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Executive Secretary

ARIZONA CORPORATION COMMISSION

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DATE: January 29, 2003  
DOCKET NOS: E-00000A-02-0051  
E-01345A-01-0822  
TO ALL PARTIES: E-00000A-01-0630  
E-01933A-02-0069

AZ CORP COMMISSION  
DOCUMENT CONTROL

Enclosed please find the recommendation of Administrative Law Judge Teena Wolfe. The recommendation has been filed in the form of an Opinion and Order on:

GENERIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING ISSUES  
(TRACK B)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

FEBRUARY 10, 2003

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

TO BE DETERMINED

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250.

Arizona Corporation Commission

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JAN 29 2003

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BRIAN C. McNEIL  
EXECUTIVE SECRETARY

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 MARC SPITZER, Chairman  
4 JIM IRVIN  
5 WILLIAM A. MUNDELL  
6 JEFF HATCH-MILLER  
7 MIKE GLEASON

8 IN THE MATTER OF THE GENERIC  
9 PROCEEDING CONCERNING ELECTRIC  
10 RESTRUCTURING ISSUES.

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. R14-2-1606.

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 VAIRANCE OF CERTAIN ELECTRIC  
22 COMPETITION RULES COMPLIANCE DATES.

DOCKET NO. E-01933A-02-0069

DECISION NO. \_\_\_\_\_

**OPINION AND ORDER**

23 DATES OF HEARING: November 20, (pre-hearing) 21, 22, 25, 26 and 27, 2002

24 PLACE OF HEARING: Phoenix, Arizona

25 ADMINISTRATIVE LAW JUDGE: Teena Wolfe

26 IN ATTENDANCE: William A. Mundell, Chairman  
27 Marc Spitzer, Commissioner  
28 Jim Irvin, Commissioner

APPEARANCES: Mr. Michael R. Engleman, DICKSTEIN, SHAPIRO,  
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DeWULF, PLC, on behalf of Tucson Electric Power  
Company;

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Mr. Lawrence V. Robertson, Jr., MUNGER CHADWICK, on behalf of Sempra Energy Resources and Southwestern Power Group II, and Mr. Theodore E. Roberts, on behalf of Sempra Energy Resources;

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Mr. Walter W. Meek, President, on behalf of the Arizona Utility Investors Association;

Ms. Karen A. Potts and Mr. Roger F. Ferland, QUARLES & BRADY STREICH LANG, LLP, on behalf of the Harquahala Generating Company;

Mr. Eric C. Guidry on behalf of the Land and Water Fund of the Rockies;

Mr. Jay I. Moyes and Mr. Steven L. Wene, MOYES STOREY, on behalf of PPL Southwest Generating Holdings, LLC, PPL Energy Plus, LLC, and PPL Sundance Energy, Ltd.;

Mr. Christopher C. Kempley, Chief Counsel, and Ms. Janet F. Wagner, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

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1 **BY THE COMMISSION:**

2  
3 **I. INTRODUCTION**

4 **A. Procedural Background**

5 Following a Special Open Meeting held on April 25, 2002, the Commission issued a  
6 Procedural Order in these consolidated dockets on May 2, 2002. The May 2, 2002 Procedural Order  
7 set a hearing schedule for those issues delineated as "Track A" issues, and established a preliminary  
8 procedural framework for meeting an October 21, 2002 completion date for Commission  
9 consideration of competitive solicitation issues, which were delineated as "Track B" issues. The May  
10 2, 2002 Procedural Order directed that Track B proceed concurrently with Track A, and instructed  
11 interested parties to file by May 13, 2002, a list of proposed issues for consideration, and a procedural  
12 timetable (including comment periods) for the Track B issues. The May 2, 2002 Procedural Order  
13 also ordered the parties to submit to the Commission's Utilities Division Staff ("Staff") a list of  
14 qualified persons to act as an independent consultant/evaluator, and ordered Staff to begin any  
15 required procurement process as soon as possible. The May 2, 2002 Procedural Order directed Staff  
16 and the parties to keep the Commission and the Hearing Division apprised of the progress being  
17 made on Track B through docket filings, and to immediately contact the Hearing Division if  
18 additional issues required resolution.  
19  
20

