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IN THE MATTER OF THE GENERIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING ISSUES.	Docket No. E-00000A-02-0051
IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR VARIANCE OF CERTAIN REQUIREMENTS OF A.A.C. 4-14-2-1606	Docket No. E-01345A-01-0822
IN THE MATTER OF THE GENERIC PROCEEDINGS CONCERNING THE ARIZONA INDEPENDENT SCHEDULING ADMINISTRATOR	Docket No. E-00000A-01-0630
IN THE MATTER OF TUCSON ELECTRIC COMPANY'S APPLICATION FOR A VARIANCE OF CERTAIN ELECTRIC POWER COMPETITION RULES COMPLIANCE DATES	Docket No. E-01933A-98-0471
ISSUES IN THE MATTER OF TUCSON ELECTRIC POWER COMPANY'S APPLICATION FOR A VARIANCE OF CERTAIN ELECTRIC COMPETITION RULES COMPLIANCE DATES	Docket No. E01933A-02-0069

TUCSON ELECTRIC POWER COMPANY'S RESPONSE TO STAFF'S TRACK B ISSUES

Tucson Electric Power Company ("TEP") through undersigned counsel, hereby submits its response to the list of Track B issues compiled by the Commission Staff and distributed on May 31, 2002. TEP reserves the right to supplement these responses as the Track A and Track B proceedings progress, as additional information is made known regarding the status of the Electric Competition Rules and as the Commission continues its evaluation of electric competition and related issues. Accordingly, TEP states as follows:

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1. What types of competitive solicitation process(es) should be utilized?

a. When should the competitive solicitation process begin?

As stated in TEP's Request for Variance and Track A testimony, TEP believes that the implementation of the competitive solicitation process should begin either December 31, 2003, or a date six months after the Commission has issued a final order in "In the Matter of the Generic Proceedings Concerning Electric Restructuring Issues," A.C.C. Docket No. E-00000A-02-0051 (the "Generic Restructuring Docket"), whichever is later.

b. How will the competitive solicitations be disseminated?

TEP believes that competitive solicitation requests for proposal ("RFPs") should be public documents. RFPs could be disseminated through utility and Commission web-sites and distributed to participants who are deemed to be qualified bidders.

c. What percentage of a utility's power requirements should be obtained through the competitive solicitation process?

Procuring electric power through a competitive solicitation process will be new to the Arizona electric industry. To ensure an effective implementation of the process, TEP recommends that utilities initially be required to procure forecasted Standard Offer load power requirements consistent with the Staff recommendation in the APS Variance matter. TEP estimates that this would require TEP to competitively procure five (5) to ten (10) percent of its Standard Offer load in 2004. As the integrity and efficiency of the competitive solicitation process is demonstrated, these amounts can be adjusted accordingly.

d. Should the percentage of a utility's power requirement obtained through the competitive solicitation process be established at one time or should it be phased-in?

As previously explained, TEP believes that it is prudent to phase in the percentage of power procured through the competitive solicitation process. A gradual approach will allow the process to become established and

appropriate adjustments made without jeopardizing a utility's ability to acquire the majority of its power requirements in a cost effective manner.

e. How will the competitive solicitation percentage be calculated?

TEP believes that the percentage of power that a utility procures through the competitive solicitation process should be calculated based upon a percentage of a utility's projected annual Standard Offer load requirements. An obvious alternative to TEP's preferred approach would be to base the percentage on a utility's actual Standard Offer load requirements. However, TEP believes that the benefit of basing the percentage on an estimate is that power must be purchased before consumption occurs and the exact power requirements will not be known until after the power was purchased and consumed.

f. Will a utility be subject to penalties if it does not meet the competitive solicitation percentage?

TEP believes that the Commission should retain jurisdiction to sanction a UDC if, after due process, it believes that the UDC did not make a good faith effort to meet the competitive solicitation requirements. However, TEP believes that the competitive solicitation percentage should be based on forecasted information in order for utilities to have fair notice of the requirement. Also, the determination of whether a utility has met the competitive solicitation percentage should be based on the amount of power that a utility has requested in its RFP rather than on the amounts offered or actually supplied in response to the RFPs. The utilities should not be penalized if the suppliers are not willing to respond to the RFPs or offer the amount of power stated in the RFPs or if suppliers fail to supply the power as contracted in the RFP process.

g. If a utility exceeds the annual competitive solicitation percentage, will the excess carry over to next year?

