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BEFORE THE ARIZONA CORPO

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3 WILLIAM A. MUNDELL
Chairman
4 JIM IRVIN
Commissioner
5 MARC SPITZER
Commissioner

Arizona Corporation Commission

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8 IN THE MATTER OF THE GENERIC
9 PROCEEDINGS CONCERNING ELECTRIC
RESTRUCTURING ISSUES

Docket No. E-00000A-02-0051

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

Docket No. E-01345A-01-0822

12 IN THE MATTER OF THE GENERIC
13 PROCEEDING CONCERNING THE ARIZONA
14 INDEPENDENT SCHEDULING
ADMINISTRATOR

Docket No. E-00000A-01-0630

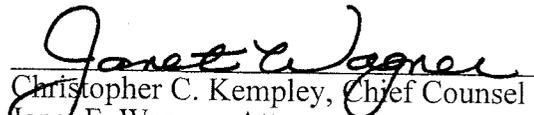
15 IN THE MATTER OF TUCSON ELECTRIC
16 POWER COMPANY'S APPLICATION FOR A
VARIANCE OF CERTAIN ELECTRIC
17 COMPETITION RULES COMPLIANCE DATES

Docket No. E-01933A-02-0069

**NOTICE OF FILING
REBUTTAL TESTIMONY**

18 Staff hereby provides notice of filing its rebuttal testimony in Track B of this docket. An
19 original and fifteen copies are submitted of the rebuttal testimony of Ernest G. Johnson, Alan
20 Kessler, and Jerry D. Smith.

21 RESPECTFULLY SUBMITTED this 18th day of November, 2002.

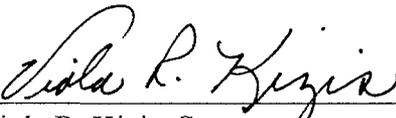
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1 Original and fifteen copies of the foregoing
2 filed this 18th day of November, 2002 with

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington
6 Phoenix, AZ 85007

7 Copies of the foregoing mailed and/or e-mailed
8 this 18th day of November, 2002 to

9 All parties of record

10 

11 Viola R. Kizis, Secretary to
12 Janet F. Wagner

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REBUTTAL

TESTIMONY

OF

ERNEST G. JOHNSON

ALAN KESSLER

JERRY D. SMITH

**IN THE MATTER OF THE GENERIC
PROCEEDINGS CONCERNING ELECTRIC
RESTRUCTURING ISSUES.**

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

**IN THE MATTER OF THE GENERIC
PROCEEDINGS CONCERNING THE ARIZONA
INDEPENDENT SCHEDULING
ADMINISTRATOR.**

**IN THE MATTER OF TUCSON ELECTRIC
POWER COMPANY'S APPLICATION FOR A
VARIANCE OF CERTAIN ELECTRIC
COMPETITION RULES COMPLIANCE DATES.**

DOCKET NO. E-00000A-02-0051

NOVEMBER 18, 2002

E.
JOHNSON

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL

Chairman

JIM IRVIN

Commissioner

MARC SPITZER

Commissioner

IN THE MATTER OF THE GENERIC)	DOCKET NO. E-00000A-02-0051
PROCEEDINGS CONCERNING ELECTRIC)	
<u>RESTRUCTURING ISSUES</u>)	
IN THE MATTER OF ARIZONA PUBLIC)	DOCKET NO. E-01345A-01-0822
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<u>A.A.C. R14-2-1606</u>)	
IN THE MATTER OF THE GENERIC)	DOCKET NO. E-00000A-01-0630
PROCEEDINGS CONCERNING THE)	
INDEPENENT SCHEDULING)	
<u>ADMINISTRATOR</u>)	
IN THE MATTER OF TUCSON ELECTRIC)	DOCKET NO. E-01933A-02-0069
POWER COMPANY'S APPLICATION FOR A)	
VARIANCE OF CERTAIN ELECTRIC)	
<u>COMPETITION RULES COMPLIANCE DATES</u>)	

TRACK B REBUTTAL TESTIMONY

OF

ERNEST G. JOHNSON

DIRECTOR

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

NOVEMBER 18, 2002

SUMMARY
TRACK B REBUTTAL TESTIMONY
ERNEST G. JOHNSON
GENERIC ELECTRIC RESTRUCTURING DOCKET
DOCKET NO. E-00000A-02-0051, ET. AL.

My rebuttal testimony responds to APS witness Steven M. Wheeler and focuses on two issues: **Expedited Contract Approval** and **Price to Beat**.

I conclude that Expedited Contract Approval is unnecessary, inappropriate and is not in the public interest, and could result in rates that are not just and reasonable. This conclusion is bolstered by the fact that this process is occurring against a backdrop of a wholesale marketplace which is not workably competitive as determined by the Commission in Order #65154. If adopted, an expedited approval process may inadvertently relieve the utility of its responsibility to procure power in a prudent manner resulting in rates that are not just and reasonable. Also, an expedited approval process may short change or limit the Commission's opportunity to thoughtfully and completely examine both the process and the results emanating therefrom. Such a result would clearly not be in the public interest.

Turning to the issue of Price to Beat, Staff proposed the price to beat concept as a compromise position which would provide some cost recovery assurance to the utilities and merchants within certain parameters, while avoiding the pitfalls of pre-approval. From Staff's review of the testimony, it would appear that some parties perceive Staff's proposal as too problematic or undesirable.

Therefore, Staff respectfully withdraws its proposed Price to Beat and urges the Commission not to pre-approve or allow for Expedited Contract Approval.

Rejection of Expedited or Automatic recovery is necessary in order to protect ratepayers against significant unknown economic harm without adequate recourse.

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1 **INTRODUCTION/SUMMARY**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Ernest G. Johnson, 1200 West Washington, Phoenix, AZ 85007.

4 **Q. By whom are you employed and in what capacity?**

5 A. I am employed by the Arizona Corporation Commission (“ACC” or “Commission”) as the
6 Director of the Utilities Division.

