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BEFORE THE ARIZONA CORPORATION COMMISSION

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

DOCKET NO. E-00000A-02-0051

10 IN THE MATTER OF ARIZONA PUBLIC
11 SERVICE COMPANY'S REQUEST FOR
12 VARIANCE OF CERTAIN REQUIREMENTS OF
13 A.A.C. 4-14-2-1606

DOCKET NO. E-01345A-01-0822

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

DOCKET NO. E-00000A-01-0630

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

DOCKET NO. E-01933A-98-0471

22 ISSUES IN THE MATTER OF TUCSON
23 ELECTRIC POWER COMPANY'S
24 APPLICATION FOR A VARIANCE OF
25 CERTAIN ELECTRIC COMPETITION RULES
26 COMPLIANCE DATES.

DOCKET NO. E-01933A-02-0069

MOTION OF
ARIZONA PUBLIC SERVICE COMPANY
FOR DETERMINATION OF THRESHOLD ISSUE

Arizona Public Service Company ("APS") hereby submits this Motion and respectfully requests that the Arizona Corporation Commission ("Commission") promptly

1 decide the critical threshold questions described below concerning the direction that this
2 Commission intends to take on Retail Electric Competition. These questions would exist
3 irrespective of and independent from the outcome of APS' pending Request for a Partial
4 Variance. APS further requests that the Chief Administrative Law Judge establish a
5 procedural schedule in the Generic Electric Restructuring Docket, Docket No. E-00000A-
6 02-0051 ("Generic Docket"), to set a course towards resolving each of the principal
7 recommendations identified in Staff's March 22, 2002 Report in the Generic Docket
8 ("Staff Report").
9

10 I. INTRODUCTION.

11 Over six months ago, APS filed its Request for a Partial Variance to Rule 1606(B)
12 in Docket No. E-01365A-01-0822, which is scheduled for a hearing commencing on April
13 29, 2002.¹ Contrary to the positions take by some in reaction to that filing, APS did not
14 ask the Commission to change the competitive model established by the Retail Electric
15 Competition Rules. Rather, APS' request addresses only "how much" and "how fast" the
16 transition to competitive acquisition of power for APS Standard Offer customers would
17 occur at the wholesale level.² APS has never argued, and does not argue now, that the
18 Commission should retreat from the core competitive market model that it adopted and
19 affirmed in decision after decision starting back in 1996.

20 APS' goal in filing the Request for a Partial Variance was to protect its Standard
21 Offer customers without impeding the continued development of a competitive wholesale
22 market. The Company has repeatedly stated that if the Commission determines that the
23 requested partial variance and proposed Purchase Power Agreement are not in the best

24 _____
25 ¹ APS is not in any way suggesting in this Motion that the April 29, 2002 hearing be delayed.

26 ² APS is not speaking for any of the other Affected Utilities, although most of them are already
exempt from Rule 1606(B).

1 interests of APS' Standard Offer customers, then the Company will proceed with the
2 divestiture of its generation and with good faith compliance with Rule 1606(B) as written.
3 It is, after all, the Commission that is ultimately accountable to the citizens of Arizona,
4 just as APS has a responsibility for protecting the interests of its customers and
5 shareholders.

6 However, based on comments in the Staff Report and the current absence of any
7 timetable or plan to resolve what appear to APS to be fundamental questions on Retail
8 Electric Competition, APS is becoming increasingly concerned that the Commission's
9 focus is being diverted by the details, rather than the fundamental policy choice that either
10 needs to be reconfirmed or, with appropriate consideration, reversed. That threshold
11 policy choice is straightforward—do we continue towards Retail Electric Competition or
12 does the Commission reverse course and return to traditional cost-of-service monopoly
13 regulation. The answer, of course, is more complex than the question, but it must be made
14 promptly and fairly so that affected parties can take those steps necessary to implement
15 the Commission's decision.

16 17 **II. APS' SCHEDULE FOR COMPETITIVE BIDDING**

18 Given the Commission's and APS' mutual obligation under the Settlement
19 Agreement relating to the transfer of APS' generation assets no later than the end of 2002,
20 the answer to the threshold question posed above must be at hand no later than September
21 1, 2002. Accordingly, in addition to proposing a plan to address the six issue areas
22 identified by Staff in the Staff Report, which is discussed in more detail in Section IV
23 below,³ APS intends to submit the 30-day letter regarding the asset transfer on

24 ³ APS is not requesting Commission approval of the schedule set forth in this Section II. What is set
25 forth in this section is simply intended to advise the Commission of the schedule that APS plans to pursue
26 irrespective of the resolution of APS' Request for a Partial Variance or proceedings in the generic docket.
Additionally, in part, this is intended to provide parties (including Staff) some degree of certainty as to
when APS intends to file the 30-day letter regarding the asset transfer.

