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ARIZONA CORPORATION COMMISSION

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Enclosed please find the recommendation of Administrative Law Judge Teena Wolfe. The recommendation has been filed in the form of an Opinion and Order on:

**GENERIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING ISSUES
(TRACK B)**

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00 p.m.** on or before:

FEBRUARY 10, 2003

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

TO BE DETERMINED

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250.

Arizona Corporation Commission
DOCKETED
JAN 29 2003

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DOCKETED BY

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 MARC SPITZER, Chairman
4 JIM IRVIN
5 WILLIAM A. MUNDELL
6 JEFF HATCH-MILLER
7 MIKE GLEASON

8 IN THE MATTER OF THE GENERIC
9 PROCEEDING CONCERNING ELECTRIC
10 RESTRUCTURING ISSUES.

DOCKET NO. E-00000A-02-0051

11 IN THE MATTER OF ARIZONA PUBLIC
12 SERVICE COMPANY'S REQUEST FOR
13 VARIANCE OF CERTAIN REQUIREMENTS OF
14 A.A.C. R14-2-1606.

DOCKET NO. E-01345A-01-0822

15 IN THE MATTER OF THE GENERIC
16 PROCEEDING CONCERNING THE ARIZONA
17 INDEPENDENT SCHEDULING
18 ADMINISTRATOR.

DOCKET NO. E-00000A-01-0630

19 IN THE MATTER OF TUCSON ELECTRIC
20 POWER COMPANY'S APPLICATION FOR A
21 VAIRANCE OF CERTAIN ELECTRIC
22 COMPETITION RULES COMPLIANCE DATES.

DOCKET NO. E-01933A-02-0069

DECISION NO. _____

OPINION AND ORDER

16 DATES OF HEARING: November 20, (pre-hearing) 21, 22, 25, 26 and 27, 2002

17 PLACE OF HEARING: Phoenix, Arizona

18 ADMINISTRATIVE LAW JUDGE: Teena Wolfe

19 IN ATTENDANCE: William A. Mundell, Chairman
20 Marc Spitzer, Commissioner
21 Jim Irvin, Commissioner

22 APPEARANCES: Mr. Michael R. Engleman, DICKSTEIN, SHAPIRO,
23 MORIN & OSHINSKY, on behalf of Panda Gila River,
24 LP;

25 Mr. Scott S. Wakefield, Chief Counsel, on behalf of the
26 Residential Utility Consumer Office;

27 Mr. Thomas L. Mumaw and Ms. Karilee Ramaley,
28 PINNACLE WEST CAPITAL CORP. Law Department,
and Mr. Jeffrey B. Guldner, SNELL & WILMER, LLP.,
on behalf of Arizona Public Service Company;

Mr. Michael W. Patten, ROSHKA, HEYMAN &
DeWULF, PLC, on behalf of Tucson Electric Power
Company;

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Mr. Lawrence V. Robertson, Jr., MUNGER CHADWICK, on behalf of Sempra Energy Resources and Southwestern Power Group II, and Mr. Theodore E. Roberts, on behalf of Sempra Energy Resources;

Mr. William P. Sullivan, MARTINEZ & CURTIS, PC, on behalf of Reliant Energy Resources;

Mr. Paul R. Michaud, MARTINEZ & CURTIS, PC, on behalf of Wellton-Mohawk Generating Facility;

Mr. Walter W. Meek, President, on behalf of the Arizona Utility Investors Association;

Ms. Karen A. Potts and Mr. Roger F. Ferland, QUARLES & BRADY STREICH LANG, LLP, on behalf of the Harquahala Generating Company;

Mr. Eric C. Guidry on behalf of the Land and Water Fund of the Rockies;

Mr. Jay I. Moyes and Mr. Steven L. Wene, MOYES STOREY, on behalf of PPL Southwest Generating Holdings, LLC, PPL Energy Plus, LLC, and PPL Sundance Energy, Ltd.;

Mr. Christopher C. Kempley, Chief Counsel, and Ms. Janet F. Wagner, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

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1 **BY THE COMMISSION:**

2
3 **I. INTRODUCTION**

4 **A. Procedural Background**

5
6 Following a Special Open Meeting held on April 25, 2002, the Commission issued a
7 Procedural Order in these consolidated dockets on May 2, 2002. The May 2, 2002 Procedural Order
8 set a hearing schedule for those issues delineated as "Track A" issues, and established a preliminary
9 procedural framework for meeting an October 21, 2002 completion date for Commission
10 consideration of competitive solicitation issues, which were delineated as "Track B" issues. The May
11 2, 2002 Procedural Order directed that Track B proceed concurrently with Track A, and instructed
12 interested parties to file by May 13, 2002, a list of proposed issues for consideration, and a procedural
13 timetable (including comment periods) for the Track B issues. The May 2, 2002 Procedural Order
14 also ordered the parties to submit to the Commission's Utilities Division Staff ("Staff") a list of
15 qualified persons to act as an independent consultant/evaluator, and ordered Staff to begin any
16 required procurement process as soon as possible. The May 2, 2002 Procedural Order directed Staff
17 and the parties to keep the Commission and the Hearing Division apprised of the progress being
18 made on Track B through docket filings, and to immediately contact the Hearing Division if
19 additional issues required resolution.
20

21
22 On May 13, 2002, Tucson Electric Power Company ("TEP"), Arizona Public Service
23 Company ("APS"), the Arizona Competitive Power Alliance ("Alliance"), the Residential Utility
24 Consumer Office ("RUCO") and Staff filed Track B proposals in compliance with the May 2, 2002
25 Procedural Order. Staff indicated in its filing that it anticipated awarding a contract to an
26 Independent Evaluator on or around July 8, 2002.
27
28

1 On May 31, 2002, Staff filed a list of issues for comment of the other parties. On June 20,
2 2002, based on the proposals submitted on May 13, 2002, the First Procedural Order on Track B
3 Issues established a procedural schedule that included workshops, as proposed by Staff, on July 24
4 and 25, 2002. The First Procedural Order stated that the balance of the procedural schedule would be
5 dependent upon the Commission's Decision on the Track A issues, the consensus reached by the
6 parties during the workshops or otherwise, and whether a hearing on any Track B issues became
7 necessary. The First Procedural Order set a deadline for the parties to respond to Staff's May 31,
8 2002 list of issues by July 1, 2002, which response was to include any competitive solicitation issues
9 not addressed in Staff's May 31, 2002 filing, and also set a deadline of July 17, 2002, for Staff and
10 the Independent Evaluator to file a list of issues to be addressed at the July 24 and 25, 2002
11 workshops. In addition, the First Procedural Order encouraged the parties to meet and attempt to
12 achieve a consensus competitive solicitation proposal as outlined by APS in its May 13, 2002 filing,
13 and directed Staff to continue preparation for the filing of a Draft Staff Report by the August 28,
14 2002 deadline referred to in its May 13, 2002 filing, pending the issuance of a further procedural
15 schedule.
16
17

18 Hearings were held on the Track A issues during the last two weeks of June, 2002, and
19 Decision No. 65154 was issued on September 10, 2002, in these dockets. In addition to its
20 determination of Track A issues, Decision No. 65154 ordered the parties to continue their efforts in
21 Track B to develop a competitive solicitation process¹ that can begin by March 1, 2003.
22

23 The parties held an additional workshop on August 13 and 14, 2002.

24 On September 16, 2002, Staff filed a Request for Procedural Order ("Request") asking that a
25 hearing be set to commence on November 20, 2002, following a third and final two-day workshop to
26

27 ¹ Decision No. 65154 ordered that upon implementation of the outcome of Track B, APS and TEP shall acquire, at
28 a minimum, any required power that cannot be produced from their respective existing assets, though the competitive
procurement process as developed in the Track B proceeding; and that the minimum amount of power, the timing, and the
form of procurement shall be determined in the Track B proceeding.

1 be held on September 26 and 27, 2002. APS and Panda Gila River, L.P. ("PGR") filed responses to
2 Staff's request indicating their agreement that a hearing would likely be necessary to achieve a
3 resolution of the Track B issues. While APS agreed with the procedural schedule proposed by Staff
4 in its Request, PGR requested a scheduling conference so that all parties might comment on dates to
5 be included in any procedural order and on issues to be addressed at the hearing. The Second
6 Procedural Order on Track B Issues was issued on September 24, 2002 and required the parties to
7 file, by October 1, 2002, their proposed schedules for the conduct of a hearing to be held following
8 the third workshop, and a list of the specific issues the parties believed remained to be addressed at
9 the hearing. A Procedural Conference was held as scheduled on October 2, 2002. It became known
10 at the October 2, 2002 Procedural Conference that the existing Track B schedule being discussed in
11 the workshops did not require APS and TEP to provide their needs assessments and procurement
12 proposals until January 31, 2003, which was after the hearing dates being proposed by the parties.
13 The Third Procedural Order on Track B Issues, issued on October 9, 2002, therefore required that
14 APS and TEP file a needs assessment and procurement proposal, sufficient to inform the Commission
15 in its determination of the minimum amount of power, the timing, and the form of procurement as
16 required by Decision No. 65154 ("Needs Assessment"), along with supporting testimony, by
17 November 4, 2002, in order to allow the other parties to respond in their pre-filed direct testimony.
18 The Third Procedural Order also set the remainder of the procedural schedule for the hearing, and for
19 the pre-filing of direct and rebuttal testimony and exhibits.

20 On October 25, 2002, Staff filed its Staff Report on the Track B Issues. The Staff Report
21 contained a "Detailed Staff Proposed Solicitation Process" and also included a separate section
22 setting forth Staff's position on unresolved issues. On November 4, 2002, APS and TEP filed their
23 Needs Assessments pursuant to the requirements of the Third Procedural Order. Following the
24 November 4, 2002 filings, the parties held an additional workshop on November 6, 2002.

25 On November 12, 2002, APS and TEP filed their direct testimony, including their response to
26 the Staff Report. Also on November 12, 2002, Harquahala Generating Company, L.L.C.
27 ("Harquahala"), PGR, Reliant Resources, Inc. ("Reliant"), Sempra Energy Resources ("Sempra"),
28 Wellton-Mohawk Generating Facility ("WMGF"), the Land and Water Fund of the Rockies ("LAW

1 Fund”) and RUCO filed their direct testimony and exhibits, including their responses to the Staff
 2 Report and to APS’ and TEP’s Needs Assessments. On November 18, 2002, Harquahala, PGR,
 3 Reliant, Sempra, WMGF, the LAW Fund, RUCO and Staff filed rebuttal testimony and exhibits.

4 Public notice of the proceedings on the Track B issues was published in the *Arizona Daily*
 5 *Star* on November 4, 2002, and in newspapers of general circulation across APS’ service territory² on
 6 either November 5 or 6, 2002. No further intervention requests were filed following the publication.
 7 The hearing commenced on November 21, 2002. Mr. Bob Liden of Stirling Energy Systems
 8 provided public comment at the hearing, encouraging the Commission to make sure that renewables
 9 are included in the bidding process, are given some preferences in the bidding process, and that
 10 power purchase agreements for renewable energy are made for long terms in order to support the
 11 capitalization of such plants. No other parties appeared to provide public comment on the Track B
 12 issues. Staff, APS, TEP, Harquahala, PGR, Reliant, Sempra, WMGF, the LAW Fund and RUCO
 13 appeared through counsel and presented their witnesses. Other parties participating in the hearing
 14 included the Arizona Utility Investors Association (“AUIA”) and PPL Southwest Generating
 15 Holdings, LLC, PPL Energy Plus, LLC and PPL Sundance Energy, Ltd. (“PPL”) and Southwestern
 16 Power Group II (“SWPG”).

17 Staff, APS, TEP, AUIA, Harquahala, PGR, PPL, Reliant, Sempra/SWPG, WMGF, the LAW
 18 Fund, and RUCO filed initial post-hearing briefs on December 18, 2002. APS, TEP, Harquahala,
 19 PGR, Reliant, Sempra/SWPG, WMGF, the LAW Fund, RUCO and Staff filed reply briefs on
 20 December 31, 2002.

21 **B. Goals of the Staff Proposed Solicitation Process**

22 The Staff Report, filed on October 25, 2002, included a Detailed Staff Proposed Solicitation
 23 Process and Solicitation Timelines. (Exh. S-1 at 6-29) During the workshop process, Staff
 24 developed a draft working paper regarding the competitive solicitation process and parties were able
 25 to provide substantive comment and make suggestions to Staff on the draft solicitation process. (*Id.*
 26
 27
 28

1 at 3) The numerous participants in the workshops, not all of whom participated in the hearing
2 process, are listed in the Staff Report at pages 2-3.

3 Staff has stated that its overriding goal in this process is to establish a transparent process that
4 will result in cost savings for ratepayers, and that this goal should be used as a standard to evaluate
5 every disputed issue in this proceeding. PGR agreed, stating it believes that the only way to fully
6 explore and establish potential ratepayer cost savings is to solicit, from the competitive market,
7 alternatives to "current ratepayer cost items." PPL also believes that the competitive solicitation must
8 be open, transparent, fair and unbiased as to all participants, and structured so as to best achieve the
9 best value for ratepayers. Sempra and SWPG strongly support the competitive process procurement
10 goals set forth in the Staff Report, and believe that the Commission should adopt a competitive
11 procurement process that allows for consideration of all types of competitive solicitations and
12 proposals; requires sound economic and deliverability analysis of bids; and is not biased by nature
13 and design towards any predetermined outcome.
14

15 As RUCO points out, the parties are nearly unanimous in their agreement that the goal of
16 competitive power solicitation should be a least-cost mix of reliable power to customers. RUCO
17 believes that the competitive power solicitation should yield cost savings for customers compared to
18 what they pay today and what they expect to pay in the future, and believes that the Commission can
19 meet these goals if the solicitation gives standard offer customers a least-cost portfolio of reliable
20 electricity services.
21

22 APS also endorsed the general goals of Staff in carrying out the Track B process, and supports
23 an effective power procurement process for consumers.
24
25
26

27 ² The newspapers in which publication occurred were *Arizona Republic*, *Bisbee Daily Review*, *Douglas Daily*
28 *Dispatch*, *Flagstaff AZ Daily Sun*, *Holbrook Tribune*, *Parker Pioneer*, *Payson Roundup*, *Prescott Daily Courier*, *Sedona*
Red Rock News, *Tri Valley Dispatch*, *Wickenburg Sun*, *Winslow Mail* and *Yuma Daily Sun*.

1 **C. Issues Requiring Resolution**

2 The issues on which the parties were unable to reach consensus, and thus require a
3 Commission resolution, are as follows: 1) the solicitation and bid process to be approved,
4 including whether to institute an integrated resource planning process; 2) the amount of capacity and
5 energy to be solicited; 3) the bid evaluation method to be approved, including whether APS and TEP
6 are required to accept any bids; 4) affiliate participation in the bid process; 5) the Commission's
7 prudence review of contracts resulting from the bid process; and 6) the direction of future
8 proceedings, including DSM and environmental risk mitigation programs.
9

10 **II. PARAMETERS OF THE SOLICITATION**

11 **A. Decision No. 65154's Track B Requirements**

12 Decision No. 65154 ordered that upon implementation of the outcome of Track B, APS and
13 TEP shall acquire, at a minimum, any required power that cannot be produced from their respective
14 existing assets, through the competitive procurement process as developed in the Track B proceeding;
15 and that the minimum amount of power, the timing, and the form of procurement shall be determined
16 in the Track B proceeding. Decision No. 65154 stated that the overriding concern of the Commission
17 must continue to be ensuring that the citizens of Arizona have safe, reliable and fairly priced electric
18 power, and found that it is incumbent upon all parties to work together in such a manner that will
19 allow competition and its expected benefits to develop in whatever timeframe is needed to make it
20 successful, while satisfying that concern. In Decision No. 65154, the Commission stated its belief
21 that requiring some power to be purchased through the competitive procurement process will
22 encourage a phase-in to competition, encourage the development of a robust market for wholesale
23 generation, and obtain some of the benefits of the new Arizona generation resources, while at the
24 same time protecting ratepayers.
25
26
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28

1 Decision No. 65154 required that for purposes of the competitive solicitation process, the
2 generating assets that APS may seek to acquire from its affiliate, PWEC, shall not be counted as APS
3 assets in determining the amount, timing and manner of the competitive solicitation. Also pertinent
4 to Track B, Decision No. 65154 ordered TEP and APS to work with Staff to develop a plan to resolve
5 reliability must-run generation (“RMR”) concerns, and ordered Staff to include the results of such a
6 plan in the 2004 Biennial Transmission Assessment (“BTA”). Decision No. 65154 ordered APS and
7 TEP to file annual reliability must-run generation study reports with the Commission in concert with
8 their January 31 ten year plan, for review prior to implementing any new RMR generation strategies.
9 until the 2004 BTA is issued.
10

11 **1. Parties’ Interpretations of Decision No. 65154**

12 a. “Minimum amount of power”

13 In Decision No. 65154, the Commission ordered “that upon implementation of the outcome of
14 Track B, APS [and TEP] shall acquire, at a minimum, any required power that cannot be produced
15 from its own existing assets, through the competitive procurement process as developed in the Track
16 B proceeding. The minimum amount of power, the timing, and the form of procurement shall be
17 determined in the Track B proceeding.” (Decision No. 65154 at 33) Decision No. 65154 expounded
18 on the phrase “at a minimum,” stating that “APS and TEP may decide to retire or displace inefficient,
19 uneconomic, environmentally undesirable plants.” (Decision No. 65154 at 23, fn. 8) Decision No.
20 65154 thus set the minimum baseline amount of power that APS and TEP would be required to
21 acquire in the solicitation process. Decision No. 65154 left for this proceeding, however, the
22 determination of the actual minimum amount of power to be acquired, the timing of the power
23 procurement, and the form of the procurement. (Decision No. 65154 at 33)
24
25

26 The parties are not in agreement as to the interpretation of Decision No. 65154 regarding the
27 amount of power that APS and TEP must solicit in the Track B procurement process. APS takes the
28

1 position that it should not be required to solicit supply beyond that which its own resources and firm
2 contracts cannot provide. APS defines this supply as its “unmet needs,” and believes its calculations
3 of unmet needs, as set forth in its November 4, 2002, Needs Assessment filing, are in “strict
4 conformance” with Decision No. 65154. TEP takes a similar position, stating that its contestable
5 load for the initial competitive solicitation should include only TEP’s capacity and energy needs that
6 cannot be met by its existing assets. AUIA similarly argues that the utilities should not be required to
7 solicit any generation beyond any required power that cannot be produced from their own existing
8 assets, unless the utilities decide to retire some generating plants.
9

10 Staff and the merchant intervenors disagree with the interpretation that APS, TEP and AUIA
11 lend to Decision No. 65154’s language regarding the minimum amount of power that APS and TEP
12 must acquire. PGR argues, and Reliant agrees, that the Commission reference to “at a minimum” in
13 Decision No. 65154 is modifying what APS and TEP are required to acquire, and not the amount that
14 will be sent out for solicitation. Staff asserts that this proceeding is concerned with determining
15 contestable load amounts, rather than establishing unmet needs.³
16

17 b. “Economically”

18 Staff, in its pre-filed rebuttal testimony, proposed a modification to the language in the Staff
19 Report pertaining to the amount of capacity or energy that APS and TEP must acquire through
20 competitive solicitation. (Exh. S-4 at 11-12 (Rebuttal Testimony of Alan Kessler)) Staff proposed to
21 insert the word “economically” on page 4, line 20 of the Staff Report before the word “served.”⁴
22 Staff proposed this change in response to APS’ November 4, 2002 Needs Assessment, in which APS
23 proposed to procure a large portion of its required energy on the spot market, outside of the Track B
24

25 ³ Staff explains that “unmet needs” describes the capacity and energy that the utility is not able to supply from its
26 own facilities, and that “contestable load” describes the amount of capacity and energy for which a competitive
27 alternative may be available. TEP similarly states that “unmet needs” connote those capacity and energy needs that
28 simply cannot be met by the utility’s existing assets, and that “contestable load” connotes the amount of capacity and
energy that must be put out to bid in the solicitation process.