7
8 **Q. Briefly describe your responsibilities as Utilities Director.**

9 A. I am responsible for the day to day operations of the utilities division, including policy
10 development, case strategy and overall division management.

11
12 **Q. Please summarize your educational background and professional experience.**

13 A. In 1979 and 1982 respectively, I earned Bachelor of Science and Juris Doctorate degrees,
14 both from the University of Oklahoma. I have been involved in the regulation of public
15 utilities since 1986. I was employed by the Oklahoma Corporation Commission in 1986
16 in various legal capacities. In 1993, I was named acting Director and served in that
17 position until mid 1994. I served as permanent Director from mid 1994 until October
18 2001. While serving in these capacities I have participated in numerous regulatory
19 proceedings including providing policy analysis concerning Electric Restructuring before
20 the Oklahoma Corporation Commission and Oklahoma State Legislature.

21
22 **Q. Did you participate in the Track B workshops?**

23 A. Yes, I attended and participated in each of the Track B workshops.

1 **Q. Are you sponsoring the Track B Staff Report, which was filed on October 25, 2002?**

2 A. Yes, I am one of three witnesses sponsoring the Track B Staff Report.

3

4 **Q. What is the purpose of your rebuttal testimony in this case?**

5 A. I respond to comments made by APS witness Steven M. Wheeler. In particular I address
6 the issues of expedited contract approval and the price to beat.

7

8 **EXPEDITED CONTRACT APPROVAL**

9 **Q. Have you reviewed the testimony of APS witness Steve Wheeler?**

10 A. Yes, I have.

11 **Q. Do you have any comments regarding his testimony?**

12 A. Yes, I do.

13 **Q. In his testimony (page 6, line 25 – page 7, line 11) Mr. Wheeler argues that the**
14 **Commission should approve the contracts resulting from the solicitation on an**
15 **expedited basis and that such approval should provide for full and timely cost**
16 **recovery. What is Staff's position on this issue?**

17 A. In Staff's opinion, expedited contract approval would not be in the public interest and is
18 unnecessary and inappropriate for this solicitation.

19 **Q. Why?**

20 A. While Staff is committed to assisting the Commission in its efforts to transition to and
21 facilitate a robustly competitive wholesale electric market in Arizona, this is not the time
22 to adopt an expedited approval process. Staff believes that expedited contract approval is

1 not a necessary component in facilitating a robustly competitive wholesale electricity
2 market. This is especially true when viewed against two facts:

- 3 1. A backdrop of a wholesale market place, which is not workably competitive as
4 determined by this Commission in Order # 65154,
- 5 2. And the level of risk that ratepayers would be required to assume under the APS'
6 proposal.

7 In Staff's opinion, adoption of the APS proposal could result in rates that are not just and
8 reasonable. Staff would not be opposed to reconsidering this issue in subsequent
9 solicitations.

10 In light of the oversupply of generation that currently exists in Arizona, Staff believes that
11 in-state generators will be compelled to bid for APS' contestable load. Also, out of state
12 suppliers may find the solicitation process amenable and APS' contestable load desirable.
13 Consequently, expedited approval simply is not required to attract bidders at this time. In
14 this case, it would appear that APS is simply seeking to shift the risk of cost recovery
15 away from itself on to consumers.

16
17 **Q. Could adoption of the APS proposal result in adverse consequences to consumers?**

18 A. Yes, if adopted an expedited approval process may, inadvertently relieve the utility of its
19 responsibility to procure power in a prudent manner resulting in rates that are not just and
20 reasonable. Such a result would clearly not be in the public interest.

21 It is my understanding that currently APS procures its required resources without ACC
22 expedited approval. It would appear that APS is able to meet its service obligation and

1 remain financially viable. In Staff's opinion, APS has not made a compelling showing to
2 support expedited approval.

3 Staff's proposal in Track B leaves the utility with the ultimate decision-making authority
4 regarding its needs and the ultimate responsibility to act prudently.

5
6 **Q. Are there other concerns with Expedited or Pre-Approval Processes?**

7 Yes, in Staff's opinion, utilities must have sufficient incentive to procure power in a
8 prudent manner on behalf of its customers. An expedited or pre-approval process may
9 eliminate prudency reviews, a very necessary incentive.

10
11 **Q. Do you have any further thoughts on this matter?**

12 A. Yes, in Staff's opinion an expedited approval process may short change or limit the
13 Commission's opportunity to thoughtfully and completely examine both the process and
14 the results emanating therefrom. I would think that in the initial solicitation the
15 Commission would decide to retain utmost flexibility such that it is not limited in its
16 abilities to effectuate remedies or make course adjustments as may be necessary. This
17 would seem most appropriate based upon the fact that this will be the first time that the
18 Commission has ventured down this path. Retaining flexibility would seem to be critical
19 at this juncture.

20
21 **Q. Do you think expedited approval is necessary for competition to develop and**
22 **succeed?**

1 A. Not in my opinion. It has been my observation that industries that are competitive operate
2 effectively without guarantees of cost recovery. For example, when an automobile
3 manufacturer enters into a contract to buy parts from a supplier neither the manufacturer
4 nor the supplier has any guarantee that the cost of the contract will be recovered. In spite
5 of this uncertainty, competition is quite vibrant within the highly capital intensive
6 automobile industry.

7

8 **PRICE TO BEAT**

9 **Q. Can you explain the genesis of the Staff's "Price to Beat" concept?**

10 A. As more fully discussed in the testimony of Staff witness Alan Kessler, the price to beat
11 was a compromise proposed by Staff. During the workshops, it was apparent that the
12 utilities and merchants favored expedited review or pre-approval of their power
13 agreements. Staff proposed the price to beat concept as a compromise position: that
14 would provide some assurance to the utilities and merchants within certain parameters
15 while avoiding the pitfalls of pre-approval.

