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2002 JUL -1 P 3: 32 Arizona Corporation Commission

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JUL -1 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
13 VARIANCE OF CERTAIN REQUIREMENTS OF
14 A.A.C. 4-14-2-1606

DOCKET NO. E-01345A-01-0822

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

DOCKET NO. E-00000A-01-0630

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

DOCKET NO. E-01933A-98-0471

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

DOCKET NO. E-01933A-02-0069

COMMENTS OF ARIZONA PUBLIC SERVICE
COMPANY ON "TRACK B" ISSUES

Pursuant to the Chief Administrative Law Judge's First Procedural Order on Track B Issues, dated June 20, 2002, Arizona Public Service Company ("APS") hereby submits its comments in response to the issues identified by the Arizona Corporation Commission

1 (“Commission”) Utilities Division Staff (“Staff”) in their May 31, 2002 filing, as well as
2 other “Track B” issues.

3 4 Overview of APS’ Comments on Competitive Bidding

5 Staff’s May 31, 2002 filing of “Track B” issues includes many significant
6 questions that may be generically relevant to competitive bidding or competitive power
7 procurement. However, as most parties to these consolidated proceedings have
8 recognized, both the relevance and importance of the issues identified by Staff are
9 significantly dependent upon how “Track A” issues and APS’ pending Request for a
10 Partial Variance are resolved by the Commission. Specifically, what is to be done with the
11 portfolio of generation already constructed or under construction to serve APS customers?
12 Will it be retained or acquired by APS, which would thereby remain a traditionally
13 regulated vertically-integrated utility? Will it be owned by Pinnacle West Energy
14 Corporation (“PWEC”) with all or some portion dedicated back to APS customers through
15 the proposed PPA or some variant thereof?

16 While “Track A” will likely resolve whether the generating assets serving APS are
17 to be held by APS or PWEC, the size and scope of either a PPA between APS and PWEC
18 or an incremental competitive procurement by a still vertically-integrated APS are more
19 properly “Track B” issues or are dependent on the resolution of APS’ Partial Variance
20 Request. Accordingly, APS’ discussion of the Staff issues list and other issues relating to
21 competitive solicitation is necessarily preliminary and contingent on the prior resolution
22 of several important and interrelated issues that must occur in the “Track A” and “Track
23 B” and Partial Variance Request proceedings.

24 APS discusses in its Memorandum on Track B Issues (“Memorandum”), attached
25 as Exhibit A and incorporated by reference, an example of an auction process that is open,
26 transparent, and objective. It will assure that all bidders are afforded equal and non-

1 discriminatory treatment. Properly structured, such a process could result in the most
2 bidders competing in the most efficient manner for the portion of APS' Standard Offer
3 load subject to the auction. The issues relevant to such a competitive bidding method are
4 discussed in the Memorandum in the form of preliminary comments on such an auction,
5 but APS is not foreclosing the possibility of other methods of competitive bidding. APS
6 welcomes the comments of other interested parties and Staff on the Memorandum.

7 Although APS believes that the auction method discussed in the Memorandum
8 deserves consideration, and is likely scalable over various competitive bidding amounts or
9 timeframes, it is also important to place the competitive bidding component of APS'
10 wholesale power procurement efforts in context—a context that, as discussed above, may
11 largely be shaped by the resolution of the “Track A” issues. First, the competitive bidding
12 required in A.A.C. R14-2-1606(B) only applies to Utility Distribution Companies and is
13 therefore dependent on the divestiture of APS' generation assets. It is common sense that
14 if APS is not allowed to divest its generation assets, APS cannot obtain all of its Standard
15 Offer power from the competitive market or even 50 percent. If the Commission does not
16 allow divestiture to proceed, the amount or scope of any competitive procurement will be
17 affected. Second, APS believes that a PPA with cost-based rates and reliable, proven,
18 fuel-diverse generation assets covering a significant portion of its divested generating
19 assets is in the best interests of APS' customers. Thus, the competitive bidding method
20 discussed in the Memorandum should be considered as only one element of a portfolio
21 that includes a large long-term, cost-based PPA component, a progressively larger
22 competitively-bid component, and potential and perhaps future components addressing
23 renewable energy, demand response, and spot-market transactions. Third, any competitive
24 procurement requirements adopted by the Commission must include an assurance of cost-
25 recovery. Pursuant to the 1999 APS Settlement Agreement and Decision No. 61973
26 (October 6, 1999), APS has filed an application for a Purchase Power Adjustment

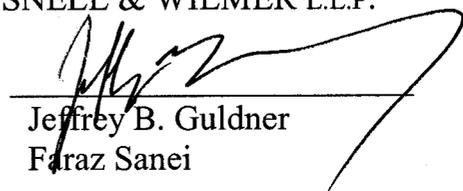
1 Mechanism that provides the forum to address this essential element to competitive
2 procurement.

