BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

IN THE MATTER OF THE GENERIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING.	DOCKET NO. E-00000-02-0051
IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR VARIANCE OF CERTAIN REQUIREMENTS OF A.A.C. R14-2-1606	DOCKET NO. E-01345-01-0822
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 POWER COMPANY'S APPLICATION FOR A VARIANCE OF CERTAIN ELECTRIC COMPETITION RULES COMPLIANCE DATES	DOCKET NO. E-01933A-02-0069
IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR APPROVAL OF ITS STRANDED COST RECOVERY	

HARQUAHALA GENERATING COMPANY, LLC's CLOSING BRIEF ON TRACK "B" ISSUES

Pursuant to the instructions of Administrative Law Judge Teena Wolfe, Harquahala Generating Company, LLC ("HGC"), by and through its attorneys, hereby files its Closing Brief on Track "B" issues. HGC has been an active participant in the Track "B" process and hereby submits the following closing comments.

I. AMOUNT OF CAPACITY AND ENERGY SUBJECT TO COMPETITIVE PROCUREMENT IN MARCH 2003

Before the March 2003 solicitation can occur, the capacity ("MW") and energy ("MwH") that will be required to serve load must be clearly identified. HGC believes that a specific number in terms of MW and MwH should be included in the Commission's Order. In Staff Exhibit S-5, Staff has calculated the amount of contestable energy and capacity that it believes should be solicited in 2003. (See Staff Exh. S-5). As Mr. Ernest G. Johnson, Utilities Director for the Arizona Corporation Commission (the "Commission"), testified during the hearing, the numbers set forth in Exhibit S-5 should be at least the "minimum" amount included in the solicitations. (See Tr. vol. I, at p. 44).

Like Staff, HGC and Panda Gila River LLP ("Panda") have each calculated their own estimates of APS' unmet capacity and energy needs. (See e.g., Exh. H-2; Dr. Roach's Direct Test., Table 4). Despite having used different formulas and calculations, Staff's, HGC's, and Panda's results were strikingly similar to one another. (See Exh. "A", attached hereto, comparing the results of Staff's, HGC's, and Panda's calculations). Accordingly, HGC fully supports using the numbers presented in Exhibit S-5 as the "minimum" amount to be competitively procured.

APS disagrees with the numbers contained in Staff's Exhibit S-5, claiming that the amounts set forth in Schedule PME-1, which is based on its October 2002 load forecast, better represent its unmet needs. (See Tr. vol. III, at p. 504). As the testimony indicates, however, Schedule PME-1 significantly understates APS's unmet needs. These numbers are substantially lower than those reached by Staff, HGC, and Panda. (See Exh. "A", attached hereto, comparing Staff's, HGC's and Panda's unmet needs calculations to those set forth in APS Schedule PME-1.).

In addition, APS' October 2002 forecast of unmet needs is significantly lower than its April 2002 forecast of third party purchases, conducted just a few months earlier. Comparing APS' April 2002 forecast to its October 2002 forecast, APS is no longer seeking to procure from third parties the same volumes it eagerly sought to procure from its affiliate this past spring. (Compare Exh. H-2 to Schedule PME-13).[1] Further, in the April 2002 forecast, APS reveals plans to substantially idle its existing gas and oil units and reduce purchases from Salt River Project.[2] These same plans are not reflected in the October 2002 forecast. Further, under cross-examination, Mr. Peter M. Ewen, testifying for APS, discusses APS' earlier plans to purchase substantially greater quantities of energy from Pinnacle West Energy Corporation ("PWEC") for 2003 and 2004 than is contained in the October 2002 forecast with the result of further displacing higher cost APS generation. (See Tr. vol. V, at p.525 – 27). During cross-examination, Mr. Ewen was given, but did not take, the opportunity to indicate that it no longer wished to purchase from PWEC the large volume of purchases indicated in its April 2002 plan. (See Tr. vol. III, at pp. 524, 528).

Given these discrepancies, HGC believes that the amounts submitted by Staff, HGC, and Panda are far more accurate predictions of APS' unmet capacity and energy needs than Schedule PME-1. Further, the fact that the Staff, HGC, Panda and earlier APS forecasts reached similar conclusions using independent formulas, supports the prudence of using these volumes for the March 2003 solicitation rather than APS Schedule PME-1.