16

17 **Q. At page 8, lines 13-24 of his testimony, Mr. Wheeler criticizes Staff's intent not to**
18 **disclose the price to beat. Can you comment on this?**

19 A. First, I would like to point out that Mr. Wheeler's assertion that the price to beat could be
20 revealed at some "...future moment to support disallowance of power costs for which the
21 utility was already contractually committed..." is not consistent with Staff's position.
22 Staff believes that revealing the price to beat before contracts are executed could adversely
23 influence bids and that disclosure subsequent to bidding but before contracting could

1 possibly skew the selection process. Staff did not view either possible outcome as
2 desirable or consistent with the public interest.

3

4 **Q. Are there any changes to the price to beat concept that you would like to propose?**

5 A. Yes, as indicated in Staff testimony, the price to beat was put forward as an
6 accommodation or compromise to address the concerns expressed by the utilities and
7 merchants. It was the Staff equivalent of an 'olive branch.' It would appear that to some
8 parties Staff's proposal is too problematic or undesirable.

9 Therefore, at this time the Staff respectfully withdraws its proposed price to beat and
10 would urge the Commission not to pre-approve or provide for expedited contract approval
11 because such a course of action could subject ratepayers to significant unknown economic
12 harm without adequate recourse.

13 **Q. Does this conclude your testimony?**

14 A. Yes, it does.

15

KESSLER

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL

Chairman

JIM IRVIN

Commissioner

MARC SPITZER

Commissioner

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TRACK B REBUTTAL TESTIMONY

OF

ALAN KESSLER

ON BEHALF OF

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

November 18, 2002

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1 **Q. Please state your name and business address.**

2 A. Alan Kessler, 244 N. Main Street, Concord, NH 03301

3

4 **Q. By whom are you employed and in what capacity?**

5 A. I am a Managing Director of Accion Group, Inc., a consultancy providing
6 regulatory, strategic, operational and financial advisory services to a broad range
7 of clients, including electric, gas, and water utilities, regulatory agencies, and
8 other organizations involved in utility-related matters. My responsibilities include
9 coordinating our practice activities relating to services we provide in planning and
10 regulatory matters, as well as in business organizational issues.

11

12 **Q. Please discuss your educational background.**

13 A. I graduated from the City College of New York in 1969 with a B.S. degree in
14 Economics. In 1975, I was awarded a J.D. degree by Capital University. I have
15 also done graduate studies in Economics at the Massachusetts Institute of
16 Technology. Since graduation, I have continued my education by taking
17 professional education courses in finance, law, and economics.

18

19 **Q. Please discuss your professional experience.**

20 A. After graduation from the City College of New York, I was employed by the
21 Columbia Gas System as an economic analyst assigned to financial and asset
22 acquisition issues. Subsequent to law school, I was employed by the Public
23 Utilities Commission of Ohio as a hearing officer where I presided over rate, fuel
24 clause, and quality of services cases for electric, gas and telephone companies. In
25 1978, I joined the law department of Ohio Power Company where I was
26 responsible for all of the company's regulatory litigation. I was promoted to

1 General Counsel in 1984. In 1987, I joined the Utilities Consulting practice of
2 Ernst & Young, where I focused on advising clients on issues related to
3 financially distressed utilities. In 1998, I joined Deloitte Consulting, specializing
4 in mergers and acquisitions and regulatory matters. In 2002, I co-founded Accion
5 Group, Inc., my current employer.

6

7 **Q. Have you ever testified before any regulatory agencies prior to this**
8 **testimony?**

9 **A.** Yes. I have previously testified before the Vermont Public Service Board, the
10 New Hampshire Public Utilities Commission, the Public Utilities Commission of
11 Ohio, and the Federal Energy Regulatory Commission (FERC). Additionally, I
12 have testified on utility-related matters in bankruptcy court and before the New
13 Hampshire and Ohio legislatures. I have also advised clients on regulatory
14 matters before the utility regulatory authorities of New York, Michigan, Missouri,
15 Kansas, Virginia, Pennsylvania and California.

16

17 **Q. Would you please describe your role in the Track B proceedings?**

18 **A.** Accion Group, Inc. was retained by the Staff to assist in planning and facilitating
19 the four Track B workshops and to advise the Staff on matters relating to the
20 operations of competitive wholesale markets. Our assistance included advising
21 the Staff on the different approaches to conducting solicitations for wholesale
22 power employed in various markets, and how other regulatory bodies monitor
23 competitive solicitation processes. We assisted the Staff in preparing the Staff
24 Report that was issued on October 25, 2002. I participated in each phase of our
25 engagement and attended each workshop held.

26 **Q. Are you sponsoring the Staff Track B Staff Report?**

27 **A.** Yes, I am one of three witnesses sponsoring the Track B Staff Report.

1 **Q. What is the purpose of your Rebuttal Testimony?**

2 A. Several witnesses have expressed concerns relating to the Staff's proposed use of
3 a "price to beat." I will explain why the Staff proposed the approach and the
4 purpose to which the Staff intended to use the "price to beat" concept. I will
5 discuss APS' and TEP's approach to quantifying their unmet capacity and energy
6 needs, as presented in the Needs Assessments they filed on November 4, 2002.
7 Also, my testimony presents an amendment to the Staff Report that should be
8 considered by the Commission. This change results from discussions held at the
9 Workshop conducted on November 6, 2002, after the issuance of the Staff Report.
10 The amendment will clarify the Staff's position on the issue of how to define
11 "unmet needs." Finally, I discuss the Staff's position regarding communications
12 among the utilities, the Staff, the Independent Monitor, potential bidders, and
13 other persons having an interest in the solicitation process. Finally, I address the
14 Staff's position on issues raised regarding how renewable energy resources should
15 be treated in the initial solicitation.

16
17 **Q. Please summarize the workshop process and its impact on the Staff's
18 proposed solicitation process.**

19
20 A. Through the workshop process, the Staff successfully forged agreement among
21 the parties on nearly all of the issues surrounding a competitive solicitation. It is a
22 credit to all those involved that they came together to provide a consensus on
23 what would produce the best solicitation approach.