3
4 **Conclusion**

5 APS recognizes that its discussion of a method of competitive bidding is only a
6 piece of the final procurement process. However, when coupled with the strong
7 foundation of a cost-based, long-term PPA and appropriate cost recovery mechanisms,
8 APS believes that an auction similar to that discussed in the Memorandum will provide
9 reasonable exposure to the competitive wholesale market without jeopardizing the
10 reliability and cost-stability that APS' Standard Offer customers have come to expect, and
11 without limiting APS customers from choosing a Direct Access alternative. APS
12 welcomes the opportunity to further discuss these issues at the July 24-25, 2002
13 Workshops.

14 RESPECTFULLY SUBMITTED this 1st day of July, 2002.

15 SNELL & WILMER L.L.P.

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19 PINNACLE WEST CAPITAL CORP.
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23 Original and 18 copies of the foregoing
24 filed this 1st day of July, 2002, with:

25 Docket Control
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2 transmitted electronically this 1st
day of July, 2002, to:

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APS' Memorandum on Track B Issues July 1, 2002

This Memorandum responds to the issues identified by Staff in their May 21, 2002 list of Track B issues. While the Memorandum discusses a specific method of conducting competitive bidding by APS, it is organized in generally the same format and sequence as Staff's list of issues. Further, the specific auction discussed by APS is intended as a vehicle to illustrate the relevant issues raised by Staff, and is not necessarily a final recommendation by APS for a specific competitive procurement process. APS anticipates discussing these items and obtaining feedback from interested parties at the July 24-25, 2002 Workshops.

I. What type of competitive solicitation process(es) should be utilized?

1. Descending Clock Auction.

A descending clock auction could be used to procure competitive bid power for a portion of APS' Standard Offer load. A descending clock auction, which is described in more detail below, is an open and transparent process that places all bidders on a level playing field. When successfully structured and implemented, such a process will benefit APS customers.

The descending clock auction encourages bidding competition. It allows bidders through an iterative process to price-arbitrage and to pursue their preferred offering of multiple products. It is widely recognized as a highly transparent and objective process—qualified bidders win only when no other qualified bidder is willing and able to bid lower prices. The result is efficient, in that the contracts are awarded to those qualified bidders who can provide reliable products at the least cost. The descending clock auction has been used successfully in the electric industry in the past.

Additionally, APS expects that part of the advance work for the competitive bidding process will include allowing interested parties an opportunity to comment on the proposed auction rules, standard form of agreements, and other elements of the process. That consultation, as noted in the outline of tasks and timelines below, would precede the marketing and promotion, informational activity, and other steps associated with announcing the competitive bidding process and with the actual auction process itself.

In this response, APS sets forth a summary of the principal features of the descending clock auction process and, in doing so, focuses on the specific issues raised by the Staff's inquiry.

2. Bidding Process Format: How the Descending Clock Auction Works.

The descending clock auction proceeds through a series of bidding rounds, where the Auction Administrator announces the acceptable price for each product for the

July 1, 2002

opening round of bids and then generally lowers (and never raises) the announced price for each successive round thereafter until the final bid quantities equal the Standard Offer Service ("SOS") product needs. To be a successful bidder, a supplier must submit bids in every round of the auction.

In the bidding phase of the first round, each bidder submits a quantity bid for each of the SOS products on which it would like to bid in the first round. In subsequent rounds, a bidder generally cannot increase its bid quantity and may reduce its quantity bid for a product from the preceding round if and only if the going price for that product has been reduced from the preceding round. There may be special activity rules that, in some cases, would allow a bidder to reduce its quantity bid on one product (if and only if the going price has been reduced for that product) and increase its quantity bid on another product from one round to the next.

In all rounds, a bid is a firm offer and commitment to supply the bid quantity at the current, going price announced by the Auction Administrator. Offers to supply at the going price cannot be rescinded or withdrawn. Also, during the bidding rounds, the bidders are not provided any information about other bidders, including the bids supplied by other bidders.

