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BEFORE THE ARIZONA CORPORATION COMMISSION 3: 21

Arizona Corporation Commission

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

DOCKETED

AZ CORP COMMISSION
DOCUMENT CONTROL

DEC 18 2002

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IN THE MATTER OF THE GENERIC) DOCKET NO. E-00000A-02-0051
PROCEEDING CONCERNING ELECTRIC)
RESTRUCTURING ISSUES)

IN THE MATTER OF ARIZONA PUBLIC) DOCKET NO. E-01345A-01-0822
SERVICE COMPANY'S REQUEST FOR)
VARIANCE OF CERTAIN REQUIREMENTS)
OF A.A.C. R14-2-1606)

IN THE MATTER OF THE GENERIC) DOCKET NO. E-00000A-01-0630
PROCEEDING CONCERNING THE ARIZONA)
INDEPENDENT SCHEDULING)
ADMINISTRATOR)

IN THE MATTER OF TUCSON ELECTRIC) DOCKET NO. E-01933A-02-0069
POWER COMPANY'S APPLICATION FOR A)
VARIANCE OF CERTAIN ELECTRIC)
COMPETITION RULES COMPLIANCE)
DATES)

**NOTICE OF FILING OPENING POST-HEARING BRIEF OF
RELIANT RESOURCES, INC.**

Reliant Resources, Inc., by and through its attorneys, hereby files its
Opening Post-Hearing Brief.

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RESPECTFULLY submitted this 18th day of December, 2002.

MARTINEZ & CURTIS, P.C.

By 

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BEFORE THE ARIZONA CORPORATION COMMISSION

1
2 WILLIAM A. MUNDELL
CHAIRMAN
3 JIM IRVIN
4 COMMISSIONER
5 MARC SPITZER
COMMISSIONER

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15)
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18 VARIANCE OF CERTAIN ELECTRIC)
19 COMPETITION RULES COMPLIANCE)
DATES)
_____)

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21 **OPENING POST-HEARING BRIEF**
22 **OF**
23 **RELIANT RESOURCES, INC. ("RELIANT")**
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26 **DECEMBER 18, 2002**

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I. INTRODUCTION

In compliance with the instructions of Administrative Law Judge Teena Wolfe (“ALJ Wolfe” or the “ALJ”), Reliant Resources, Inc. (“Reliant”) files its Opening Post-Hearing Brief setting forth Reliant’s position on the following issues:¹

1. A fair, open and transparent competitive solicitation process must include an auction process for a significant portion of the solicitation;
2. A transparent and level playing field requires a Code of Conduct that does not provide a utility’s affiliate the sole access to information regarding solicitation and dispatch of the supplies to be competitively procured;
3. While incumbent utilities have the burden to demonstrate the level of their unmet needs and that the offers they accept are fair and prudent to their Standard Offer customers, a utility following the process established by the Commission in Track B is entitled to a prompt and certain prudency review of their selections; and
4. Certain alterations to the Staff Report on Track B are necessary to accurately reflect the competitive process in Texas.

II. BACKGROUND AND PROCEDURAL HISTORY

The Arizona Corporation Commission (the “Commission”) adopted Retail Competition Rules effective on or about December 26, 1996 (the “Initial Competition Rules”). The Initial Competition Rules provided the framework for Arizona to transition from traditional regulated monopoly to a competitive electric industry.

¹ In this Opening Brief, Reliant addresses only the issues that it directly advocated at hearing. Reliant reserves the right to address any issue raised by another party or which other parties fail to raise in their Reply Brief.

1 Subsequently, the Initial Competition Rules were amended and re-adopted, in whole
2 or in part, and the implementation of many of the provisions of the amended Initial
3 Competition Rules have been delayed by various Commission Decisions approving
4 amendments, settlements or variances to the Rules (the "Competition Rules"). The
5 Competition Rules required both Tucson Electric Power Company ("TEP") and
6 Arizona Public Service Corporation ("APS") to divest their competitive generation
7 assets no later than January 1, 2003 and to acquire all power purchased after January
8 1, 2003 for Standard Offer Service from the competitive market through prudent,
9 arm's length transactions, with at least 50% acquired through a competitive bid
10 process. *See*, A.A.C. R14-2-1615(A) and A.A.C. R14-2-1606(B).
11