1 competitive solicitation process.⁵ Staff explained that it proposed this change to clarify that, during
2 the development of the solicitation process, Staff's intention was to have the vast majority of
3 reasonably expected purchases of capacity and energy acquired through the initial solicitation process
4 Staff proposed. (*Id.* at 12) Staff believes the anticipated amount of "economy energy" APS
5 identified in its Needs Assessment should be solicited on a firm or dispatchable basis, and then
6 evaluated by the utility based on the information it will acquire as a result of the solicitation, to
7 determine whether contracts for power are better alternatives than reliance on spot markets. (*Id.*)
8 Staff emphasized that the utility should remain responsible for making, and justifying its decisions
9 when evaluating bids. (*Id.*)
10

11 APS argues that a requirement that it acquire, through competitive solicitation, needs not
12 "economically" served by existing utility-owned generating capacity or through existing contracts is
13 contrary to specific language in Decision No. 65154 and would subject APS to financial risk. AUIA
14 argues that insertion of the term "economically" in the parameters of the competitive solicitation
15 would dramatically alter the amount of utility load that could be subject to bid under the terms of
16 Decision No. 65154. TEP is also concerned that such an approach may subject the entire load of a
17 utility to competitive solicitation, and believes that it will complicate the process and interfere with
18 an assessment of how a competitive solicitation may best be conducted in the future.
19

20 Harquahala, PPL, PGR, Reliant, Sempra and SWPG support the use of the term
21 "economically" as recommended by Staff. Harquahala believes the term "economically" should
22 apply to both capacity and energy procurements, and is of the opinion that imposing an "economic"
23 criteria for the solicitation will promote fiscally responsible choices, not financial risks. Sempra and
24 SWPG believe inclusion of the term "economically" is consistent with the Commission's stated
25

26
27 ⁴ During the hearing, Staff confirmed that in accordance with this change, the word "economically" should also be
inserted in the Staff Report at page 6, line 5, before the word "served" and at page 35, line 5, before the word "supply."

28 ⁵ APS stated that these purchases would be "economy energy" purchases. This issue is discussed in a separate
section below.

1 objective, in Decision No. 65154, of insuring just and reasonable rates for captive customers. PPL
2 states that the concept is consistent with the goal of reduced costs to customers, and that allowing
3 efficient new generation units to compete against less efficient units should result in consumer
4 savings with less environmental impact. Staff asserts that to construe Decision No. 65154 as omitting
5 considerations of cost when determining contestable load is logically inconsistent with the
6 Commission's goal of providing ratepayers with reliable power at the lowest possible cost.

7 8 **2. Discussion/Resolution**

9 We do not believe requiring APS and TEP to solicit, through competitive solicitation, needs
10 not economically served by existing utility-owned generating capacity or through existing contracts.
11 is contrary to Decision No. 65154. In their arguments that Decision No. 65154 limits the competitive
12 solicitation to "unmet needs," APS, TEP and AUIA offer no convincing reason for us to disregard
13 our prior statements that "the minimum amount of power, the timing, and the form of procurement
14 shall be determined in the Track B proceeding" (Decision No. 65154 at 33), and that "APS and TEP
15 may decide to "retire or displace inefficient, uneconomic, environmentally undesirable plants."
16 (Decision No. 65154 at 23, fn 8, emphasis added) Decision No. 65154 does not limit the
17 Commission in the amount of power we may require APS and TEP to solicit in the competitive
18 procurement process. At a minimum, as we stated in Decision No. 65154, APS and TEP must
19 acquire, through this competitive solicitation, any required power that cannot be produced from their
20 respective existing assets. Nothing in this Decision changes that requirement.

21
22 The Commission's purpose in establishing this Track B proceeding was not to determine
23 APS' and TEP's "unmet needs," but to determine the actual amount of power to be solicited in the
24 competitive solicitation, which necessarily will include, but will not be limited to, their required
25 power that cannot be produced from their respective existing assets. Based on the record in this
26 proceeding, we believe that it is in the best interest of APS' and TEP's ratepayers for APS and TEP
27
28

1 to test the market in this solicitation, beyond the amount of required power that cannot be produced
2 from their respective existing assets or existing contracts, to determine whether reliable generation is
3 available at a lower cost than that produced by their own existing assets, or at a comparable level of
4 cost, but with reduced adverse environmental effects, compared to their own existing assets. A
5 broader solicitation will also further the goal of encouraging the development of a robustly
6 competitive wholesale generation market in Arizona. The amount by which APS and TEP must test
7 the market in this competitive solicitation, and which will include their required power that cannot be
8 produced from their respective existing assets or existing contracts, will be referred to herein as
9 “contestable load.” We will require that the initial competitive solicitation be issued for the amount
10 of APS’ and TEP’s contestable load, as set forth in this Decision, and that it not be limited to required
11 power that cannot be produced from their respective existing assets or existing contracts. If the
12 competitive solicitation for contestable load yields bids for capacity or energy beyond required power
13 that cannot be produced from their respective existing assets or existing contracts, and if the utilities
14 determine, after serious economic and technical analysis, that the offered capacity or energy would
15 serve their customers more economically than their existing assets, then the utilities should make
16 procurements accordingly, keeping in mind that the goal of the competitive solicitation is to provide
17 ratepayers with reliable power at the lowest cost while furthering the Commission’s goal of
18 encouraging the development of a vibrant wholesale generation market in Arizona.
19
20

21 In regard to the APS’ claim that expanding the solicitation beyond required power that cannot
22 be produced from its existing assets or contracts would subject APS to financial risk, we note that
23 since APS will make the decision as to how much competitive power to procure, beyond its
24 requirements that cannot be produced from its own existing assets or contracts, any financial impact
25 of such procurement is within APS’ control.
26
27
28

B. Capacity and Energy to be Solicited (Contestable Load)**1. Determination of Contestable Load Estimates****a. Positions of the Parties**

1
2
3
4 APS and TEP took the position that contestable load (as defined herein, above) should consist
5 only of required power that cannot be produced from their respective existing assets or existing
6 contracts. In its Needs Assessment, APS proposed to procure only the amounts set forth in Schedule
7 PME-1, attached to Mr. Ewen's Direct Testimony, Exh. APS-1, through the initial Track B
8 solicitation. Staff and the merchant intervenors took the position that contestable load for the initial
9 solicitation should include more capacity and energy than APS' and TEP's estimates of required
10 power that cannot be produced from their respective existing assets or existing contracts, as
11 represented in their respective Needs Assessments.
12

13 The Staff Report included a table that provided estimated contestable loads for APS and TEP
14 for the years 2003, 2004, 2005 and 2006, broken down into capacity and energy. (Exh. S-1 at 7)
15 Staff states that it used the capacity requirement and an average system capacity factor information
16 provided by the utilities to develop its estimates, which are not precise. (Exh. S-3 at 7 (Rebuttal
17 Testimony of Alan Kessler)) Staff explained that under its approach, contestable load and energy
18 would be adjusted during the Pre-Solicitation phase of the solicitation process (*see* Exh. S-1 at 12-16)
19 to accommodate changes in projected load and system economics, with final quantification to occur
20 prior to the issuance of the initial solicitation. (Exh. S-3 at 7) At the hearing, Staff presented its
21 Revised Contestable Loads Estimate, Exh. S-5, which is an updated version of the Staff
22
23
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1 Report estimates.⁶ A significant portion of the increase in Staff's APS energy estimates from those in
 2 the Staff Report results from the addition of "economy purchase" amounts. Those "economy
 3 purchase" amounts are identical to the "economy energy" amounts appearing in Schedule PME-13 to
 4 APS' Needs Assessment, Exh. APS-1. Staff subsequently attached an updated version of hearing
 5 Exh. S-5 as Exhibit A to its Initial Closing Brief filed on December 18, 2002.⁷

6 PGR supported the numbers in Exh. S-5 as the minimum solicitation of capacity that should
 7 be required. However, PGR believes that in order to be consistent with APS' prior positions in these
 8 consolidated dockets, that a higher number for solicitation of energy is appropriate for APS, and that
 9 the Commission should instead adopt the higher solicitation volumes contained in Exh. S-1, the Staff
 10 Report. As justification for Commission adoption of the higher contestable load for APS, PGR
 11 points to APS' stated plans at the August workshop, prior to Decision No. 65154, to displace 5,728
 12 gigawatt hours ("GWH") of energy from its own generation with long-term procurement of energy
 13 from its affiliate Pinnacle West Energy Corporation's ("PWEC") new combined cycle gas fired units
 14 in 2003. (See Schedule PME-3R to Exh. APS-4 (Ewen Rebuttal Testimony)) Harquahala also
 15 reasons that the discrepancy between APS' earlier plans to procure energy and capacity from its
 16 affiliate PWEC, and the current plans to purchase comparable amounts of energy on the spot market,
 17 as revealed in APS' Schedules PME-1 and PME-13 attached to its Needs Assessment, lends greater
 18
 19
 20

21 _____
 22 ⁶ The Staff Report states that the table appearing at page 7 of Exh. S-1 (the Staff Report) was based on capacity
 23 numbers, provided by APS at the August workshop, which Staff also used to derive the energy numbers. APS provided
 24 revised capacity and energy numbers to Staff on October 23, 2002. Because there was not sufficient time for Staff to
 25 review and analyze the revised information for inclusion in the Staff Report by the October 25, 2002 filing date, Staff
 26 attached the revised APS information as Appendix Two to the Staff Report. At the hearing, Staff presented hearing Exh.
 27 S-5 as a replacement for the table appearing on page 7 of Exh. S-1. Staff's witness stated that APS supplied all the parties
 28 with additional new information at a November 6, 2002 workshop, that more additional information was received a few
 days prior to the hearing, and that the new information was incorporated into Staff's preparation of Exh. S-5. (Tr. at 51-
 52)

⁷ This most recent of Staff's contestable load estimates incorporates the elimination, discussed at the hearing, of
 215 MW from Staff's energy estimates for APS. For Staff's TEP estimates, the updated version of S-5 includes the
 addition of previously unavailable local RMR generation estimates, and the addition of "economy purchases" to Staff's
 energy estimates for TEP. In its Reply Brief, TEP argues that the new contestable load amounts in that exhibit have not
 been subject to cross-examination or other inquiry and should not be adopted in this Decision, particularly since Staff
 acknowledges those loads will be refined and adjusted in the Pre-Solicitation process.

1 credibility to the capacity and energy calculations for APS submitted by Staff, PGR and Harquahala.⁸
 2 Harquahala believes that a specific number in terms of megawatts (representing capacity) and
 3 megawatt-hours (representing energy) should be included in the Decision on this matter, and supports
 4 using the numbers presented in Exh. S-5 as the minimum amounts for the utilities to competitively
 5 procure.

6 APS stated in its brief that although it finds the numbers set out in Exh. S-5 to be acceptable
 7 estimates of what they purport to be, with the caveat that reliability must-run generation (“RMR”)
 8 numbers may be revised upon completion of the ongoing RMR study,⁹ the numbers are estimates
 9 based on the information then currently available, and should not be viewed as any definitive
 10 indication of what APS may procure through the solicitation process.

12 TEP advocates that the Commission should clearly set out the types of load and the
 13 appropriate methodologies for determining contestable load, rather than adopting contestable load
 14 numbers that will require updating, and believes that a focus on methodology in this Track B
 15 Decision will meet the Commission’s goals for a competitive solicitation. Staff’s position is
 16 somewhat aligned with APS’ and TEP’s on this specific point, insofar as Staff believes that while the
 17 Commission will have to choose an appropriate number to represent the utilities’ contestable loads,
 18 those numbers should be targets, rather than absolute requirements. Staff recommends that the
 19

21 ⁸ Schedule PME-3R to Exh. APS-4 (Rebuttal Testimony of Peter M. Ewen), and Exh. No. CCR-1 to Exh. Panda-2
 22 (Direct Testimony of Craig R. Roach, PhD), depict APS’ August Workshop estimates of the amount of APS generation it
 23 planned to displace with energy from what APS termed “PWEC Dedicated Generation.” Footnote 7 to Schedule PME-1,
 and Schedule PME-13 to Exh. APS-1 (Direct Testimony of Peter M. Ewen) depict APS’ Needs Assessment estimates of
 potential economy energy purchases and for net unmet reliability needs. A comparison is reproduced here for the years
 2003-2005:

	APS’ August Workshop plans for PWEC displacement of APS generation energy	APS’ November Needs Assessment Plans for potential economy energy purchases	APS’ November Needs Assessment Plans for net unmet reliability needs
26 2003	5,728 GWH	3,705 GWH	639 GWH
27 2004	6,170 GWH	4,033 GWH	840 GWH
28 2005	7,217 GWH	6,695 GWH	1,228 GWH

28 ⁹ APS added that even though Staff estimates of RMR and economy energy may be reasonable, APS believes it is
 inappropriate to include RMR and economy energy in the Track B solicitation process.

1 Commission focus on determining an appropriate method for calculating contestable load instead of
2 focusing on developing specific numbers, because it will be necessary to update the numbers prior to
3 the solicitation.

4 RUCO believes that the solicitation requirements beyond APS' and TEP's immediate needs
5 for the year 2003 should be determined by the Commission in an Integrated Resource Planning
6 ("IRP") process. RUCO takes the position that the Commission should establish the amount of
7 capacity, but not energy, for which the utilities should solicit bids. RUCO states that soliciting for
8 capacity is more important, because once the utility has sufficient capacity, the dispatch of that
9 capacity will be determined by the variable cost of each MW of capacity and the demand in each
10 hour. The LAW Fund took no position on the contestable load for the initial solicitation, stating that
11 it did not wish to delay the first round of solicitations, but advocated for mandatory inclusion of a
12 Demand Side Management ("DSM") solicitation component and an environmental risk management
13 policy in the second and subsequent solicitations.
14

15
16 b. Discussion/Resolution

17 At the hearing, Staff provided the following explanation of the purpose of its contestable load
18 estimates:

19 Staff's recommendation that this amount be solicited is not a recommendation that
20 necessarily the utilities purchase as a result of this first solicitation all of those
21 supplies, both capacity and energy that are offered or that are being solicited for. They
22 still have the obligation of evaluating those bids to see whether or not they are the
23 most economical and reasonable products to serve their customers' needs.

(Tr. at 156)

24 We agree with Staff on this point. We believe that the solicitation process developed by the
25 parties, as proposed by Staff, is a necessary step in our goal of encouraging the development of a
26 healthy competitive wholesale generation market in Arizona. We also recognize that the
27 responsibility of the utilities is to provide for the continuing need of its ratepayers to maintain a
28 reliable supply of electricity at reasonable rates, and that this primary obligation exists, and will

1 continue to exist, whether a utility has an affiliate operating in the Arizona wholesale market or not.
 2 TEP's position that we should only set out the types of load and the appropriate methodologies for
 3 determining contestable load, rather than adopting specific contestable load numbers that will require
 4 updating, might be acceptable under differing circumstances. However, at this time, we are faced
 5 with the fact that although the parties to this matter spent months working out numerous issues
 6 regarding the solicitation, they were unable to reach a consensus on contestable load amounts prior to
 7 the hearing. Because it is our desire to provide the parties as much clarity as possible on the
 8 parameters of the solicitation, we will adopt contestable load numbers for capacity and energy in this
 9 Decision, and will set out the appropriate methodology for refining and adjusting them in the Pre-
 10 Solicitation process. Our adoption of specific numbers for contestable load will not require the
 11 utilities to accept bids that they judge to be uneconomic pursuant to the bid evaluation requirements
 12 of this Decision.
 13

14 The major areas of disagreement regarding determination of contestable load numbers
 15 centered on whether contestable load should include RMR and economy energy purchases.
 16

17 **2. Reliability Must-Run Generation ("RMR")**

18 Transmission constraints currently limit the capacity and energy that can be delivered from
 19 particular generators over particular lines to load in the Phoenix, Tucson, and Yuma areas, and may
 20 give rise to RMR requirements inside those load pockets. (Exh. S-4 at 3-4 (Rebuttal Testimony of
 21 Jerry Smith))
 22

23 a. Inclusion of RMR in the Solicitation

24 1) Positions of the Parties

25 Staff believes that RMR should be included in the initial solicitation as contestable load,
 26 because such inclusion will reveal whether and to what extent the market will provide solutions to
 27 transmission import constraints (Tr. at 277-278). PPL, PGR, Harquahala, and WMGF are in
 28

1 agreement with Staff.¹⁰ Staff states that failure to include RMR in a utility's contestable load has the
2 potential to diminish the benefits to be derived from competitive bidding, and would serve to
3 encourage the utility to continue using generating plants within a constrained area, and not look to
4 meet system needs from cheaper and cleaner sources. (Exh. S-4 at 3) Staff also believes that
5 inclusion of RMR in contestable load will offer a market response reference regarding the relative
6 economic and environmental merits of generation solutions to the transmission import constraint.
7 (Exh. S-4 at 6) Staff states that there are three conditions under which RMR capacity and energy
8 could be contestable: 1) if non-utility owned or non-rate based generation exists locally; 2) if remote
9 generation has access to non-APS or non-TEP firm transmission capacity that would enable delivery
10 to the local area; and 3) if owners of remote generation offer to finance transmission improvements to
11 remedy the transmission constraint. (Exh. S-4 at 5) Staff asserts that units exist internal to the
12 constraint that can bid, that transmission paths other than the incumbents' exist that could be used,
13 and that, at least in the long term, transmission enhancements could accompany an RMR bid. (Staff's
14 Initial Br. at 4, citing Tr. at 149-150, 151, 173-174, 279-280)

15
16
17 TEP opposes inclusion of RMR in the initial solicitation, as it believes that such a requirement
18 goes beyond the intent of Decision No. 65154. TEP argues that RMR is not suitable for the proposed
19 solicitation process, and that TEP cannot reasonably acquire RMR economically through that
20 process. TEP claims that the vast majority of its RMR needs are for voltage stabilization of the
21 system, and can only be served by TEP's local generation. TEP argues that given the nature of TEP's
22 service area, no realistic short-term RMR solutions are available on a competitive basis, and that all
23 three of Staff's factors on RMR contestability likely cannot be met for the TEP service area in the
24 short term. TEP disagrees with Staff's position that inclusion of RMR in the solicitation may lead to

25
26
27 ¹⁰ PGR does not believe that it has yet been established that there presently should be either RMR capacity or
28 energy requirements, as it has not been allowed to participate in the RMR studies, and has seen no evidence that would justify such requirements. However, PGR agrees that previously designated RMR capacity should be subject to competitive solicitation.