1 approximately August 1, 2002 irrespective of whether the Commission has by then
2 decided APS' Request for a Partial Variance and irrespective of how it decides that
3 matter.

4 The Company will then proceed to issue an RFP (or RFPs) on September 1, 2002
5 for the procurement of Standard Offer power, to the extent it is then legally required to do
6 so. If the Request for a Partial Variance has been approved by that date, APS will issue an
7 RFP for the first 270 MW with implementation scheduled for January 1, 2003. If the
8 Request for a Partial Variance is denied or is not decided by September 1, 2002, APS will
9 issue an RFP or RFPs for at least the full 50 percent requirement specified in Rule
10 1606(B). Both of these RFP processes, of course, will be contingent upon the transfer of
11 APS generating assets to Pinnacle West Energy Corporation (PWEC") and the status of
12 the Electric Competition Rules at that time. PWEC will be invited to competitively bid
13 with its generating assets, including those to be transferred from APS. In either case, APS
14 intends to discuss with Staff and other consumer groups its plan for competitive bidding
15 and will consider the comments filed by the merchant generators in this consolidated
16 docket, but does not intend to promote a free-for-all among merchant generators
17 attempting to manipulate a competitive bid to suit their own commercial interests rather
18 than the best interests of APS' Standard Offer customers.

19 If, however, the Commission elects to reverse its course on Retail Electric
20 Competition or attempts to stay the transfer of APS' generating assets as recommended by
21 Staff, APS will not be subject to the competitive bidding requirements of Rule 1606(B),
22 which only apply to Utility Distribution Companies (i.e., utilities without generation).
23 Neither, in this event, would it have 50 percent of its Standard Offer load to bid.
24 Obviously, if APS is required to retain cost-of-service regulated generation, it would only
25 look to the market when it is short capacity or cannot economically self-supply its own
26 requirements. Additionally, APS would have to acquire any PWEC generating assets that

1 were built to serve APS customers to avoid continued bifurcated ownership of such
 2 reliability-related generation and the financing difficulties that result from such bifurcated
 3 ownership. A tabular summary of actions and outcomes reflecting each of these issues is
 4 provided below:

Commission Action	Competitive Bidding/Asset Transfer Outcomes
Approval of Partial Variance as proposed	<ul style="list-style-type: none"> • Bidding process discussed with Staff • APS transfers assets on or after 9/1/02 but before 12/31/02 • Proposed PPA entered between APS and PWCC • Competitive bidding for 270 MW on 9/1/02
Denial of Partial Variance	<ul style="list-style-type: none"> • Bidding process discussed with Staff • APS transfers assets on or after 9/1/02 but before 12/31/02 • Competitive bidding for at least 50 percent on 9/1/02 • Bilateral contracts or spot purchases for other requirements
Stay or Reversal of Asset Transfer	<ul style="list-style-type: none"> • Rule 1606(B) no longer applicable to APS • No competitive bidding required • APS acquires PWEC Dedicated Assets • Analysis of legal options, damages incurred by APS, PWCC, PWEC, and just compensation

21 22 III. 1999 APS SETTLEMENT AGREEMENT.

23 As the discussion in Section II illustrates, the Commission's evaluation in the
 24 Generic Docket must be grounded on not only the previous competition-related
 25 rulemaking decisions that it approved, but also the regulatory settlements into which it
 26 entered. APS has made significant sacrifices pursuant to and in reliance on its 1999

1 Settlement Agreement with the Commission and has incurred tens of millions of dollars of
2 additional costs associated with implementing the Electric Competition Rules. And, as
3 discussed below, APS' affiliate PWEC was created solely for the purpose and with the
4 expectation that it would receive APS' generation assets pursuant to the 1999 Settlement
5 Agreement. PWEC has committed to a \$1 billion investment in generating capacity that
6 neither it nor APS would have undertaken had it not been necessary to meet the APS
7 customer needs. Moreover, it was the Commission's explicit prohibition on APS
8 ownership of new generation set forth in Rule 1615 that required the formation of PWEC
9 to construct this needed capacity for APS' customers. Put simply, there is no "clean slate"
10 upon which to write "new" rules relating to competition without first settling existing
11 obligations.