For an SOS product that is just subscribed or is under-subscribed at the end of a round, the announced, going price for that SOS product would not change for the next round and the auction would be complete for that product. There will also be rules to resolve the possible result in which an SOS product is under-subscribed at the last announced bid price for the product. In contrast, SOS products that receive excess supply bids would have their going prices in effect for the next round reduced by some decrement. The auction would continue and prices would edge down until, for each of the SOS products, there no longer is an excess of supply bids—in other words, the number of MWs bid at the current going price just equals the number of MWs APS needs to purchase. The tentative winning bidders (tentative until the auction results are officially accepted) are those qualified bidders who submitted quantity bids at the last announced, going price.

3. Amount of APS' SOS Load Requirement to be Included in the Descending Clock Auction.

Mandatory competitive bidding requirements could be phased in over time. A phased-in process will help ensure that the process and products are satisfactory. As noted in the accompanying pleading, the amount to be phased in depends on what is decided about the current generation assets devoted to serving APS load—i.e., will divestiture be permitted in accordance with the 1999 APS Settlement Agreement and what will be the scope of any purchase power agreement between APS and its affiliate. However, under any scenario, it is assumed that the competitively-bid percentage could increase with load growth after the initial competitive bid and would also be tied to the capabilities of the transmission system.

The initial competitive bid could distinguish between periods prior to 2006, at which time a Regional Transmission Organization ("RTO") is expected to be in place and fully operational, and periods after 2006. The implementation of an RTO may impact the regional market so that a revision of the competitive bidding process at that time may become beneficial to APS customers. However, the competitive bid could include a portion of products to be delivered after 2006 if wholesale terms warrant such extended procurement.

4. The Products to be Purchased through the Competitive Bid Process.

The specific products that would be procured through a competitive bid are dependent on the specific resolution of Track A issues. For example, if APS is not permitted to divest its generation assets, the products that may be required could be limited to on-peak products. Assuming full divestiture, however, an auction could involve multiple 25 MW horizontal blocks of firm energy and capacity delivered at its four most active trading hubs—Palo Verde, Mead, Four Corners and Navajo. Two products could be delivered, on-peak and off-peak hours, respectively, every day of the year (i.e., 7x16 on peak and 7x8 off peak). Also, two additional products could be delivered during on-peak and off-peak hours, respectively, during every day of the third quarter of the year. For this purpose, Quarter 3 will be defined as May 15 through September 15.

One year contracts could be awarded for each of the years 2003, 2004, 2005, and 2006 with the possibility of a portion of the competitive bid extending beyond 2006. The one-year products allow bidders to assemble their own preferred contract lengths through the bid process, which would allow bidders with assets coming on line in the future to participate, and give APS maximum flexibility.

Thus, apart from contracts calling for delivery dates after 2006, there could be 64 simple and straightforward products and contracts (4 years, 4 time period blocks, 4 delivery points) as follows:

Products Required for Each Year of Competitive Bid

Block	Four Corners	Mead	Navajo	Palo Verde
On Peak, full year	n	n	n	n
Off Peak, full year	n	n	n	n
On Peak, Q3 Supplemental	n	n	n	n
Off Peak, Q3 Supplemental	n	n	n	n

Q3 = May 15 - Sept. 15
n = number of 25 MW blocks
(based on amount of power required and
available transmission at delivery point)

These simple and straightforward products should allow the competitive bidding process to produce appropriate results for APS' customers. It should attract significant interest from prospective bidders, because bidders can deliver to each of the trading hubs. That in turn should garner greater bidding competition and likely yield lower bids.

5. Progression of the Descending Clock Auction Process.

The following table illustrates how the descending clock auction progresses, showing hypothetical prices and quantity bids (100 MW is assumed solely for illustrative purposes) in each of the rounds.

Sample Round Results for Descending Clock Auction *

Round		Products			
		2003 Four Corners On Peak, full year Need 100 MW	2003 Four Corners Off Peak, full year Need 100 MW	...	2006 Palo Verde Off Peak, Q3 Need 100 MW
1	Announced Price	\$0.082/kWh	\$0.124/kWh	...	\$0.158/kWh
	Total MW Bid	425	775	...	325
2	Announced Price	\$0.074/kWh	\$0.118/kWh	...	\$0.149/kWh
	Total MW Bid	375	750	...	275
3	Announced Price	\$0.058/kWh	\$0.111/kWh	...	\$0.145/kWh
	Total MW Bid	350	725	...	250
...	Announced Price
	Total MW Bid

The auction rounds in the hypothetical would continue with successive price reductions until the quantities bid match the quantities required by APS.