21 On May 13, 2002, Tucson Electric Power Company ("TEP"), Arizona Public Service  
22 Company ("APS"), the Arizona Competitive Power Alliance ("Alliance"), the Residential Utility  
23 Consumer Office ("RUCO") and Staff filed Track B proposals in compliance with the May 2, 2002  
24 Procedural Order. Staff indicated in its filing that it anticipated awarding a contract to an  
25 Independent Evaluator on or around July 8, 2002.  
26  
27  
28

1 On May 31, 2002, Staff filed a list of issues for comment of the other parties. On June 20,  
2 2002, based on the proposals submitted on May 13, 2002, the First Procedural Order on Track B  
3 Issues established a procedural schedule that included workshops, as proposed by Staff, on July 24  
4 and 25, 2002. The First Procedural Order stated that the balance of the procedural schedule would be  
5 dependent upon the Commission's Decision on the Track A issues, the consensus reached by the  
6 parties during the workshops or otherwise, and whether a hearing on any Track B issues became  
7 necessary. The First Procedural Order set a deadline for the parties to respond to Staff's May 31,  
8 2002 list of issues by July 1, 2002, which response was to include any competitive solicitation issues  
9 not addressed in Staff's May 31, 2002 filing, and also set a deadline of July 17, 2002, for Staff and  
10 the Independent Evaluator to file a list of issues to be addressed at the July 24 and 25, 2002  
11 workshops. In addition, the First Procedural Order encouraged the parties to meet and attempt to  
12 achieve a consensus competitive solicitation proposal as outlined by APS in its May 13, 2002 filing,  
13 and directed Staff to continue preparation for the filing of a Draft Staff Report by the August 28,  
14 2002 deadline referred to in its May 13, 2002 filing, pending the issuance of a further procedural  
15 schedule.  
16  
17

18 Hearings were held on the Track A issues during the last two weeks of June, 2002, and  
19 Decision No. 65154 was issued on September 10, 2002, in these dockets. In addition to its  
20 determination of Track A issues, Decision No. 65154 ordered the parties to continue their efforts in  
21 Track B to develop a competitive solicitation process<sup>1</sup> that can begin by March 1, 2003.

22 The parties held an additional workshop on August 13 and 14, 2002.  
23

24 On September 16, 2002, Staff filed a Request for Procedural Order ("Request") asking that a  
25 hearing be set to commence on November 20, 2002, following a third and final two-day workshop to  
26

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27 <sup>1</sup> Decision No. 65154 ordered that upon implementation of the outcome of Track B, APS and TEP shall acquire, at  
28 a minimum, any required power that cannot be produced from their respective existing assets, though the competitive  
procurement process as developed in the Track B proceeding; and that the minimum amount of power, the timing, and the  
form of procurement shall be determined in the Track B proceeding.

1 be held on September 26 and 27, 2002. APS and Panda Gila River, L.P. ("PGR") filed responses to  
2 Staff's request indicating their agreement that a hearing would likely be necessary to achieve a  
3 resolution of the Track B issues. While APS agreed with the procedural schedule proposed by Staff  
4 in its Request, PGR requested a scheduling conference so that all parties might comment on dates to  
5 be included in any procedural order and on issues to be addressed at the hearing. The Second  
6 Procedural Order on Track B Issues was issued on September 24, 2002 and required the parties to  
7 file, by October 1, 2002, their proposed schedules for the conduct of a hearing to be held following  
8 the third workshop, and a list of the specific issues the parties believed remained to be addressed at  
9 the hearing. A Procedural Conference was held as scheduled on October 2, 2002. It became known  
10 at the October 2, 2002 Procedural Conference that the existing Track B schedule being discussed in  
11 the workshops did not require APS and TEP to provide their needs assessments and procurement  
12 proposals until January 31, 2003, which was after the hearing dates being proposed by the parties.  
13 The Third Procedural Order on Track B Issues, issued on October 9, 2002, therefore required that  
14 APS and TEP file a needs assessment and procurement proposal, sufficient to inform the Commission  
15 in its determination of the minimum amount of power, the timing, and the form of procurement as  
16 required by Decision No. 65154 ("Needs Assessment"), along with supporting testimony, by  
17 November 4, 2002, in order to allow the other parties to respond in their pre-filed direct testimony.  
18 The Third Procedural Order also set the remainder of the procedural schedule for the hearing, and for  
19 the pre-filing of direct and rebuttal testimony and exhibits.