12 On October 18, 2001, APS filed a Request for a Partial Variance to A.A.C.
13 R14-2-1606(B) and for Approval of a Purchase Power Agreement. This Request
14 sought Commission authorization for APS to enter into a long-term (13 years, with
15 three five year options) purchase power agreement with its affiliate, Pinnacle West
16 Energy Corporation. TEP also filed a request for a variance from a portion of the
17 Competition Rules. The Commission held a Special Open Meeting on April 25, 2002,
18 to consider an Order to Show Cause filed by Panda Gila River, LP requesting the
19 Commission order APS to proceed with implementing the requirements of Rule
20 1606(B), as well as to consider other issues raised by the Commissioners and
21 Commission Staff regarding the propriety of staying APS' Variance Request until
22 certain other threshold issues were decided. During the Commission's Special Open
23 Meeting, the Commissioners stayed APS' variance hearing, which was scheduled to
24 begin on April 29, 2002, and ordered the Hearing Division to issue a Procedural Order
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1 to address certain threshold issues on an expedited basis. Proceedings on TEP's
2 variance request were also stayed by a May 2, 2002 Procedural Order.

3 On April 29, 2002, a procedural conference was held in this generic docket to
4 discuss how to proceed with the issues identified by the Commissioners at the Special
5 Open Meeting. A Procedural Order was issued May 2, 2002 dividing the proceeding
6 into Track A to consider the issues related to the transfer of assets and associated
7 market power issues, issues regarding the Code of Conduct, the Affiliated Interest
8 Rules, and the jurisdictional issues and Track B to consider issues associated with the
9 competitive solicitation process needed to implement Rule 1606(B).
10

11 On September 10, 2002, after receiving evidence at hearing and through briefs,
12 the Commission issued Decision No. 65154 in the Track A proceeding. The
13 Commission ordered both APS and TEP to "acquire, *at a minimum*, any required
14 power that cannot be produced from its own existing assets, through the competitive
15 procurement process as developed in the Track B proceeding. Decision No. 65154, p.
16 33, ll. 6-9. (Emphasis added) "The minimum amount of power, the timing, and the
17 form of procurement shall be determined in the Track B proceeding." *Id.*, p. 33, ll. 6-
18 14.
19

20 A procedural schedule was developed to address the Track B issues that
21 included the filing of direct testimony on November 12, 2002, the filing of rebuttal
22 testimony on November 18, 2002 and holding a public hearing from November 21-22,
23 2002, and November 25-27, 2002. Reliant is a party to these proceedings and filed
24 the direct testimony of Curtis Kebler on November 12, 2002 (Reliant-1). Rebuttal
25 testimony of Mr. Kebler was filed on November 18, 2002 (Reliant-2).
26

1 **III. SUMMARY**

2 In Decision No. 65154, the Commission established the goals for the
3 competitive solicitation to “encourage a phase-in to competition, encourage the
4 development of a robust wholesale market for generation, and obtain some benefits of
5 the new Arizona generation resources, while at the same time protecting ratepayers.”
6 Decision No. 65154, p. 30, ll. 13-16. The Commission further mandated that the
7 Track B process determine the “minimum amount of power, the timing, and the form
8 of procurement” for the Arizona utilities’ unmet needs. *Id.*, p. 33, ll. 6-14. Reliant
9 contends the following concepts are vital to achieving the Commission’s goals for the
10 competitive solicitation process:
11

12 **1) A fair, open, and transparent auction process for a significant**
13 **portion of the solicitation.**

14 This will ensure that the competitive solicitation is auditable and
15 understandable and results in the lowest costs for Arizona consumers.

16 **2) Appropriate safeguards must be in place to ensure a fair, open,**
17 **and transparent solicitation and dispatch of competitively procured**
18 **supplies.**

19 The Codes of Conduct, which the incumbent utilities are required to
20 adopt, are critical to ensuring all parties participate on a level playing
21 field in competitive solicitations. APS’ proposed Code of Conduct must
22 be amended to preclude sharing responsibilities and information
23 between APS and its affiliates that will participate in competitive
24 solicitations in the area of system dispatch, risk management and
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1 contract management. In the short-term, at a minimum, APS should be
2 required to provide all entities participating in a competitive solicitation
3 the information made available to its affiliates participating in the
4 solicitation.