1 long-term transmission enhancements, arguing that long-term solutions are contrary to the generally
2 anticipated 2003-2006 timeframe to be covered by the initial solicitation. TEP also believes that
3 including RMR in contestable load may significantly delay the initial solicitation, due to the interest
4 in RMR issues and the anticipated adjustment of RMR load numbers based on the January 2003
5 RMR study results. TEP also argues that soliciting and analyzing bids for RMR capacity and energy
6 involves issues beyond an analysis that focuses primarily on price. TEP urges that if the Commission
7 decides that RMR capacity should be competitively bid, that such bidding be deferred.
8

9 APS states that there is no precedent of which it is aware for bidding out company-owned
10 RMR capacity, that Staff took the position in the Track A proceeding that RMR should not be
11 divested, and that bidding APS-owned RMR runs the risk of ignoring the ancillary services benefits
12 offered by such RMR units, such as spinning reserve and voltage support. APS points out that it has
13 agreed to competitively bid for non-APS supplied RMR, and that this will allow for a "market test"
14 as suggested by Staff and some of the intervenors. APS argues that although the likelihood of
15 receiving a competing bid for the handful of hours served by APS-owned generation resources is
16 slight, the continued non-contestability of existing APS generation has important symbolic
17 significance in the financial community, and that there is no evidence on the record that making rate-
18 based assets contestable will benefit customers.
19

20 WMGF argues that whether APS-owned RMR does or does not provide ancillary services is
21 not a matter that affects whether such generation should be contestable in the competitive solicitation
22 process, because APS can simply include any required ancillary services in the bid solicitation, and
23 can consider their value during the bid evaluation process.
24

25 AUIA believes that inclusion of RMR in the 2003 solicitation does not serve a public purpose,
26 is premature prior to completion of the required RMR studies, and may be destabilizing to utility
27 finances.
28

2) Discussion/Resolution

1
2 The possibility that a competitive solicitation for RMR may result in less costly, more
3 efficient, cleaner solutions to load pocket problems places the solicitation of RMR generation clearly
4 within the public interest. In regard to the utilities' and AUIA's concern regarding the effect on
5 utility finances, since APS and TEP will make the decision as to how much competitive power to
6 procure beyond their requirements that cannot be produced from their own existing assets, any
7 financial impact of such procurements is within their control. The RMR studies, discussed below,
8 should be completed in time to have the required information available in time for the Pre-
9 Solicitation review process as outlined in the Staff Report. Inclusion of RMR in this initial
10 solicitation is therefore not premature.
11

12 We agree with WMGF that whether APS-owned RMR does or does not provide ancillary
13 services is not a matter that affects whether such generation should be contestable in the competitive
14 solicitation process, because APS and TEP can simply include any required ancillary services in the
15 bid solicitation, and can consider their value during the bid evaluation process.
16

17 TEP argued that all three of the conditions under which RMR capacity and energy could be
18 contestable likely cannot be met for the TEP service area in the short term. Staff's witness testified,
19 however, that he was aware of distributed generation and renewable facilities in the TEP service area.
20 (Tr. at 279) Until the solicitation occurs, it remains unknown whether, as TEP claims, RMR is
21 suitable for the proposed solicitation process and can reasonably be acquired economically through
22 that process. We believe that many of the issues TEP raised can and should be addressed in the Pre-
23 Solicitation process proposed in the Staff Report following the completion of the RMR study, in
24 which TEP is a participant. TEP's participation in that study should also provide TEP an opportunity
25 to prepare for the additional issues it states are involved in the RMR solicitation process. Regarding
26 the long-term solutions to load pocket problems, although the Staff Report does generally anticipate a
27
28

1 2003-2006 timeframe, longer term RMR solicitations or offers should not be discouraged. As with
2 non-RMR bids, and consistent with our desire to encourage the development of a robust wholesale
3 generation market in Arizona, we expect both TEP and APS to give serious consideration to longer-
4 term bids as well as short term bids.

5 We find that it is reasonable and in the public interest that all generation that can reliably
6 deliver energy into the load pockets, under the RMR conditions outlined by Staff, should be allowed
7 to compete in a fair and open manner to supply energy and capacity to both APS and TEP. We will
8 therefore require that RMR capacity and energy resources, including both utility owned and non-
9 utility owned resources, be contestable in the competitive solicitation process to help resolve
10 Arizona's load pocket problems in the most economical, efficient and environmentally friendly
11 manner possible.
12

13 b. Separate vs. concurrent solicitation of RMR capacity and energy

14 1) Positions of the Parties

15
16 APS and TEP propose that if RMR capacity and energy must be solicited, that the solicitation
17 should be conducted separately from the initial solicitation. APS believes that the unique delivery
18 issues associated with non-APS owned RMR needs, which it does not oppose being made
19 contestable, merit separate consideration. PGR agrees that a solicitation for RMR requirements
20 should be conducted as part of the Track B solicitation, but separately from the solicitation for non-
21 RMR requirements. PGR argues that by carving out RMR from the solicitation, that bidders may be
22 able to make better deals for capacity and energy because they know that other capacity and energy
23 would be used to provide RMR service during RMR hours.
24

25 Staff believes that inclusion of RMR capacity and energy in the initial solicitation is necessary
26 to determine to what extent the market will provide solutions to transmission import constraints.
27 RUCO, in advocating for its least-cost planning process, asserts that RMR and non-RMR needs must
28

1 be evaluated simultaneously, because the least-cost RMR and non-RMR portfolios will affect one
2 another. Harquahala and PPL are also opposed to the RMR solicitation being addressed separately.

3 2) Discussion/Resolution

4 We agree with Staff that inclusion of RMR capacity and energy in the initial solicitation is
5 necessary to determine to what extent the market will provide solutions to transmission import
6 constraints. We also agree with RUCO that RMR and non-RMR needs should be evaluated
7 simultaneously, in order to determine the utility's best least-cost portfolio. We will therefore require
8 that RMR capacity and energy be included in the initial solicitation. We believe that the issue of
9 whether RMR is included in the same RFP or auction block with non-RMR capacity and energy in
10 this initial solicitation will be adequately addressed during the Pre-Solicitation process described in
11 the Staff Report. Whichever means the utilities use to solicit RMR, they must adhere to the goal of
12 obtaining reliable power for their customers at the most reasonable cost possible, while also keeping
13 in mind the environmental effects of their procurement decisions.
14

15 c. RMR Studies

16 APS, Salt River Project and the Western Area Power Administration are currently
17 participating in RMR studies for the years 2003-2007 to be filed with the Commission by January 31,
18 2003, and which are to include the identification of RMR hours, capacity and energy. (Tr. at 147,
19 150; Exh. S-4 at 5) Staff states that the resulting study information will then be available to
20 incorporate in the pre-solicitation activities of the 2003 competitive solicitation process. Staff
21 anticipates that, once the RMR study reports are filed, parties will have an opportunity to comment
22 on and critique them, and Staff would utilize those comments as a means of judging the merits of the
23 study results. (Tr. at 151-152)
24

25 PPL, Harquahala and PGR expressed concern that the merchant intervenors were not
26 participants in the RMR studies. PGR requests that the Commission order that merchant intervenors
27
28

1 be allowed to participate and comment. Staff testified that the transmission providers are under a
2 short time constraint to complete the study work, and that Staff believes that as long as the process
3 ends up with the opportunity for comment and review that the public interest will be served. (Tr. At
4 148) PPL believes that our Decision in this matter should address the substance and timing of non-
5 utility participation in review and comment on the study, and that substantive response and
6 modification, if called for by the “informed and credible” comments from recognized authorities, be
7 required. PPL believes that the critical impact of the studies upon the competitive solicitation and its
8 economic impacts on Arizona ratepayers mandate that such a meaningful “peer review” component
9 be built into the process as part of our Decision in this matter, and further believes that once RMR
10 conditions are quantified, that the Commission should continue to monitor the situation, as active
11 monitoring may lead to a better understanding of the physical constraints and solutions to help
12 resolve the RMR condition, and deter any unbiased operation of the system.
13

14 We believe that the anticipated Staff and Independent Evaluator review of comments from
15 non-utilities in response to the January, 2003 RMR studies will allow Staff and the Independent
16 Evaluator to judge the merits of the study results and properly apply the results during the Pre-
17 Solicitation process outlined in the Staff Report. PPL’s concerns regarding continuing monitoring of
18 RMR conditions are being met by Staff’s ongoing BTA process. If PPL has specific continuing
19 concerns, it may consult with Staff.
20

21 d. RMR Bid and Management Protocols
22

23 Staff recommends that RMR capacity and energy be bid and managed in accordance with
24 applicable Arizona Independent Scheduling Administrator (“AISA”) and West Connect protocols.
25 (Tr. at 350-352) TEP claims that this creates a dilemma for TEP because it would require TEP to
26 seek a market-based solution for RMR at the same time that TEP’s FERC Open Access Transmission
27 Tariff (“OATT”) requires RMR to be provided at a cost basis. APS acknowledges that bidding RMR
28

1 could require amendments to OATT tariffs. (APS Initial Br. at 10) WMGF agrees with Staff, and
2 points out that the AISA and West Connect protocols are known, and would limit the price for the
3 utility to incremental cost until WestConnect is operational, when market prices would be allowed.
4 (Tr. at 350-352)

5 A utility's existing OATT can be amended if it becomes necessary to do so in order to allow a
6 utility to charge lower rates to its customers as a result of a favorable RMR bid. It is highly unlikely
7 that the Federal Energy Regulatory Commission ("FERC") would be opposed to a utility obtaining
8 the benefit for its customers of lower RMR costs, if the utility were to receive a bid lower than its
9 incremental RMR costs. The RMR bid and management protocols should conform to the AISA or
10 WestConnect protocols, whichever protocols are in place on a given date. We believe that
11 contracting parties can adequately and effectively deal with the hypothetical event (*see* Tr. at 352)
12 that neither set of protocols are in effect at some time in the future.
13

14 e. Yuma area

15 WMGF disagrees with APS' position that existing transmission counterflows in the Yuma
16 area, which result from two Yuma area generators selling power into California (Tr. at 667), obviate
17 the need for APS to solicit RMR generation for the Yuma area. WMGF claims that because APS'
18 customers have no assurance that this no-cost transmission "service" will be available when needed,
19 that APS should not be allowed to use the existence of the counterflows in the competitive
20 solicitation evaluation process.
21

22 APS responds that the fact that APS can take advantage of local generation support provided
23 by two non-APS units that sell outside the Yuma area, at no cost to APS customers, so that APS can
24 use local generation only when necessary, does not support requiring APS to buy products from
25 WMGF that it does not need. APS views the WMGF project as one of several possible future
26 resources for meeting load-serving obligations in Yuma, but states that the proposed WMGF project
27
28

1 is by no means the only option APS has to address future load-serving capability at Yuma. (Exh.
 2 APS-7 at 6 (Rebuttal Testimony of Thomas Glock)) APS states that it would not want to foreclose
 3 other options by committing now to a project that does not have either a Certificate of Environmental
 4 Compatibility or any financing, particularly given today's difficult credit environment. (*Id.*)

5 The same solicitation parameters for RMR capacity and generation will apply to APS for the
 6 Yuma area as for the Phoenix area. A determination of whether RMR in the Yuma area is
 7 contestable will be dependent upon the results of the forthcoming RMR studies, and Staff and the
 8 Independent Evaluator's review of comments filed on those results. If there is contestable load in the
 9 Yuma area, as determined in the Pre-Solicitation process by Staff and the Independent Evaluator after
 10 their review of comments submitted on the RMR study results, APS will be required to solicit bids.
 11 WMGF may make a proposal to APS, and as with all bids received, it will be up to the utility to
 12 determine whether it is in the best interests of its ratepayers to procure a product or products from
 13 WMGF in this solicitation.
 14

15 **3. Economy Energy – Solicitation versus Spot Market Purchases**

16 a. APS

17
 18 In its Needs Assessment, APS proposed to procure only the amounts set forth in Schedule
 19 PME-1 attached to Mr. Ewen's Direct Testimony, Exh. APS-1, through the initial Track B
 20 solicitation. APS proposed to displace production¹¹ from its existing generating assets and its SRP
 21 T&C contract not by solicitation in the Track B process, but only by purchases made outside the
 22 solicitation process, in the same manner that it currently makes such purchases. (Exh. APS-1 at 22-
 23 23; Exh. APS-2 at 13-14) APS showed these amounts in Schedule PME-13 to APS-1, which is titled
 24 "Potential Economy Energy Purchases."¹² APS explained that it currently determines whether to
 25

26
 27 ¹¹ Schedule PME-1 already reflects APS' plans to retire the 4MW Childs/Irving hydro facilities at the end of 2004
 and to place the older West Phoenix steam units 4 and 6 in cold reserve for the years 2003 through 2012. (Exh. APS-1 at
 18)

28 ¹² These amounts are also reproduced for the years 2003-2005 in footnote 8, above.

1 secure economy energy and other short-term purchases on a daily basis, based on a comparison of the
2 anticipated market price of power and forward gas prices. (Exh. APS-2 at 13-14) In rebuttal
3 testimony, APS proposed a compromise involving bidding 50 percent of its Needs Assessment
4 forecast economy energy needs for the upcoming 12 months, outside the initial solicitation process.
5 through a series of quarterly auctions held on the first business day of the month preceding each
6 quarter, with the balance of APS' economy and other short-term energy needs being acquired from
7 non-affiliates or through "blind" procurements using electronic trading platforms or independent
8 brokers, also outside the initial solicitation process. (Exh. APS-5 at 10-13 (Carlson Rebuttal
9 Testimony)) APS argued that this would be the "least-harmful" way to test the viability of a formal
10 solicitation process for "economy energy."

12 Staff, Harquahala, and PGR are opposed to both of APS' proposals. Staff characterized the
13 type of purchase described by APS as spot market purchases, and stated that it is not opposed to APS
14 acquiring energy on the spot market, as long as APS makes every effort to solicit for all of its needs
15 in a fair and transparent solicitation. (Exh. S-3 at 8-9) Staff believes that the initial solicitation
16 should include all the additional capacity that APS and TEP believe they will need for the period
17 covered by the solicitation, and all of the energy that they expect to purchase from third parties for
18 the specified time period, in order to determine market prices for both capacity and energy and to
19 then assess the risks of alternative supply scenarios. (*Id.*) Staff believes that such a solicitation will
20 reveal whether there is energy on the market that is priced in a way to make the spot market
21 unattractive. (*Id.* at 10) Staff explained that a utility might find that firm energy is available at prices
22 that make the potential benefits of the spot market, with its price volatility, unattractive, and might
23 also find that dispatchable energy is available at prices below the utility's marginal costs of
24 generation. (*Id.*) Staff believes that under those circumstances, locking in dispatchable energy
25 during the initial solicitation will assure some consumer benefits while still allowing the utility to
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1 maintain the flexibility to go to the economy market when circumstances dictate. (*Id.*) PPL also
2 believes that utilities should be allowed to make economy purchases, but that they should not use this
3 practice as a means of avoiding and frustrating the essence of the competitive solicitation
4 requirement. PPL argues that the Commission should require APS to bid almost all of the economy
5 energy purchases identified in the Needs Assessment.

6 PGR claims that a comparison of Schedule PME-1 to Exh. APS-1, which appears in APS'
7 Needs Assessment, to an APS Load and Resource Forecast table presented at the August 13 and 14,
8 2002 workshop¹³ demonstrates that APS, with its economy energy plan, hopes to subvert the
9 solicitation and instead purchase from PWEC's Redhawk plant at spot market prices. (Exh. Panda-2
10 at 15) PGR states that these two documents evidence a change from an APS proposal, in August
11 2002, to acquire energy on the basis of a 38 percent to 41 percent average annual capacity factor, to a
12 6 percent capacity factor¹⁴ in APS' Schedule PME-1. (*Id.*) PGR's witness stated that APS' August
13 workshop table shows that what APS termed "PWEC Dedicated Generation,"¹⁵ with 1,700 MW of
14 capacity, would generate 6,170 GWH of energy in 2004 to displace APS generation, which equates to
15 a 41 percent capacity factor in that year. (*Id.*) PGR's witness pointed out that in November's
16 Schedule PME-1, for the same year 2004, and for approximately the same amount of capacity (1,634
17 MW), APS used a capacity factor of only 6 percent to reach its energy estimate of only 840 GWH for
18 acquisition in the solicitation for 2004, and to possibly acquire 4,033 GWH of energy as "economy
19 energy purchases." (See Schedule PME-1, fn 7, Schedule PME-13 to APS-1, Exhibit CCR-1 to Exh.
20 Panda-2 and Schedule PME-3R to Exh. APS-4) PGR asserts that APS reduced its planned capacity
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26 ¹³ The referenced table is reproduced in Exh. No. CCR-1 attached to hearing Exh. Panda-2 (Direct Testimony of
Craig R. Roach, PhD). See also footnote 8, above.

27 ¹⁴ "Capacity factor" is the percentage of hours a generating unit is actually in operation out of the hours it is
available.

28 ¹⁵ Identified on Exhibit CCR-1 to Exh. Panda-2 as West Phoenix CC Units 4 & 5, Saguaro CT Unit 3, and
Redhawk CC Units 1&2.

1 factor for its energy solicitations when it became clear that PWEC's generation units might not
2 supply the energy to displace APS generation.

3 Harquahala, PGR, and PPL are also opposed to APS' proposed "compromise" to bid 50
4 percent of its forecast "economy energy" needs outside the initial solicitation process, through a
5 series of quarterly auctions. Harquahala asserts that APS' compromise solicitation process is an
6 attempt to delay significant competitive procurement until after APS can make its case for including
7 the PWEC units in rate base in the upcoming rate case. Reliant, however, in line with its position that
8 an auction should be held for at least one-third of the utilities' contestable load, supports the
9 Commission requiring adoption of APS' proposal for both APS and TEP to solicit economy energy.
10 Reliant suggests that if the auction process provides Arizona's consumers the benefits desired by the
11 Commission, that the Commission consider it as its policy for Arizona and possible future expansion
12 beyond 50 percent of economy energy. AUIA argues that APS should have the choice of meeting its
13 energy requirements in the manner of its choosing.
14

15
16 APS believes that the appropriate benchmark for determining whether pre-bidding economy
17 purchases is better for customers is not simply whether a generator can beat a current estimate of the
18 future operating costs of a particular APS generator. Rather, APS argues, the correct questions are
19 whether 1) placing restrictions on how APS procures economy energy in Track B and 2) requiring the
20 procurement to occur far earlier than would otherwise be the case yield a better result than simply
21 continuing with an already proven and successful economy energy program.
22

23 The Commission does not discourage the appropriate use of economy purchases for utilities to
24 reduce energy costs to customers. The utilities should retain the ability to fill unplanned or
25 unexpected needs from the spot market when appropriate. However, the record in this proceeding
26 demonstrates that prior to Decision No. 65154, APS was considering a procurement strategy that was
27 not dependent upon spot market purchases for such a large amount of its energy needs, but instead
28

1 anticipated displacement of APS generating assets with power from its affiliate, PWEC. We do not
2 believe that including in contestable load what APS has termed “economy energy” amounts to
3 “placing restrictions on how APS procures economy energy” or “requiring procurement far earlier
4 than would otherwise be the case.” Rather, inclusion of these amounts simply requires that APS
5 solicit bids, in a fair and transparent process, for this energy. This solicitation is necessary so that
6 APS can determine, in its expertise, whether the procurement of such energy might yield a better
7 result than relying on the spot market. APS has previously made such a determination, as evidenced
8 by its prior plans to purchase a comparable amount of energy from its affiliate PWEC. (*see* Tr. at
9 525, 526) Without soliciting and evaluating bids from wholesale generators who have expressed a
10 keen interest in supplying APS’ anticipated energy needs, APS will forego the opportunity to
11 compare the costs of such procurement at today’s wholesale prices to its proposed economy energy
12 program. If APS determines that any or all bids received will not yield a better result than spot
13 market purchases, APS may reject them. We are requiring APS to solicit bids for this “economy
14 energy” amount to further the Commission’s goal, as set forth in Decision No. 65154, of encouraging
15 the development of a robust wholesale generation market in Arizona while at the same time
16 protecting Arizona ratepayers. In preparing the solicitations and in evaluating the bids received to
17 determine the wisest procurement strategy, the utilities must keep those goals in mind.

20 APS’ proposal of a quarterly auction process for solicitation of economy energy purchases, as
21 a compromise to including the disputed economy energy in contestable load, is not the “least-
22 harmful” way to test the viability of a formal solicitation process for economy energy. Based on the
23 record in this proceeding, we find that postponing the solicitation of this portion of APS’ contestable
24 load may well prove harmful to the overall success of the solicitation process. The initial solicitation
25 should include all anticipated third-party purchases in order to provide the utilities with the widest
26 array of bids from which to compare and choose. Such a solicitation will best serve the goal of
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1 encouraging the development of a competitively robust wholesale generation market in Arizona
2 without harming ratepayers.