20 On October 25, 2002, Staff filed its Staff Report on the Track B Issues. The Staff Report  
21 contained a "Detailed Staff Proposed Solicitation Process" and also included a separate section  
22 setting forth Staff's position on unresolved issues. On November 4, 2002, APS and TEP filed their  
23 Needs Assessments pursuant to the requirements of the Third Procedural Order. Following the  
24 November 4, 2002 filings, the parties held an additional workshop on November 6, 2002.

25 On November 12, 2002, APS and TEP filed their direct testimony, including their response to  
26 the Staff Report. Also on November 12, 2002, Harquahala Generating Company, L.L.C.  
27 ("Harquahala"), PGR, Reliant Resources, Inc. ("Reliant"), Sempra Energy Resources ("Sempra"),  
28 Wellton-Mohawk Generating Facility ("WMGF"), the Land and Water Fund of the Rockies ("LAW

1 Fund”) and RUCO filed their direct testimony and exhibits, including their responses to the Staff  
2 Report and to APS’ and TEP’s Needs Assessments. On November 18, 2002, Harquahala, PGR,  
3 Reliant, Sempra, WMGF, the LAW Fund, RUCO and Staff filed rebuttal testimony and exhibits.

4 Public notice of the proceedings on the Track B issues was published in the *Arizona Daily*  
5 *Star* on November 4, 2002, and in newspapers of general circulation across APS’ service territory<sup>2</sup> on  
6 either November 5 or 6, 2002. No further intervention requests were filed following the publication.  
7 The hearing commenced on November 21, 2002. Mr. Bob Liden of Stirling Energy Systems  
8 provided public comment at the hearing, encouraging the Commission to make sure that renewables  
9 are included in the bidding process, are given some preferences in the bidding process, and that  
10 power purchase agreements for renewable energy are made for long terms in order to support the  
11 capitalization of such plants. No other parties appeared to provide public comment on the Track B  
12 issues. Staff, APS, TEP, Harquahala, PGR, Reliant, Sempra, WMGF, the LAW Fund and RUCO  
13 appeared through counsel and presented their witnesses. Other parties participating in the hearing  
14 included the Arizona Utility Investors Association (“AUIA”) and PPL Southwest Generating  
15 Holdings, LLC, PPL Energy Plus, LLC and PPL Sundance Energy, Ltd. (“PPL”) and Southwestern  
16 Power Group II (“SWPG”).

17 Staff, APS, TEP, AUIA, Harquahala, PGR, PPL, Reliant, Sempra/SWPG, WMGF, the LAW  
18 Fund, and RUCO filed initial post-hearing briefs on December 18, 2002. APS, TEP, Harquahala,  
19 PGR, Reliant, Sempra/SWPG, WMGF, the LAW Fund, RUCO and Staff filed reply briefs on  
20 December 31, 2002.

21 **B. Goals of the Staff Proposed Solicitation Process**

22 The Staff Report, filed on October 25, 2002, included a Detailed Staff Proposed Solicitation  
23 Process and Solicitation Timelines. (Exh. S-1 at 6-29) During the workshop process, Staff  
24 developed a draft working paper regarding the competitive solicitation process and parties were able  
25 to provide substantive comment and make suggestions to Staff on the draft solicitation process. (*Id.*  
26  
27  
28

1 at 3) The numerous participants in the workshops, not all of whom participated in the hearing  
2 process, are listed in the Staff Report at pages 2-3.

3 Staff has stated that its overriding goal in this process is to establish a transparent process that  
4 will result in cost savings for ratepayers, and that this goal should be used as a standard to evaluate  
5 every disputed issue in this proceeding. PGR agreed, stating it believes that the only way to fully  
6 explore and establish potential ratepayer cost savings is to solicit, from the competitive market,  
7 alternatives to "current ratepayer cost items." PPL also believes that the competitive solicitation must  
8 be open, transparent, fair and unbiased as to all participants, and structured so as to best achieve the  
9 best value for ratepayers. Sempra and SWPG strongly support the competitive process procurement  
10 goals set forth in the Staff Report, and believe that the Commission should adopt a competitive  
11 procurement process that allows for consideration of all types of competitive solicitations and  
12 proposals; requires sound economic and deliverability analysis of bids; and is not biased by nature  
13 and design towards any predetermined outcome.  
14