24 As the testimony of the parties shows, disagreement remains on a few important
25 points, such as how the amount of the solicitation will be determined and whether
26 pre-approval will be granted by the Commission.

27

1 **Q. How was the Staff solicitation proposal developed?**

2

3 **A.** The Staff used the workshops to first identify and then narrow the issues that
4 needed to be addressed in creating a competitive solicitation process. Next the
5 Staff circulated a draft proposal for comments from the workshop participants,
6 and conducted an additional one-day workshop to refine concerns of the parties
7 and provide an opportunity for the parties to reach agreement. Finally, the Staff
8 revised its solicitation proposal to incorporate workshop comments, and released
9 it to the parties.

10

11 **Q. Please discuss why the Staff proposed the use of a “price to beat.”**

12

13 **A.** Several workshop participants, including the utilities, sought an assurance that the
14 power contracts resulting from a solicitation would receive pre-approval by the
15 Commission through the use of an expedited prudence review. The utilities
16 wanted to mitigate the risk of a future disallowance of some or all of the cost of
17 purchase power. The merchants sought regulatory approval in order to make it
18 easier for them to assign the power contract proceeds as a financing tool.

19 The Staff believed that such a process was, and still is, unworkable because this
20 Commission is unfamiliar with the operation of competitive wholesale power
21 markets, and time is required for careful review of the reasonableness of the
22 Utilities’ decisions before full approval can be granted. In particular, the Staff
23 believes that both the bids selected and the reasonableness of each utility’s power
24 supply portfolio resulting from the addition to its existing power supplies of the
25 supplies selected will need thorough review. It is the Staff’s opinion that the
26 expedited approvals sought could not be issued in the time frame proposed

1 without unduly compromising its ability to conduct a meaningful analysis of the
2 complex issues that arise from redesigning a power supply portfolio.

3 At the same time, the Staff understands the parties' desire to have some indication
4 of the likelihood that specific contracts will not be challenged by the Staff when
5 the utility seeks to recover its costs from consumers. To address that need, the
6 Staff proposed to accept as reasonable, without further analysis, the prices
7 contained in specific contracts if they met certain conditions and were at prices
8 below the Staff's "price to beat." As proposed, the Staff would determine the
9 "price to beat" before bids were selected, based on the Staff's review of historic
10 and forecast market prices for delivery of capacity and energy in Arizona.

11 While the Staff Intention was to support contracts meeting the "price to beat", the
12 Staff did not propose finding all other contracts unreasonable or imprudent.
13 Rather, the Staff reserved judgment so it could, in a thoughtful manner, consider
14 whether the utility exercised reasonable business judgment and whether, when
15 taken as a whole, the utility's power supply portfolio was appropriate.

16
17 **Q. Why did the Staff decide not to disclose the "prices to beat" it established?**

18
19 **A.** The Staff chose not to disclose its "prices to beat" because such a disclosure could
20 bias the decision making process. If the "price to beat" is disclosed prior to
21 bidding, bidders are likely to use it as a target price. If it is disclosed subsequent
22 to bids being submitted but prior to contracts being entered, the utilities may skew
23 their selection to gain the Staff's support. Either result would diminish the
24 effectiveness of the solicitation process. Therefore, the Staff decided not to
25 disclose its "prices to beat", but rather proposed to simply announce which
26 selected bids met the "prices to beat" criteria.

27

1 **Q. Do the parties to Track B agree with the Staff's proposal?**

2

3 **A.** Based on the testimony of several parties, apparently not. Several would require
4 the Staff to disclose the "prices to beat," others believe it will be extremely
5 difficult to establish "prices to beat" while others apparently believe the Staff
6 proposal is inadequate to provide the assurances they seek.

7

8 **Q. Do utilities presently have their power supply purchases pre-approved by**
9 **this Commission?**

10

11 **A.** To the best of my knowledge, Arizona utilities presently do not have their power
12 supply contracts, or other contracts for goods or services, pre-approved by this
13 Commission. Rather, they exercise their business judgment and enter such
14 contracts in the normal course of business. Those contracts are generally only
15 reviewed at such time as their reasonableness is contested.

16

17 **Q. Which Staff witness will testify on the Staff's current proposal regarding**
18 **regulatory approvals?**

19 **A.** Mr. Johnson of the Staff addresses this issue in his filed testimony.

20

21 **Q. How does the Staff define the unmet needs for utilities?**

22

23 **A.** It is the Staff's belief that unmet needs should be defined as the difference
24 between a utility's capacity and energy requirements, and the amount of capacity
25 and energy that it has available to it at reasonable and competitive cost.

26

27 **Q. Please explain how the Staff determined the unmet needs of APS and TEP.**

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A. As explained in the Staff Report at Page 7, the estimates contained in the Staff Report were based on information provided to the Staff by the utilities during the August workshops. The Staff used the capacity requirement and an average system capacity factor provided by the utilities to develop the estimate of unmet needs as presented in the Staff report. The Staff did not attempt to establish precise estimates of the contestable capacity or energy requirements for either utility because unmet needs are fluid. Under the Staff's approach, contestable load and energy would be adjusted during the Pre-Solicitation phase of the process to accommodate changes in projected load and system economics. Final unmet needs are expected to be quantified prior to the issuance of the initial solicitation.

Q. Did the utilities adopt that definition in preparing their needs assessments filed November 4, 2002?

A. No. In particular APS defined unmet needs as the difference between its forecast load and all capacity and energy it was physically capable of producing, irrespective of the cost of that generation.

Q. Did this create a significant difference between what the Staff proposed as unmet needs and what APS proposed?

A. Yes. The current APS approach significantly reduced the amount of energy APS proposed to solicit from what the company identified during the workshop.

Q. Would the APS approach mean that APS would not competitively acquire any significant amount of energy in the 2003 solicitation ?