12 With respect to the 1999 Settlement Agreement, APS has taken the following steps
13 pursuant to that agreement and the Commission's Electric Competition Rules:

- 14 • Written off \$234 million of prudently incurred costs;
- 15 • Reduced retail rates to date by roughly \$120 million in a still-ongoing series
16 of rate reductions;
- 17 • Created a generation company affiliate, PWEC, and hired and transferred
18 personnel to such affiliate, and to Pinnacle West Capital Corporation
19 ("PWCC") Marketing and Trading, to effect the required separation of
20 competitive assets;
- 21 • Dismissed its legal challenges to the Electric Competition Rules;
- 22 • Initiated negotiations with co-participants, fuel suppliers, governmental
23 entities, creditors, and others for consents relating to the transfer of APS'
24 generation;
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- Prepared and filed an application with the Nuclear Regulatory Commission for approval of the transfer of APS' share in the Palo Verde Nuclear Generating Station to PWEC;
- Obtained contingent credit ratings for PWEC from the three credit rating agencies premised on the assumption that PWEC would receive the APS generating assets; and
- Prepared appraisals, legal documents of transfer, and obtained Private Letter Rulings from the Internal Revenue Service relating to the asset transfer.

APS undertook all of these steps and provided its customers with rate reductions during a period in which many Western United States utility customers were experiencing rate shock and rolling blackouts.

Just as significant, however, is the \$1 billion commitment that PWEC made since the 1999 Settlement Agreement to construct generation to assure that APS customers enjoyed continued reliable electric service. When the Electric Competition Rules were adopted and APS was told it could no longer construct new generation, it was necessarily PWEC that constructed local generation within the Phoenix area, installed trailer mounted temporary and now permanent generation to provide needed peaking capacity to APS customers, and constructed Redhawk Units 1 and 2 to meet the needs of APS customers beginning this summer, bypassing the option to sell Redhawk into the rich California market. No other party stepped forward to undertake this reliability obligation for APS, and without this commitment APS customers would have faced last summer and would be facing this summer and next significant risk of curtailments. In addition, PWCC provided bridge financing for this construction program, with the understanding that PWEC would be able to secure its own long-term financing once the APS generating assets were transferred pursuant to the 1999 Settlement Agreement.

1 Thus, APS was disappointed with Staff's recommendation that the asset transfer
2 already approved by the Commission should be stayed or modified until at least the
3 completion of an as yet undetermined generic review. The Electric Competition Rules
4 never intended for generating assets to be bifurcated between PWEC and APS, and the
5 added financing costs associated with the continued bifurcation of generation asset
6 ownership between APS and the \$1 billion investment in generation by PWEC is
7 adversely affecting the financial integrity of both companies, as well as PWCC. In fact,
8 APS believes that if the Commission indeed reneges on its approval of the asset transfer,
9 the resultant financial impact could well result in a downgrade of both PWCC and APS by
10 its rating agencies,⁴ exacerbating the damages incurred by such a breach of the 1999
11 Settlement Agreement.

12 If, notwithstanding the Settlement Agreement, the Commission stays or refuses to
13 allow the transfer of APS' generation to PWEC, which would amount to a reversal of
14 course towards Retail Electric Competition, then the Commission would be legally
15 required to address just compensation to APS, PWCC and PWEC as well as be subject to
16 other appropriate remedies for breach of the Settlement Agreement in the Company's next
17 rate case. At a minimum, this would include (1) recognizing the transfer to APS of all
18 assets that PWEC constructed to meet APS' load-serving requirements, and subsequently
19 including such units in APS' rate base in accordance with traditional rate-of-return
20 regulation,⁵ (2) reversing APS' \$234 million write-off and providing for the recovery of
21 such amounts in future rates, and (3) providing for the recovery of all costs incurred as a
22 result of the transition to competition, including 100 percent of the costs incurred in

23 _____
24 ⁴ PWEC's investment grade rating, which was contingent on the asset transfer, would never
materialize, thus crippling its future, perhaps irreversibly.

25 ⁵ Although these reliability-related generating assets would increase the Company's rate base, they
26 would also offset significant purchased power expenses that APS would otherwise incur and have to
recover through rates.