5 **3) While each utility has the burden of demonstrating the level of its**
6 **unmet needs and that the offers it accepts are fair and prudent to**
7 **serve its Standard Offer Customers, utilities following the process**
8 **established by a Track B decision are entitled to a prompt and**
9 **certain prudency review of the selected bids by the Commission.**

10 By determining the rules for prudency review up front, the Commission
11 can affirm the results of the solicitation in a prompt manner that reduces
12 certain risks to both buyers and sellers. The reduction of these risks will
13 result in lower costs for the Arizona consumer.
14

15 Reliant also briefly discusses the need to revise the discussion regarding the Texas
16 competitive solicitation process contained in the Staff Report. The discussion in the
17 Report fails to properly capture the nature of the competitive solicitation process
18 followed in Texas, and the discussion must be amended if accuracy is important to the
19 Commission.
20

21 **IV. THE FORM OF THE COMPETITIVE PROCESS**

22 **A. There Is General Support For The Process And Timeline** 23 **Delineated By The Staff Report.**

24 The Staff Report on Track B sets forth a solid foundation and vision for
25 competitive procurement of electric utilities' unmet needs in Arizona. Among the
26 notable items included in the Staff Report are timelines for the procurement of power,

1 and those by a particular auction design or by request for proposal. Staff ("S")-1, p.
2 28-29. The parties to this proceeding did not object to this timeline nor a majority of
3 the issues discussed in the Staff Report. In fact, six days of fruitful workshops created
4 consensus on a number of issues as detailed in the Report. S-1, p. 31-33. Those few
5 remaining issues, which remain unresolved, have been the focus of this proceeding.

6 **B. Requiring Use Of An Auction Process Will Provide Benefits For**
7 **The Arizona Consumer, The Incumbent Utilities And The Potential**
8 **Suppliers.**

9 In both Direct and Rebuttal testimony, Reliant witness Mr. Curtis Kebler
10 described why it is in the best interest of all parties in this proceeding, including the
11 Arizona consumer, that an auction process be utilized for at least one-third of the
12 competitive solicitation. *See*, Reliant-1, p. 3, ll. 9-13; Reliant-2, p. 6, ll. 9-17. This
13 proposal received support from a number of different parties in this proceeding. For
14 instance, the Staff Report supports a descending clock auction as a viable and
15 preferred method for competitive solicitation. S-1, p. 23, ll. 18-20. During cross-
16 examination, APS witness Mr. Thomas Carlson stated his company's support for an
17 auction process, particularly in the long term. *Tr. v. III*, p. 656, ll. 18-19. This
18 concept was implicitly supported in the Direct Testimony of Panda witness Dr. Craig
19 Roach. Dr. Roach proposed that approximately one-third of the products be solicited
20 as seasonal call options, a highly standardized product appropriate for procurement
21 via auction. Panda-2, p. 5, ll. 19-23. TEP witness David Hutchens also testified that
22 "[t]here are certain products for which an auction process is well-suited including
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1 standard on-peak and super-peak products that TEP is contemplating in its
2 solicitation.” TEP-3, p. 6, ll. 7-8.²

3 Use of an auction process to secure a substantial portion of the unmet needs of
4 Arizona’s utilities will provide significant benefits to Arizona consumers, the
5 incumbent utilities, as well as the Commission. The transparent nature of a properly
6 designed auction provides assurance of an open and fair process in which all
7 participants can be confident that the results are the best attainable from the surplus of
8 capacity in the region. Reliant-1, p. 4, ll. 9-12. Thus an auction process furthers the
9 Commission’s goals of encouraging the development of a robust wholesale market for
10 generation and obtaining benefits of the new Arizona generation resources, while at
11 the same time protecting ratepayers. Many of the products APS and TEP are looking
12 to obtain through the competitive solicitation are suited for procurement through an
13 auction process. In fact, APS recognized that a portion of its economy purchases
14 should be procured through auction and committed to quarterly auctions to secure at
15 least half of its economy purchases for 2003. *See*, APS-5, p. 10, ll. 25-26; Tr. v. III, p.
16 506, ll. 21-25. By ensuring that a significant portion of TEP’s and/or APS’ unmet
17 needs are secured through a combination of the auction and RFP processes, the
18 participants and the Commission will be able to evaluate and contrast the pros and
19 cons of the two solicitation methodologies. Participants will also be provided
20 additional pricing information from the results of alternative procurement
21 methodologies. The experience gained and the lessons learned from an initial
22 solicitation utilizing multiple solicitation methodologies will prove invaluable, as the
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² On cross-examination, APS acknowledged that an auction could be conducted in the time frame proposed in the Staff Report. Tr. v. III, p. 656, l. 12 – p. 657, l. 20.