1

2 A. No. According to Mr. Carlson, APS would probably acquire a significant amount
3 of its energy requirement through competitive solicitations for both short-term
4 and economy energy. Mr. Carlson claims APS' approach would meet all of APS'
5 unplanned needs and that the as yet undefined subsequent competitive solicitation
6 for economy energy would displace higher cost APS generation when
7 opportunities to do so occurred.

8

9 **Q. How did APS propose to acquire that energy?**

10

11 A. APS proposed to acquire capacity and energy to cover what they call unplanned
12 needs and to purchase economy power, as it has in the past, by relying on the spot
13 market.

14

15 **Q. Does the Staff disagree with this approach?**

16

17 A. Not if the utilities make every effort to first solicit for all their unmet needs,
18 including an amount equal to or greater than their anticipated economy energy
19 requirements, in a fair and transparent solicitation.

20

21 **Q. Then why is there a dispute between the utilities and the Staff regarding the
22 level of unmet needs to be solicited in this initial solicitation?**

23

24 A. The Staff believes that for the initial solicitation each utility should seek bids for
25 all of the capacity it reasonably expects it will need for the periods it believes are
26 reasonable and for all of the energy it expects to purchase from third parties, in

1 order to determine market prices for both capacity and energy and to then assess
2 the risks of alternative supply scenarios.

3 The Staff believes the first solicitation should include (1) all of the additional
4 capacity, including reserves, the utility expects it will need for the periods
5 covered by the solicitation, and (2) all of the energy the utility expects to purchase
6 from third parties for specified time periods. Once bids are received, the utility
7 will be responsible for assessing the risks of accepting each alternative supply
8 scenario. In contrast, APS wants to solicit the capacity it will need, and then
9 procure short term and anticipated economy energy purchases from the spot
10 market, without evaluating the potential benefit of contracting for all unmet
11 energy needs.

12
13 **Q. Is there a fundamental difference between the Staff's proposal and the**
14 **utilities' approaches?**

15
16 **A.** Interestingly, there is not a fundamental difference. As APS witness, Mr. Carlson
17 stated, APS plans to solicit for three products: capacity only, capacity with
18 minimal energy, and physical "call" options. He also noted that subsequently and
19 as circumstances dictated APS would purchase economy energy.

20 The Staff believes that, in addition to the products APS proposes to solicit bids
21 for, it should also solicit bids for firm energy and dispatchable energy (whether
22 coupled with bids for capacity or not) in an amount equal to its total unmet needs
23 as defined by the Staff and as finally determined during the pre-solicitation phase
24 of the process proposed by the Staff.

25
26 **Q. What is the benefit of the approach supported by the Staff?**
27

1 A. First, it is important to remember that the Staff has taken the position that this
2 process is intended to enable each utility to manage its power supply portfolio in a
3 reasonable manner. The process is not intended to relieve the utilities of their
4 obligation to manage their businesses in a prudent manner, nor is it intended to
5 deprive the utilities of the means and flexibility they need to do so. Soliciting for
6 all of the energy reasonably expected to be purchased from third parties, that is to
7 say unmet needs as defined by the Staff, during the initial solicitation does not
8 obligate the utilities to purchase all of the power sought during the solicitation.
9 As the Staff clearly stated in its Staff Report at Page 16, the utilities have the right
10 to reject all bids if, based on a reasonable rationale, their opinion is that the bids
11 do not meet the needs of the utility and are not in the best interests of consumers.
12 For instance, a utility soliciting firm or dispatchable energy may find that firm
13 energy is available at prices that make the potential benefits of the spot market,
14 with its price volatility, unattractive. The utility may also find that dispatchable
15 energy is available at prices below the utility's marginal costs of generation.
16 Locking in that dispatchable energy during the initial solicitation will assure some
17 consumer benefits and still maintain the flexibility to go to the economy market
18 when circumstances dictate.

19 **Q. That sounds like a very different approach than the one presented by APS.**
20 **Is it?**

21
22 A. Not really. Mr. Carlson proposed a solicitation for call options on energy.
23 Call options as Mr. Carlson explains, give the Utility the right to take capacity and
24 energy at predetermined prices when it chooses consistent with the terms of the
25 option. In other words, the utility can in effect dispatch the capacity and energy.
26 Options are in fact a financial proxy for a contract for dispatchable energy.
27

1 **Q. Has the Staff recalculated its estimate of APS' and TEP's unmet energy**
2 **needs?**

3
4 **A.** We are still in the process of completing that analysis and will provide that
5 information as soon as it is available.

6
7 **Q. Does the Staff dispute APS' or TEP's quantification of their unmet capacity**
8 **needs?**

9
10 **A.** Yes. APS has quantified its needs based on a reserve level reflecting reserves
11 associated only with APS generation. They argue that firm capacity acquired
12 from third parties will provide reserves and therefore APS will not need to solicit
13 for those reserves. In effect, that approach limits APS' ability to decide when it is
14 most cost efficient to take and pay for reserves offered by bidders, and what cost
15 savings would be realized by APS providing its own reserves.

16 As Dr. Roach observed, reserves provided by bidders could easily be counted
17 against unmet needs. Recognizing bidders' reserves will also make it easier for
18 the Staff and the Independent Monitor to compare the merits of alternative bids as
19 the evaluation of bids is conducted.

20 The Staff also has concerns relating to the RMR capacity and energy needs
21 quantified by both APS and TEP. These concerns are addressed by Mr. Smith in
22 his testimony.