1 preparation for divestiture (and not just the 2/3 permitted under the Settlement
2 Agreement). APS, however, believes that such a reversal in course is neither necessary
3 nor worth the costs to all involved.

4 Moreover, given the commitments and actions discussed above, APS does not
5 believe that simply delaying everything is an acceptable alternative. There is significant
6 concern in the financial community regarding the Commission's apparent or potential
7 change in direction with respect to the Electric Competition Rules and the 1999
8 Settlement Agreement. This uncertainty that the Commission has created regarding these
9 subjects itself threatens the bond ratings of the Company and its affiliates. Thus, APS
10 believes that Arizona can and should move forward towards Retail Electric Competition,
11 irrespective of the Commission's decision in APS' Request for a Partial Variance, by
12 adopting the procedural plan discussed below.

13 14 **IV. PROPOSED PROCEDURAL PLAN.**

15 APS recommends that the following procedural plan be adopted to address the
16 issues identified by Staff in its Staff Report and that such a plan proceed concurrently with
17 the procedural schedule for APS' Request for a Partial Variance. This plan is focused
18 around the six issue areas identified in the Staff Report, and is discussed in the same order
19 presented in the Staff Report, and will allow parties to take those steps necessary to make
20 real progress in implementing the principles of electric competition on a realistic but still
21 aggressive schedule while not upsetting the continuation of reliable, predictable, and
22 reasonably-priced Standard Offer Service to APS' customers.

23 **1. Market Power and Market Monitoring.**

24 With respect to wholesale markets, there is significant activity at the Federal
25 Energy Regulatory Commission ("FERC") dealing with these issues. FERC has issued
26 and is taking comment on its standard market design working papers for wholesale power

1 markets.⁶ It is expected this summer to commence the “GigaNOPR” rulemaking for
2 wholesale power markets that will necessarily impact wholesale market issues in Arizona.
3 Additionally, in Arizona the formation of the WestConnect Regional Transmission
4 Organization (“RTO”) and the continued implementation of FERC’s Order 2000
5 regarding RTO formation will affect wholesale power markets, specifically regarding
6 interstate transmission. Thus, many of the significant federal drivers affecting wholesale
7 power issues and market monitoring are still under development and are unlikely to be
8 implemented this year. Accordingly, the most appropriate course of action on this issue is
9 for the Commission to continue to actively monitor and participate in these issues at
10 FERC and before Congress, and to continue to review all jurisdictional public service
11 corporation filings at FERC on wholesale power issues. If and when the Commission
12 believes that action at the state level is necessary and appropriate on market power or
13 market monitoring issues, the Commission could respond specifically to such issues in the
14 then-current context. However, the federal issues probably need to develop further before
15 specific state action can be discerned or undertaken to complement for Arizonans the
16 future actions of FERC and, potentially, the Congress.

17 **2. Competitive Bidding.**

18 Regardless of the ultimate resolution of APS’ Request for a Partial Variance, a
19 competitive bidding process needs to be developed and implemented. APS intends to
20 issue an RFP (or RFPs) for competitive bidding no later than September 1, 2002. APS
21 will discuss this RFP with Staff and consumer groups, but does not intend to open the
22 competitive bidding plan for debate by those who would prefer to structure the process in
23 a way that suits their desires, rather than the best interests of APS’ customers. If the
24 Commission determined that a rulemaking was required to provide more definition to

25 ⁶ Federal Energy Regulatory Commission, *Working Paper on Standardized Transmission Service*
26 *and Wholesale Electric Market Design* (March 15, 2002); Federal Energy Regulatory Commission,
Options for Resolving Rate and Transition Issues (April 10, 2002).

1 Rule 1606(B), it could initiate such a proceeding which, pursuant to the Administrative
2 Procedures Act, would apply prospectively.

3 **3. Transfer of Generation Assets.**

4 Rule 1615 requires the separation of Competitive Services, including generation
5 assets, from Affected Utilities such as APS. In the 1999 Settlement Agreement and in
6 Decision No. 61973, the Commission approved the transfer of APS' generating assets and
7 Competitive Services to separate affiliates of APS. As discussed above, APS has
8 substantially relied on that approval, and that the Commission should not and legally
9 cannot now revoke the authority to transfer APS' generation assets. Further, the
10 Commission's decision that generation would be regulated by FERC under the Federal
11 Power Act, rather than by the state under cost-of-service principles, was made four years
12 ago and cannot realistically be revisited now. Accordingly, APS intends to submit its 30-
13 day letter regarding the generation asset transfer on approximately August 1, 2002.