3 b. TEP

4 TEP urges that unplanned economy energy purchases should be excluded from contestable
5 load, and agrees with Staff's position that utilities should retain their ability to fill unplanned or
6 unexpected needs from the spot market when appropriate. TEP does not believe that it will derive
7 any better-than-market benefits by bidding out economy energy through the formal solicitation
8 process, particularly if it cannot accurately identify when it will need a certain amount of spot energy.
9

10 As we stated above, the Commission does not discourage the appropriate use of economy
11 purchases for utilities to reduce energy costs to customers. We note that, unlike the case with APS'
12 Needs Assessment, no party to this proceeding presented evidence controverting TEP's estimates of
13 future economy energy purchases as they appeared in TEP's Needs Assessment. We also note that
14 Staff's Exhibit S-5 as prepared for the hearing included economy energy numbers for APS, but not
15 for TEP. Staff's witness testified that Exhibit S-5 did not include TEP's economy energy purchases
16 as contestable load because the figures supplied by TEP did not include any portion of their capacity
17 and energy as being required to be met by economy purchases, and that TEP's figures included
18 "strictly truly economy purchases where they would be displacing other resources because of the
19 economics involved." (Tr. at 316) Staff modified its position to include TEP's economy energy
20 figures in Staff's contestable load estimates for TEP only in order to be "consistent between the two
21 companies." (Tr. at 317) We find that TEP should not be required to incur the costs of soliciting its
22 "strictly truly economy purchases" solely for the purpose of maintaining an appearance of
23 consistency, when the record clearly reflects differing circumstances for APS and TEP.¹⁶ We will
24 therefore not require TEP to include the amounts appearing on Staff's revised Exhibit S-5 as
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28 ¹⁶ TEP currently does not have an affiliate offering power on the wholesale generation market.

1 economy purchases in its contestable load during the initial solicitation. This is consistent with our
2 treatment of APS.

3 **4. Capacity to be Solicited**

4 a. APS

5 Staff accepted APS' projected unmet capacity needs as set forth in Schedule PME-1 attached
6 to its November 4, 2002 Needs Assessment, but added 15 percent reserves for all load.¹⁷ APS
7 acknowledged that inclusion of reserves on all load, and not just APS load, could be appropriate.
8 (Exh. APS-4 at 13-14) Staff also added APS' RMR capacity for the Phoenix area to its solicitation
9 recommendation, but did not include RMR capacity for the Yuma area in its calculation due to the
10 unavailability of the Yuma area data. Staff recommends that the final APS capacity solicitation
11 amounts be appropriately updated by the RMR capacity amount for the Yuma area when the results
12 of the RMR study are available, which should be on or before January 31, 2002. As currently set
13 forth in its updated version of hearing Exhibit S-5, Staff recommends that APS solicit bids for 2,460
14 MW of capacity in 2003; 2,734 MW of capacity in 2004; 2,854 MW of capacity for 2005; and 2,950
15 MW of capacity for 2006, with those numbers to be updated by the results of the RMR study.
16
17

18 PGR and Harquahala support Staff's recommended capacity solicitation amounts for APS.

19 We find Staff's capacity estimates above to be reasonable, and find it reasonable for the RMR
20 updates to be made during the Pre-Solicitation process set forth in the Staff Report. We will
21 therefore require that APS' minimum capacity solicitation amounts conform to Staff's estimates as
22 set forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR
23 amounts as determined by Staff and the Independent Evaluator following their receipt and review of
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27 ¹⁷ Staff agreed with PGR witness Roach's observation that reserves provided by bidders could easily be counted
28 against requirements. Staff stated that recognizing bidders' reserves will also make it easier for the Staff and the
Independent Monitor to compare the merits of alternative bids during the bid evaluation.

1 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in
2 the Staff Report.

3 b. TEP

4 In order to reach its recommended capacity solicitation for TEP, Staff accepted TEP's retail
5 monthly peak hour demand forecast as set forth in Exhibit 5 attached to TEP's November 4, 2002
6 Needs Assessment, and subtracted the transmission import limit for the Tucson area. Staff's resulting
7 recommended capacity solicitation for TEP thus consists solely of RMR capacity being supplied by
8 local units. Staff recommends that TEP solicit bids for 758 MW of capacity in 2003; 824 MW of
9 capacity in 2004; 861 MW of capacity for 2005; and 898 MW of capacity for 2006.
10

11 We find Staff's capacity estimates above to be reasonable, and find it reasonable for the RMR
12 updates to be made during the Pre-Solicitation process set forth in the Staff Report. We will
13 therefore require that TEP's minimum capacity solicitation amounts conform to Staff's estimates as
14 set forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR
15 amounts as determined by Staff and the Independent Evaluator following their receipt and review of
16 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in
17 the Staff Report.
18

19 **5. Energy to be Solicited**

20 a. APS

21 Staff recommends that APS solicit energy for each year 2003, 2004, 2005 and 2006 that
22 equals the sum of APS' unmet energy needs from Schedule PME-1 of its Needs Assessment; APS'
23 Phoenix supplied RMR energy from work papers supplied to the parties with its Needs Assessment;
24 APS' Yuma supplied RMR energy as determined in the RMR study due January 31, 2002; and APS'
25 "potential economy energy purchases" as set forth in Schedule PME-13 of its Needs Assessment.
26 Staff's recommended energy solicitation amounts, which it states require adjustment to include APS'
27
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1 Yuma supplied RMR energy, are 4,381 GWH of energy for 2003; 4,963 GWH of energy for 2004;
2 8,088 GWH of energy for 2005; and 8,680 GWH of energy for 2006.

3 RUCO takes the position that whatever solicitation process is used, the bids solicited by each
4 distribution utility should not be limited with respect to the total amount of energy requested.

5 Harquahala fully supports the Commission requiring APS to solicit at least the quantities of
6 energy contained in Exh. S-5. PGR believes that APS should be required to solicit energy in at least
7 the amount APS previously anticipated would be supplied by PWEC's combined cycle units (*see* Tr.
8 at 184-185) and prefers that the energy numbers appearing in Exh. S-1 be used for APS in lieu of the
9 lower energy numbers appearing in Exh. S-5 or in the updated version of S-5 attached to Staff's
10 Initial Brief.
11

12 We note that Staff testified that it anticipates that irrespective of the size of the actual
13 solicitation, based on the amount of capacity and energy that is available at this time, that either size
14 minimum solicitation [S-1 or S-5] would yield bids for capacity and energy significantly in excess of
15 either amount appearing in S-1 or S-5, and the utility would still have a sufficient array of capacity
16 products and energy products from which to select so that it could make the right procurement
17 decision. (Tr. at 172-173) We agree with that statement, and therefore find that there is no need to
18 require that the contestable energy numbers be set at Staff's estimates appearing in Exh. S-1.
19

20 We find Staff's energy estimates above to be reasonable, and find it reasonable for the RMR
21 updates to be made during the Pre-Solicitation process set forth in the Staff Report. We will
22 therefore require that APS' minimum energy solicitation amounts conform to Staff's estimates as set
23 forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR amounts
24 as determined by Staff and the Independent Evaluator following their receipt and review of
25 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in
26 the Staff Report.
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b. TEP

1
2 In formulating its recommendation for the amount of energy that TEP should solicit, Staff
3 utilized the energy amount included in Exhibit 2 attached to TEP's Needs Assessment, added local
4 RMR generation and economy purchases supplied from information provided by TEP based on a
5 November 2, 2002 load forecast. Staff states it is likely that the energy solicitation numbers it
6 recommends for TEP will require adjustment as a result of the RMR study, and that its adjusted
7 energy numbers could potentially be as high as 1,000 GWH annually. Staff's recommendation, based
8 on the information available, for TEP's energy solicitation is as follows: that TEP should solicit bids
9 for 443 GWH of energy for 2003; 688 GWH of energy for 2004; 596 GWH of energy for 2005; and
10 561 GWH of energy for 2006.
11

12 With the exception of the economy energy amounts, we find Staff's energy estimates above to
13 be reasonable, and find it reasonable for the RMR updates to be made during the Pre-Solicitation
14 process set forth in the Staff Report. We will therefore require that TEP's minimum energy
15 solicitation amounts conform to Staff's estimates as set forth in its December 18, 2002 revision to
16 Exh. S-5, with the exception of the amounts appearing as economy purchases, and with the addition
17 of the necessary RMR amounts as determined by Staff and the Independent Evaluator following their
18 receipt and review of comments to the January, 2003 RMR Study Results, during the Pre-Solicitation
19 process set forth in the Staff Report.
20

III. SOLICITATION/PROCUREMENT PROCESS**A. Solicitation Method - Auction vs. RFP**

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23
24 The Staff Proposed Solicitation process includes procedures for both a descending clock
25 auction and a Request for Proposal ("RFP") process.

26 Reliant advocates that APS and TEP be required to solicit at least one-third of their
27 contestable load through an auction process. Reliant believes that such a requirement would not only
28

1 ensure that the utilities receive the lowest price for the product being solicited, but would ensure that
2 all competitors are offered a fair opportunity to participate and that the Commission is provided a
3 complete array of potential responses. Reliant claims the benefit of an auction is that it induces
4 vigorous competition for standard products. Reliant also asserts that the capacity products described
5 by TEP and APS in this proceeding are either already standard products or can be easily standardized
6 for procurement from today's wholesale electric markets.

7
8 RUCO argues that Reliant's auction methodology is flawed because an auction alone will not
9 reveal whether a winning bid can fit within a least cost portfolio of resources; and only a system
10 dispatch model can provide that answer. (Exh. RUCO-2 at 6-7 (Rebuttal Testimony of Dr. Richard
11 A. Rosen))

12 PPL asserts that, as long as the principles of maintaining an open, transparent and unbiased
13 solicitation process are observed, the utilities should be allowed to establish the method of
14 solicitation, depending on which method the utility deems most appropriate for the type of product
15 being solicited.

16
17 APS states that, at this time, it favors an auction for future procurements, but that there is
18 insufficient time to develop an auction and accommodate all of the variables that require resolution
19 prior to the first solicitation.

20 We believe that the various types of bids that the parties propose in this proceeding will
21 encompass numerous variables, and agree with APS' assessment that there is insufficient time to
22 develop an auction to account for all those variables while meeting the deadline for the first
23 solicitation. Despite the fact that the parties have worked toward general agreement regarding this
24 solicitation, there is no general agreement of the parties on standard products, and such agreement
25 would be a requirement of a fair, open and transparent solicitation process through an auction. It is of
26 great importance that the utilities have the maximum amount of information available through bids in
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1 order to determine which procurement will best serve the ratepayers' interests, and it appears that an
2 RFP will be the better means of providing the utilities with the broadest array of responses from
3 which to choose.

4 **B. Who may participate in the solicitation**

5 The LAW Fund asserts that all interested parties should be allowed to review and comment on
6 the bid solicitation materials; that the load forecast, resource plan and needs assessment should be
7 available for review by all interested parties; and that all interested parties should be allowed to
8 attend bidders conferences. (Exh. LAW-1 at 11-12 (Direct Testimony of Dr. David Berry)) The
9 LAW Fund believes that expanding the review to include other parties could allow interested parties
10 other than bidders to identify provisions in the draft solicitation that needlessly restrict creative bids
11 or dissuade potential bidders. (*Id.*)

13 The Staff Proposed Solicitation Process allows prospective bidders, and interested persons
14 who agree to keep certain information confidential, to review and comment on the bid solicitation
15 materials (Exh. S-1 at 8), to provide comments to the utility, the Independent Monitor or the Staff
16 regarding the completeness or quality of the information provided and the process being employed or
17 the decisions made regarding execution of the solicitation process (*id.*), and the opportunity to ask
18 questions directly of the utility as well as to identify any deficiencies in the solicitation documents or
19 supporting data. (*Id.* at 9) We believe that in conjunction with the utilities' November Needs
20 Assessment filings, the Staff Proposed Solicitation Process adequately addresses the other issues
21 raised by the LAW Fund for purposes of this initial solicitation. In a section below, we discuss other
22 issues raised by the LAW Fund that may be addressed in subsequent solicitations. Depending on the
23 outcome of the workshops that the LAW Fund has recommended, the issue of non-bidder
24 participation for limited purposes may be revisited.
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1 **C. Product Definition**

2 **1. Unit-Contingent Bids**

3 PGR requests that the Commission require APS to solicit asset-backed, dispatchable unit-
 4 contingent bids and enter into traditional pay-for performance PPAs to meet the majority of its needs.
 5 Harquahala supports PGR's request.¹⁸ PGR asserts that APS' proposed affiliate PPA¹⁹ anticipated
 6 the same unit-contingent portfolio that PGR is advocating in this proceeding. PGR believes that APS
 7 is likely to get better bids at lower prices for direct solicitation for unit contingent capacity and
 8 dispatchable energy than it would get if such bids were submitted as non-conforming bids in an RFP
 9 for other products. PGR points to APS' acknowledgement that it may not have time to consider bids
 10 not conforming to specific parameters of the products it decides to solicit (*see* Exh. APS-3 at 5) as
 11 support for its request that the Commission require APS to solicit the unit-contingent portfolio that
 12 PGR advocates. Further, PGR claims that it is only through solicitation of these products that APS
 13 and Staff can determine which portfolio of products is in the best interests of APS ratepayers.
 14

15 **2. Length of Contracts**

16 PPL asserts that in order to maximize the consumers' benefits from the current wholesale
 17 market, the utilities should seek some medium- and long-term contracts to lock in longer-term
 18 benefits of the current price situation. Sempra and SWPG likewise argue, in agreement with WMGF,
 19 that a well-conceived power procurement process should require that current market circumstances
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24 ¹⁸ PGR proposes two types of bids: One would be a unit contingent offer with an availability guarantee of 95
 25 percent, and the second would be a firm LD offer that would include a 100 percent availability guarantee backed up by
 26 the requirement to pay for replacement capacity and energy if the 100 percent guarantee is not met (liquidated damages).
 PGR further recommends that the remaining amount of capacity to be procured should be met by seasonal firm LD call
 options. "Call options" means the utility has the right, but not the obligation, to call on the bidder during the summer
 months for either 16 peak hours in a day or in just 6 super-peak hours. All the calls are under day-ahead scheduling and
 once called to run, the unit would be guaranteed to run for the full 16 or 6 hours.

27 ¹⁹ On October 18, 2001, APS filed a Request for a Partial Variance to A.A.C. R14-2-1606(B) and for Approval of a
 28 Purchase Power Agreement, Docket No E-01345A-01-0822, requesting authority to enter into a purchase power
 agreement with its affiliate PWEC.

1 be considered and evaluated to determine if longer-term contract offerings could be used to lock in
2 reasonable rates for electric consumers regardless of what happens in the volatile spot price
3 wholesale market during the next few years, and recommend that a solicitation process be adopted
4 that expressly considers intermediate and long-term contracts. Reliant generally agrees with PGR,
5 Sempra, SWPG, WMGF and PPL that the Commission's Decision in this matter should encourage
6 APS and TEP to solicit a variety of products with varying terms.

7
8 WMGF asserts that a failure to seriously consider long-term contract proposals would be
9 contrary to the Commission's stated intent in establishing the Track B solicitation process, which is
10 to encourage the development of a robust wholesale market for generation in Arizona, to allow
11 consumers the benefits of new Arizona generation resources, while protecting ratepayers. Staff
12 agreed with WMGF that Arizona is currently experiencing low electricity prices due in part to
13 reduced demand for electricity coupled with a surplus of generation. (Tr. at 250-252) WMGF argues
14 that by developing a well-balanced portfolio of contracts, including some long-term contracts, which
15 would lock in current low electricity prices in this "buyers' market," the utilities will protect
16 ratepayers by shielding them from an uncertain future. WMGF recommended that the Decision in
17 this matter include language stating that ratepayers are best served if the utilities acquire through the
18 competitive solicitation process a well-balanced mixture of contracts, including contracts with terms
19 of up to 15 to 20 years, in order to protect ratepayers from future market price uncertainty, and to
20 allow new and proposed generating projects the opportunity to meaningfully participate in the
21 competitive solicitation process, since new power generation projects require long-term off-take
22 contracts to satisfy lenders' requirements.
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25 TEP believes that longer-term agreements should be considered, at the utility's discretion, in
26 the solicitation process to enable necessary transmission infrastructure to be built and to insure that
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1 the output from power plants located in Arizona stays in Arizona to meet its growing demand. (Exh.
2 TEP-2 at 10 (Rebuttal Testimony of David Hutchens))

3 PGR raised its concern with giving APS sole discretion to determine the term of any contract
4 given APS' stated intent to seek rate base treatment of the PWEC generation, and asserts that such a
5 result would "completely obliterate" the Track B process and the instruction in Decision No. 65154
6 that those assets should not be treated as APS assets for the Track B solicitation.

7
8 The Staff Report states while during 2003 each utility is anticipated to primarily require
9 peaking capacity and energy with contract terms of one to three years, that each utility must
10 demonstrate that its power supply portfolio contract durations are adequately diversified and that its
11 portfolio's structure mitigates both cost and reliability risks appropriately, and that if, in the judgment
12 of the utility, market conditions or economic opportunities dictate contract terms longer than three
13 years, it will be the responsibility of the utility to enter into such contracts as are reasonable. (Exh. S-
14 1 at 6)

15
16 APS stated that it presently proposes to target its solicitation for the 3-4 years that Staff
17 acknowledged was most likely appropriate. APS also stated that while it will consider bids for longer
18 than the period covered by the initial solicitation, it does not believe that it should be required to
19 solicit for such products. APS argues that increasing risks are associated with longer-term contracts,
20 such as counter-party credit risk, regulatory risk, the potential implications of FERC's Standard
21 Market Design ("SMD") initiative, changes in future system needs, and potential customer attrition to
22 Direct Access in later years.

23 24 **3. Discussion/Resolution**

25 The evidence presented on the record in this proceeding supports a finding that both APS and
26 TEP should seriously evaluate and consider a well-balanced mixture of contracts, including long-term
27 contracts, in the competitive solicitation in order to protect ratepayers from future upswings in power
28

1 prices. In making its determination regarding the appropriate resource portfolio in the best interests
2 of its customers, APS should bear in mind the Commission's instruction in Decision No. 65154 that
3 the PWEC assets that it may seek rate base treatment for in the future should not be treated as APS
4 assets for the Track B solicitation. The Commission expects the utilities to make procurement
5 decisions that further the goal of encouraging the development of a vibrant wholesale generation
6 market in Arizona.

7
8 **D. Bid Evaluation**

9 **1. Production Modeling (Bid Evaluation)**

10 a. Positions of Parties

11 Sempra and SWPG advocated that the utilities perform a system-integrated analysis of bids
12 received using computer programs and modeling. They believe that such analysis would provide
13 some form of preliminary yardstick by which to measure the reasonableness of APS' and TEP's
14 actions. Staff's witness testified that it believed such a program would be an integral part of the
15 preparation of a needs assessment. (Tr. At 93) Both APS and TEP confirmed their intention to rely
16 on production modeling to evaluate the economics of bids and existing assets. (Tr. at 479, 489, 490,
17 Exh. APS-5 at 21) Sempra and SWPG assert that a longer time frame than that appearing in the Staff
18 Report may be required for the utilities to evaluate competitive proposals as to price and
19 deliverability using a system integration analysis, but do not believe that the time required need
20 extend the overall timeline beyond what the Staff Report contemplates. RUCO also believes that the
21 utilities must perform production cost simulations of the various combinations of resources to obtain
22 the least-cost result, and that the utilities will likely need 6-8 weeks to adequately review available
23 options before determining the most prudent course of action. (Exh. RUCO-2 at 7 (Rebuttal
24 Testimony of Dr. Richard A. Rosen))
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b. Discussion/Resolution

1
2 During the workshop process, the participants reached a consensus in developing the
3 Solicitation Timelines appearing in the Staff Report at pages 27-29. The record reflects that APS and
4 TEP were active participants in the workshops wherein the timelines were developed, and that APS
5 and TEP plan to utilize production modeling to evaluate the bids received. We therefore believe that
6 Sempra, SWPG, and RUCO's concerns will be adequately addressed. As to Sempra and SWPG's
7 assertion that the described analysis would provide some form of preliminary yardstick by which to
8 measure the reasonableness of APS' and TEP's actions, we agree. As we have emphasized, the
9 utilities will be responsible for determining the best resource mix to provide reliable power to their
10 customers at the most reasonable cost possible, while taking environmental concerns into account.

