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BEFORE THE ARIZONA CORPORATION COMMISSION

2002 MAY 20 P 4: 33 Arizona Corporation Commission

1  
2 WILLIAM A. MUNDELL  
3 Chairman  
4 JIM IRVIN  
5 Commissioner  
6 MARC SPITZER  
7 Commissioner

AZ CORP COMMISSION  
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DOCKETED

MAY 20 2002

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

DOCKET NO. E-00000A-02-0051

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

DOCKET NO. E-01345A-01-0822

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

DOCKET NO. E-00000A-01-0630

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

DOCKET NO. E-01933A-98-0471

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

DOCKET NO. E-01933A-02-0069

26  
27 **COMMENTS OF ARIZONA PUBLIC SERVICE COMPANY  
28 IN RESPONSE TO STAFF REQUEST FOR PROCEDURAL ORDER**

29 Arizona Public Service Company ("APS" or "Company") hereby submits its  
30 Comments in response to Arizona Corporation Commission ("Commission") Utilities  
31 Division Staff's ("Staff") Request for Procedural Order dated May 13, 2002 ("Staff  
32 Request"). Although Staff's proposed solicitation of comments on four specific issues has

Snell & Wilmer

L.L.P.  
LAW OFFICES  
One Arizona Center, 400 E. Van Buren  
Phoenix, Arizona 85004-2202  
(602) 382-6000

1 not, as of this date, been adopted in a formal Procedural Order, APS will to provide its  
2 limited input on such issues in the time suggested by the Staff Request.

3  
4 **STAFF'S ISSUES**

5 *Issue No. 1 – What should be the criteria for selecting the “independent*  
6 *evaluator?”*

7 Without fully understanding the necessity for or role of such an “independent  
8 evaluator,” it is difficult to propose specific criteria. However, in general APS would  
9 stress the adjective “independent.” Staff’s consultant should be, to the greatest extent  
10 possible, 100% free from actual or apparent conflicts of interest. Clearly consultants that  
11 are working or have very recently worked for merchant plant interests in developing or  
12 participating in competitive procurement schemes should be avoided absent special  
13 circumstances. The same would be true if the proposed consultant had ties to the  
14 generation affiliate of a UDC. Also, the consultant should have a strong background in  
15 bid theory and, if possible, relevant practical experience on behalf of either a regulatory  
16 agency or a UDC buyer.

17  
18 *Issue No. 2 – What is the role of the “Independent Evaluator.”*

19 The Staff Request appears to have already established this role as one of a  
20 consultant to Staff on competitive procurement issues rather acting as some manner of  
21 independent arbitrator. However, Staff itself is a party to this contested proceeding, and  
22 its consultants, although perhaps independent from either the buyer or the sellers in a  
23 competitive procurement process, are not completely “independent” of the litigation in  
24 any traditional sense of the word. With such qualification, APS does not object to the  
25 Staff’s proposed retention of an outside expert on competitive power solicitation.

26

1            *Issue No. 3 – What are the payment arrangements for the “Independent*  
2 *Evaluator?”*

3            APS would presume this consultant would be paid in the same manner as other  
4 Staff consultants, i.e., from funds appropriated by the Legislature for such purposes. The  
5 Company is unaware of any circumstances or legal authority warranting a different  
6 conclusion. Moreover, any other funding mechanism could create an appearance of  
7 conflict of interest that would likely undermine whatever degree of true independence  
8 could be ascribed to the proposed consultant’s recommendations and advice.

9  
10           *Issue No. 4 – What are the various types of competitive solicitations that should be*  
11 *considered by the Commission and what are their attributes?*

12           APS continues to believe that the proposed Purchase Power Agreement (“PPA”)  
13 with Pinnacle West Marketing & Trading, as modified in its rebuttal testimony in Docket  
14 No. E-01345A-01-0822, represents the preferred mode of procurement for Standard Offer  
15 requirements. But that PPA does require, both expressly and by implication, very  
16 significant amounts of power from the competitive wholesale market. Hence, competitive  
17 solicitation is a relevant topic with or without the proposed PPA.