1 parties and the Commission evaluate changes for future solicitations. The confidence
2 in the results obtained through a combination of competitive procurement
3 methodologies should also lead to a lesser administrative burden upon the
4 Commission and Staff in determining the prudence of such purchases.

5 Staff has stated on numerous occasions in workshops and in testimony that it is
6 the obligation of APS to procure the required Standard Offer load from the most cost
7 effective and reliable generation resources possible. See, S-1, p. 8, ll. 1-5; S-1, p. 12,
8 ll. 23-25; S-1, p. 16, ll. 3-4. In turn, Staff's proposed competitive solicitation process
9 has provided the utilities the flexibility and latitude to procure what they deem to be
10 the most efficient products to serve their customers. With the abundance of
11 generating facilities in Arizona today, it is Reliant's position that commitment to an
12 auction process is an important element in meeting that goal.

14 APS witness Carlson testified that APS would use a quarterly auction process
15 for up to 50% of its economy energy purchases in 2003 and 2004. APS-5, p. 10, ll.
16 25-26. Reliant supports this action as a workable first step to a fair, open, and
17 transparent process to introduce vigorous wholesale competition for the benefit of
18 Arizona's consumers. However, Reliant urges the Commission to require APS and
19 TEP to utilize an auction process, not only for a significant portion of their economy
20 purchases beyond 2004, but also as the method for acquiring at least one-third of their
21 capacity needs as well. By adopting these recommendations the Commission will
22 create an open and transparent process for the utilities to solicit their unmet needs,
23 while realizing benefits for Arizona's consumers. In turn, the Commission, the
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1 participants, and the Arizona consumer can be assured of receiving the best possible
2 outcome at the time of the solicitation. Reliant-1, p. 4, ll. 4-13.

3 **C. The Commission Decision Should Determine the Minimum Amount**
4 **of Power to be Procured Through Competitive Solicitation.**

5 By Decision No. 65154, APS and TEP were required to determine their unmet
6 needs and enter into a competitive solicitation to acquire those needs. Decision No.
7 65154, p.33, ll. 6-14. APS witness Peter Ewen's direct testimony identified a specific
8 number of megawatts as well as an associated amount of energy. APS-1, Schedule
9 PWE-1. Staff, Panda Gila River and Harquahala also offered various calculations of
10 megawatts and associated energy for solicitation based on certain inputs. See, S-5, p.
11 1; Panda-2, p. 23, ll. 11-12; Harquahala-1, Exhibit TB-2. A significant portion of this
12 proceeding has focused on the calculation of unmet needs. In fact, Staff called this
13 calculation "the penultimate issue." S-1, p. 35, ll. 1.

14
15 According to the solicitation timeline provided in the Staff Report, APS and
16 TEP will not release the solicitation bid package that outlines in specific detail the
17 amount and type of products that it is purchasing until February 2003. S-1, pp. 28-29.
18 APS has pointed out that based on their forecast of needs, they are willing to rely on
19 "economy purchases" to secure any associated energy shortfall. APS-2, p. 12, ll. 20-
20 40. On the other hand, Panda and Harquahala have argued that the abundance of
21 supply and the current saturated market affords APS and TEP the opportunity to
22 secure long-term supply agreements at very reasonable prices.

23
24 No utility can forecast its needs, or the cost of supplies with 100% accuracy.
25 As part of its risk management practices, a utility strives to balance low cost supply
26 alternatives while at the same time minimizing price risks to itself and its customers.