12 **2. RUCO - Least Cost Planning/Integrated Resource Planning**

13 a. Positions of Parties

14 RUCO believes that a comparison to the utilities' cost to generate power themselves is
15 appropriate to determine the reasonableness of bids received from independent power producers.
16 Based on its belief that such bids can serve as a baseline for evaluating bids from the unregulated
17 market, RUCO has called for a requirement for cost-of-service proxy bids, for new self-built
18 generation and transmission, from the incumbent utilities for purposes of such comparison. The
19 vehicle RUCO proposed for such comparison is the re-institution of a traditional integrated resource
20 planning ("IRP") process, in which the Commission would review the utilities' resource planning in
21 advance, such as the process in place at the Commission prior to Arizona's move toward the
22 restructuring of the Arizona electricity markets. RUCO believes that an added benefit of a new IRP
23 process would be that Demand-Side Management, transmission and generation resources (including
24 both RMR and non-RMR generation) could be evaluated simultaneously, and that IRP provides a
25 framework for addressing environmental implications, as well as cost implications, of resource
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1 planning. In addition, RUCO asserts that an IRP process can address a number of other complex
2 issues, including the reasonableness of prices, the reliability and deliverability of the supply, the
3 creditworthiness of the counterparties, and short and long term impacts on customers.

4 RUCO proposed that because the time required for the institution of an IRP process exceeds
5 the time remaining for a solicitation of the utilities' 2003 requirements, that the utilities procure only
6 enough power for their 2003 capacity growth needs in the initial solicitation. Then, RUCO envisions
7 that the IRP process would take place, which process would include a determination of the total
8 present value of revenue requirements ("PVRR")²⁰ for all possible, technologically compatible
9 resource portfolios and a comparison of each portfolio's PVRR to the PVRR of all other such
10 portfolios over the relevant planning period. RUCO believes the planning horizon over which the
11 PVRR should be measured should extend over 20, and perhaps 30 years. RUCO believes that after
12 the bids are evaluated, the utilities should reject, as imprudent, market bids that exceed the utilities'
13 cost of service proxy bids; acquire the mix of the remaining market bids that would result in the least
14 cost to consumers; and if the remaining bids do not meet the utilities' needs, the utilities should
15 acquire the mix of merchant-bid and utility self-build resources that will result in the least cost to
16 consumers.
17
18

19 Staff states that a responsible utility should use least cost planning principles to develop its
20 overall portfolio. Staff also states that least cost planning principles are present in the Pre-
21 Solicitation process outlined in the Staff Report, which requires each utility to prepare load
22 assessments, needs assessments, price forecasts, and various other documentation that Staff and the
23 Independent Monitor would review. In response to RUCO's position that the Commission should be
24 more involved in the planning process, Staff states that whatever the merits of RUCO's suggestions
25
26

27 ²⁰ RUCO emphasizes that there is a difference between PVRR and Harquahala's recommended net present value of
28 rate impacts for bid evaluation, which RUCO does not believe minimizes the total cost of a given resource portfolio to
consumers.

1 on this issue may be, a decision on institution of an IRP process is beyond the scope of this
2 proceeding.

3 APS supports Staff's position on IRP, and adds that while it is a significant issue, it should
4 not complicate an already complex solicitation process with an already challenging implementation
5 timeline. APS comments that an IRP process, if done in the future, would necessarily be limited and
6 constrained by procurement decisions previously made in the initial solicitation.

7
8 The LAW Fund opposes the use of either PVRR or the net present value of rate impacts test
9 proposed by Harquahala to determine resource portfolio, because the tests may not accurately reflect
10 the benefits of DSM or correctly incorporate environmental impacts of power production.

11 Reliant agrees that the competitive solicitation should result in a least-cost mix of supplies for
12 the benefit of Arizona's consumers, but asserts that it is the utilities' responsibility to determine this
13 mix and that a time-consuming IRP process is not necessary. Reliant agrees with Staff that RUCO's
14 suggestions are beyond the scope of this proceeding, but is supportive of APS' proposal that, to the
15 extent the Commission wishes to consider the issue further, additional workshops be scheduled to
16 address it.

17
18 b. Discussion/Resolution

19 We do not disagree with the goals of RUCO's proposed institution of an IRP process, and we
20 expect that the utilities will use least cost planning principles to develop their overall portfolios. We
21 believe that the Staff Proposed Solicitation Process, its bid evaluation criteria (*see* Exh. S-1 at 18) and
22 the utilities' stated intentions to utilize production modeling to evaluate the bids received, will
23 encompass the majority of the IRP concepts advocated by RUCO, and will not require the
24 Commission to be an active participant in the utilities' planning and procurement processes. We find
25 that based on the record in this Track B proceeding, re-institution of an integrated resource planning
26 process is not necessary at this point in time. However, we do not wish to completely rule out the
27
28

1 possibility that an IRP process may for some reason become desirable or necessary in the future. We
 2 will therefore require that Staff file a report in these dockets informing the Commission of its position
 3 at that time on the advisability of the institution of a formal Commission IRP process.

4 **3. LAW Fund - Demand Side Management (“DSM”) and Environmental**
 5 **Risk Management**

6 a. Environmental Risk Management

7 The LAW Fund asserts that environmental improvement will not be achieved through the
 8 resource acquisition process, or will occur only by happenstance, unless the Commission takes
 9 explicit, proactive steps to ensure that environmental factors are integrated into the competitive
 10 solicitation process.²¹ The LAW Fund proposed a series of steps to Commission adoption of an
 11 environmental risk management policy through a series of workshops and hearings. (See Exhibit
 12 DB-3 to Exh. LAW-1 (Direct Testimony of Dr. David Berry)) The LAW Fund states that as a
 13 practical matter, the Commission’s desire to implement Track B expeditiously means that there will
 14 not be time to integrate consideration of environmental performance into the first round of
 15 competitive solicitation, but urges the Commission to act now to ensure that an environmental risk
 16 management policy is in place in time for the second and subsequent solicitations.
 17

18 b. DSM

19 The LAW Fund believes that cost effective DSM is a resource that can help meet the demand
 20 for electric energy services at lower cost than conventional generation resources, and that because
 21 DSM displaces electricity and generally has a stable cost, it helps consumers and utilities avoid
 22 fluctuations in the price of electricity and natural gas used to generate electricity. The LAW Fund
 23 states that DSM may reduce or eliminate the need for more transmission or distribution capacity, may
 24 avoid transmission constraints, and can reduce the environmental impacts of electricity consumption,
 25
 26

27 _____
 28 ²¹ The LAW Fund noted that other than the APS plans to retire the Childs/Irving hydro facility and the older West Phoenix units, there are no current plans to retire any other environmentally undesirable units.

1 including compliance costs associated with future environmental regulation. (See Exh. LAW-1 at 2)
2 The LAW Fund proposed a series of steps to Commission adoption of a Demand Side Management
3 Policy through a series of workshops and hearings. (See Exhibit DB-2 to Exh. LAW-1 (Direct
4 Testimony of Dr. David Berry)) As with its recommendations regarding Commission institution of
5 an Environmental Risk Management policy, the LAW Fund advises that the DSM policy process be
6 begun quickly so that it can be comprehensively reviewed and completed in time to be applied as
7 inputs to the second and subsequent rounds of competitive solicitations.
8

9 Staff states that bidders are free to submit bids that include DSM and environmental risk
10 management in response to a utility solicitation, but that such bids should not be required in the initial
11 solicitation. Sempra and SWPG agree.

12 c. Discussion/Resolution

13 We appreciate the concerns of the LAW Fund regarding DSM and environmental risk
14 management policy. While we do not discourage the consideration of DSM in the initial solicitation,
15 we agree that workshops to address DSM issues and the development of a DSM acquisition process
16 are in the public interest. Likewise, we believe that workshops on the development of an
17 environmental risk management policy will provide a forum for a discussion of the costs and benefits
18 of environmental mitigation. We will therefore require that Staff facilitate a workshop process to
19 explore the development of a DSM policy and an environmental risk management policy, with such
20 exploration to include an examination of the possible costs and benefits of the respective policies, and
21 to file a report informing the Commission of the progress achieved in the workshops, including a
22 Staff recommendation on whether hearings should be held as suggested in Exhibits DB-2 and DB-3
23 to Exh. LAW-1.
24
25

26 In a somewhat related recommendation, the LAW Fund has recommended that Staff and the
27 Independent Monitor be required to provide, as part of their reports pursuant to the Staff Proposed
28

1 Solicitation Process, environmental information including information on air emissions and water
2 usage of the resources acquired and of the utilities' entire portfolios. The LAW Fund believes that
3 this information would be instructive for the Commission to evaluate whether the competitive
4 solicitation process would result in improved environmental performance.

5 This initial solicitation will largely be concerned with currently planned and existing
6 generation supply, the environmental effects of which have already been largely determined. We
7 believe that even without the additional requirement that the LAW Fund wishes us to impose, that the
8 duties of the utilities, the Staff and the Independent Evaluator will be very time-consuming in this
9 initial solicitation, and we do not believe that the extra burden that the recommended requirement
10 would place on the process would yield results justifying the burden. This issue should instead be
11 examined in the workshop addressing environmental risk management.
12

13 **4. Environmental Portfolio Standard ("EPS")**

14 WGMF asserts that generators with a renewable resource component should be permitted to
15 make proposals in the competitive solicitation, and that such proposals should receive appropriate
16 credit in recognition of the "added value" they provide the utilities in meeting their renewable
17 resource requirements under the EPS. WGMF urges that the Decision in this matter specifically state
18 that such proposals may be submitted, that the utilities should consider these proposals in meeting
19 their unmet renewable resource needs under the EPS, and that the utilities should explicitly credit
20 such proposals with the added value they provide the utility in meeting its renewable energy
21 requirements under the EPS.²²
22

23
24 APS agrees that proposals may be submitted to meet APS' needs as part of the general
25 procurement process, but does not believe that it should be required to include its EPS requirement in
26

27 ²² WGMF asserts that the Commission should adopt the following method for calculating such a credit: add
28 monies collected by the utility from its ratepayers under the EPS surcharges, and divide this amount by the total MWH
that APS must purchase from renewable energy providers in compliance with the EPS.

1 the solicitation, or that renewable proposals should receive any preference in the general procurement
2 process. (Tr. at 691, 699) APS noted at the hearing that it currently has an EPS RFP outstanding.

3 Staff states that bidders are free to submit bids that include renewable resources in response to
4 a utility solicitation, but that such bids should not be required in the initial solicitation.

5 We agree with APS and Staff. While we are not opposed to the concept of a utility giving a
6 preference to environmentally-friendly generation in its bid evaluation, we do not believe at this time
7 that the record in this proceeding supports the imposition of such a requirement.
8

9 **5. Ability to Reject All Offers**

10 Staff states that the utilities should have the right to reject all bids if the bids do not
11 reasonably meet the needs of the utility and its customers, and that since the utilities are obligated to
12 supply electricity to their customers in a prudent manner, they will have an obligation to reject
13 uneconomic bids.

14 PGR agrees with Staff that the utilities should be able to reject all bids if it is truly in the
15 ratepayers' interest. PGR urges that the Commission articulate clear expectations of the
16 circumstances under which the utilities will be expected to contract with bidders, such as when the
17 utilities can "lock in" ratepayer savings. Harquahala supports PGR in this. AUIA urges that the
18 utilities be given the flexibility to carry out the responsibilities for which they will be held
19 accountable.
20

21 We agree with Staff and AUIA, and will again clarify that the utilities have the right to reject
22 all bids exceeding their requirements that cannot be produced from their own existing assets, if the
23 bids do not reasonably meet the needs of the utility and its customers. We do expect the utilities to
24 give serious consideration to all bids received, including long- and short-term bids, which
25 consideration should include sound economic and deliverability analysis of the bids. The utilities'
26 goal should be to obtain for their customers the least-cost mix of reliable power over the long term,
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28

1 while being mindful of the environmental effects of their procurement decisions, as well as whether
 2 their procurement decisions will further the goal of encouraging the development of a competitive
 3 wholesale generation market in Arizona. While we are not requiring APS and TEP to accept bids in
 4 the solicitation process beyond their requirements that cannot be produced from their own existing
 5 assets, APS and TEP should be on notice that the Commission will closely scrutinize the offered bids
 6 and the utilities' procurement decisions based on those bids for conformity with those goals.
 7

8 **IV. AFFILIATE PARTICIPATION/STANDARDS OF CONDUCT**

9 **A. APS**

10 **1. Information sharing between APS and its affiliates**

11 PGR, Reliant, and Harquahala believe that information sharing between APS and its affiliates
 12 may create an unfair competitive advantage to PWEC, and recommend that measures be taken to
 13 prevent such sharing. PGR points out that Pinnacle West Capital Corp. ("Pinnacle West") has all
 14 APS unit cost information, as it has been performing APS' generation dispatch on unit commitment
 15 decisions (Tr. at 604-606), and would continue to have access to such information under the terms of
 16 the "confidential information" and "shared services" sections of the proposed Code of Conduct that
 17 APS has filed pursuant to Decision No. 65154. (Tr. At 607) Reliant also recognized that such
 18 information sharing gives the competitive electric affiliate an advantage during dispatch protocol.
 19 Reliant recommended that the Commission require APS to adopt a Code of Conduct prohibiting its
 20 affiliates that intend to participate in the solicitation from handling system dispatch, risk management
 21 or contract management for APS or receiving information from APS (directly or indirectly) that
 22 would advantage them in the solicitation process. Reliant stated that if such information sharing
 23 cannot be avoided, the remedy should be that in the short term, all participants in the competitive
 24 process should be provided the same information about APS and its products as is available to
 25 PWEC.
 26
 27
 28

1
2 **2. APS conduct of its solicitation process**

3 PGR has requested that the Independent Monitor run the solicitation process for APS, and
4 Harquahala has stated its agreement with PGR on this point. PGR believes that the contemplated
5 participation of APS' merchant affiliate in the proposed solicitation makes third-party independent
6 management of the APS solicitation necessary, and further submits that on the basis of the testimony,
7 actions and filings by APS regarding its affiliate,²³ that the showing referred to in the Staff Report has
8 been made that an independent party should manage the APS solicitation and have the final say in
9 determining the acceptable products and winning bidders. PGR asserts that it is only through such
10 oversight that the Commission can ensure that ratepayer benefits are not displaced by affiliate
11 preferences.
12

13 The Staff Proposed Solicitation Process provides that absent evidence of abuse, the utility will
14 be responsible for preparing the solicitation and conducting the solicitation process. (Exh. S-1 at 8)
15 It also provides that if the Commission finds that the utility failed to conduct an appropriate
16 solicitation, the Commission may order that a new solicitation be conducted by an independent party.
17 (*Id.* at 12) Staff also addressed this issue in the section of its Staff Report addressing unresolved
18 issues, and is of the opinion that the judgment of a third party should not, in the ordinary situation, be
19 substituted for that of the utility. (Exh. S-1 at 37) Staff believes, however, that the Commission
20 should, through the Staff and an Independent Monitor, review the actions of the utility and be
21 prepared to appoint a third party to conduct the solicitation should the utility fail to conduct a fair and
22 transparent solicitation. (*Id.*) In particular, Staff believes that should there be any evidence of
23
24
25

26 _____
27 ²³ PGR believes that APS' pending \$500 million refinancing proposal, if approved, would provide a significant
28 competitive advantage to APS' merchant affiliate, and in addition, if APS had \$500 million invested in PWEC, that APS
would have a substantial interest in assuring that PWEC is successful in the competitive solicitation. Harquahala claims
that APS' stated intent, in the financing request, to request rate base treatment of PWEC assets in the upcoming rate case,
if granted, would provide a year-round capacity payment to those affiliate assets.

1 improper contact between the utility and an affiliate, the Commission should have a third party
2 conduct the solicitation if it is determined that the contact was a material violation of the standard of
3 conduct. (*Id.*)

4 Staff believes that the Commission should leave the obligation to appropriately conduct the
5 solicitation and to select bids with the utility (Tr. at 192), that the utility has the expertise to best
6 determine the products that it needs to fulfill its obligations to its customers to provide reliable
7 service at reasonable cost, (Tr. at 188-189, 303) and that as compared to Staff and the Independent
8 Monitor, the utility is best-positioned to make an informed decision when it evaluates bids. (*Id.*)
9 Staff believes that the oversight provided by the Independent Monitor as well as Staff participation
10 provide an appropriate level of involvement to ensure that the utilities act in the best interests of
11 customers.
12

13 APS agrees with Staff that the utility needs to be the decision-maker on the products, process
14 and selection of winning bids. APS responds to PGR and Harquahala that the fact that APS has
15 publicly filed the financing application, and has publicly discussed its intent to seek rate base
16 treatment of the PWEC assets in the upcoming rate case, does not mean that APS will conduct the
17 solicitation unfairly or in bad faith.
18

19 3. Standards of Conduct

20 The Staff Report outlines a process by which Staff believes a utility should submit a draft
21 standard of conduct to Staff and the Independent Monitor, and following a discussion of changes, the
22 draft should be shared with prospective bidders. The Staff Report process outline includes
23 completion of a draft standard of conduct completed by the end of January 2003. (Exh. S-1 at 37-38)
24 The Staff Report sets forth the minimum requirements for an acceptable standard of conduct, and will
25 include monitoring by Staff and the Independent Monitor of the solicitation process. (*See id.*) Staff
26 testified that the standard of conduct is intended to ensure that the utility and its affiliate have
27
28

1 procedures in place to provide for separation of information, rather than complete separation of
2 function. (Tr. at 139-140)

3 PGR believes that it is necessary as part of this Track B proceeding to ensure that adequate
4 protections are written into the Track B process and coordinated with the Code of Conduct, which, as
5 PGR notes, is still subject to a separate hearing. PGR believes that the Track B standards of conduct
6 must, in coordination with APS' Code of Conduct, at a minimum: 1) eliminate all affiliate
7 preferences; 2) require APS to treat all suppliers, both affiliated and non-affiliated, in a non-
8 discriminatory fashion; 3) keep the utility and its affiliate completely separate during the solicitation
9 process; and 4) contain effective enforcement and penalty provisions.

11 Staff stated that it recognizes that there are shared services between APS and Pinnacle West
12 that cannot realistically be separated or reorganized in time for the first solicitation. (Tr. at 139-140)
13 Staff states in its Reply Brief that although it would be ideal for the Commission to review the
14 standards of conduct in a separate proceeding, the timing for the Track B solicitation does not allow
15 enough time to complete such a proceeding. Staff proposed that the standards of conduct be
16 addressed in the Pre-Solicitation materials, rather than by Commission order.

18 Reliant is generally supportive of Staff's position regarding Standards of Conduct outlined in
19 the Staff Report, except to the extent it could be construed as allowing APS and Pinnacle West to
20 share services related to system dispatch, risk management or contract management. Reliant asserts
21 that these areas provide access to information that creates an unfair competitive advantage to the
22 affiliate and must not be permitted.