TEP does not believe that a carry over provision would best promote the competitive solicitation process. TEP believes that the competitive solicitation percentage should be considered a minimum annual standard.

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Whether a utility distribution company ("UDC") can or should exceed the minimum standard should be determined by the utility.

h. What requirements, if any, should be imposed on the purchase of power that is obtained outside of the competitive solicitation process?

TEP believes that power purchases made outside of the competitive solicitation process should be "arms-length" bilateral transactions. TEP has recommended to the Commission in the Track A proceeding that it should implement a Purchase Power and Fuel Adjustment ("PPFA")mechanism in connection with electric competition. The non-competitive solicitation purchases can be reviewed in connection with a PPFA.

i. What are the time frames for initiating and completing the steps of the competitive solicitation process?

TEP believes that the time required to initiate and complete the steps of the competitive solicitation process depends upon several factors that are presently subject to Commission action in this proceeding. The Commission has not yet determined what type of competitive solicitation process it will require or the amount of power that must be procured through the process. Another important factor that must be considered is the complexity of the power "products" that may be procured through the competitive solicitation process.

j. Who will determine the components of each utility's portfolio of competitively solicited purchases?

TEP believes that each UDC should retain the ability to determine how its portfolio of competitively solicited purchases should be constructed. Each UDC is in the best position to factor and manage specific requirements and risks pertinent to the unique characteristics of its load.

k. What are the criteria and process for determining which offer(s) in response to competitive solicitations should be selected by a utility?

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As previously stated, TEP believes that the UDC should determine the nature (capacity, energy, estimated load shape, delivery points, duration, etc.) of the power to be obtained through the competitive solicitation process. The UDC would then issue RFPs for the power. Bids that are received in a timely fashion and that meet the RFP's requirements should be evaluated with primary focus on the delivered price (including transmission costs, losses, etc.) of power products and the points of delivery. Another factor which must be considered is the ability of the bidder to provide the service, including its creditworthiness. TEP believes that the UDC should be required to maintain copies of the RFPs, responses and UDC evaluations thereof for periodic review by Staff.

l. What mechanism will be in place for dispute resolutions related to competitive solicitations?

TEP believes that parties who object to the competitive solicitation process should be able to utilize the Commission's informal and formal complaint process.

m. What protections will be in place to maintain the confidentiality of utility and participant information?

TEP believes that the Commission and UDCs should jointly agree upon a standard confidentiality agreement that the participants in the competitive solicitation process and the UDC will be required to enter into. In addition, the Commission must maintain the confidentially of any information which it receives.

n. In the event that a supplier of power defaults on the obligation to provide the power, how will replacement energy be obtained?

TEP believes that to some degree, the rights and obligations in a default situation should be governed by the terms and conditions of the agreements entered into between the supplier and recipient of the power. Subject to that

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caveat, the options for replacement of power in the circumstance of the supplier's default could include, at the UDC's discretion:

- Spot market purchases for the immediate replacement of undelivered power.
- Utilization of power from other agreements in the UDC's portfolio to replace undelivered power, to the extent possible (e.g. increase procurement amount from other existing agreements).
- Short to mid-term power purchases for the remainder of the agreement or for the time required to secure replacement power.

o. How should the competitive solicitation process factor alternative delivery and transmission points?

TEP believes that the competitive solicitation process should be developed factoring transmission delivery and receipt capabilities. Each UDC is aware of its respective transmission rights and should be allowed to prepare their RFPs, taking those rights into consideration. RFPs should clearly state the amounts of power will be accepted at each described delivery point and any price adjustment factors which will be applied to each delivery point. Transmission to the point is the responsibility of the supplier, with any transmission costs included in the sales price.

p. Will the competitive solicitation process utilize the "Western Systems Power Pool umbrella agreement" or similar agreements?

TEP believes that the use of standardized industry contract terms and conditions such as those included in the "Western Systems Power Pool Agreement" or "Edison Electric Institute Master Purchase and Sale Agreement" would increase the efficiency of the competitive solicitation process.

q. What are the appropriate contract duration periods?

TEP believes that there should be different terms for agreements for power based upon the nature of the product being purchased. TEP is advocating that the UDCs should be afforded the flexibility to establish their own power portfolios with Commission review. TEP believes that a UDC might want to have a mix of spot (daily and hourly), short-term (monthly and quarterly), mid-term (1 to 3 years) and long-term (3-15 years) purchases to ensure that it

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is not over-dependent on any segment of the market and to reduce price volatility.

r. What are the appropriate delivery dates?