14 **4. Transmission Constraints and Reliability.**

15 The siting of new merchant generating capacity has created transmission
16 constraints and is a factor affecting the configuration and operation of the transmission
17 system in Arizona. There are also significant emerging regulatory and market-based
18 initiatives, including the WestConnect RTO, that give rise to uncertainty in future system
19 planning. For example, there are significant issues regarding the allocation and recovery
20 of costs for transmission upgrades driven not by system reliability, but by economics and
21 the siting choices of merchant power plants. All of these evolving issues have the
22 potential to affect continued reliable service to APS' customers.

23 Due to facilities siting requirements, reliability issues, long permitting and
24 construction lead times, the treatment of existing contracts, and the continued
25 development of the RTO process and standard market design, addressing transmission
26 constraints and associated issues is a long-term process. Accordingly, further Commission

1 activity addressing this issue should occur in the context of the 2002-2003 Biennial
2 Transmission Assessment which is scheduled to commence in May 2002. APS believes
3 that Staff should attempt to structure that process to address and collaboratively resolve as
4 many of these transmission issues as possible. Also, an explicit transmission study
5 addressing Arizona transmission constraints, system reliability, and market issues could
6 be performed as part of the Biennial Transmission Assessment, which study could include
7 the regulatory treatment and appropriate function of must run local generation resources.

8 **5. Adjustor Mechanisms.**

9 Section 2.6 of the 1999 APS Settlement Agreement requires APS to submit an
10 adjustment clause for Commission approval that will recover Electric Competition-related
11 costs specified in that Settlement Agreement. APS believes that it is appropriate to
12 consider specific adjustor mechanisms in utility-specific proceedings. Thus, for APS, the
13 submission of the adjustor mechanism and the process for addressing that mechanism
14 should occur in the context laid out in the 1999 Settlement Agreement.

15 **6. Retail Direct Access and Shopping Credits.**

16 As part of the Generic Docket, Staff should initiate a workshop process to assess
17 the appropriate scope of retail Direct Access. The purpose of the workshop process shall
18 be to determine whether a rulemaking proceeding to amend the Electric Competition
19 Rules should be initiated to facilitate Direct Access to all or certain customer classes. Also
20 pursuant to the 1999 Settlement Agreement, APS is required to file a general rate case by
21 June 30, 2003, with any resulting rate changes to be implemented beginning July 1, 2004.
22 Specific issues surrounding the "shopping credit" for APS, as well as rate design and
23 unbundling can best be addressed in this already scheduled proceeding for APS.

24 **7. Other Issues.**

25 Certainly, the six issues outlined in Staff's recommendations in the Staff Report do
26 not represent every issue that must or should be addressed in the Generic Docket.

1 However, they do represent the core issues. Other issues can be addressed in a more *ad*
2 *hoc* fashion, using the most appropriate procedural vehicle (workshops, rulemakings,
3 etc.).
4

5 **V. CONCLUSION.**

6 The Commission is at a critical juncture where it must make a threshold decision
7 adopting one or the other of two alternatives. It must make the decision of whether we
8 continue towards Retail Electric Competition—irrespective of whatever action it takes in
9 APS' Request for a Partial Variance—or whether we reverse course now, and try to repair
10 the damage that has been done. Simply delaying a decision is not an option given the 1999
11 Settlement Agreement and the significant commitments that APS, PWCC and PWEC
12 have made in reliance on the Settlement Agreement and the Commission's prior decisions
13 regarding Retail Electric Competition.

14 Accordingly, APS respectfully requests that the Commission timely take whatever
15 action it deems necessary to make the threshold decision and eliminate at least the harmful
16 uncertainty surrounding whether Arizona continues towards retail competition and
17 whether the Commission will honor its commitments in the 1999 Settlement Agreement.
18 The Chief Administrative Law Judge could then approve an appropriate procedural
19 schedule, or otherwise initiate a process, to adopt a plan to follow through on that
20 threshold decision.

21 RESPECTFULLY SUBMITTED this 19th day of April, 2002.

22 SNELL & WILMER L.L.P.

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1 Original and 18 copies of the foregoing
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