24 APS' witness testified that the separation of Pinnacle West employees who are dispatching
25 the system and who would thereby know APS' costs of generation, from Pinnacle West employees
26 who are bidding the PWEC facilities, is a work in progress and remains to be developed through this
27 process, and that Pinnacle West is in the process of providing some physical separation between areas
28

1 in Pinnacle West Marketing and Trading ("M&T") that deal only with APS and areas that deal with
2 other aspects of M&T operations. (Tr. at 608-609) APS also testified at the hearing that the
3 standards of conduct it anticipated working through with Staff would have a separation of functions
4 at Pinnacle West between those people who are responsible for commitment of dispatch and
5 management of the APS resources, and those people who are responsible for those same functions for
6 non-APS assets. (Tr. at 606) In its Reply Brief, APS stated that it is identifying the team of
7 employees that will conduct the solicitation and will take steps to ensure that they do not share
8 inappropriate information with employees of APS affiliates who may be directly involved in the
9 preparation of a bid in the solicitation process.
10

11 **4. Equal Treatment of PWEC and other bidders**

12 PGR takes the position that if an incumbent utility's affiliate will bid in a Commission
13 mandated competitive solicitation, the incumbent utility must treat the affiliated and non-affiliated
14 generation equally in all respects. PGR believes that this equal treatment should apply to capacity,
15 gas, or electric transmission, and that if APS' affiliate is to bid in the solicitation, then APS must
16 make gas capacity held by APS for the benefit of Arizona consumers available to any merchant
17 bidder on the same terms as would be available to APS' affiliate. Thus, before any APS affiliate
18 could bid with gas capacity belonging to APS, that gas capacity would be made available to all
19 bidders on equal terms, such as through a tolling arrangement. Harquahala also believes that the
20 Commission should require APS to offer to all the merchants any El Paso gas capacity either it or
21 Pinnacle West has.
22

23
24 APS responded that APS and PWEC are co-shippers on a transportation service agreement
25 ("TSA") with El Paso Natural Gas, each with their own individual rights, and the determination of
26 those respective rights is currently before the Federal Energy Regulatory Commission ("FERC").
27 (Tr. at 615) APS also stated that, although it does not believe it is required to offer its own gas
28

1 transportation capacity to anyone just because they want it (Tr. at 614), APS does believe that the
2 TSA allows it to use its own gas capacity through a tolling arrangement with any generator. (Tr. at
3 616-618, *see also* Exh. PGR-1)

4 **5. Discussion/Resolution**

5 We agree that the standards of conduct developed in this proceeding will be material to the
6 Code of Conduct hearing which shall be scheduled to take place as soon as practicable after the initial
7 solicitation, and that the experience of the initial solicitation will provide insight to the requirements
8 of a working Code of Conduct an current environment that includes the availability to regulated
9 utilities of both affiliated and non-affiliated generation resources. We will therefore direct Staff,
10 following completion of the initial solicitation, to file reports in these dockets on the Codes of
11 Conduct previously filed by APS and TEP. The Staff Reports should include an analysis of the
12 standards of conduct developed in this proceeding, their applicability to the respective Codes of
13 Conduct filed by TEP and APS, and recommendations regarding their incorporation into the Codes of
14 Conduct. Hearings will be scheduled on the Codes of Conduct following the filing of those Staff
15 Reports.
16
17

18 We agree with Staff that the oversight provided by the Independent Monitor, as well as Staff
19 participation in the solicitation process, will aid in assuring that the utilities act in the best interests of
20 customers, while furthering the Commission's goal of encouraging the development of a vibrant
21 wholesale generation market in Arizona. We also acknowledge and appreciate APS' assurances that
22 it is identifying the team of employees that will conduct the solicitation and that it will take steps to
23 ensure that they do not share inappropriate information with employees of APS affiliates who may be
24 directly involved in the preparation of a bid in the solicitation process. The standards of conduct
25 should go far toward alleviating the concerns of the merchants who face competition from APS'
26 affiliate in the APS solicitation process. However, the content of the standards of conduct are not in
27
28

1 the record of this proceeding. In addition, we have not completed our review of APS' revised Code
2 of Conduct, which APS filed as required. We therefore find it necessary to set forth some guidelines
3 to clarify the Commission's position that no exercise of affiliate preferences will be tolerated in the
4 solicitation process.

5 We note that the Staff Proposed Solicitation Process provides for the establishment by the
6 utility of a system for logging all contacts between utility personnel and bidders and potential
7 bidders. (See Exh. S-1 at 20) We will require that APS keep detailed records of any and all contacts
8 with all non-APS entities, including but not limited to M&T, PWEC and Pinnacle West, regarding
9 this initial and subsequent solicitations up through the time that the procurement process is complete.
10 These records shall be subject to the same maintenance and availability requirements as those
11 described on pages 26 and 27 of the Staff Report.
12

13 In addition, the record in this proceeding supports a requirement that APS's parent and
14 affiliates, including but not limited to M&T, PWEC and Pinnacle West, who may be involved in the
15 preparation of a bid in the solicitation process shall not have contact with employees that will conduct
16 the solicitation. We do not wish to harm APS customers by depriving APS of access to needed
17 expertise provided by Pinnacle West "shared services," such as consulting legal counsel or in-house
18 environmental experts, the examples provided by APS in its Reply Brief. However, we see no reason
19 to allow APS's parent and affiliates, including but not limited to M&T, PWEC and Pinnacle West,
20 access to such expertise if such access could provide even an appearance of impropriety in the
21 solicitation process. We will therefore require that for the purposes of the solicitation and
22 procurement, APS shall prohibit personnel who provide advice to APS in the solicitation process
23 from communicating with personnel working for APS's parent or affiliates who may be involved in
24 the preparation of a bid in the solicitation process. If APS affiliates, including but not limited to
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1 M&T, PWEC and Pinnacle West, require access to expertise that is dedicated to APS in the
2 procurement process, they can obtain such expertise elsewhere, at their own expense.

3 The time remaining for the initial solicitation process does not allow for a hearing on the
4 Codes of Conduct as requested by Reliant. We believe that the requirements for standards of conduct
5 set forth in the Staff Proposed Solicitation Process, along with the additional requirements stated
6 above, should provide adequate safeguards to address the merchants' concerns.

7
8 We believe that a requirement that an incumbent utility treat affiliated generation equally in
9 all respects with non-affiliated generation in the solicitation process would logically extend to any
10 contractual arrangements associated with the bidding and procurement process, including natural gas
11 tolling, that the incumbent utility enters into with any affiliated entity involved in the solicitation and
12 procurement process.

13 While we adopt these guidelines, they do not constitute an all-inclusive list of the restrictions
14 on the type of activities that APS and its affiliates must prevent. In determining whether an act or
15 communication is appropriate, the APS employee should evaluate whether the act or communication
16 would further the Commission's goal of encouraging the development of a robust wholesale
17 generation market in Arizona. We want to make clear that any preferential or discriminatory activity
18 by APS, its parent or affiliates that interferes with a fair, unbiased solicitation process, whether
19 specifically delineated or not in the standards of conduct, the Code of Conduct, or this Decision, will
20 not be tolerated, and that we will closely scrutinize the solicitation process for signs of any such
21 abuse.
22

23
24 **B. TEP**

25 Because TEP does not have an affiliate that will bid in the upcoming competitive solicitation
26 process, TEP proposed that its Wholesale Marketing department be allowed to conduct the
27 competitive solicitation. (Exh. TEP-1 at 8-9 (Testimony of David Hutchens regarding Needs
28

1 Assessment and Procurement Proposal), Exh TEP-2 at 5-6, 12 (Direct Testimony of David
2 Hutchens)) TEP requested that the Commission waive the applicability of Section IV.C, paragraph 1,
3 lines 10-19 of the Staff Report with respect to TEP, thus allowing TEP's Wholesale Marketing
4 department to be involved in the solicitation process. (Exh. TEP-2 at 12) Staff had no objection to
5 TEP's request for a waiver of this paragraph of the Staff Report's Solicitation Process for the initial
6 solicitation (Tr. at 89-90), and no other party to the proceeding objected to TEP's request. TEP
7 acknowledged that if at some point in the future there is a TEP affiliate that could participate in a
8 competitive solicitation on TEP contestable load, then appropriate steps should be taken to address
9 the specific affiliate concerns. Based on this acknowledgement, and on the fact that TEP does not
10 have an affiliate that will bid in the upcoming competitive solicitation process, we find that it is
11 reasonable to grant TEP's request to allow TEP's Wholesale Marketing department to be involved in
12 the solicitation process.
13

14 **C. Protocol for Short-Term Energy Procurement by APS and TEP**

15 Harquahala recommended that in order to limit any advantage PWEC might receive from
16 APS, that a protocol be adopted to guide APS' procurement of short-term energy. APS has stated
17 that it increasingly uses "blind" procurement techniques for short-term economy purchases. (Exh.
18 APS-5 at 10-13 (Rebuttal Testimony of Thomas J. Carlson)) We believe that it would be wise for
19 APS to adopt the practice of using such "blind" procurement techniques, such as electronic trading
20 platforms or independent brokers, for all its short term purchases with the exception of emergency
21 purchases. We will require APS to file, for Commission approval, a draft protocol adopting such a
22 practice.
23
24

25 TEP does not currently have an affiliate offering power on the wholesale market. However, if
26 it does in the future, TEP should also adopt the practice of using "blind" procurement techniques,
27 such as electronic trading platforms or independent brokers, for all its short term purchases with the
28

1 exception of emergency purchases. We will therefore require that, if a competitive affiliate of TEP
2 will offer power on the wholesale market, TEP shall file, for Commission approval, 60 days prior to
3 the commencement of such offer, a draft protocol adopting such a practice.

4 **V. PRUDENCY REVIEW**

5 The Staff Proposed Solicitation Process provides that after the completion of each utility's
6 initial solicitation, Staff will commence a review of the utility's power supply portfolio to examine
7 the prudence of that utility's planning and procurement practices, and to determine the effectiveness
8 and efficiency of the solicitation process employed.

9
10 APS proposes that after bid evaluation is complete, provisional contracts would be awarded to
11 bidders, and that the Commission should either affirmatively approve such contracts within 15 days
12 or alternatively, deem them as being approved if the Independent Monitor's report concludes that the
13 solicitation was effective and fair. (Exh. APS-3 at 6-7 (Direct Testimony of Steven M. Wheeler))
14 APS proposes that in either event, Commission approval should constitute a finding that the utility
15 acted prudently and reasonably in entering into the approved contracts, both individually and
16 collectively. (*Id.* at 7) APS proposes that such a finding should also provide for full and timely cost
17 recovery, either through a purchase power adjustment mechanism or some similar procedure. (*Id.*)

18
19 TEP believes that the Commission approval process and cost-recovery mechanism for
20 purchases made under the solicitation process should be addressed in this proceeding. (Exh. TEP-2 at
21 10 (Direct Testimony of David Hutchens)) TEP states that it is critical that the utility knows what the
22 approval process will be at the beginning of the process because it will affect procurement decisions
23 and other issues in the proceeding, and the process should provide a specific timeline for contract
24 approval and the ability of the utility to reject accepted bids if the Commission does not find those
25 contracts reasonable and prudent. (*Id.* at 11)

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1 Staff believes that the requested expedited contract approval would not be in the public
2 interest and is unnecessary and inappropriate. (Exh. S-2 at 2 (Direct Testimony of Ernest G.
3 Johnson)) Staff states that while it is committed to assisting the Commission in its efforts to
4 transition to and facilitate a robustly competitive wholesale electric market in Arizona, that this is not
5 the time to adopt an expedited approval process, and further, that expedited approval is not a
6 necessary component to facilitating the envisioned robustly competitive wholesale electric market.
7 (*Id.* at 2-3) Staff believes that in light of the oversupply of generation that currently exists in
8 Arizona, in-state generators will be compelled to bid for contestable load, and that out-of-state
9 suppliers may also find the solicitation process amenable and contestable load desirable, such that
10 expedited approval is not required to attract bidders at this time. (*Id.* at 3) Staff believes that
11 granting expedited approval would shift the risk of cost recovery away from the utility onto
12 consumers. (*See Id.*)
13

14 Staff states that ultimately, the Commission must evaluate whether the utility was prudent in
15 its selection of its portfolio as a whole and whether the utility solicited the right products (Tr. at 78-
16 79, 107-108), and argues that neither of these factors is addressed by an expedited approval process
17 that assumes the prudence of any contract that results from a competitive bid.
18

19 RUCO generally shares Staff's concerns about prematurely declaring contracts prudent, but
20 states that the traditional IRP process, which it advocates, is sufficient to assure the Commission that
21 the utility has engaged in prudent planning. (Exh. RUCO-1 at 33-34 (Direct Testimony of Dr.
22 Richard A. Rosen), RUCO-2 at 7-8 (Rebuttal Testimony of Dr. Richard A. Rosen)) Even if an IRP
23 process would assure prudent planning, however, RUCO states that implementation of the plan
24 should still be subject to prudency review only in a proceeding that determines final cost recovery.
25

26 Sempra and SWPG generally agree with the balance that Staff's position strikes between
27 allowing the utility to conduct the competitive solicitation and make the final bid selections, and
28

1 providing for continuing Commission oversight and subsequent prudency review. They believe that
2 because the utility must implement and live with the results of a given power procurement decision, it
3 is appropriate that the utility perform a significant role in the making of such decision. Sempra and
4 SWPG believe that the utility should be held accountable for the results of its decision and its
5 compliance or lack of compliance with the Commission-approved competitive procurement process,
6 and that the contemplated subsequent prudency review is the appropriate setting for such
7 accountability to be determined.
8

9 Reliant asserts that the role and responsibilities of the Independent Monitor provide sufficient
10 safeguards in the solicitation process to allow the Commission to make a prudency determination of
11 the solicitation process, products, and outcome within 5 to 30 days. Reliant argues that with
12 extensive participation by Staff, the Independent Monitor, and other participants throughout this
13 process, the Commission will already have access to the knowledge of all facets of the solicitation by
14 the time the procurement takes place. Reliant cites regulatory uncertainty, and higher bids, as a
15 drawback to the Commission's failure to provide a quick prudency review of contracts.
16

17 AUIA disagrees with Staff's position regarding the prudency review of utilities' procurement
18 decisions, and argues that the Commission should adopt an expedited approval process. AUIA also
19 argues, however, in support of its position that the utilities should be allowed to choose their manner
20 of solicitation, that the Commission should heed the Staff's imperative that the utility should be left
21 with the ultimate decision-making authority regarding its needs and the ultimate responsibility to act
22 prudently. (AUIA Br. at 9, citing Exh. S-2 at 4 (Rebuttal Testimony of Ernest G. Johnson))
23

24 APS asserted that Commission and Staff assurance of cost recovery is especially appropriate
25 given that the Commission has mandated this procurement through a formal process and on a
26 schedule not entirely of the Company's choosing, and which is in contrast to the flexibility allowed in
27 the current version of A.A.C. R14-2-1606(B). (Exh. APS-3 at 7 (Direct Testimony of Steven M.
28

1 Wheeler)) We disagree with the premises of that assertion. Firstly, we disagree with APS' argument
2 that the Track B solicitation process restricts the manner by which APS procures power. We strongly
3 agree with Staff, and AUIA, that the utility should have decision-making authority regarding its
4 needs and the responsibility to act prudently, and our Decision in this matter adopts Staff's wise
5 recommendation to leave the responsibility and choice of procurement squarely in the lap of the
6 utility. Secondly, the Track B solicitation process is, rather than a "mandated procurement," the
7 means by which this Commission is dealing with the fact that leading up to our determination, in
8 Decision No. 65154, to stay the requirements of A.A.C. R14-2-1606(B)²⁴, APS had chosen not to
9 commence the competitive bid process that rule required, but had chosen instead to propose a
10 variance from the rule in order to allow it to enter into a purchase power agreement with its affiliate
11 PWEC.
12

13 To the extent that the utilities need guidance as to review of their procurement decisions,
14 among the issues the Commission may look to are: 1) whether the process was fair and non-
15 discriminatory, or whether it favored an affiliate; 2) evidence to support a determination that the
16 decision was in the best interests of the ratepayers; and 3) whether the utility's decision facilitated
17 the development of a competitive wholesale generation market in Arizona.
18

19 We believe that the solicitation process outlined in the Staff Report and clarified in this
20 Decision can encourage the development of a robust wholesale market while providing benefits to
21 Arizona consumers, without the Commission's direct involvement through the requested expedited
22 prudence review, in the solicitation process. We agree with Staff that expedited approval of contracts
23 is not necessary for the protection of either the utilities or the merchants, and further, that such
24 expedited approval would pose a substantial risk to consumers. We recognize that the utilities have
25
26

27 ²⁴ A.A.C. R14-2-1606(B) provides: After January 1, 2001, power purchased by an investor owned Utility
28 Distribution Company for Standard Offer Service shall be acquired from the competitive market through prudent, arm's
length transactions, and with at least 50% through a competitive bid process.

1 developed great expertise in energy procurement decisions under the vertically-integrated utility
 2 model, and believe that they should utilize that expertise in the solicitation process that has been
 3 developed in this proceeding in order to take advantage of the existence of the new supply of
 4 competitive generation resources.

5 **VI. THE STAFF REPORT AS GUIDE FOR THE SOLICITATION PROCESS**

6 We find that the record in this proceeding supports Commission adoption of the section of the
 7 Staff Report entitled Detailed Staff Proposed Solicitation Process, Exh. S-1, pages 6-27.²⁵ In our
 8 discussion, we have addressed certain issues on which the parties were unable to reach consensus in
 9 the workshop process. The Detailed Staff Proposed Solicitation Process shall be interpreted in
 10 the workshop process. The Detailed Staff Proposed Solicitation Process shall be interpreted in
 11 keeping with our resolution of those issues as set forth in our discussion herein.

12 **VII. REVIEW OF SOLICITATION PROCESS**

13 The Staff Proposed Solicitation Process adopted herein provides that after the completion of
 14 each utility's initial solicitation, Staff will commence a review of the utility's power supply portfolio
 15 to examine the prudence of that utility's planning and procurement practices, and to determine the
 16 effectiveness and efficiency of the solicitation process employed.
 17

18 The Staff Proposed Solicitation Process adopted herein also contemplates that Staff will
 19 commence a proceeding to review the solicitation process, address the planning for future
 20 solicitations, and recommend such changes to the process as may be appropriate. Sempra and SWPG
 21 recommended that a Decision in this matter expressly indicate that all future competitive solicitations
 22 will be conducted with the same openness and opportunity to participate as have characterized the
 23 current Track B proceeding, and that merchant plant competitors and other interested persons who
 24

25 _____
 26 ²⁵ Reliant has requested that the Commission adopt, as part of Appendix One to the Staff Report, its amended
 27 description of the Texas competitive process to more accurately reflect the situation in Texas. As Reliant notes, its
 28 suggested change to the Staff Report was not opposed by any party. While the inclusion in the Staff Report of Appendix
 One was generally helpful in providing a broad overview of competitive solicitation for wholesale generation supply in
 selected states, we do not find it necessary to adopt or endorse Appendix One. Therefore, we will note Reliant's request,
 but we find that it is unnecessary to adopt Reliant's amended description for purposes of our Decision in this matter.

1 were not in a position to participate in the initial solicitation in 2003 should not be precluded from
2 participation in subsequent competitive procurements. We see no reason why future competitive
3 solicitation would not be as open as the initial solicitation, and therefore see no need to make such an
4 explicit finding here. However, if Sempra and SWPG wish to formally raise that issue, they may
5 raise it in the solicitation process review proceeding described above.

6 We will require that Staff file a report in these dockets informing the Commission of its
7 progress in the contemplated reviews described above and at page 27 of the Staff Report, Exh. S-1.
8

9 **VIII. AISA**

10 The AISA has yet to be examined in these dockets. We will therefore direct Staff to file a
11 report in these docket on the issue that includes a description and analysis of the function of the AISA
12 and a recommendation to the Commission regarding whether a hearing should be held on that matter.

13 * * * * *

14 Having considered the entire record herein and being fully advised in the premises, the
15 Commission finds, concludes, and orders that:

16 **FINDINGS OF FACT**

17 1. On October 18, 2001, Arizona Public Service Company filed a Request for a Partial
18 Variance to A.A.C. R14-2-1606(B) and for Approval of a Purchase Power Agreement.

19 2. By Procedural Order issued January 22, 2002, the Commission opened this generic
20 docket on electric restructuring (Docket No. E-00000A-02-0051).

21 3. On January 28, 2002, Tucson Electric Power Company filed a Request for Variance
22 (Docket No. E-01933A-02-0069).

