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BEFORE THE ARIZONA CORPORATION COMMISSION

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CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

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
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

NOTICE OF FILING TESTIMONY

Pursuant to Third Procedural Order on Track B (dated October 9, 2002), Tucson Electric Power Company ("TEP"), through undersigned counsel, provides notice that it has filed the Response Testimony of David Hutchens regarding Track B Issues, a copy of which is attached.

Arizona Corporation Commission
DOCKETED

NOV 18 2002

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RESPECTFULLY SUBMITTED this 18th day of November, 2002.

ROSHKA HEYMAN & DEWULF, PLC

By _____

Raymond S. Heyman
Michael W. Patten
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004
(602) 256-6100

Attorneys for Tucson Electric Power Company

ORIGINAL and 19 COPIES of the foregoing filed November 18, 2002, with:

Docket Control
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

COPIES of the foregoing hand-delivered November 18, 2002, to:

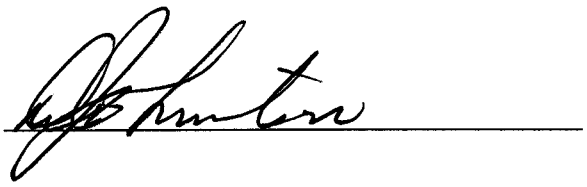
Teena I. Wolfe, Esq.
ALJ, Hearing Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Christopher Kempley, Esq.
Chief Counsel, Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Ernest G. Johnson, Esq.
Director, Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

ROSHKA HEYMAN & DEWULF, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

COPIES of the foregoing sent via mail/electronic mail on November 18, 2002, to the attached Service List



ROSHKA HEYMAN & DEWULF, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

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RESPONSE TESTIMONY OF DAVID HUTCHENS

ON BEHALF OF

TUCSON ELECTRIC POWER COMPANY

RE: TRACK B ISSUES

NOVEMBER 18, 2002

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WITNESS BACKGROUND

Q: Please state your name and employment position.

A: My name is David Hutchens. I am Manager of Wholesale Marketing for Tucson Electric Power Company.

Q: What are your job responsibilities at Tucson Electric?

A: I oversee the Wholesale Marketing department functions, including wholesale gas and electricity procurement, resource management, risk management, marketing, scheduling and trading.

Q: What has been your involvement in the Track B proceedings?

A: I have represented TEP in every workshop and submitted testimony on TEP's Needs Assessment and Procurement Proposal (November 4, 2002) and Track B Issues (November 12, 2002).

Q: What is the purpose of your Response Testimony?

A: The purpose of this testimony is to provide TEP's comments on November 12, 2002 testimony submitted by other parties in the Track B process and provide clarifications on TEP's previously filed Track B testimonies.

SUMMARY

Q: Please summarize your testimony.

A: Several parties have suggested modifications or additions to the initial competitive solicitation process. Some of those suggestions make sense, such as using standard industry contracts, and should be incorporated into the process as appropriate. Other suggestions would unduly complicate and prolong this initial solicitation process, such as including RMR or Environmental Portfolio needs as a part of the energy put out for bid. Further, nothing in the testimony of the other parties changes TEP's recommendations concerning the process, as set forth in my direct testimony. In fact, other parties' testimony supports TEP's two key recommendations that (i) all existing generation assets, including TEP's two newest RMR units, be included in the needs assessment and

(ii) TEP's Wholesale Marketing department be allowed to conduct the solicitation for TEP because TEP does not have an affiliate that will participate in the solicitation.

COMMENTS ON TESTIMONY BY OTHER PARTIES

RUCO (RICHARD A. ROSEN, PH.D)

Q: Do you agree with Dr. Rosen's testimony (at pp. 39-40) that longer-term contracts should be included in the solicitation?

A: Yes. It is TEP's position that longer-term contracts can, at the utility's discretion, be included in the solicitation. The inclusion of RFPs for longer-term contracts should be done only on a purely economic basis to give the utilities and ratepayers the best deal available. However, such RFPs should not be issued (or awarded) to address project financing concerns raised by other parties. [*See* Direct Testimony of Robert W. Kendall (Wellton-Mohawk), p.10] TEP believes that the Arizona utilities are not obligated to structure their RFPs to ensure the viability of existing merchant plants as a going concern – or create a favorable financing environment for proposed plants – to the detriment of the utilities' ratepayers.

Q: What is TEP's position on RUCO's least cost planning recommendations?

A: Least cost planning must play an integral role in any utility procurement process. Such planning is essential to protect both ratepayer and utility from uneconomic outcomes of a solicitation process. All costs, operational constraints and reliability parameters must be considered in that analysis to determine what truly constitutes the "least cost" option. That analysis also provides the Commission information necessary to evaluate the prudency of any procurement. Although TEP intends to evaluate solicitation bids on a least cost basis using its production modeling software systems, it also will consider other factors that can affect the acceptance of bids including counter-party risk, price assumptions and volatility, contract terms, imbedded options, and the desired portfolio structure. Even though other factors should be evaluated in the RFP process, least cost is important and Staff's involvement in the solicitation processes should insure the implementation of the least cost planning principles without the necessity of a formal integrated resource planning ("IRP") process.