As stated previously, TEP believes that the implementation of the competitive solicitation process should begin either December 31, 2003 or a date six months after the Commission has issued a final order in "In the Matter of the Generic Proceedings Concerning Electric Restructuring Issues," A.C.C. Docket No. E-00000A-02-0051 (the "Generic Restructuring Docket"), whichever is later. This would set the earliest beginning delivery dates. The period of each delivery would vary contract to contract as a function of the UDC's portfolio approach and suppliers' offered terms.

s. Will demand-side management options be allowed to compete?

TEP believes that if demand-side management options are truly competitive (e.g., they must be able to demonstrate that they can provide the same results as the generation alternatives), they should be included in the competitive solicitation process.

t. Will the costs for local transmission upgrades for proposed projects be directly assigned to each bid or included as general transmission costs?

TEP believes that the cost for local transmission upgrades will be treated in accordance with Federal Energy Regulatory Commission interconnection policies. If a transmission upgrade is required specifically for a supplier to deliver power to a distribution system the costs would typically be directly assigned. If the transmission upgrade is part of the general delivery system it would typically be assigned to general transmission costs.

u. Will there be a price ceiling for bids?

TEP does not believe that there should be a price ceiling for bids in a competitive market. TEP believes that it is most appropriate that all participants know going into a competitive solicitation process that prices will reflect market forces.

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v. Will there be a maximum limit on the number of MW bid by an entity?

TEP does not believe that there should be a maximum limit imposed. TEP believes that counter-party and delivery risks of large bids should be addressed in the supplier certification process.

w. How will the competitive solicitation process be evaluated for future improvements?

TEP believes that the Commission should consider conducting a periodic review of the competitive solicitation process.

x. Will the utilization of this process(es) develop an optimal portfolio resulting in the best price.

TEP believes that the objective of the competitive solicitation process should be for UDCs to acquire a diverse mix of power products which result in a relatively stable portfolio cost amid volatile and unknown future wholesale electric and natural gas prices. TEP does not believe that the standard for "best" price should be based on an after the fact hypothetical "optimal" resource portfolio.

2. What types of products will be subject to competitive solicitation?

a. Will the competitive solicitation process include financial and physical options?

TEP believes that the competitive solicitation process should only include physical capacity, energy and options. TEP does not believe that financial options should be a part of the competitive solicitation process.

b. Will the competitive solicitation percentage include standard block purchases through a broker or power pool?

TEP believes that if the percentage of Standard Offer load to be served though the competitive solicitation process is "large" (greater than twenty percent, 20%, of the load), then UDC's should be permitted to utilize "broker transactions" to meet their minimum competitive solicitation requirement. TEP recognizes that the Commission may deem it desirable to limit these types of purchases in terms of duration and percentage of the total competitive solicitation purchase portfolio.

c. How will power produced by "must-run" generators be considered in the competitive solicitation process?

As TEP recommended in its Track A testimony, power required by "must-run" generators should be addressed through the protocols of the Arizona Independent System Administrator (or its successor "RTO") and/or cost-based PPA's with generation affiliates. TEP does not believe that required "must-run" generation should be considered in the competitive solicitation process.

d. Should the competitive solicitation percentage consist of block energy purchases, purchases shaped like the utility's load, or a combination thereof?

TEP believes that the competitive solicitation percentage should be able to include both "block" and "shaped" power products at the discretion of the UDC. TEP believes that an important component of a diverse portfolio is the ability to aggregate a variety of product types. Additional options could include "on and off peak" blocks, "peaking" (time of day and time of year), "fixed and variable price", and "capacity with callable energy" products.

e. What are the characteristics of the power to be bid (peak/off-peak, energy/capacity, etc.)?

See Response to 2.d.

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3. What transmission constraints have been identified or anticipated by the utilities that will affect delivery of competitively procured power?

a. To what extent would transmission constraints affect delivery of competitively procured power?

TEP does not believe that competitively procured power will be affected by transmission constraints because TEP will only procure power in accordance with available transmission capacity.

b. How and when could the constraints be resolved?