18           In general terms, there are numerous different methods of conducting “competitive  
19 solicitations” and several potential variations on each of these methods. A generic  
20 discussion of some of these types of competitive solicitation is provided below:

21           **Simultaneous Multiple Round (SMR) Auction.** In this process, bids are  
22 submitted in successive bidding rounds that each have pre-defined beginning and ending  
23 times. Bids are simultaneously taken on available products with a price and quantity pair  
24 specified for each product. At the end of each round, the auctioneer determines the  
25 current winning bids for each product by ranking bids received in ascending order of price  
26 until the desired quantity is met for each product. The bid price at which this occurs is

1 called the "current price" and "current winning bids" are those at or below the current  
2 price. Then, a maximum acceptable bid price is determined for each product, which will  
3 be some increment below the current price, and new bids in the next round must be at or  
4 below the maximum acceptable bid price. The auction ends after a round in which no  
5 new bids are submitted on any product, at which time the current winning bids are  
6 provisionally determined to be the winning bids, pending execution of contracts.

7 The generic advantages of an SMR auction method include an efficient price  
8 discovery mechanism that reduces the effect of the "winner's curse" (i.e., overly  
9 conservative bidding to reduce the risk of submitting a below-market bid), and thus often  
10 results in efficient auction outcomes. An SMR auction method could also allow bidders  
11 to form preferred packages of products. The process is transparent and offers flexibility  
12 (e.g., controlling the pace of the auction).

13 **Descending Clock Auction.** A descending clock auction is a simpler version of an  
14 SMR auction. At the start of each round, the auctioneer announces the current price for  
15 each product, and each bidder submits a quantity of the product that it is willing to supply  
16 for that price. At the end of each round, the current price is reduced, and those bidders  
17 remaining in the auction can bid at the reduced current price in the next round of the  
18 auction. The auction ends when no new bids are received and the quantity of each  
19 product matches the purchaser's requirements. The advantages of descending clock  
20 auctions are similar to SMR auctions, but descending clock auctions tend to be simpler  
21 and quicker.

22 **RFPs and Sealed-Bid Auctions.** Competitive procurement processes involving  
23 requests for proposals ("RFP") often are implemented essentially as a two-step sealed-bid  
24 "auction." Winning bidders in the first step earn the right to enter into multi-lateral  
25 negotiations with the purchaser. This auction process may have some advantages if the  
26 bidding competition is expected to be weak and the products being solicited are not

1 related in value (i.e., they are neither product substitutes or complements). RFPs and  
2 sealed-bid auctions are, however, less transparent than the various forms of auctions  
3 discussed above.

4 **Anglo-Dutch Hybrid Auction.** This process is a blend of the SMR-type of  
5 auction and sealed-bid format. The first phase of the auction is an SMR or clock auction  
6 that proceeds until only a few bidders remain. The second phase involves a one-shot  
7 sealed-bid to determine the final winning bidders. To some extent, this hybrid auction  
8 process blends the advantages and disadvantages of the other auction processes.

9 Although the auction/RFP processes described above capture, in broad terms, the  
10 range of potential bidding mechanisms, it is difficult to comment on a specific mechanism  
11 until more is known about the overall process. For example, the products that are  
12 ultimately involved (i.e., vertical slice versus horizontal block, the term of contract, etc.)  
13 could affect which auction/RFP process is most likely to yield the lowest competitively-  
14 bid price to APS and its customers for an energy product or products of acceptable  
15 reliability. Accordingly, APS will be able to better comment in detail on the “fairness,  
16 efficiency, and transparency” of these respective processes, or their specific benefits and  
17 drawbacks, or what potential “benefits” each process will bring to competition when more  
18 is know about the scope of this “Track B” process. Additionally, the non-competitively  
19 bid 50% of Standard Offer power may affect the selection of an appropriate competitive  
20 bidding process.

21  
22 **CONCLUSION**

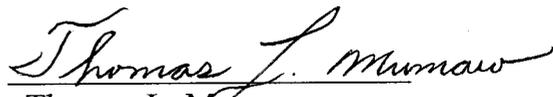
23 APS has attempted to be responsive to the Staff Request in the limited time  
24 available. Once further details are developed on the issues that APS identified in its May  
25 13, 2002 Statement of Issues, which may well be the result of Staff’s proposed May 24,  
26 2002 meeting on “Track B,” APS reserves the right to provide additional responses to

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Staff's four inquiries and to amend the general discussion of competitive procurement options given above.

RESPECTFULLY SUBMITTED this 20th day of May 2002.

SNELL & WILMER L.L.P.



Thomas L. Mumaw  
Jeffrey B. Guldner  
Faraz Sanei

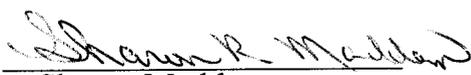
Attorneys for Arizona Public Service Company

Original and 18 copies of the foregoing filed this 20th day of May, 2002, with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85007

Copies of the foregoing mailed, faxed or transmitted electronically this 20th day of May, 2002, to:

All parties of record



Sharon Madden