23 4. Intervention was granted to numerous parties.

24 5. On March 19, 2002, Panda Gila River, L.P. filed a Request for Order to Show Cause.

25 6. On March 22, 2002, Staff filed its Staff Report in the generic docket.

26 7. On April 25, 2002, the Commission held a Special Open Meeting at which the
27 Commission directed that certain issues be addressed in the Generic Docket.
28

1 8. By Procedural Order issued on May 2, 2002, a hearing was set on the issues identified
2 by the Commission as "Track A" issues. Track B, Competitive Procurement, was also established.

3 9. The May 2, 2002 Procedural Order also directed that Track B proceed concurrently
4 with Track A, and instructed interested parties to file by May 13, 2002, a list of proposed issues for
5 consideration, and a procedural timetable (including comment periods) for the Track B issues.

6 10. On May 13, 2002, TEP, APS, the Arizona Competitive Power Alliance, RUCO, and
7 Staff filed Track B proposals in compliance with the May 2, 2002 Procedural Order. Staff indicated
8 in its filing that it anticipated awarding a contract to an Independent Evaluator on or around July 8,
9 2002.

10 11. On May 31, 2002, Staff filed a list of issues for comment of the other parties.

11 12. On June 20, 2002, based on the proposals submitted on May 13, 2002, the First
12 Procedural Order on Track B Issues established a procedural schedule that included workshops, as
13 proposed by Staff, on July 24 and 25, 2002. The First Procedural Order stated that the balance of the
14 procedural schedule would be dependent upon the Commission's Decision on the Track A issues, the
15 consensus reached by the parties during the workshops or otherwise, and whether a hearing on any
16 Track B issues became necessary. The First Procedural Order set a deadline for the parties to
17 respond to Staff's May 31, 2002 list of issues by July 1, 2002, which response was to include any
18 competitive solicitation issues not addressed in Staff's May 31, 2002 filing, and also set a deadline of
19 July 17, 2002, for Staff and the Independent Evaluator to file a list of issues to be addressed at the
20 July 24 and 25, 2002 workshops.

21 13. Hearings were held on the Track A issues during the last two weeks of June, 2002, and
22 Decision No. 65154 was issued on September 10, 2002, in these dockets. In addition to its
23 determination of Track A issues, Decision No. 65154 ordered the parties to continue their efforts in
24 Track B to develop a competitive solicitation process that can begin by March 1, 2003.

25 14. The parties held an additional Track B workshop on August 13 and 14, 2002.

26 15. On September 16, 2002, Staff filed a Request for Procedural Order asking that a
27 hearing be set to commence on November 20, 2002, following a third and final two-day workshop to
28 be held on September 26 and 27, 2002.

1 16. APS and PGR filed responses to Staff's request indicating their agreement that a
2 hearing would likely be necessary to achieve a resolution of the Track B issues. While APS agreed
3 with the procedural schedule proposed by Staff in its Request, PGR requested a scheduling
4 conference so that all parties might comment on dates to be included in any procedural order and on
5 issues to be addressed at the hearing.

6 17. The Second Procedural Order on Track B Issues was issued on September 24, 2002
7 and required the parties to file, by October 1, 2002, their proposed schedules for the conduct of a
8 hearing to be held following the third workshop, and a list of the specific issues the parties believed
9 remained to be addressed at the hearing.

10 18. A procedural conference was held as scheduled on October 2, 2002.

11 19. The Third Procedural Order on Track B Issues, issued on October 9, 2002, required
12 APS and TEP to file a needs assessment and procurement proposal, sufficient to inform the
13 Commission in its determination of the minimum amount of power, the timing, and the form of
14 procurement as required by Decision No. 65154.

15 20. Public notice of the proceedings on the Track B issues was published in newspapers of
16 general circulation in the APS and TEP service areas statewide between November 4 and 6, 2002.
17 No further intervention requests were filed following the publication.

18 21. The hearing was held as scheduled. Mr. Bob Liden of Stirling Energy Systems
19 provided public comment at the hearing. No other parties appeared to provide public comment on the
20 Track B issues. Witnesses testified on behalf of Staff, APS, TEP, Harquahala, PGR, Reliant, Sempra,
21 WMGF, the LAW Fund and RUCO.

22 22. AUIA, PPL, and SWPG did not present witnesses, but participated in the hearing.

23 23. APS, TEP, AUIA, Harquahala, PGR, PPL, Reliant, Sempra/SWPG, WMGF, the LAW
24 Fund, RUCO and Staff filed Initial Briefs on December 18, 2002.

25 24. APS, TEP, Harquahala, PGR, Reliant, Sempra/SWPG, WMGF, the LAW Fund,
26 RUCO and Staff filed Reply Briefs on December 31, 2002.

27 25. The solicitation process developed by the parties, as set forth in the Detailed Staff
28 Proposed Solicitation Process appearing at pages 6-27 of the October 25, 2002 Staff Report, is a

1 necessary step in the Commission's goal of encouraging the development of a competitive wholesale
2 generation market in Arizona while protecting Arizona's ratepayers, and should be adopted.

3 26. APS and TEP are responsible for providing for the continuing need of their ratepayers
4 to maintain a reliable supply of electricity at reasonable rates.

5 27. The issues that the parties were unable to reach a consensus agreement on in the Track
6 B workshop processes, and which therefore require a Commission resolution, are as follows: 1) the
7 solicitation and bid process to be approved, including whether to institute an integrated resource
8 planning process; 2) the amount of capacity and energy to be solicited; 3) the bid evaluation method
9 to be approved, including whether APS and TEP are required to accept any bids; 4) affiliate
10 participation in the bid process; 5) the Commission's prudence review of contracts resulting from the
11 bid process; and 6) the direction of future proceedings, including DSM and environmental risk
12 mitigation programs.

13 28. Decision No. 65154 set the minimum baseline amount of power that APS and TEP
14 would be required to acquire in the competitive solicitation, but left for this Track B proceeding the
15 determination of the actual minimum amount of power to be acquired, the timing of the power
16 procurement, and the form of the procurement.

17 29. Decision No. 65154 does not limit the amount of power that the Commission may
18 require APS and TEP to solicit in the competitive solicitation.

19 30. APS and TEP shall test the market in this solicitation, beyond the required power that
20 cannot be produced from their respective existing assets or existing contracts, to determine whether
21 reliable generation is available at a lower cost than that produced by their own existing assets, or at a
22 comparable level of cost, but with reduced adverse environmental effects, compared to their own
23 existing assets. The amount by which APS and TEP must test the market in this competitive
24 solicitation, and which will include required power that cannot be produced from their respective
25 existing assets or existing contracts, is their contestable load.

26 31. If the competitive solicitation for contestable load yields bids for capacity or energy
27 beyond required power that cannot be produced from APS' and TEP's respective existing assets or
28 existing contracts, and if APS and TEP determine, after serious economic and technical analysis of all

1 bids, including long-term and short-term bids, that the offered capacity or energy would serve their
2 customers more economically than their existing assets, then APS and TEP shall make procurements
3 accordingly, keeping in mind that the goal of the competitive solicitation is to provide ratepayers with
4 reliable power at the lowest cost, while considering the environmental effects of their procurement
5 decisions and whether their decisions further the Commission's goals of encouraging the
6 development of a robust competitive wholesale generation market.

7 32. Transmission constraints currently limit the capacity and energy that can be delivered
8 from particular generators over particular lines to load in the Phoenix, Tucson, and Yuma areas, and
9 may give rise to RMR requirements inside those load pockets.

10 33. Inclusion of RMR in contestable load should increase the benefits to be derived from
11 competitive bidding by providing a market response reference regarding the relative economic and
12 environmental merits of competitive generation solutions to Arizona's load pocket problems.

13 34. All generation that can reliably deliver energy into load pockets, under the RMR
14 contestability conditions set forth in Findings of Fact No 35 below, shall be allowed to compete in a
15 fair and open manner to supply energy and capacity to both APS and TEP in the solicitation process.

16 35. RMR capacity and energy should be contestable under the following conditions: 1) if
17 non-utility owned or non-rate based generation exists locally; 2) if remote generation has access to
18 non-APS or non-TEP firm transmission capacity that would enable delivery to the local area; and 3)
19 if owners of remote generation offer to finance transmission improvements to remedy the
20 transmission constraint.

21 36. APS, Salt River Project and the Western Area Power Administration are currently
22 participating in RMR studies for the years 2003-2007 to be filed with the Commission by January 31,
23 2003, and which are to include the identification of RMR hours, capacity and energy.

24 37. It is reasonable for Staff and the Independent Evaluator to review the January, 2003
25 RMR study results, and comments to those results, and to thereafter make necessary revisions to the
26 RMR amounts appearing in Staff's contestable load estimates during the Pre-Solicitation process set
27 forth in the Staff Report.

28 38. The utilities shall evaluate RMR and non-RMR bids concurrently, in order to

1 determine their best least-cost portfolio.

2 39. The protocols applicable to RMR bids and contract management shall be the AISA or
3 WestConnect protocols, whichever are in effect on a given date.

4 40. APS shall solicit capacity in amounts conforming to, at a minimum, Staff's estimates
5 as set forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR
6 amounts as determined by Staff and the Independent Evaluator following their receipt and review of
7 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in
8 the Staff Report.

9 41. TEP shall solicit capacity in amounts conforming, at a minimum, to Staff's estimates
10 as set forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR
11 amounts as determined by Staff and the Independent Evaluator following their receipt and review of
12 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in
13 the Staff Report.

14 42. APS shall solicit energy in amounts conforming to, at a minimum, Staff's estimates as
15 set forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR
16 amounts as determined by Staff and the Independent Evaluator following their receipt and review of
17 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in
18 the Staff Report.

19 43. TEP shall solicit energy in amounts conforming to, at a minimum, Staff's estimates as
20 set forth in its December 18, 2002 revision to Exh. S-5, with the exception of the amounts labeled as
21 economy purchases, and with the addition of the necessary RMR amounts as determined by Staff and
22 the Independent Evaluator following their receipt and review of comments to the January, 2003 RMR
23 Study Results, during the Pre-Solicitation process set forth in the Staff Report.

24 44. The utilities shall use least cost planning principles to develop their overall portfolios.
25 In determining the appropriate resource portfolio in the best interests of their customers, APS and
26 TEP shall seriously consider a well-balanced mixture of contracts, including long-term contracts, in
27 order to protect ratepayers from future upswings in power prices.

28 45. APS and TEP shall have the right to reject all bids if the bids do not reasonably meet

1 the needs of the utility and its customers, after sound economic and deliverability analysis of all bids
2 received, including long- and short-term bids. The utilities' goal should be to obtain for their
3 customers the least-cost mix of reliable power over the long term, while being mindful of the
4 environmental effects of their procurement decisions, as well as whether their procurement decisions
5 will further the goal of encouraging the development of a competitively robust wholesale generation
6 market in Arizona. While we are not requiring APS and TEP to accept bids in the solicitation process
7 beyond their requirements that cannot be produced from their own existing assets, APS and TEP
8 should be on notice that the Commission will closely scrutinize the offered bids and the utilities'
9 procurement decisions based on those bids for conformity with those goals.

10 46 APS buys power on the wholesale market, and its affiliate offers power on the
11 wholesale market.

12 47. Merchant generators have expressed concern that allowing Pinnacle West to share
13 services with APS related to system dispatch, risk management or contract management would
14 provide APS' competitive affiliates access to information that would impermissibly create an unfair
15 competitive advantage to the affiliate.

16 48. APS stated that it is working with Staff to establish the standards of conduct required
17 by the Staff Proposed Solicitation Process, and is identifying the team of employees that will conduct
18 the solicitation and will take steps to ensure that they do not share inappropriate information with
19 employees of APS affiliates who may be directly involved in the preparation of a bid in the
20 solicitation process.

21 49. While we acknowledge and appreciate APS' efforts regarding standards of conduct,
22 the fact that the standards of conduct are not a part of the record in this proceeding necessitate the
23 establishment of guidelines to clarify the Commission's position that no exercise of affiliate
24 preferences will be tolerated in the solicitation process.

25 50. APS shall treat affiliated generation equally in all respects with non-affiliated
26 generation in the solicitation process. This requirement extends to any contractual arrangements
27 associated with the bidding and procurement process, including natural gas tolling, that APS enters
28 into with any affiliated entity involved in the solicitation and procurement process.

1 51. APS shall keep detailed records of any and all contacts with all non-APS entities.
2 including employees of and contractors for its parent and all affiliates, including but not limited to
3 M&T, PWEC and Pinnacle West, regarding this initial solicitation, and subsequent solicitations, up
4 through the time that the procurement process is complete. These records shall be subject to the same
5 maintenance and availability requirements as those described on pages 26 and 27 of the Staff Report.

6 52. Employees of and contractors for APS's parent and affiliates, including but not limited
7 to M&T, PWEC and Pinnacle West, who may be involved in the preparation of a bid in the
8 solicitation process, shall not have contact with employees that will conduct the solicitation.

9 53. For the purposes of the solicitation and procurement, APS shall prohibit all personnel
10 who provide advice to APS in the solicitation process from communicating with any personnel
11 working for or contracted to APS's parent or affiliates who may be involved in the preparation of a
12 bid in the solicitation process.

13 54. APS shall adopt the practice of using "blind" procurement techniques, such as
14 electronic trading platforms or independent brokers, for all its short term purchases with the
15 exception of emergency purchases. APS shall file a draft protocol adopting this practice, for
16 Commission approval, by March 30, 2003.

17 55. While we adopt the guidelines set forth in Findings of Fact Nos. 50-54 above, they do
18 not constitute an all-inclusive list of the restrictions on the type of activities that APS and its affiliates
19 must prevent. In determining whether an act or communication is appropriate, the APS employee
20 shall evaluate whether the act or communication would further the Commission's goal of
21 encouraging the development of a robust competitive wholesale generation market in Arizona. We
22 want to make clear that any preferential or discriminatory activity by APS, its parent or affiliates that
23 interferes with a fair, unbiased solicitation process, whether specifically delineated or not in the
24 standards of conduct, the Code of Conduct, or this Decision, will not be tolerated, and that we will
25 closely scrutinize the solicitation process for signs of any such abuse.

26 56. TEP buys power on the wholesale market, but currently has no affiliate offering power
27 on the wholesale market.

28 57. TEP requested that the Commission waive the applicability of Section IV.C, paragraph

1 1, lines 10-19 of the Staff Report with respect to TEP, thus allowing TEP's Wholesale Marketing
2 department to be involved in the initial solicitation process.

3 58. Because TEP does not have an affiliate that will bid in the upcoming initial
4 competitive solicitation process, we find that it is reasonable to, and shall, grant TEP's request to
5 allow TEP's Wholesale Marketing department to be involved in this initial solicitation process.

6 59. In the event a TEP affiliate does plan to offer power on the wholesale market, TEP
7 shall adopt the practice of using "blind" procurement techniques, such as electronic trading platforms
8 or independent brokers, for all its short term purchases with the exception of emergency purchases.
9 TEP shall file a draft protocol adopting this practice, for Commission approval, 60 days prior to a
10 TEP affiliate offering any power on the wholesale market.

11 60. Based on the record in this proceeding, it is not necessary at this time to institute a
12 formal Commission IRP process. However, an IRP process may for some reason become desirable
13 or necessary in the future. We will therefore direct Staff to file a report in these dockets, by
14 November 3, 2003, informing the Commission of its position at that time on the advisability of the
15 institution of a formal Commission IRP process.

16 61. Based on the record in this proceeding, it is not necessary at this time to require that
17 APS or TEP solicit DSM bids, but this finding does not prohibit the submission of such bids.

18 62. It is reasonable for the Commission to hold workshops to explore the development of
19 a DSM policy and an environmental risk management policy, with such exploration to include an
20 examination of the possible costs and benefits of the respective policies. We will therefore direct
21 Staff to facilitate a workshop process to explore the development of a DSM policy and an
22 environmental risk management policy, with such exploration to include an examination of the
23 possible costs and benefits of the respective policies, and to file a report, by July 31, 2003, informing
24 the Commission of the progress achieved in the workshops, including a Staff recommendation on
25 whether hearings should be held as suggested in Exhibits DB-2 and DB-3 to Exh. LAW-1.

26 63. The Codes of Conduct have not yet been addressed in these dockets. We will
27 therefore direct Staff to file reports in these dockets, not later than April 1, 2003, on the Codes of
28 Conduct previously filed by APS and TEP. The Staff Reports should include, but not be limited to,

1 an analysis of the standards of conduct developed in this proceeding, their applicability to the
2 respective Codes of Conduct filed by TEP and APS, and recommendations regarding their
3 incorporation into the Codes of Conduct. Hearings will be scheduled on the Codes of Conduct
4 following the filing of those Staff Reports.

5 64. The issue of the AISA has yet to be examined in these dockets. We will therefore
6 direct Staff to file a report in these docket on the issue by July 31, 2003, that includes a description
7 and analysis of the function of the AISA and a recommendation to the Commission regarding
8 whether a hearing should be held.

9 65. Expedited approval of procurement contracts entered as a result of the competitive
10 solicitation would pose a substantial risk to consumers and is not necessary at this time for the
11 protection of either the utilities or the merchants.

12 66. The review processes set forth in the Staff Report at page 27, including the prudency
13 review, are reasonable. We will require that Staff file a report in these dockets by July 15, 2003, or
14 earlier, informing the Commission of its progress in the contemplated reviews described at page 27 of
15 the Staff Report.

16 CONCLUSIONS OF LAW

17 1. The Commission has jurisdiction over these proceedings.
18 2. Notice of these proceedings was given as required by law.
19 3. Pursuant to Article 15, § 3 of the Arizona Constitution, the Commission has full power
20 to make and enforce reasonable rules, regulations, and orders for the convenience, comfort, and
21 safety, and the preservation of the health, of the employees and patrons of public service
22 corporations.

23 4. Pursuant to A.R.S. § 40-361, every public service corporation shall furnish and
24 maintain such service, equipment and facilities as will promote the safety, health, comfort and
25 convenience of its patrons, employees and the public, and as will be in all respects adequate,
26 efficient, and reasonable.

27 5. Pursuant to A.R.S. § 40-321 and 40-331, the Commission has broad authority to
28 regulate the service and facilities of public service corporations in order to protect the public.

1 6. It is reasonable and in the public interest to require that APS and TEP test the market
2 in this solicitation, beyond the required power that cannot be produced from their respective existing
3 assets or existing contracts, to determine whether reliable generation is available at a lower cost than
4 that produced by their own existing assets, or at a comparable level of cost, but with reduced adverse
5 environmental effects, compared to their own existing assets.

6 7. It is reasonable and in the public interest to require APS to solicit for capacity and
7 energy in the amounts referenced in Findings of Fact Nos. 40 and 42 above.

8 8. It is reasonable and in the public interest to require TEP to solicit for capacity and
9 energy in the amounts referenced in Findings of Fact Nos. 41 and 43 above.

10 9. It is also reasonable and in the public interest to require APS and TEP to determine,
11 after serious economic and technical analysis, using least cost planning principles, whether bids
12 offered in the solicitation, including both long- and short-term bids, would serve their customers
13 more economically than their existing assets, and to make procurements accordingly, with the right to
14 reject all bids if necessary, keeping in mind that the goal of the competitive solicitation is to provide
15 ratepayers with reliable power at the lowest cost, while considering the environmental effects of their
16 procurement decisions, as well as whether their decisions further the Commission's goal of
17 encouraging the development of a robust competitive wholesale generation market.

18 10. Imposition of the conduct requirements set forth in Findings of Fact Nos. 50-55 and
19 59 is reasonable and necessary in order to protect the integrity of the solicitation process and the
20 public interest.

21 11. It is reasonable and in the public interest to allow TEP's Wholesale Marketing
22 department to be involved in the initial solicitation process, as TEP has no affiliate offering power on
23 the wholesale market at this time.