Both HGC and Panda supported their calculations of APS' unmet needs with economic comparisons of older and newer power plants. (See, e.g., Tr. vol. V, at pp. 904-907). On behalf of HGC, Mr. Broderick submitted Exhibit H-2, comparing the incremental operating costs of a 14,000 heat rate (i.e., older) unit versus a current total bid for a 7,000 heat rate (i.e., newer) gas plant. (See id.; Exh. H-2). Exhibit H-2 demonstrates that the newer combined cycle 7,000 heat rate unit can beat the incremental operating costs of an older 14,000 heat rate gas unit for all gas

[1] See also Tr. vol. V, at p. 943. Neither in its filings nor in its testimony did APS explain what occurred between April and October 2002 to so substantially change its prediction of unmet needs.

[2] APS' actual purchases in 2001 and 2002 demonstrate they were well on their way to doing just that. (T. Broderick Direct Test., at page 5). As compared to 2001, all 18 of the APS gas/oil units experienced significant reductions in capacity factor in 2002. (Id. at p. 12).

prices in excess of $2 per MMBTU. Current gas prices are over $3 per MMBTU. Thus, these newer units can beat the older units even assuming that the Commission allows continued cost recovery of the fixed costs of these older units. Furthermore, not a single party in this case recommended that the fixed costs of these older plants, including their rate base amounts, need to be removed from rates in order for the new plant to be the more economical choice for customers.

With regard to the inclusion of economy purchases in the solicitation, APS' Tom Carlson offered alternatively to procure larger quantities of economy energy through a quarterly auction. (See Tr. vol. III, at p. 506). While HGC appreciates the counteroffer, it nonetheless concludes that the public interest is best served by staying the course and soliciting at least the quantities contained in Staff Exhibit S-5. First, as Mr. Broderick stated in his sur-rebuttal testimony, the APS approach mismatches the product(s) demanded (ones that are best suited to supply by combustion turbine technologies) with what the market largely has constructed (intermediate and base load supply combined cycle facilities). (See Tr. vol. V, at pp. 900-901). Second, APS' own earlier plans (April 2002) did not seek such a product combination. Rather, its plans sought to acquire products from combined cycle units – precisely what the market is supplying today. HGC does, however, recommend that all economy purchases, whatever the amount, be procured under a protocol ensuring competition. (See, e.g., C. Kebler's Direct Test., at pp. 6-7).

Finally, as to the timing of the procurement, APS' Mr. Steve Wheeler indicated under cross-examination that no start date for deliveries of power under the Track "B" process exists thus far. (See Tr. vol. III, at p. 556). While clearly APS will need to begin procuring no later than mid-year in order to obtain the economic volumes identified in Staff Exhibit S-5, it might nevertheless be helpful if the Commission articulated a specific start date of, perhaps, no later than July 1, 2003.

II. ECONOMIC CRITERIA FOR SOLICITATION

HGC urges the Commission to endorse an "economic" criteria for the solicitations. As Mr. Broderick stated in both his direct and sur-rebuttal testimonies, HGC recommends inserting the word "economically" in the Track "B" Order for all references to procurements from APS' assets. (See Tr. vol. V, at p. 900). For example, the term "economically" would be inserted as follows:

"...that cannot be ***economically*** produced from its own assets..."

HGC continues to support using the term "economically" and believes that it should apply to both capacity and energy procurements.

In addition, several parties, including Sempra, Panda, and HGC, recommended reliance on "production costing" or "production modeling" in the evaluation of bids. Both APS and Tucson Electric Power Company ("TEP") confirmed their intention to rely on production costing simulation to evaluate the economics of bids and existing assets. (See, e.g., Tr. vol. III, at pp. 489, 490, at 526). Therefore, in interpreting the impact of inserting the word "economically," HGC recommends that the Commission require APS and TEP to conduct "production modeling" for the March 2003 solicitation and that such analyses integrate both bids and existing utility assets.

APS' testimony repeatedly indicated that uncertainties (e.g., fuel price volatility, future wholesale electric prices) exist and, therefore, bids must be evaluated in light of future uncertainties. (See, e.g., Tr. vol. III, at p. 530). Thus, as Mr. Broderick testified, HGC strongly recommends that the selected Independent Monitor have extensive experience in conducting production modeling analysis in order to ensure that APS uses sound economic decision-making. (See Tr. vol. V, at p. 903).