1 Reliant agrees with Staff that it is unnecessary for this process to “arrive at a magic
2 number or a precise number” regarding the unmet needs of either APS or TEP. Tr. v.
3 I, p. 14, ll. 1-8. It is in the best interest of Arizona utilities, and the Arizona
4 consumers they serve, for a decision in Track B to establish a sufficient *minimum*
5 solicitation level and a solicitation process that fosters as many competitive proposals
6 as possible. When APS and TEP finish the solicitation and begin their review of the
7 supply proposals, they will have real price discovery and viable alternatives that can
8 be incorporated into the utilities’ supply plan to determine the least cost alternative
9 currently available. The Arizona market should provide the utilities an abundance of
10 low cost alternatives from which to structure the optimal supply portfolio from a risk
11 management perspective.
12

13 **D. Arguments By RUCO Against An Auction Process Fail To Be**
14 **Persuasive.**

15 In his rebuttal testimony, RUCO witness Dr. Richard Rosen claimed that the
16 auction process does not answer the question of “how much” of a product to buy.
17 RUCO-2, p. 6, ll. 10-19; p. 7, ll. 1-7. Dr. Rosen ignores the portions of the proposed
18 competitive solicitation process that require APS and TEP to submit their resource
19 plans to Staff for review and comment. S-1, p.13, l. 14 – p.14, l. 17. Furthermore,
20 both APS and TEP testified that they maintain resource planning models, which, in
21 the normal course of business, are used to determine what capacity and energy
22 products to pursue. See, Tr. v. III, p. 479, ll. 18-19; Tr. v. III, p. 489, ll. 17-25; Tr, v.
23 III, p. 490, ll. 1-2; Tr. v. III, p. 704, ll. 1-10. The reality is that a utility (and the
24 Commission) can never be absolutely certain at what price capacity and energy will
25 be offered until bids are actively solicited. The utility determines the optimal mix of
26

1 resources based upon the offers with which it is presented. Where there is an
2 abundant supply of capacity and energy available, as is the case in the Arizona
3 market, especially where the incumbent utilities already have a diversified portfolio
4 base upon which they are building, the marketplace represents an opportunity for APS
5 and TEP to secure reasonably priced power today. The formalized least cost and
6 integrated resource planning ("IRP") process advocated by Dr. Rosen would only
7 serve to unnecessarily delay the execution of the specific directions given in the Track
8 A Order and result in the lost opportunity for Arizona consumer savings. The
9 Arizona utilities are properly positioned to take advantage of a competitive wholesale
10 market and pass those savings on to Arizona consumers. RUCO's arguments against
11 an auction process based upon an insistence on adoption of an overly formulistic IRP
12 process should be dismissed as unpersuasive and counter-productive.

14 **V. APPROPRIATE SAFEGUARDS MUST BE IN PLACE TO ENSURE A
15 FAIR, TRANSPARENT, AND OPEN PROCESS IS UTILIZED FOR
16 THE SOLICITATION AND DISPATCH OF ANY ECONOMY ENERGY
PURCHASES**

17 For the long-term success of the competitive solicitation and the wholesale
18 market in general, appropriate safeguards are needed that provide a fair, transparent,
19 and open process. These safeguards revolve around the appropriate behavior between
20 the incumbent utility and any of its affiliates in the competitive procurement, as well
21 as the behavior between the utility and its affiliates in dispatching resources.

22 By no means does Reliant intend to omit any competitor from this process. To
23 the contrary, Reliant's support of an auction process is arguably the most open and
24 competitive process advocated by any party in this proceeding. However, the utilities
25 have suggested some policies going forward that may restrain competition from
26

1 reaching its potential to the detriment of Arizona consumers. In particular, APS has
2 proposed in their draft Code of Conduct that "Confidential Information" may be used
3 when providing "Shared Services" to affiliates. "Shared Services" includes energy
4 risk management, contract management and system dispatch. This clearly gives the
5 "Competitive Electric Affiliate" an advantage during dispatch protocol.³

6 Decision No. 65154 requires a hearing to review the merits of the utilities'
7 code of conduct proposals. Decision No. 65154, p. 30, ll. 2-4. Reliant urges the
8 Commission to direct APS and TEP to modify their new Codes prior to the release of
9 first draft solicitation material. According to the timeline contained in the Staff
10 Report, the draft is expected by February 18, 2003. These new Codes must be in
11 place and adhered to as soon as possible (and certainly prior to the first competitive
12 solicitation) to ensure the optimal outcome for Arizona's consumers.