6. Allocation of Risk.

6.1 Bidder Qualification. Only serious, creditworthy bidders should be allowed to participate in the auction. Creditworthiness is a significant concern, particularly because most wholesale generators are incorporated as out-of-state limited liability corporations that may not have the financial backing of their larger, and often more credit-worthy, parents or affiliates. APS intends to impose default provisions that will eliminate or at least significantly minimize the financial risks to APS and its customers in the event that a winning bidder fails to perform. The ability to have meaningful default provisions or contractual remedies is critical to ensuring that reliability does not deteriorate for APS' Standard Offer customers.

* The prices and quantities in this sample are purely hypothetical and are for illustrative purposes only. They are not meant to suggest actual starting prices, quantities, or any expected spreads between products.

APS will adopt and announce bidder qualification criteria in advance. Interested bidders will be invited to submit an application to be qualified to participate in the auction. Among the conditions of qualification, applicants must demonstrate that they meet pre-bidding creditworthiness requirements, agree to comply with all rules of the auction, and agree that if they become auction winners, they will execute the agreements proffered by APS within timeframes identified by APS. By a pre-specified date prior to the auction date, interested parties who meet the qualification criteria will then be informed of their qualified bidder status.

The process of qualifying bidders for the auction is intended to ensure that only strong, committed bidders are allowed to bid in the auction—bidders that are capable of closing the transaction and carrying out the terms of the contract with a high degree of certainty. The criteria for qualifying bidders will be clearly spelled out and applied consistently across all potential bidders.

The qualification criteria should ultimately tend to put significant emphasis on the financial ability of the bidder to perform in addition to the bidder's operational capabilities (e.g., ownership of generation). In that regard, qualification criteria will include an assessment of public and non-public financial documents such as asset and income statements, bond and credit ratings, Dunn & Bradstreet and similar reports, relationships with guarantors and creditors, lines of credit, and other credit issues.

6.2 Bidder price risk. In contrast to the need for protection for APS and its customers, bidders must take responsibility for managing market and price risk because they are in the best position to manage those risks most efficiently. For this reason, bids on the SOS products auctioned are for quantities that will be supplied at the fixed prices for the duration of the contract.

7. Pricing.

7.1 Reserve Prices. To protect APS customers and to ensure that the auction process works to their benefit, APS will impose a reserve price for each product auctioned. The reserve price for an SOS product, while not disclosed to bidders, will be set prior to the auction as the price above which a bid will not be accepted as a winning bid. Imposition of a reserve price should mitigate the risk that winning bids will be inordinately high for any number of reasons. If the final bids are above the reserve price, a contingency plan would be implemented for all or part of the auction.

7.2 Starting Prices. To encourage multiple bidders, starting prices should be set conservatively high for the SOS competitive bid process and may be set above the reserve price discussed above to encourage participation in the auction. Starting the process at a higher price level should produce initial bid quantities in total that exceed the amount APS is procuring in the auction, allowing the current price to be dropped for the subsequent bidding round. As noted above in the description of the descending clock auction process, prices for products receiving excess supply bids then would drop round

to round until prices reach a point where the supply bids just equal the amount being purchased for each product, at which point the auction closes.

8. Auction Administrator.

A third party would act as the Auction Administrator. However, as the party to the contracts being auctioned, APS will continue to be an integral part of the competitive bidding process working with the Auction Administrator.

9. APS' Role.

Designated APS personnel will work with the Auction Administrator on the tasks needed to implement the auction. These tasks include (1) developing the products and the contracts, (2) assisting in specifying the auction rules and procedures, (3) assisting in gathering stakeholder information related to the auction products, rules and procedures, and contracts, (4) establishing bidder qualification criteria, (5) evaluating qualification applications from potential bidders, (6) handling financial transactions such as bid deposits, (6) marketing and promoting the auction, (7) providing information to potential bidders, (8) observing the conduct of the bidding itself, (9) confirming the winning bids and winning bidders, and (10) conducting post-auction settlement and ensuring the contracts are signed.

Beyond the initial competitive bid process, APS will have a monitoring role to ensure the winning SOS providers are delivering electricity in accordance with the SOS contract. In the case of default or non-performance on the part of an SOS provider, APS or its agent will be responsible for replacing the lost supplies (in the marketplace in the short run, under contract in the longer run) and charging the defaulting SOS provider to avoid any financial harm to APS and its customers. APS also will be responsible for forecasting SOS load growth and for making arrangements to procure additional SOS supplies prior to the end of the contracts awarded in the initial competitive bid process.