23
24 **Q. You mentioned earlier that you would present a change to the Staff Report.**
25 **Could you please identify that change and explain why it is being proposed?**

26

1 A. Yes, at Page 4 of the Staff Report, the Staff would insert the word “economically”
2 on line 20 before the word “served.” The Staff proposes this change to make it
3 clear that during the development of the solicitation process, the Staff’s intention
4 was to have the vast majority of reasonably expected purchases of capacity and
5 energy acquired through the process proposed by the Staff. The Staff was clear
6 that only power, capacity and/or energy to meet “unplanned needs” would be
7 acquired outside the process. Obviously, the utilities plan to make economy
8 purchases. After they conduct the initial solicitation and acquire all the capacity
9 and energy they deem to be appropriate as a result of that solicitation, they should
10 still take advantage of economy purchases if, and as, they are available. The Staff
11 believes the amount of anticipated economy energy should be solicited on a firm
12 or dispatchable basis, and then evaluated by the utility based on the information it
13 will acquire as a result of the solicitation, to determine whether contracts for
14 power are better alternatives than reliance on spot markets. As stated before, the
15 utility remains responsible for making, and justifying, Its decisions when
16 evaluating bids.

17
18 **Q. Several parties expressed concerns over how open the Staff’s process was**
19 **and how parties would communicate with the Staff, the Independent**
20 **Monitor, and the utilities. Would you care to comment on those concerns?**

21
22 A. Yes. The Staff made every effort to ensure that the process would be as
23 transparent as possible and as accessible to all parties as they could make it. The
24 Staff proposal was developed with the assistance of the workshop parties.
25 Particular interest was paid to transparency and preventing any potential bidder
26 from gaining an unfair advantage, especially utility affiliates.

1 The Staff's process is designed to encourage open and frank discussion of issues
2 as they arise. It is not the Staff's intention to hinder, in any way, the free flow of
3 conversation between bidders and the utilities, the access to data made available
4 as a result of the solicitation, or the ability of non-bidding parties to attend or
5 participate in meetings held by the utility to discuss their proposed bid packages,
6 or to keep from the utilities concerns developed by the Staff or the Independent
7 Monitor during the solicitation process. On the contrary, as indicated in the Staff
8 Report, there are mandated information requirements for the solicitation and
9 informational meetings to discuss that data, and there are defined obligations of
10 the Independent Monitor to communicate with all parties, including the utilities.
11 There are also requirements that communications by and between utilities and
12 their merchant affiliates with regard to the solicitation be monitored and
13 restricted. Also, all bidders should have access to the same data, so all
14 communications between utilities and bidders will be made available to all
15 bidders on a web site. The Staff believes that the standards set out in its proposed
16 process will allow the process to progress in an orderly and appropriate fashion.

17
18 **Q. Mr. Kendall, representing Wellton-Mohawk Generating Facility,**
19 **recommended in his Direct Testimony (pages 4 and 5) that in the competitive**
20 **procurement process, utilities give additional credit to renewable resources**
21 **for their public benefits. What is the Staff's position on this issue?**

22
23 **A.** The Staff believes that bidders of renewable resources should be
24 allowed to bid in this initial solicitation and that utilities should not be required to
25 give credit for the value of the renewable resource to the utility in meeting the
26 Environmental Portfolio Standard. However, whether such credits should be

1 required in subsequent solicitations should be considered in any future review of
2 the process adopted.

3

4 **Q. On page 17 of his Direct Testimony, Mr. Kendall recommends that**
5 **renewable resources be specifically solicited in Track B and that separate**
6 **renewables-only solicitations may be held as needed. What is the Staff's**
7 **position on this issue?**

8

9 **A.** The Staff believes that the utilities may solicit renewable resource products
10 through the competitive procurement process. In addition, renewables-only
11 solicitations may be held. However, utilities should be allowed to solicit
12 renewable resource products in the initial solicitation.

13

14 **Q. Does that conclude your testimony?**

15

16 **A.** Yes, it does.

17

18

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27

J. SMITH

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL

Chairman

JIM IRVIN

Commissioner

MARC SPITZER

Commissioner

IN THE MATTER OF THE GENERIC)	DOCKET NO. E-00000A-02-0051
PROCEEDINGS CONCERNING ELECTRIC)	
<u>RESTRUCTURING ISSUES.</u>)	
IN THE MATTER OF ARIZONA PUBLIC)	DOCKET NO. E-01345A-01-0822
SERVICE COMPANY'S REQUEST FOR A)	
VARIANCE OF CERTAIN REQUIREMENTS OF)	
<u>A.A.C. R14-2-1606.</u>)	
IN THE MATTER OF THE GENERIC)	DOCKET NO. E-00000A-01-0630
PROCEEDINGS CONCERNING THE ARIZONA)	
INDEPENDENT SCHEDULING)	
<u>ADMINISTRATOR.</u>)	
IN THE MATTER OF TUCSON ELECTRIC)	DOCKET NO. E-01933A-02-0069
POWER COMPANY'S APPLICATION FOR A)	
VARIANCE OF CERTAIN ELECTRIC)	
<u>COMPETITION RULES COMPLIANCE DATES.)</u>	

TRACK B REBUTTAL TESTIMONY

OF

JERRY D. SMITH

ELECTRIC UTILITIES ENGINEER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

November 18, 2002

SUMMARY
TRACK B REBUTTAL TESTIMONY
JERRY D. SMITH
GENERIC ELECTRIC RESTRUCTURING DOCKET
DOCKET NO. E-00000A-02-0051, ET. AL.

Mr. Smith's Track B rebuttal testimony identifies discrepancies and omission of RMR capacity and energy figures in the APS and TEP Track B needs assessment filings. In addition, he restates Staff's position regarding when RMR capacity and energy are legitimately contestable. Mr. Smith's testimony concludes with a Staff recommendation of including APS and TEP RMR capacity and energy in the contestable load tables of Staff's Track B report. He also recommends that the RMR Study results filed by APS and TEP with the Commission by January 31, 2003, should be used to adjust Staff's recommended contestable load offered in Track B.

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Local Transmission Import Constraints	2
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1 **INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. Jerry D. Smith, 1200 West Washington, Phoenix, Arizona 85007.

4
5 **Q. By whom are you employed and in what capacity?**

6 A. I am employed by the Arizona Corporation Commission (“Commission”) as an Electric
7 Utilities Engineer for the Utilities Division.