13
14 **VI. PROMPT PRUDENCY REVIEW PROVIDES BENEFITS FOR THE**
15 **ARIZONA CONSUMER, THE INCUMBENT UTILITIES, AND THE**
16 **POTENTIAL SUPPLIERS**

17 Several parties in this proceeding have lauded the importance of a prompt and
18 certain prudency review by the Commission with regards to the solicitation of the
19 utilities' unmet needs. The proponents of this include Reliant, APS, Panda, TEP, and
20 PPL. *See*, Reliant-1, p. 10, ll. 4-14; APS-3, p. 6, ll. 25-26; APS-3, p. 7, ll. 1-11;
21 Panda-3, p. 9, ll. 9-11; TEP-2, p. 11, ll. 2-9; Tr. v. I, p. 28, ll. 14-25, Tr. v. I, p. 29, ll.
22 1-9. Prompt prudency review by the Commission provides three distinct benefits.

23
24 ³ APS argues such information sharing cannot be avoided at this time due to the historical use of
25 Pinnacle West employees to perform marketing and dispatch functions. APS-6, p. 7, ll. 1-24.
26 Under such circumstances, in the short-term, all participants in the competitive process should be
provided the same information about APS and its products as available to PWEC.

1 Foremost is the lower prices for consumers, achievable because buyers and suppliers
2 are able to exclude or minimize certain regulatory risks associated with approval of
3 such contracts. When the parameters of prudency review are known to all parties and
4 accomplished in a timely manner, participants do not need to mitigate regulatory risk
5 by increasing price to compensate for that risk. In turn, the benefits of these lower
6 bids flow directly to the Arizona consumer. Secondly, a prompt regulatory review of
7 contracts and prudency are consistent with the Track A Order to “encourage a phase-
8 in to competition, encourage the development of a robust wholesale market for
9 generation, and obtain some of the benefits of the new Arizona generation resources,
10 while at the same time protecting ratepayers” in Arizona. Decision No. 65154, p. 30,
11 ll. 13-15. Finally, if there is a rejection of a solicitation result upon review by the
12 Commission, the utility may still re-enter the market for additional solicitations in a
13 timely enough fashion to secure resources when needed. The assurance of prompt
14 regulatory review by the Commission builds the robust competitive wholesale market
15 that the Commission desires, minimizes any added costs that would otherwise result
16 from an undefined prudency review, and transfers the benefits therein to Arizona
17 consumers.
18

19 Staff, throughout the workshops and the hearing in the Track B proceeding,
20 have argued that prompt prudency review is inappropriate, at least for Arizona’s
21 “initial” solicitation. S-2, p. 2, ll. 20-22. This position runs counter to the
22 Commission’s mandate to encourage the development of a robust wholesale market
23 and to provide benefits to Arizona consumers. Decision No. 65154, p. 30, ll. 13-16.
24 Furthermore, this line of reasoning discounts multiple protections built into the
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1 process adopted in the Staff Report and supported by the majority of the parties in this
2 proceeding. Specifically, the Staff Report proposes to have multiple iterations of bid
3 evaluation which will readily determine the best possible prices available to the utility
4 and, in turn, the Arizona consumer from the wholesale market. S-1, p. 23, ll. 5-25. In
5 addition, the Independent Monitor will be an active participant in evaluating and
6 witnessing the process. S-1, p. 10, ll. 1-27. Even Staff itself is provided the
7 opportunity to review and comment on the solicitation process and the results thereof.
8 S-1, p. 11, ll. 20-28; S-1, p. 12, ll. 1-2. This involvement by the Independent Monitor
9 and Staff should give the Commission appropriate assurance that the outcome is either
10 fair and reasonable or flawed. While apprehension over this initial solicitation is
11 understandable, it is important to recognize that the level of review added to this
12 process is unprecedented as well. If Staff and the Independent Monitor are expending
13 resources to be involved during the process, the ratepayers should receive the
14 maximum benefit of that involvement.
15

16 Given that market prices will be the best available to the utility, the only other
17 materially important issue for prudency determination will be the products procured
18 by the utility given its unmet needs. Staff both defers to APS and TEP in determining
19 what is the best product, and holds them responsible for demonstrating that the
20 solicitation process and products chosen are reasonable at the time procurement
21 results are executed. *See*, S-1, p. 8, ll. 1-5; S-1, p. 12, ll. 23-25; S-1, p.16, ll. 3-4. The
22 Track A Decision, as confirmed by Staff during cross-examination, requires the Track
23 B proceeding to determine the level of product to be secured and the process by which
24 it will be secured. Decision No. 65154, p. 33, ll. 6-14; Tr. v. I, p. 104, ll. 9-25. The
25
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1 process reflected in the Staff Report is designed to ensure a fair and transparent
2 solicitation process. The evidentiary hearing process has provided all parties the
3 opportunity to investigate the level of unmet needs and the type of products proposed
4 by APS and TEP. Furthermore, the Independent Monitor, and each utility will
5 provide reports to the Commission identifying any observed flaws in the process.
6 Thus, the prudence of the products selected to satisfy the unmet needs of the utilities
7 are inherently determined by the Track B and solicitation process approved thereby.
8 Delaying Commission review and validation or rejection of the products actually
9 selected through the solicitation process mandated by the Commission only adds an
10 unwarranted element of uncertainty to the process that increase the cost to Arizona
11 consumers.
12

