of natural gas or to
6 some measure of power price inflation. Even when used in evaluating a multi-
7 year fixed price product, the "price to beat" should be based on executable
8 forward market prices obtainable from independent brokers. Alternatives such as
9 the non-market-based "cost-of-service" or scenario-based price forecasts do not
10 accurately reflect the current discounted value of the product or products
11 actually available for purchase in the market.

12
13 VI. STANDARDS OF CONDUCT

14 **Q. WILL APS SUBMIT STANDARDS OF CONDUCT AS PROPOSED IN
15 THE STAFF REPORT?**

16 A. Yes. APS will comply with any Track B procurement requirement ordered by
17 the Commission.

18 **Q. WHAT ISSUES WILL BE ADDRESSED BY ANY SUCH STANDARDS
19 OF CONDUCT?**

20 A. These are listed at page 38 of the Staff Report. However, some of the specific
21 language on these issues in the Staff Report could be interpreted in such an
22 overly literal fashion as to be internally inconsistent and counterproductive to
23 efficient power procurement by the Company. APS will work with Staff to
24 clarify these points. What I can say today is that with or without Standards of
25 Conduct as proposed by Staff, APS employees will conduct this solicitation, and
26 they will act solely in the best interests of APS and its customers. Any Pinnacle

1 West employees used by APS for this solicitation will also be required to act in
2 the best interests of APS and its customers.

3
4 **Q. COULD YOU CITE A FEW EXAMPLES OF WHAT YOU ARE**
5 **REFERRING TO CONCERNING LANGUAGE IN THE STAFF**
6 **REPORT THAT APPEARS TROUBLING IF TAKEN LITERALLY?**

7
8 A. Yes. At page 19, lines 15 through 19 of the Staff Report, it appears that any APS
9 personnel involved with APS generation cannot “participate in the solicitation
10 preparation or evaluation of bids, or have any contact regarding the solicitation
11 with any personnel assigned to conduct the solicitation . . .” Because Mr.
12 Carlson, the Company’s witness on Track B solicitation and head of the
13 Company’s power procurement department, is part of APS generation, this
14 prohibition would make it impossible for APS to even conduct the Track B
15 solicitation. And APS also receives shared services such as legal, risk
16 management and environmental support from Pinnacle West Capital
17 Corporation (“Pinnacle West”), which (through a separate division) is “involved
18 in the sale or marketing of resources from generating assets owned by the utility
19 [APS].” APS does not propose to attempt to prepare a solicitation and evaluate
20 bids without legal assistance, or without input on environmental and credit
21 issues. This would be a disservice to our customers.

22
23 Similarly, at page 37, the Staff Report uses absolutes such as “all contact” or “no
24 contact” when describing the “wall” it proposes to erect between APS and its
25 affiliates. I assume (or at least hope) that contacts not relating to the Track B
26 solicitation such as those from the Pinnacle West employee benefits personnel,
or from other shared services, were not intended to be swept into the scope of
this prohibition. Although page 38 does so qualify the Staff Report’s apparent

1 intent, there are sufficient examples to the contrary to warrant cooperation
2 between Staff and the Company in compiling any such Standards of Conduct.
3

4 VII. CONFIDENTIALITY OF DATA

5 **Q. WHY IS DATA CONFIDENTIALITY AN ISSUE IF THE STAFF
6 REPORT PROVIDES FOR CONFIDENTIALITY OF UTILITY COST
7 INFORMATION, FORECASTS OF MARKET PRICES AND OTHER
8 PROPRIETARY UTILITY DATA?**

9 A. The parties, both buyers and sellers, require a Commission order that validates
10 Staff's position on confidentiality. Specifically, the Staff Report states that:
11 "[P]rice and cost forecasts for power supplies and fuel costs prepared by, or
12 available to the utility, will not be made available to bidders." See Staff Report
13 at 13, lines 12 through 14. Page 8, lines 24 through 26 speaks of other
14 information that may be restricted. Other data is available only to those who
15 have entered into protective agreements. See Staff Report at 13, lines 10 through
16 12. The discovery process in this proceeding has made it perfectly clear to me
17 that "confidential" should mean "confidential" and not "sort of confidential" or
18 "partially confidential" or "confidential until somebody asks for it." This is a
19 highly competitive business, and there are millions of dollars at stake for APS
20 and its customers and for potential sellers as well. If they are to fully and
21 enthusiastically participate in this process, they must have absolute assurance
22 that their competitively sensitive and proprietary information will be protected
23 from competitors or those engaged in the Track B bidding.

24 VIII. CONCLUSION

25 **Q. DO YOU HAVE ANY CONCLUDING REMARKS?**

26 A. Yes. APS appreciates Staff's efforts to develop a workable procurement process
that aims to benefits consumers. My comments are made in the sincere hope that

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the recommendations in my testimony will lead to less uncertainty, greater participation, more openness, and fewer disputes down the road. All of these will improve the likelihood of realizing the goals laid down at the beginning of that Staff Report.

Q. DOES THAT CONCLUDE YOUR PREFILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, it does.