8
9 **Q. Please summarize your educational background.**

10 A. I graduated from the University of New Mexico with a Bachelor of Science degree in
11 Electrical Engineering. I received a Masters of Science degree in Electrical Engineering
12 from New Mexico State University majoring in power systems and electric utility
13 management.

14
15 **Q. Do you hold any special licenses or certificates?**

16 A. I am licensed with the State of Arizona as a Professional Engineer - Electrical.

17
18 **Q. Have you previously submitted testimony on behalf of Arizona Corporation
19 Commission Staff in Track A and Track B proceedings?**

20 A. Yes, I have. I submitted direct and rebuttal testimony in Track A proceedings and
21 contributed to the Staff Report filed in both the Track A and Track B proceedings.

22
23 **Q. Did you participate in the Track B workshops?**

24 A. Yes, I attended and participated in each of the Track B workshops.

25
26 **Q. Are you sponsoring the Track B Staff Report, which was filed on October 25, 2002?**

27 A. Yes, I am one of the three witnesses sponsoring the Track B Staff Report.

1 **PURPOSE OF REBUTTAL TESTIMONY**

2 **Q. What is the purpose of your rebuttal testimony in these proceedings?**

3 A. My rebuttal testimony will respond to specific segments of Track B direct testimony
4 provided by Peter M. Ewen, David Hutchens, Dr. Craig Roach, Curtis L. Kebler, and
5 Robert W. Kendall. My rebuttal testimony focuses on the following topics:

- 6 1. Local service area transmission import constraints for the Arizona Public Service
7 Company (“APS”) and Tucson Electric Power (“TEP”);
8 2. Reliability Must-Run (“RMR”) generation requirements associated with the above
9 transmission import constrained areas; and
10 3. Staff recommended treatment of RMR capacity and energy requirements in the
11 competitive solicitation process.

12
13 **Q. Please summarize the contents of your rebuttal testimony.**

14 A. My testimony identifies discrepancies and omission of RMR capacity and energy figures
15 in the APS and TEP Track B needs assessment filings. In addition, I restate Staff’s position
16 regarding when RMR capacity and energy are legitimately contestable. My testimony concludes
17 with a Staff recommendation of including APS and TEP RMR capacity and energy in the
18 contestable load tables of Staff’s Track B report. I suggest the RMR Study results filed with the
19 Commission by January 31, 2003, should be used to adjust the recommendation about
20 contestable load offered by Staff in Track B.

21
22 **LOCAL TRANSMISSION IMPORT CONSTRAINTS**

23 **Q. Please describe how transmission constraints impact the “contestable capacity and
24 energy” levels procurable from the competitive wholesale market.**

25 A. Transmission constraints limit what capacity and energy can be delivered from particular
26 generators over particular lines to the intended load. Furthermore, a Reliability Must-Run
27 (RMR) condition exists, for a geographic area, during any period of time that local load
28 exceeds the transmission import capability for that local area. When that occurs, the load

1 serving utility must rely upon local generating units to serve the amount of load that
2 exceeds the local transmission import limit. When determining how much energy and
3 capacity should be procured by competitive solicitation, it is necessary to (i) accurately
4 define the extent of transmission constraints, (ii) determine what hours of the which days
5 the constraints occur, and (iii) what generating units can meet RMR requirements.

6
7 **Q. How is this relevant to this proceeding?**

8 A. In the case of APS, the utility has suggested that only units it owns can meet RMR
9 needs, though the company has agreed to entertain bids for RMR service. The result is
10 the utility claiming that RMR capacity and energy should not be considered contestable
11 when procuring capacity and energy from the competitive wholesale market. This
12 approach has the potential to diminish the benefits to be derived from competitive
13 bidding, and serve to encourage the utility to continue using generating plants within a
14 constrained area, and not looking to meet system needs from cheaper and cleaner sources.

15
16 **Q. APS and TEP filed needs assessments in accordance with the third procedural order
17 on Track B issues dated October 9, 2002. Have APS and TEP accurately defined
18 their transmission import constraints for their respective local service areas in their
19 needs assessments?**

20 A. There are inaccuracies in the transmission import limits reported by APS. Mr. Peter Ewen
21 identifies the APS transmission import limit for metro Phoenix as being 3535 MW from
22 2003 through 2012.¹ This import capacity assumes 600 MW of additional APS
23 transmission import capacity resulting from construction of the Palo Verde to Rudd 500
24 kV line by the summer of 2003. However, Staff confirmed with APS and SRP during the
25 October 18th 2002 Biennial Transmission Assessment workshop that only half of that
26 import capacity addition would actually be realized. Similarly, it was confirmed that APS
27 would share in each 600 MW transmission import capacity increase assumed to result
28

¹ Work Papers, APS Metro Phoenix Reliability Must Run Estimates, Peter M. Ewen, November 4, 2002, page 76.

1 from the addition of the Palo Verde to Southeast Valley 500 kV line in 2006, and the Palo
2 Verde to Table Mesa 500 kV line in 2008. Neither of these two transmission import
3 improvements was acknowledged by Mr. Ewen in his Reliability Must Run Estimates. In
4 addition, Mr. Ewen ignored the transmission import constraints known to exist for APS'
5 Yuma service area.

6
7 Neither transmission import capacity nor RMR capacity and energy calculations were
8 included in TEP's needs assessment filed by David Hutchins on November 4.² Therefore,
9 Staff will use information about transmission import constraints for the Tucson area
10 presented by TEP throughout the electric restructuring proceedings and the Biennial
11 Transmission Assessment workshops. Its transmission import capability is dependent
12 upon the combination and output of local generating units in service.