TEP's transmission constraints are related primarily to voltage support in the local area. TEP believes that in order to eliminate transmission constraints into TEP's service territory, an extensive construction and reconstruction effort would have to be undertaken regarding TEP's "EHV" system. The resultant cost of transmission to TEP customers would be significantly greater compared to the charges presently incurred for RMR generation.

c. How will constraints be reflected in bid evaluation?

See Responses to 3.a and 1.o.

4. What issues will affect the participants to the competitive solicitation process?

a. How will potential suppliers become qualified participants in the competitive solicitation process?

TEP recommends two possible methods for qualifying participants to the competitive solicitation process.

1. Potential participants could be required to be pre-certified by the Commission. This would require the Commission to adopt certification criteria and procedures. This would designate the Commission as the party that determines whether and under what specific terms (i.e. contract

size and duration) a potential participant would be permitted to participate in the competitive solicitation process.

2. Participants could be required to submit "qualifying" information in connection with their response to RFP. This procedure would require the UDC to determine whether a participant has the appropriate qualifications, which would be a factor in determining which party would be selected to provide power in response to a RFP.

b. Will potential suppliers be required to obtain authorization from the Commission?

See Response to 4.a.

c. Will potential suppliers be required to submit proposal fees or bonds?

TEP believes that proposal fees should be required of potential suppliers and that RFPs should require that a performance bond be posted by the successful supplier. The potential fee should be larger for suppliers who are not certified by the Commission due to the additional effort required by the UDC in the bid evaluation.

d. How will utility affiliates be treated in the competitive solicitation process?

TEP believes that utility affiliates should be treated the same as any other similarly situated participant. In connection therewith, TEP has advocated that RFP evaluation criteria should be public information and that the Commission should be the forum to resolve disputes that may arise in connection with the competitive solicitation process.

e. How will utility-owned generating units be treated in the competitive solicitation process?

TEP believes that utility-owned generating units should be treated the same as any other bidder. Bid evaluation criteria will be public information. Any bidder, including non-affiliated bidder, may appeal the decision to Commission.

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f. Will the Commission keep a list of qualified suppliers?

Yes, if the first alternative in response 4.d is implemented.

5. How will the cost of procured power be recovered by the utility?

a. What will be the scope, terms, and effect of a utility's purchase power adjustment clause?

TEP has stated in its Track A testimony that one of the best mechanisms for matching current electric power procurement costs with electric power use is through a PPAC mechanism. As the Arizona competitive electric market matures, retail electric rates should reflect a market price rather than be set pursuant to a cost-based methodology. An appropriately designed PPAC mechanism will help mitigate the potential negative impact of significant price volatility to UDCs' Standard Offer customers. The PPAC mechanism should be designed to minimize the effect of electric power price swings over time by "banking" purchase price deviations above and below a pre-determined base cost and then, once an established level has been attained in the account, recovering or returning the bank balance amounts over a specified period of time. All power purchased for retail customers, both short and long-term purchases, should flow through the PPAC mechanism.

6. If a competitive bid process is adopted, will least-cost planning be used for the evaluation of all competitive bids?

a. If not, how will the bids be evaluated?

TEP does not believe that least cost planning should be used to evaluate competitive bids. RFPs and responses should be evaluated based on pre-determined criteria including price, dispatch characteristics, performance guarantees, and the viability of supplier.

b. Will a least-cost planning framework be used to evaluate the benefits of more transmission given the location of existing and planned generating units?

TEP does not believe that the competitive solicitation process is the appropriate forum for evaluating transmission additions.

7. How will the potential for the exercise of market power be assessed for competitive bids, in order to determine whether or not the bids are reasonably competitive?

a. If there are not enough competitive bids, will there be a re-bid?

TEP believes that if the UDC determines that there are not enough responses to RFPs to generate competitive prices, it should have the flexibility to issue another RFP with different terms.

b. Will the utilities be obligated to calculate a price baseline derived from a least-cost plan consisting of self-built generation at regulated prices in order to determine if the "competitive" bids are likely to save ratepayers money?

As stated in responses 4.d and 4.e, TEP believes that utility owned generation should be treated the same as other generation in the bid process. If a utility is concerned that RFP responses would result in long-term pricing that greatly exceeds "all-in costs" of new generation including a reasonable rate of return, it would be able to submit a bid based on the cost of self-built generation.

Respectfully submitted this 1st day of July 2002.

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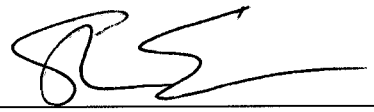

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