10. PWCC's Role.

PWCC would be allowed to participate in the descending clock auction process as would any other qualified bidder. Prohibiting PWCC from bidding would distort the market mechanism, reduce bidding competition, make the process less competitive, and lead to higher SOS prices. It also would be inconsistent with the terms of the 1999 APS Settlement Agreement.

The allowed communications protocols among all parties will be specified as part of the rules for the process. These protocols will apply to all participants to facilitate a competitive process and a level playing field for all bidders.

11. ACC's Role.

The role of the ACC is to approve the overall auction process, to minimize uncertainty for bidders, to approve or reject the auction results, and to provide for cost-recovery by APS of the cost of procuring competitively-bid power. The more the ACC can provide assurances that it supports a well-designed and implemented competitive bidding process, the more interest bidders will have in the auction and the more competitive will be the bidding.

12. Timing of the Competitive Bid Process to Follow PPA.

The PPA comprising the non-bid portion of APS' anticipated power supply requirements should be in place prior to any competitive bidding. This provides certainty for the bidding process, in that bidders know their primary opportunity to provide SOS supply is through the competitive bid process, and not otherwise. If the PPA came after the competitive bid, some bidders might choose to forego the bidding to pursue bilateral contracts later, weakening the bidding process. It also allows for a determination of the amount of transmission capacity that ultimately would be available for the competitive bid process.

13. Tasks and Timeline

The table below sets forth a proposed timeline for the major tasks associated with the auction process and assuming a January 1, 2003 delivery date. The ability to meet the deadlines of later tasks generally depends on meeting the deadlines of earlier tasks, as well as prompt Commission resolution of both Track A and Track B issues. Many details regarding the conduct of the auction must be settled in order to complete the documents on time.

Task	Date
Document preparation: Contracts, Information Memorandum, Auction Participation Agreement, Auction Rules, marketing materials, Virtual Data Room materials, Web site	Begin immediately
Customize Bidding Software (need will depend on auction format)	Begin immediately
Stakeholder consultation	As soon as practical
ACC approval of auction process	End of August
Marketing and Promotion: Road show, Information Sessions, Web site, establish Virtual Data Room, contact lists, etc.	September 1
Complete Bidder Qualification	Early October
Technical Session for Qualified Bidders	Mid-October
Bidding	End of October
Review/Approval of Auction Results and Post-Bidding Settlement	Early November
Deliveries Begin	January 1, 2003

14. Contingency Plan.

As in any competitive bid or auction process, there should be a contingency plan in place should the results of the process be determined to be unacceptable. Contingency

plans should cover a variety of circumstances, ranging from the default of a single winning bidder to perform to the rejection of all tentative winning bids by APS or the ACC. The contingency plan may provide for a re-auction for part or all of the SOS requirements or may specify alternative methods of procuring necessary supplies.

15. Additional Responses to Staff Questions.

a. When should the competitive solicitation process begin?

Response:

The summary set forth above describes the components of a possible competitive solicitation process. It identifies much of the preparatory work associated with a bidding process. Upon completion of that pre-auction process, the timing for actual competitive bids should be tied to commencement of energy deliveries. This bidding process—starting with the notification of qualified bidders and ending with the initial delivery date—would require at least three months from beginning to end. Assuming energy deliveries are to begin on January 1, 2003, the qualification period for bidders should be completed in early October 2002, with bidding, auction and post-bidding settlement occurring through the end of November 2002. Meeting this schedule requires that each intervening step in the process is successfully completed on time. In particular, the schedule requires Commission approval of the auction method and completion of all auction documents prior to September 1, 2002. Completing these auction documents requires coordination with and approval by various parties.

b. How will the competitive solicitations be disseminated?

Response:

As noted above, the Auction Administrator, working with APS and using any additional information gleaned from an informational workshop of interested parties, would devise appropriate dissemination methods. Initially, however, APS observes that two likely sources would include:

- Mailing a "Notification of Competitive Solicitation" letter to all known market participants.
- Posting a "Notification of Competitive Solicitation" on an APS web site.

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

Response:

The competitive bid process should cover the amount of SOS power that is not previously committed under the PPA or acquired for economic dispatch and

emergency purchases. However, the majority of its SOS power should be covered by a cost-based purchase power agreement that includes generation assets that have been dedicated to serving APS loads. However, the auction method discussed above is scalable for various amounts of competitively-bid power.