13
14 **Q. What are the consequences of the local transmission import capacity inaccuracies**
15 **and omissions from the APS and TEP filed needs assessments?**

16 A. In the case of APS, it means the RMR capacity and energy is understated in 2003
17 through 2006 and overstated in later years. In other words, the unmet RMR capacity and
18 energy needs are similarly understated from 2003 to 2006 and overstated in later years. In
19 the case of TEP, it means we have no record of RMR capacity and energy components in
20 their needs assessment.

21
22 **RELIABILITY MUST-RUN GENERATION REQUIREMENTS**

23 **Q. Did Staff include RMR capacity and energy in the contestable capacity and energy**
24 **tables³ of its Track B Staff Report?**

25 A. No, we did not. Staff did not have adequately defined RMR capacity and energy numbers
26 available at the time of the report. Such information still is not available to Staff as stated
27

28

² Track B Needs Assessment and Procurement Proposal, David Hutchins, November 4, 2002.

³ Staff Report on Track B: Competitive Solicitation, October 25, 2002, page 7.

1 earlier in this rebuttal testimony. In fact, that is why Staff took particular steps to include
2 the deliverability qualifications section of our recommended solicitation process.⁴

3
4 **Q. Does Staff support the supposition that RMR capacity and energy should be
5 considered contestable for the 2003 competitive solicitation?**

6 A. Staff believes RMR capacity and energy should be considered contestable. Throughout
7 the Track B workshops, Staff has stated conditions under which RMR capacity and
8 energy could be contestable. Dr. Craig Roach has eloquently captured those conditions in
9 his testimony.⁵ RMR capacity and energy could be contestable if: 1) non-utility owned or
10 non-rate based generation units exist locally, 2) remote generation has access to non-APS
11 or non-TEP firm transmission capacity to delivery to the respective local area, or 3)
12 remote generation offers to finance transmission improvements to mitigate the
13 transmission import constraint. While the third condition may not be achievable within
14 the early years of the 2003 solicitation, it may be feasible for the later years.

15
16 **Q. Mr. Curtis L. Kebler expressed concerns about the RMR hours, capacity and
17 energy not being known until a decision in the Track B process is rendered.⁶ Does
18 Staff share this concern?**

19 A. Yes, we do. However, transmission providers have committed to an RMR Study Plan that
20 will be documented in the 2002 Biennial Transmission Assessment. That commitment
21 includes an agreement to perform RMR Studies for years 2003-2007 to be filed with the
22 Commission in January 2003. The identification of RMR hours, capacity and energy is
23 one of the study requirements. Refinement of the transmission import limitation is also a
24 requirement of that study. The resulting study information will then be available to
25 incorporate in the pre-solicitation activities of the 2003 competitive solicitation process.

26
27
28 ⁴ Ibid, pages 15 and 18.

⁵ Testimony of Dr. Craig R. Roach, TECO/Panda Gila River, November 12, 2002, page 27.

⁶ Direct Testimony, Reliant Resources, Curtis L. Kebler, November 12, 2002, page 16.

1 **Q. Mr. Robert Kendall suggests that the competitive solicitation process is an ideal**
2 **mechanism to use to identify any generation solutions that could help resolve local**
3 **transmission import constraints and associated RMR conditions.⁷ Does Staff agree?**

4 A. Yes, Staff agrees with Mr. Kendall on this point. In fact, his reference to Track A
5 Decision No. 65154 ordering that APS and TEP work with Staff to develop a study plan
6 to resolve RMR generation concerns and include the resulting plans in the 2004 Biennial
7 Transmission Assessment is on point. Including RMR capacity and energy as contestable
8 load in the 2003 competitive solicitation will offer a market response reference for Staff
9 regarding the relative economic and environmental merits of generation solutions to the
10 transmission import constraint. Such a comparison is most important before finalizing the
11 ten-year RMR study plan results to be incorporated into the 2004 Biennial Transmission
12 Assessment.

13
14 **TREATMENT OF RMR IN CONTESTIBLE LOAD DETERMINATION**

15 **Q. How does Staff propose RMR capacity and energy be handled in the contestable**
16 **load determination?**

17 A. Staff recommends that APS and TEP RMR capacity and energy be added to the
18 contestable load tables provided at page 7 of the Track B Staff Report.

19
20 **Q. How does Staff propose to determine what quantity of APS and TEP RMR capacity**
21 **and energy should be included in Staff's definition of contestable load for the 2003**
22 **competitive solicitation?**

23 A. Staff agrees with Mr. Ewen that his metro Phoenix RMR figures should serve as a place
24 holder until completion of the RMR study to be filed with the Commission by January 31, 2003.⁸
25 The capacity need identified as "RMR Need" and the energy identified as "Total Energy" in Mr.
26 Ewen's Metro Phoenix Reliability Must Run Estimates should be used for this purpose.⁹ Staff's
27

28 ⁷ Direct Testimony, Welton-Mohawk Generation Facility, Robert W. Kendall, November 12, 2002, page 24.

⁸ Track B Testimony, APS, Peter M. Ewen, November 4, 2002, page 21.

⁹ Work Papers, APS Metro Phoenix Reliability Must Run Estimates, Peter M. Ewen, November 4, 2002, page 76

1 Track B contestable recommendation should include these RMR figures. As the RMR Study for
2 the Phoenix area progresses, the APS transmission import capacity and contestable RMR figures
3 should be adjusted accordingly.

4
5 In addition, APS should develop similar RMR figures for the Yuma area. Similarly, TEP
6 should develop RMR figures for the Tucson area. The basic foundation of this information, at
7 least the RMR capacity number is available from the Biennial Transmission Assessment. It is
8 Staff's opinion that such numbers should be developed early in the required RMR study effort
9 and should be added to the contestable load quantities approved by the Commission in Track B.

10
11 **Q. How does Staff recommend RMR conditions should be administered?**

12 A. Staff recommends that APS and TEP should administer RMR conditions in accordance
13 with applicable Arizona Independent Scheduling Administrator (AzISA) or WestConnect
14 protocol approved by FERC.

15
16 **Q. Does that conclude your testimony?**

17 A. Yes.
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