13 **VII. THE STAFF TRACK B REPORT SHOULD BE MODIFIED TO**
14 **ACCURATELY REFLECT THE TEXAS ELECTRIC**
15 **RESTRUCTURING LEGISLATION AND RULES**

16 Reliant witness Kebler also suggested certain changes to the Staff Report's
17 Appendix regarding the Texas electric restructuring experience. Reliant-1, p. 18, ll.
18 3-5. These changes are intended to accurately set forth the Texas restructuring laws
19 and rules to avoid any confusion by parties, which may read the Staff Report
20 Appendix and use it as a template for understanding the various restructuring
21 methodologies throughout the United States. As a major retail supplier in the Texas
22 market and formerly part of the incumbent utility in a major Texas metropolitan area,
23 Reliant has experienced the Texas process first hand. A redlined copy of Reliant's
24 suggested changes were included as Exhibit D to Mr. Kebler's Direct Testimony
25 (Reliant-1). Reliant has included that redline form herein, attached as Appendix A, as
26

1 well as a clean copy of those changes for ease of use, attached as Appendix B. This
2 suggested change went unopposed by any party. Appendix B, therefore, should be
3 substituted for the discussion contained in the Staff Report at page 49 to produce an
4 accurate record of the Texas legislation and rules.

5 **VIII. CONCLUSION**

6 The Commission, in 1996, recognized the advantages a competitive electric
7 industry could provide to Arizona's consumers and adopted rules and regulations to
8 permit electric competition in Arizona. Much has happened in the intervening years.
9 The Commission recently reaffirmed its commitment to moving Arizona's electric
10 industry toward competition in Decision No. 65154. The Track B proceeding
11 provides the Commission with a unique opportunity. By taking advantage of the
12 current over supply of generation available to the Arizona market, the Commission
13 can provide safe and reliable power from a number of different sources at prices that
14 will benefit Arizona consumers. To ensure these benefits are realized now and in the
15 future, Reliant respectfully requests the Commission adopt the process outlined in the
16 Staff Report with the following amendments:
17

- 18 1. Require a significant portion (approximately one-third) of the unmet
19 need of APS and TEP be solicited through an auction process;
- 20 2. Require APS and TEP to utilize an auction process for a significant
21 portion of their economy and short-term energy purchases (e.g., the
22 quarterly auctions proposed by APS);
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- 3. Adopt a minimum quantity of capacity and energy (representing the estimated level of unmet need) for which APS and TEP must solicit offers through the competitive process approved by the Commission;
- 4. Provide prompt (within 5 to 30 days) regulatory review of the solicitations accepted through the competitive solicitation process approved by the Commission;
- 5. Require APS to adopt a Code of Conduct prohibiting its affiliates that intend to participate in the solicitation from handling system dispatch, risk management or contract management for APS or receiving information from APS (directly or indirectly) that would advantage them in the solicitation process; and
- 6. Adopt the description of the Texas competitive process proposed by Reliant and attached hereto as Appendix B.

RESPECTFULLY submitted this 18th day of December, 2002.