- 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?**

Response:

APS believes that most of its power requirements should be covered by a cost-based purchase power agreement. The competitive bidding for the remaining, uncovered requirements could occur at one time, encouraging more participation by bidders. There could, however, also be the potential for additional bidding for power requirements above the levels established in the competitive bid and PPA. Such additional bidding could address load growth, additional transmission capacity if it becomes available, the potential retirement of assets, or defaults from contracted suppliers.

- e. How will the competitive solicitation percentage be calculated?**

See the responses to (c) and (d), above.

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

Response:

No. If a competitive bid is not fully subscribed, that is an indication that the market simply is not prepared to supply as much as desired at acceptable prices. The state of uncertainty in the energy industry today presents difficulties and risks to all participants in the process. The utility's objective is to procure energy through a competitive bid process that would maximize the interest of potential suppliers in the process, maximize the competitiveness of procurement, maximize opportunities for bidders to pursue optimal strategies for substitution and complements, and minimize the prices paid in awarding the winning bids. If the market is not sufficiently liquid and mature to satisfy the competitive solicitation percentage, the utility is not at fault and should not be blamed.

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

Response:

This question is not germane to the descending clock auction process. The bidding process is designed so that the price paid to suppliers continues to fall as long as "excess" supplies are offered. The declining price eventually causes bidders to reduce the amount they offer and to eliminate the excess supply being bid. Consequently, there will be no excess that could be carried over to subsequent years.

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

Response:

The purchase of power obtained outside of the competitive solicitation process should be completed before the competitive bid process is implemented, and well before actual bidding takes place. As discussed above, APS believes that much of its power requirements should come through a long-term, cost-based PPA that includes generation assets already devoted to serving APS customers and which has been approved by the ACC.

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

Response:

See the table of Tasks and Timeline to meet a January 1, 2003 delivery date, in Section 13, above. These dates will have to be adjusted if intervening steps of the process are not successfully completed on schedule.

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

Response:

APS, in consultation with the Auction Administrator, will identify and determine the components of the competitively solicited purchases.

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

Response:

The descending clock auction described above determines winning bidders on the basis of price alone, after necessary pre-bidding qualification criteria are met. This single criterion is possible because the products to be acquired are well-defined, bidders are pre-qualified, and the auction rules establish a transparent and efficient process. Winning bidders are those willing and able to supply a standard product reliably and at the lowest cost.

The criteria for determining which bidders should be allowed to participate in the process are a key component of the descending clock auction process because of the implications for reliable supplies. As discussed above, only serious, creditworthy bidders should be invited to submit an application to be qualified to participate in the auction.

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

Response:

APS and the Auction Administrator will develop dispute resolution procedures as part of the rules that govern the competitive bidding process. Because the competitive solicitation process will include opportunity for interested parties to comment, issues related to the solicitation are expected to be identified and resolved in advance. Because all the rules are specified in advance, and given the transparency and objectivity of the descending clock auction process, there is little expectation of disputes regarding the auction.

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

Response:

Only the Auction Administrator, the ACC, and the relevant persons at APS assigned to assist the auction will see confidential information provided by bidders. Protocols will be developed as part of the auction process to protect confidentiality and complement existing protections such as the FERC Standards of Conduct.

In conjunction with the Auction Administrator, APS additionally would take steps to ensure a strong firewall between APS staff assigned to work on the auction process and APS affiliates that may participate in the competitive bid process. One of the advantages of the transparent, objective descending clock auction is

that it allows affiliates to participate without fear by other bidders that subjective decisions are being made in favor of the affiliate.

That being said, these confidentiality provisions will not be effective unless the ACC backs them up and provides protection from discovery of confidential information during subsequent proceedings. Otherwise, competitors will use legal proceedings at the ACC as an opportunity to gain commercial intelligence that will only be used in devising bidding and other market strategies to the detriment of APS customers.

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

Response:

See the discussion above concerning bidder qualifications and allocation of risk. APS would impose default penalties to eliminate or at least significantly minimize financial risks associated with default. However, APS could make separate arrangements outside the auction process for "failsafe" coverage assuming ACC assurance of cost-recovery. This potentially would be met through provisions in a purchase power agreement or other bilateral contracts. The ACC cost recovery mechanism should specifically encompass cost recovery of replacement energy from defaulting wholesale suppliers.

See also the provision for a contingency plan discussed above. This plan would specify various alternative contingencies that may be encountered in the course of, or as a result of, the auction and provide guidance about the procedures to be followed in the event of default.