III. RELIABILITY MUST-RUN ("RMR") GENERATION

HGC recommends that APS subject all of its RMR requirements to bid in the March 2003 solicitation and that those bids be subject to the following 3 evaluative criteria, as set forth in Mr. Jerry Smith's testimony: (1) non-utility owned or non—rate based generation units exist locally; (2) remote generation that has access to non-APS or non-TEP firm transmission capacity to delivery to the respective local areas; or (3) remote generation with offers to finance transmission improvements to mitigate the transmission import constraint. (See J. Smith Rebuttal Test., at p. 5).

In addition, HGC supports PP&L's ongoing position that the transmission study that will evaluate RMR and deliverability should include capacity on the Western Area Power Administration's ("WAPA") system. (See generally Tr. vol. I, at pp. 146-148). Mr. Thomas Glock, testifying on behalf of APS, confirmed WAPA's inclusion in the study. (See Tr. vol. III, at pp. 590-91). Accordingly, HGC recommends that the Commission's Track "B" Order expressly require APS and TEP to include WAPA capacity and to also properly forecast transmission capacity based on reasonable assumptions about capacity additions for the future.[3]

IV. AFFILIATE ADVANTAGE AND MARKET POWER

Like Staff, HGC supports a fair and impartial solicitation process. Nonetheless, it is HGC's position that Pinnacle West *will* enjoy a competitive advantage in the upcoming March 2003 solicitation. Examples of Pinnacle West's advantage in the solicitation process include at least the following:

a) Pinnacle West employees have been dispatching APS' existing assets for several years. These employees have intimate knowledge of each of APS' existing assets and how best Pinnacle West's recently-constructed assets will integrate with them. (See, e.g., Tr. vol. III, at pp. 605-06).

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[3] In its presentation on November 16, 2002, APS erroneously held constant the transmission capacity for the procurement period: 2003-2006.

b) The APS solicitation team will contain APS employees that were only just recently transferred back from Pinnacle West to APS. (See, e.g., Tr. vol. III, at pp. 608-09). Also, the team will receive important "shared" services from key Pinnacle West personnel in functions such as risk management and generation dispatch. Also, no evidence was presented in this proceeding regarding whether the APS employees on the solicitation team own significant quantities of Pinnacle West Stock as a result of participation in retirement or incentive related programs.

c) APS' testimony indicates it provides various services to Pinnacle West's generation assets. For example, APS provides valuable ancillary services to Pinnacle West to serve several of the latter's wholesale customers. APS has refused to provide several of these services to the merchants. In the past, APS has indicated that it provided network transmission service to Pinnacle West. And more recently, APS indicated in a discovery response to Panda that it could provide its El Paso gas allocations to Pinnacle West if it so chose.

HGC applauds the Commission for its *very* significant role over the past year in limiting Pinnacle West Energy Corporation from receiving a significant advantage from APS. In order to continue to limit the impact of these advantages, HGC supports the following measures:

a) Reliant's recommendation that APS implement a proper code of conduct to govern the March 2003 solicitation prior to January 1, 2003. (See C. Kebler's Direct Test., at p. 12).

b) That APS be required to test the market in March 2003 with a solicitation containing volumes at least as large as those presented in Staff Exhibit S-5. It is only through requiring APS to actually receive and evaluate bids for the volumes APS sought as recently as April 2002, that the market can force Pinnacle West to compete for APS' load.

c) That APS be required to offer to all the merchants any El Paso gas capacity either it or Pinnacle West has.

d) That a protocol be adopted to guide APS' procurements of short term energy. (See, e.g., C. Kebler's Direct Test., at pp. 6-7).

V. CONCLUSION

It has been HGC's position since the beginning of this process that the Track "B" competitive solicitation will provide a significant opportunity to purchase energy at competitive rates with sustainable benefits to Arizona consumers. HGC's believes the foregoing proposals best capture Staff's goals and will ensure a fair and impartial solicitation process that is understood by all parties. Accordingly, HGC urges the Commission to adopt HGC's positions and recommendations as set forth herein.

RESPECTFULLY SUBMITTED this 18th day of December, 2002

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