24 12. It is not in the public interest for the Commission to review the prudence of
25 procurement contracts resulting from this solicitation on an expedited basis.

26 13. The record in this proceeding supports Commission adoption of the Detailed Staff
27 Proposed Solicitation Process appearing at pages 6-27 of the October 25, 2002 Staff Report.

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ORDER

IT IS THEREFORE ORDERED that the Detailed Staff Proposed Solicitation Process appearing at pages 6-27 of the October 25, 2002 Staff Report is hereby adopted, and APS, TEP and Staff shall comply with its requirements.

IT IS FURTHER ORDERED that APS, TEP and Staff shall comply with the directives of the discussions and Findings of Fact herein.

IT IS FURTHER ORDERED that the Commission's actions in this proceeding do not constitute state action for the purposes of antitrust laws. It is not our intent to insulate Arizona Public Service Company, its parent, or affiliates, or Tucson Electric Power from any provisions of law that prohibit the restraint of trade.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN	COMMISSIONER	COMMISSIONER
COMMISSIONER	COMMISSIONER	

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this ____ day of _____, 2003.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____

DISSENT _____
TW:dap

1 SERVICE LIST FOR:

2 GENERIC PROCEEDINGS, ARIZONA PUBLIC
3 SERVICE COMPANY and TUCSON ELECTRIC
4 POWER COMPANY

5 DOCKET NOS.:

6 E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-
7 0630, E-01933A-02-0069

8 Scott S. Wakefield
9 RUCO
10 1110 W. Washington, Suite 220
11 Phoenix, Arizona 85007

COLUMBUS ELECTRIC COOPERATIVE, INC.
P.O. Box 631
Deming, New Mexico 88031

12 Michael A. Curtis
13 William P. Sullivan
14 Paul R. Michaud
15 MARTINEZ & CURTIS, P.C.
16 2712 North 7th Street
17 Phoenix, Arizona 85006
18 Attorneys for Arizona Municipal Power Users Association, Mohave
19 Electric Cooperative, Inc., Navopache Electric Cooperative, Inc.,
20 Reliant Resources, Inc. & Primesouth, Inc.;
21 Wellton-Mohawk Generating Facility

CONTINENTAL DIVIDE ELECTRIC COOPERATIVE
P.O. Box 1087
Grants, New Mexico 87020

DIXIE ESCALANTE RURAL ELECTRIC ASSOCIATION
CR Box 95
Beryl, Utah 84714

22 Walter W. Meek, President
23 ARIZONA UTILITY INVESTORS ASSOCIATION
24 2100 N. Central Avenue, Suite 210
25 Phoenix, Arizona 85004

GARKANE POWER ASSOCIATION, INC.
P.O. Box 790
Richfield, Utah 84701

ARIZONA DEPT OF COMMERCE
ENERGY OFFICE
3800 North Central Avenue, 12th Floor
Phoenix, Arizona 85012

26 Rick Gilliam
27 Eric C. Guidry
28 LAND AND WATER FUND OF THE ROCKIES
ENERGY PROJECT
2260 Baseline Road, Suite 200
Boulder, Colorado 80302

ARIZONA COMMUNITY ACTION ASSOC.
2627 N. 3rd Street, Suite 2
Phoenix, Arizona 85004

Terry Frothun
ARIZONA STATE AFL-CIO
5818 N. 7th Street, Suite 200
Phoenix, Arizona 85014-5811

TUCSON ELECTRIC POWER CO.
Legal Dept - DB203
220 W 6th Street
P.O. Box 711
Tucson, Arizona 85702-0711

Norman J. Furuta
DEPARTMENT OF THE NAVY
900 Commodore Drive, Building 107
San Bruno, California 94066-5006

A.B. Baardson
NORDIC POWER
6464 N. Desert Breeze Ct.
Tucson, Arizona 85750-0846

Barbara S. Bush
COALITION FOR RESPONSIBLE ENERGY EDUCATION
315 West Riviera Drive
Tempe, Arizona 85252

Jessica Youle
PAB300
SALT RIVER PROJECT
P.O. Box 52025
Phoenix, Arizona 85072-2025

Sam Defraw (Attn. Code 001)
Rate Intervention Division
NAVAL FACILITIES ENGINEERING COMMAND
Building 212, 4th Floor
901 M Street, SE
Washington, DC 20374-5018

Carl Dabelsten
CITIZENS UTILITIES COMPANY
2901 N. Central Avenue, Suite 1660
Phoenix, Arizona 85012-2736

Rick Lavis
ARIZONA COTTON GROWERS ASSOCIATION
4139 East Broadway Road
Phoenix, Arizona 85040

Barry Huddleston
DESTEC ENERGY
P.O. Box 4411
Houston, Texas 77210-4411

Steve Brittle
DON'T WASTE ARIZONA, INC.
6205 South 12th Street
Phoenix, Arizona 85040

Steve Montgomery
JOHNSON CONTROLS
2032 West 4th Street
Tempe, Arizona 85281

Terry Ross

1 CENTER FOR ENERGY AND
ECONOMIC DEVELOPMENT
P.O. Box 288
2 Franktown, Colorado 80116-0288

3
4 Larry McGraw
USDA-RUS
6266 Weeping Willow
5 Rio Rancho, New Mexico 87124

6 Jim Driscoll
ARIZONA CITIZEN ACTION
5160 E. Bellevue Street, Apt. 101
7 Tucson, AZ 85712-4828

8 William Baker
ELECTRICAL DISTRICT NO. 6
7310 N. 16th Street, Suite 320
9 Phoenix, Arizona 85020

10
11 Robert Julian
PPG
1500 Merrell Lane
12 Belgrade, Montana 59714

13 C. Webb Crockett
Jay L. Shapiro
FENNEMORE CRAIG, PC
14 3003 N. Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913
15 Attorneys for Panda Gila River, L.P.

16 Robert S. Lynch
340 E. Palm Lane, Suite 140
Phoenix, Arizona 85004-4529
17 Attorney for Arizona Transmission Dependent
Utility Group

18 K.R. Saline
K.R. SALINE & ASSOCIATES
Consulting Engineers
19 160 N. Pasadena, Suite 101
Mesa, Arizona 85201-6764

20 Douglas Nelson
DOUGLAS C. NELSON PC
21 7000 N. 16th Street, Suite 120-307
Phoenix, Arizona 85020-5547
22 Attorney for Calpine Power Services

23 Lawrence V. Robertson Jr.
MUNGER CHADWICK, PLC
333 North Wilmot, Suite 300
Tucson, Arizona 85711-2634
24 Attorney for PG&E Energy Services Corp

25 Albert Sterman
ARIZONA CONSUMERS COUNCIL
2849 East 8th Street
26 Tucson, Arizona 85716

27 Michael Grant
GALLAGHER & KENNEDY
2575 East Camelback Road
28 Phoenix, Arizona 85016-9225

Attorneys for AEPSCO, Graham County Electric Cooperative, and
Duncan Valley Electric Cooperative.

Vinnie Hunt
CITY OF TUCSON
Department of Operations
4004 S. Park Avenue, Building #2
Tucson, Arizona 85714

Ryle J. Carl III
INTERNATION BROTHERHOOD OF
ELECTRICAL WORKERS, L.U. #1116
750 S. Tucson Blvd.
Tucson, Arizona 85716-5698

Robert J. Metli
CHEIFETZ & IANNITELLI, P.A.
3238 N. 16th Street
Phoenix, Arizona 85016
Attorney for Citizens Communications Co.

Craig Marks
Deborah R. Scott
Citizens Communications
2901 North Central Avenue, Ste. 1660
Phoenix, AZ 85012

William J. Murphy
CITY OF PHOENIX
2631 S. 22nd Avenue
Phoenix, Arizona 85009

Russell E. Jones
WATERFALL ECONOMIDIS CALDWELL HANSHAW &
VILLAMANA, P.C.
5210 E. Williams Circle, Suite 800
Tucson, Arizona 85711
Attorneys for Trico Electric Cooperative, Inc.

Christopher Hitchcock
HITCHCOCK & HICKS
P.O. Box 87
Bisbee, Arizona 85603-0087
Attorney for Sulphur Springs Valley
Electric Cooperative, Inc.

Andrew Bettwy
Debra Jacobson
SOUTHWEST GAS CORPORATION
5241 Spring Mountain Road
Las Vegas, Nevada 89150-0001

Barbara R. Goldberg
OFFICE OF THE CITY ATTORNEY
3939 Civic Center Blvd.
Scottsdale, Arizona 85251

Bradford A. Borman
PACIFICORP
201 S. Main, Suite 2000
Salt Lake City, Utah 84140

Timothy M. Hogan
ARIZONA CENTER FOR LAW
IN THE PUBLIC INTEREST
202 E. McDowell Rd., Suite 153
Phoenix, Arizona 85004

Marcia Weeks
18970 N. 116th Lane
Surprise, Arizona 85374

John T. Travers

1 William H. Nau
272 Market Square, Suite 2724
Lake Forest, Illinois 60045

2 Timothy Michael Toy
WINTHROP, STIMSON, PUTNAM & ROBERTS
3 One Battery Park Plaza
New York, New York 10004-1490

4 Raymond S. Heyman
Michael W. Patten
5 ROSHKA HEYMAN & DEWULF, PLC
400 E. Van Buren, Suite 800
Phoenix, Arizona 85004

6 Attorneys for Tucson Electric Power Co.
7 Chuck Miessner
NEV SOUTHWEST LLC
P.O. Box 711, Mailstop-DA308
8 Tucson, Arizona 85702-0711

9 Billie Dean
AVIDD
P O Box 97
10 Marana, Arizona 85652-0987

11 Steven C. Gross
PORTER SIMON
40200 Truckee Airport Road
Truckee, California 96161-3307

12 Attorneys for M-S-R Public Power Agency
13 Donald R. Allen
John P. Coyle
DUNCAN & ALLEN
14 1575 Eye Street, N.W., Suite 300
Washington, DC 20005

15 Ward Camp
PHASER ADVANCED METERING SERVICES
16 Alvarado Square
MS-0806
Albuquerque, New Mexico 87158

17 Betsy Galtney
IDAHO POWER COMPANY
18 P.O. Box 70
Boise, Idaho 83707

19 Libby Brydolf
CALIFORNIA ENERGY MARKETS NEWSLETTER
20 2419 Bancroft Street
San Diego, California 92104

21 Paul W. Taylor
R W BECK
22 14635 N. Kierland Blvd., Suite 130
Scottsdale, Arizona 85254-2769

23 James P. Barlett
5333 N. 7th Street, Suite B-215
24 Phoenix, Arizona 85014
Attorney for Arizona Power Authority

25 Jay I. Moyes
MOYES STOREY
26 3003 N. Central Ave., Suite 1250
Phoenix, Arizona 85012
Attorneys for PPL Southwest Generation Holdings, LLC; PPL
27 EnergyPlus, LLC and PPL Sundance Energy, LLC

28 Stephen L. Teichler
Stephanie A. Conaghan

DUANE MORRIS & HECKSCHER, LLP
1667 K Street NW, Suite 700
Washington, DC 20006

Kathy T. Puckett
SHELL OIL COMPANY
200 N. Dairy Ashford
Houston, Texas 77079

Peter Q. Nyce, Jr.
DEPARTMENT OF THE ARMY
JAI.S-RS Suite 713
901 N. Stuart Street
Arlington, Virginia 22203-1837

Michelle Ahlmer
ARIZONA RETAILERS ASSOCIATION
224 W. 2nd Street
Mesa, Arizona 85201-6504

Dan Neidlinger
NEIDLINGER & ASSOCIATES
3020 N. 17th Drive
Phoenix, Arizona 85015

Chuck Garcia
PNM, Law Department
Alvarado Square, MS 0806
Albuquerque, New Mexico 87158

Sanford J. Asman
570 Vinington Court
Dunwoody, Georgia 30350-5710

Patricia Cooper
AEP/CO/SSWEP/CO
P.O. box 670
Benson, Arizona 85602

Steve Segal
LEBOEUF, LAMB, GREENE, & MACRAE
633 17th Street, Suite 2000
Denver, Colorado 80202-3620

Holly E. Chastain
SCHLUMBERGER RESOURCE
MANAGEMENT SERVICES, INC.
5430 Metric Place
Norcross, Georgia 30092-2550

Leslie Lawner
ENRON CORP
712 North Lea
Roswell, New Mexico 88201

Frederick M. Bloom
Commonwealth Energy Corporation
15991 Red Hill Avenue, Suite 201
Tustin, California 92780

Margaret McConnell
Maricopa Community Colleges
2411 W. 14th Street
Tempe, Arizona 85281-6942

Brian Soth
FIRSTPOINT SERVICES, INC.
1001 S.W. 5th Ave, Suite 500
Portland, Oregon 97204

Jay Kaprosy
PHOENIX CHAMBER OF COMMERCE
201 N. Central Ave., 27th Floor

1 Phoenix, Arizona 85073
Kevin McSpadden
2 MILBANK, TWEED, HADLEY AND
MCCLOY, LLP
3 601 S. Figueroa, 30th Floor
Los Angeles, California 90017
4 M.C. Arendes, Jr.
C3 COMMUNICATIONS, INC.
2600 Via Fortuna, Suite 500
5 Austin, Texas 78746
6 Patrick J. Sanderson
ARIZONA INDEPENDENT SCHEDULING
ADMINISTRATOR ASSOCIATION
7 P.O. Box 6277
Phoenix, Arizona 85005-6277
8 Roger K. Ferland
QUARLES & BRADY STREICH LANG, L.L.P.
Renaissance One
9 Two North Central Avenue
Phoenix, Arizona 85004-2391
10 Charles T. Stevens
Arizonans for Electric Choice & Competition
11 245 W. Roosevelt
Phoenix, Arizona 85003
12 Mark Sirois
ARIZONA COMMUNITY ACTION ASSOC.
13 2627 N. Third Street, Suite 2
Phoenix, Arizona 85004
14 Jeffrey Guldner
SNELL & WILMER
15 400 E. Van Buren,
One Arizona Center
16 Phoenix, Arizona 85004-0001
17 Thomas L. Mumaw
Senior Attorney
Pinnacle West Capital Corporation
18 P.O. Box 53999 MS 8695
Phoenix, AZ 85072-3999
19 Steven J. Duffy
RIDGE & ISAACSON PC
20 3101 N. Central Avenue, Suite 740
Phoenix, Arizona 85012
21 Greg Patterson
5432 E. Avalon
Phoenix, Arizona 85018
22 John Wallace
Grand Canyon State Electric Co-op
23 120 N. 44th Street, Suite 100
Phoenix, Arizona 85034-1822
24 Steven Lavigne
DUKE ENERGY
25 4 Triad Center, Suite 1000
Salt Lake City, Utah 84180
26 Dennis L. Delaney
K.R. SALINE & ASSOC.
27 160 N. Pasadena, Suite 101
Mesa, Arizona 85201-6764
28 Kevin C. Higgins

ENERGY STRATEGIES, LLC
30 Market Street, Suite 200
Salt Lake City, Utah 84101

Michael L. Kurtz
BORHM KURTZ & LOWRY
36 E. Seventh Street, Suite 2110
Cincinnati, Ohio 45202

David Berry
P.O. Box 1064
Scottsdale, Arizona 85252

William P. Inman
Dept. of Revenue
1600 W. Monroe, Room 911
Phoenix, Arizona 85007

Robert Baltes
ARIZONA COGENERATION ASSOC.
7250 N. 16th Street, Suite 102
Phoenix, Arizona 85020-5270

Jana Van Ness
APS
Mail Station 9905
P.O. Box 53999
Phoenix, Arizona 85072-3999

David Couture
TEP
4350 E. Irvington Road
Tucson, Arizona 85714

Kelly Barr
Jana Brandt
SRP
Mail Station PAB211
P.O. Box 52025
Phoenix, Arizona 85072-2025

Randall H. Warner
JONES SKELTON & HOCHULI PLC
2901 N. Central Avenue, Suite 800
Phoenix, Arizona 85012

John A. LaSota, Jr.
MILLER LASOTA & PETERS, PLC
5225 N. Central Ave., Suite 235
Phoenix, Arizona 85012

Peter W. Frost
Conoco Gas and Power Marketing
600 N. Dairy Ashford, CH-1068
Houston, Texas 77079

Joan Walker-Ratliff
Conoco Gas and Power Marketing
1000 S. Pine,
P.O. Box 1267 125-4 ST
Ponca City, Oklahoma 74602

Vicki G. Sandler
C/o Linda Spell
APS Energy Services
P.O. Box 53901
Mail Station 8103
Phoenix, Arizona 85072-3901

Lori Glover
STIRLING ENERGY SYSTEMS
2920 E. Camelback Rd., Suite 150
Phoenix, Arizona 85016

1 Jeff Schlegel
SWEEP
1167 Samalayuca Drive
2 Tucson, Arizona 85704-3224

3 Howard Geller
SWEEP
2260 Baseline Rd., Suite 200
4 Boulder, Colorado 80302

5 Mary-Ellen Kane
ACAA
2627 N. 3rd Street, Suite Two
6 Phoenix, Arizona 85004

7 Aaron Thomas
AES NewEnergy
350 S. Grand Avenue, Suite 2950
8 Los Angeles, California 90071

9 Theresa Mead
AES NewEnergy
P.O. Box 65447
10 Tucson, Arizona 85728

11 Peter Van Haren
CITY OF PHOENIX
Attn: Jesse W. Sears
200 W. Washington Street, Suite 1300
12 Phoenix, Arizona 85003-1611

13 Robert Annan
ARIZONA CLEAN ENERGY INDUSTRIES ALLIANCE
6605 E. Evening Glow Drive
14 Scottsdale, Arizona 85262

15 Curtis L. Kebler
RELIANT RESOURCES, INC.
8996 Etiwanda Avenue
16 Rancho Cucamonga, California 91739

17 Philip Key
RENEWABLE ENERGY LEADERSHIP GROUP
10631 E. Autumn Sage Drive
18 Scottsdale, Arizona 85259

19 Paul Bullis
OFFICE OF THE ATTORNEY GENERAL
1275 W. Washington Street
Phoenix, Arizona 85007

20 Laurie Woodall
OFFICE OF THE ATTORNEY GENERAL
15 S. 15th Avenue
21 Phoenix, Arizona 85007

22 Donna M. Bronski
CITY OF SCOTTSDALE
3939 N. Drinkwater Blvd
23 Scottsdale, Arizona 85251

24 Larry F. Eisenstat
Frederick D. Ochsenhirt
25 Michael R. Engleman
DICKSTEIN SHAPIRO MORIN & OSHINSKY LLP
26 2101 L Street, NW
Washington, DC 20037-1526

27 David A. Crabtree
Dierdre A. Brown
TECO POWER SERVICES CORP.
28 P.O. Box 111

Tampa, Florida 33602

Michael A. Trentel
Patrick W. Burnett
PANDA ENERGY INTERNATIONAL INC
4100 Spring Valley, Suite 1010
Dallas, Texas 75244

Theodore E. Roberts
SEMPRA ENERGY RESOURCES
101 Ash Street, HQ 12-B
San Diego, California 92101-3017

Jesse Dillon
PPL Services Corp.
2 N. Ninth Street
Allentown, Pennsylvania 18101-1179

Gary A. Dodge
HATCH, JAMES & DODGE
10 W. Broadway, Suite 400
Salt Lake City, Utah 84101

Ronald W. Grossarth
Public Service Co. of New Mexico
2401 Aztec NE
Albuquerque, NM 87107

Mark J. Smith
FPL Energy, LLC
Livermore, CA 94550

Alan R. Watts
Southern California Public Power Authority
17132 El Cajon Avenue
Yorba Linda, CA 92886

Christopher Kempley, Chief Counsel
ARIZONA CORPORATION COMMISSION
1200 W. Washington Street
Phoenix, Arizona 85007

Ernest G. Johnson, Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

ARIZONA REPORTING SERVICE, INC.
2627 N. Third Street, Suite Three
Phoenix, Arizona 85004-1104