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

Response:

To obtain the lowest cost energy supplies from the market, the most active trading hubs in the area will be specified as delivery points in the competitive bidding process. The volumes to be purchased at the delivery points will be consistent with available transmission capacity. The auction design could allow for some flexibility between delivery points or to equivalent delivery points.

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

Response:

Yes. Agreements similar to the WSPP umbrella agreement would likely be used.

q. What are the appropriate contract duration periods?

Response:

The competitive bidding process could be used initially to obtain energy supplies through 2006, with the possibility of some portion of the competitive procurement being for a longer term. The general contract duration would be for one year. One-year contracts will encourage shorter-term bidders to participate and, yet, will not preclude bidders from effectively achieving a four-year (or longer) contract by simultaneously bidding on and by winning four sequential one-year contracts. This also allows bidders with future resources to bid when those resources will be available, such as in year 2005 and 2006, but not 2003 and 2004.

Such a time frame also allows the utility to engage in ongoing review of the process and products to ensure satisfaction with the competitive bid process and compliance with deregulation requirements. This timeframe is further consistent with the expected implementation and full operation of a regional RTO. After the RTO is in place and fully operational, suppliers will be more willing to enter into longer term supply commitments. Nonetheless, some component of the competitively-bid supply could take the form of longer than four year contracts if warranted.

r. What are the appropriate delivery dates?

Response:

Assuming final necessary ACC action on Track A issues and PPA approval, APS could expedite and implement a competitive bidding process that would commence deliveries on January 1, 2003. To meet an initial delivery date of January 1, 2003, all the deadlines in the table of Tasks and Timeline above must be met. If these deadlines cannot be met, an alternative timeline could have deliveries commencing July 1, 2003.

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

Response:

The descending clock auction does not at this time include a demand-side management product. It is possible that a demand component could be considered in future competitive bidding or be administered through a separate program. At present, demand side management is only considered in determining how much load is available.

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

Response:

The auction method discussed above does not require additional transmission to be constructed on APS' network internal to the delivery points. However, suppliers would have the responsibility to obtain any necessary transmission service to deliver their supplies to these specified delivery points.

- u. **Will there be a price ceiling for bids?**

Response:

Yes, APS will impose a reserve price for each product. See the discussion above.

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

Response:

At this time, APS is not suggesting a limit on the number of MW bid by a qualified bidder.

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

Response:

APS expects that the Auction Administrator, the ACC, and APS will evaluate the initial bidding process for strengths and weaknesses. Additionally, APS will have an ongoing monitoring role to ensure that winning bidders are delivering in accordance with their contractual obligations. Ongoing evaluations will provide additional information concerning the level of satisfaction with the process and products. Periodically, the competitive bidding process will be repeated to obtain power for future years and the process could be further evaluated after an RTO is in place and after any Standard Market Design is adopted by FERC.

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

Response:

As discussed above, the majority of its wholesale power requirements should be supplied through a long-term, cost-based PPA that includes generation assets

already devoted to serving APS customers. The remainder of APS' power requirements could be supplied by a competitive-bid auction process, and including such a bid component in APS wholesale power portfolio would be a reasonable and prudent procurement strategy. A properly designed and implemented auction should provide the "best price" for this component of APS' power portfolio.

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

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

Response:

The products to be supplied by winning bidders are physical. Financial penalties will be in place to discourage default.

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

Response:

Winning bidders need not be generation owners. Supplies obtained through a qualified broker or power pool are possible.

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

Response:

APS will make separate arrangements for must run generation through bilateral contracts that will be filed with FERC. These separate arrangements are required by FERC under the APS OATT and referenced in Interconnection Agreements with APS. Ultimately, WestConnect RMR protocols should apply. However, the delivery points and products identified in the auction method described above are not expected to result in any "must run" limitations for competitive bidders.

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

Response:

See the answer to (e), below. APS believes that simple, block products would be attractive in yielding a significant number of bidders, bidding competition and

flexibility to bidders, and result in the a reasonable price. Other auction products, such as a vertical slice of system, are possible alternatives.

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

Response:

As discussed above, the specific products obtained through the competitive bidding process depend largely on the resolution of issues in Track A. Assuming full divestiture of APS generation, competitively bid block products could have the following characteristics:

- Firm energy and capacity and associated reserves
- 25 MW horizontal blocks
- Standard on-peak and off-peak products
- Annual and Q3 Supplemental blocks
- Four eligible receipt points—Four Corners, Mead, Navajo, Palo Verde

III. 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?**

Response:

Transmission limitations would be considered in developing the products and maximum amounts of products that could be received at the four delivery points. Otherwise, transmission constraints will not affect delivery of the competitively-bid power.