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APPENDIX A

Texas

Background

~~Restructuring legislation was enacted in 1999 in Texas to restructure the Texas electric industry allowing retail competition. The bill required retail competition to begin by January 2002. Under retail competition in Texas, default service for residential and small commercial consumers, ("Price to Beat" or "PTB" service) and Provider of Last Resort ("POLR") service are two separate services provided by separate Retail Electric Providers ("REPs"). PTB service is provided by the affiliate of the incumbent utility – the Affiliated Retail Electric Provider ("AREP") – for customers who elect PTB service or those customers who have had their service disconnected due to non-payment. The provider of POLR service is chosen via a competitive bid process or lottery. POLR service is intended primarily as a temporary service for those customers whose REP has exited the market.~~

~~Texas retail electricity Rrates wereare frozen from 1999 to the end of 2001or 3 years, and then a 6 percent reduction will is be required for PTB residential and small commercial consumers. This will remain the "price to beat" remains for five years after retail competition begins and may be adjusted up to twice a year to reflect significant changes in the market price of natural gas and purchased energy to serve retail customers,or until utilities lose 40 percent of their consumers to competition. The AREP can provide competitive service to residential and small commercial customers the earlier of January 2005 or when it loses 40 percent of residential and/or small commercial customers to other REPs.~~

~~Utilities were required to must unbundle into 3 separate categories — using separate companies or affiliate companies, the generation, the distribution and transmission, and the retail electric provider – using separate companies or affiliate companies.~~

1 Power generation companies are Utilities will be limited to owning and controlling
2 not more than 20 percent of installed generation capacity located in or capable of
3 delivering to in their region (ERCOT).

4 ~~The PUC adopted rules for the provider of last resort for when competition began in~~
5 ~~early 2002. The provider of last resort is required to provide to consumers no longer~~
6 ~~served by their provider of choice service at a fixed price. A competitive bidding~~
7 ~~process will designate the last resort providers for each consumer class. Bidding was~~
8 ~~completed by June 1, 2001.~~

9 During 2001, generation affiliates of the utilities in Texas began the process of
10 auctioning part of their generating capacity as described below. ~~The auction is~~
11 ~~designed to increase the pool of available power for new retail suppliers entering the~~
12 ~~market, prevent market power, and promote competition in electricity markets.~~

13 Wholesale solicitation

14 As part of the restructuring of the Texas electricity market, generation affiliates of the
15 utilities in Texas are required to acquire- sell at auction entitlements to at least 15% of
16 their installed generation capacity until the AREP loses 40% of their residential and
17 small commercial consumers to competitive REPs or 2007, whichever occurs first.
18 requirement through auction. The purpose of the auction is to promote
19 competitiveness in the wholesale market through increased availability of generation
20 and increased liquidity. The AREP is not allowed to purchase capacity in this
21 auction. The utility has the responsibility to procure the necessary capacity and
22 energy, adhering to the rules established by ERCOT. Capacity in addition to the
23 mandated capacity auction is procured through solicitation and secured by bilateral
24 contracts.

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APPENDIX B

Texas

Background

Restructuring legislation was enacted in 1999 in Texas allowing retail competition to begin by January 2002. Under retail competition in Texas, default service for residential and small commercial consumers, ("Price to Beat" or "PTB" service) and Provider of Last Resort ("POLR") service are two separate services provided by separate Retail Electric Providers ("REPs"). PTB service is provided by the affiliate of the incumbent utility—the Affiliated Retail Electric Provider ("AREP")—for customers who elect PTB service or those customers who have had their service disconnected due to non-payment. The provider of POLR service is chosen via a competitive bid process or lottery. POLR service is intended primarily as a temporary service for those customers whose REP has exited the market.

Texas retail electricity rates were frozen from 1999 to the end of 2001, and then a 6 percent reduction is required for PTB consumers. This price to beat remains for five years after retail competition begins and may be adjusted up to twice a year to reflect significant changes in the market price of natural gas and purchased energy to serve retail customers. The AREP can provide competitive service to residential and small commercial customers the earlier of January 2005 or when it loses 40 percent of residential and/or small commercial customers to other REPs.

Utilities were required to unbundle into 3 separate categories—generation, distribution and transmission, and the retail electric provider—using separate companies or affiliate companies. Power generation companies are limited to owning and controlling not more than 20 percent of installed generation capacity located in or capable of delivering to their region (ERCOT).

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During 2001, generation affiliates of the utilities in Texas began the process of auctioning part of their generating capacity as described below.

Wholesale solicitation

As part of the restructuring of the Texas electricity market, generation affiliates of the utilities in Texas are required to sell at auction entitlements to at least 15% of their installed generation capacity until the AREP loses 40% of their residential and small commercial consumers to competitive REPs or 2007, whichever occurs first. The purpose of the auction is to promote competitiveness in the wholesale market through increased availability of generation and increased liquidity. The AREP is not allowed to purchase capacity in this auction.

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