Q: According to Dr. Rosen (at p. 39:12), TEP is "limiting the types of generation products that they will solicit." Does TEP intend to limit the products it will solicit?

A: While this may be inferred from TEP's initial procurement proposal, it was not TEP's intent to limit the products. The products listed in TEP's November 4, 2002 Needs Assessment and Procurement testimony were meant to be more indicative than absolute. While the products listed are likely to be included in any TEP solicitation, TEP will not preclude other products in its pre-solicitation analysis. This does not mean, however, that TEP will be soliciting for every possible product type. Rather, TEP will perform preliminary analysis of the products available in the pre-solicitation process and bid those products that meet its operational and economic requirements on a least-cost basis.

Q: What is Dr. Rosen's position regarding TEP's recommendation regarding the inclusion of TEP's two new Combustion Turbines in its existing assets for purposes of calculating unmet needs?

A: Dr. Rosen agrees (at p. 40:13) with TEP's position and "cannot understand why it would not be appropriate to include these two relatively new units in TEP's list of existing generating resources for the purposes of determining TEP's remaining capacity needs to be bid out." Thus, RUCO appears to support one of TEP's key recommendations in the Track B proceeding – that all of TEP's existing RMR generation be included in its existing assets for purposes of needs assessment.

WELLTON-MOHAWK GENERATING FACILITY (ROBERT W. KENDALL)

Q: Mr. Kendall on behalf of Wellton-Mohawk suggests (at p. 4) that "all of the load within these load pockets, including that served by the existing RMR units, should be contestable in the Track B process." Does TEP agree?

A: Absolutely not. This is an extreme suggestion given the parameters of the 2003 solicitation and the very nature of RMR. Further, it is contrary to the Commission's Track A order to "acquire, at a minimum, any required power that cannot be produced

from it own existing assets"[1] and Staff's recommendations in the Track A proceedings that "no reliability must-run ("RMR") should be divested."[2] It has been, and should remain, the utility's responsibility to ensure the reliability of its service. That responsibility includes the determination of such critical components of service as *reliability* must-run generation requirements. The very idea of another private entity controlling a jurisdictional utility's RMR generation raises issues of market power that TEP believes the Arizona energy market is not prepared to address at this time. Mr. Kendall correctly identifies (at p. 23) Staff's recommendation that the Commission should order jurisdictional utilities to resolve RMR generation concerns but Staff's recommendation, and the Commission's resulting Order, simply do not contemplate including utility-supplied RMR in the solicitation process at this time.

Q: Does TEP's position on RMR mean that TEP will not include competitive options in its future RMR needs?

A: No. What it means is that a jurisdictional utility such as TEP, subject to review by Staff and the Commission, should retain control over both the planning and operation of RMR generation. In the evaluation phase of determining future RMR options, TEP would welcome involvement of the market participants in providing options, including building RMR generation, for evaluation by TEP. In fact, when TEP was planning to build its DeMoss CT for RMR needs, TEP initially requested proposals for third party provision of RMR services. Upon review of these proposals, TEP then competitively bid a TEP owned CT project that resulted in a lower cost solution for serving its customers. If Staff and the Commission should decide that current and future RMR requirements should be supplied through a competitive solicitation process, it should be separated from the 2003 solicitation.

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[1] ACC Decision No. 65154, p. 30.

[2] Id., p.11.

1 Q: Why should any future RMR solicitation be performed separately from the initial 2003
2 solicitation?
3 A: At this stage of the game, including RMR obligations would greatly complicate and
4 prolong the solicitation process to the detriment of all parties involved. From TEP's
5 perspective, given the critical nature of RMR obligations, the competitive solicitation of
6 RMR would involve analyzing a completely new and different set of procurement issues
7 and would delay the 2003 process. Moreover, given TEP's unique situation where *all* of
8 its RMR generation is owned by TEP and is located within TEP's constrained load
9 pocket, it is highly unlikely that any third party could compete with these existing units
10 with new generation or transmission given the Staff's apparent focus on short-term
11 procurement for the 2003 solicitation. First, any new RMR generation (that would have
12 to be built in the TEP load pocket absent any immediate transmission upgrades into that
13 load pocket) or any transmission upgrades (that would allow access to RMR generation
14 outside of the load pocket) would require a long-term planning and commitment to
15 ensure the economic benefits. Second, any non-transmission or non-generation
16 alternatives that might be considered as a possible RMR solution would require extensive
17 analysis of their ability (and reliability) to meet TEP's actual RMR needs. Because of
18 this complexity and the importance of RMR, an RFP for RMR should focus only on
19 competing generation and transmission solutions. Any RMR solicitation focusing on
20 third-party generation or transmission solutions would require an extensive evaluation
21 and negotiation period that simply does not fit with the envisioned 2003 solicitation.