- b. **How and when could the constraints be resolved?**

Response:

There are two proposed transmission projects that should increase load serving capability in the Valley in the future. If additional transmission is constructed, it may be possible to structure future competitive bids to increase product deliveries at the four APS delivery points. APS does not expect, however, that significant new (beyond that already planned) transmission import capability to the Valley will be developed prior to 2006.

c. How will constraints be reflected in bid evaluations?

Response:

Constraints will not be reflected in the bid evaluations. They are taken into account in determining the amount of capacity put out for competitive bid at the most active delivery points.

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

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

Response:

APS would consider potential suppliers that are electric utilities (investor-owned or municipal), independent power producers, qualifying facilities, exempt wholesale generators, or electric power marketers who have received certification as such by FERC. Additionally, credit quality of potential suppliers and the form of Guaranty and Credit Support, if required, will be important factors in the qualification process. While published credit ratings are an important consideration in determining the amount of Credit Support required, APS would perform an independent credit analysis which may result in an internal credit rating that differs from the published credit ratings.

Each potential supplier would provide the most current Securities and Exchange Commission (SEC) Form 10-K and 10-Q reports, including a list, with names, addresses and other electric generation and transmission activities of all equity participants having 10% or greater ownership interest in the system or facilities from which power is to be supplied to APS. Those potential suppliers not subject to SEC filing requirements would include the most recently issued statement of financial condition, including balance sheet and income statement, unconditionally certified by a nationally recognized certified public accounting firm, together with a list, with names, addresses and other electric generation and transmission activities, of all equity participants, and the most recent Dunn & Bradstreet Business Information Report and a description of pending litigation which could affect its ability to perform. Additional information may be requested if required to fully evaluate respondent's credit quality. All potential suppliers would include a summary of related experience, and the most recent annual report.

Specific credit support from potential suppliers could include parental or affiliate guarantees, letters of credit, or cash deposits.

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

Under the competitive bidding process discussed above, the ACC would be involved with the design of the auction and approve the auction results but would not need to individually pre-approve potential suppliers.

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

Under the competitive bidding process discussed above, it would be possible to include a bid fee or a qualification fee. However, such a requirement would have to be evaluated to determine whether it would adversely affect participation.

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

A utility affiliate should be treated in a non-discriminatory fashion and would not be entitled to any preferences over other potential that result solely from its affiliation with the utility.

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

The competitive bidding requirements in Rule R14-2-1606(B) do not apply if a utility owns its generation units. If, however, the ACC did not allow APS to divest its generation assets but to nonetheless competitively bid for SOS requirements, the amount of the competitive bid should be no more than the amount of SOS supplies needed after considering any APS-owned generation.

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

If it desired, the Commission could maintain a list of qualified suppliers. However, it is possible that changes in creditworthiness could at times affect the qualification of potential suppliers from APS' perspective whether or not they are included in an ACC-maintained list of qualified suppliers.

V. 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?

Response:

The purchase power adjustment clause should assure the recovery of purchase power costs incurred through the competitive bidding process. APS has submitted a proposed clause for ACC consideration pursuant to the 1999 APS Settlement

Agreement, and would propose that the same clause be used to recover competitively-bid power.

VI. 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?**
- 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?**

Response:

Traditional "least cost planning", which would include self-build options, would not be part of the evaluation of competitive bids. However, the competitive bidding process discussed above should demonstrate that winning bids will be lowest cost consistent with a competitive bidding process.

VII. 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?

Response:

The use of an auction method for a reasonable portion of APS' SOS requirements with a cost-based PPA that includes generation assets already devoted to serving APS customers would eliminate any hypothetical or potential market power issues.

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

Response:

If there are not enough competitive bids, the auction process and the market response should be evaluated to determine the causes of under-subscription. If under-subscription occurred, the ACC could conclude that the wholesale market is not yet mature enough to sustain a competitive bidding process and time will be needed for the market to develop. The contingency plan discussed above would specifically address insufficient competitive bids.

- 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?**

Response:

No, and APS doubts that such a baseline could be meaningfully derived. The auction process could, however, include a reserve price that is based on the market prices at the most active trading hubs in its competitive bid auction. APS further proposes to cover a majority of its load requirements under a long-term, cost-based PPA that includes generation assets already devoted to serving APS customers. This would provide an appropriate blend of exposure to cost-of-service based assets and the competitive market.

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