22 Q: Do you agree with Mr. Kendall's testimony (beginning at p. 16) that suggests including
23 Environmental Portfolio (EPS) obligations in the solicitation?
24 A: No. TEP believes that this solicitation should focus on procuring bulk wholesale power
25 needed to serve its customers. The inclusion of EPS in the procurement process
26 unnecessarily complicates the process. Because a utility can meet its EPS obligations in
27 a number of ways, including through the use of offsets and credits, it is not clear that the
28 Commission intended its inclusion in the solicitation process by using the term "required
29 power". As referenced in the October 25, 2002 Staff Report (at pp.32, 39) – and
30 apparently agreed to in the workshops (although not everyone seems to agree now) – the

solicitation would not preclude bidding for EPS requirements but the initial solicitation was not the right place to decide if EPS *must* be included.

RELIANT RESOURCES, INC.
(CURTIS L. KEBLER)

Q: What is TEP's position regarding Reliant's recommendation (beginning at p. 3) for utilizing an auction process for a portion of the solicitation?

A: There are certain products for which an auction process is well-suited including standard on-peak and super-peak products that TEP is contemplating in its solicitation. TEP did not intend to preclude any specific procurement type by only listing the RFP process in its November 4, 2002 testimony. Rather, TEP believes that the auction process referenced in the Staff proposal was a complicated and limiting "descending clock" auction that would take too much time and resources to implement. For standard products that TEP solicits in the first solicitation, TEP contemplates using an abbreviated RFP process that mimics an auction. This abbreviated process would require bidders to hold their bids for just a few days or less. TEP simply does not believe it should be forced to use a specific auction format.

Q: What is Reliant's position on requiring an Affiliate Code of Conduct?

A: Mr. Kebler states (at p.13): "To the extent an affiliate of any Arizona utility wants to participate in the utility's competitive solicitation, including economy and short-term energy transactions, clearly defined firewalls should be in place to protect the competitive process".

Q: Do you agree with that statement?

A: Absolutely. It is consistent with one of TEP's two recommendations in its November 12, 2002 testimony.

Q: Would this require TEP to submit a code of conduct for the 2003 solicitation?

A: No. Because TEP will have no affiliate participating in the 2003 solicitation, a code of conduct would not, and should not, be required.

SEMPRA ENERGY RESOURCES
(E. DOUGLAS MITCHELL)

Q: Mr. Mitchell, on behalf of Sempra Energy Resources, states (at p. 10:4): "Given the stated intention of the two Arizona utilities to increase their reliance on the receipt of economy energy." Does TEP agree?

A: Absolutely not. Without making any representation for other Arizona utility and assuming he implies TEP is one of the two utilities referenced, TEP has *never* stated in this process that it plans on increasing its reliance on economy purchases. To provide some indication of TEP's forward purchases made to cover its summer peak period, I have provided the table below. It should be noted that the products purchased were standard on peak (6x16) firm (WSPP Schedule C) energy.

Summer Period (June-September)	Forward Purchase Amount (MW)
2000 and prior	0
2001	25
2002	50

Q: Mr. Mitchell suggests (at p. 11) that using certain contract forms in the bid process will help remove a risk premium associated with uncertainty. What contracts does TEP propose using for its solicitation?

A: TEP plans on using two industry-standard contracts; the WSPP contract for short-term (up-to-3-years) standard products and EEI for longer-term or non-standard products.

CONCLUSION

Q: Other than the two recommendations set forth in your Direct Testimony, what is TEP's overriding concern on the competitive solicitation process in light of the direct testimony filed by other parties?

A: TEP is concerned that the polarity of the parties to this proceeding has resulted in extreme positions regarding the economics of the new merchant-owned generators compared to the utility's existing assets. When certain assertions are presented out of context or when narrow and incomplete examples are provided (*e.g.*, neglecting the significant effects of capacity payments and transmission costs that are necessarily a part of a competitive bid), the economic reality of such comparisons is inaccurate and

1 misleading. TEP is committed to a solicitation process that provides economic results
2 and will enter into purchase agreements accordingly. But TEP believes that the economic
3 realities of non-fuel related costs remain big hurdles to this goal in the near future given
4 TEP's location with respect to the new merchant plants that have actually been built.
5 Moreover, a complete analysis of *all* of the costs of the delivery of energy from a new
6 plant reveals that the "all-in cost" of a new plant delivered to TEP is much more
7 expensive than the incremental cost to run existing TEP units.

8 Q: Does this conclude your testimony?

9 A: Yes.