15  
16 As RUCO points out, the parties are nearly unanimous in their agreement that the goal of  
17 competitive power solicitation should be a least-cost mix of reliable power to customers. RUCO  
18 believes that the competitive power solicitation should yield cost savings for customers compared to  
19 what they pay today and what they expect to pay in the future, and believes that the Commission can  
20 meet these goals if the solicitation gives standard offer customers a least-cost portfolio of reliable  
21 electricity services.  
22

23 APS also endorsed the general goals of Staff in carrying out the Track B process, and supports  
24 an effective power procurement process for consumers.  
25  
26

27 <sup>2</sup> The newspapers in which publication occurred were *Arizona Republic*, *Bisbee Daily Review*, *Douglas Daily*  
28 *Dispatch*, *Flagstaff AZ Daily Sun*, *Holbrook Tribune*, *Parker Pioneer*, *Payson Roundup*, *Prescott Daily Courier*, *Sedona*  
*Red Rock News*, *Tri Valley Dispatch*, *Wickenburg Sun*, *Winslow Mail* and *Yuma Daily Sun*.

1           **C.     Issues Requiring Resolution**

2           The issues on which the parties were unable to reach consensus, and thus require a  
3 Commission resolution, are as follows: 1) the solicitation and bid process to be approved,  
4 including whether to institute an integrated resource planning process; 2) the amount of capacity and  
5 energy to be solicited; 3) the bid evaluation method to be approved, including whether APS and TEP  
6 are required to accept any bids; 4) affiliate participation in the bid process; 5) the Commission's  
7 prudence review of contracts resulting from the bid process; and 6) the direction of future  
8 proceedings, including DSM and environmental risk mitigation programs.  
9

10           **II.     PARAMETERS OF THE SOLICITATION**

11           **A.     Decision No. 65154's Track B Requirements**

12           Decision No. 65154 ordered that upon implementation of the outcome of Track B, APS and  
13 TEP shall acquire, at a minimum, any required power that cannot be produced from their respective  
14 existing assets, through the competitive procurement process as developed in the Track B proceeding;  
15 and that the minimum amount of power, the timing, and the form of procurement shall be determined  
16 in the Track B proceeding. Decision No. 65154 stated that the overriding concern of the Commission  
17 must continue to be ensuring that the citizens of Arizona have safe, reliable and fairly priced electric  
18 power, and found that it is incumbent upon all parties to work together in such a manner that will  
19 allow competition and its expected benefits to develop in whatever timeframe is needed to make it  
20 successful, while satisfying that concern. In Decision No. 65154, the Commission stated its belief  
21 that requiring some power to be purchased through the competitive procurement process will  
22 encourage a phase-in to competition, encourage the development of a robust market for wholesale  
23 generation, and obtain some of the benefits of the new Arizona generation resources, while at the  
24 same time protecting ratepayers.  
25  
26  
27  
28

1 Decision No. 65154 required that for purposes of the competitive solicitation process, the  
2 generating assets that APS may seek to acquire from its affiliate, PWEC, shall not be counted as APS  
3 assets in determining the amount, timing and manner of the competitive solicitation. Also pertinent  
4 to Track B, Decision No. 65154 ordered TEP and APS to work with Staff to develop a plan to resolve  
5 reliability must-run generation (“RMR”) concerns, and ordered Staff to include the results of such a  
6 plan in the 2004 Biennial Transmission Assessment (“BTA”). Decision No. 65154 ordered APS and  
7 TEP to file annual reliability must-run generation study reports with the Commission in concert with  
8 their January 31 ten year plan, for review prior to implementing any new RMR generation strategies,  
9 until the 2004 BTA is issued.  
10

11 **1. Parties’ Interpretations of Decision No. 65154**

12 a. “Minimum amount of power”

13 In Decision No. 65154, the Commission ordered “that upon implementation of the outcome of  
14 Track B, APS [and TEP] shall acquire, at a minimum, any required power that cannot be produced  
15 from its own existing assets, through the competitive procurement process as developed in the Track  
16 B proceeding. The minimum amount of power, the timing, and the form of procurement shall be  
17 determined in the Track B proceeding.” (Decision No. 65154 at 33) Decision No. 65154 expounded  
18 on the phrase “at a minimum,” stating that “APS and TEP may decide to retire or displace inefficient,  
19 uneconomic, environmentally undesirable plants.” (Decision No. 65154 at 23, fn. 8) Decision No.  
20 65154 thus set the minimum baseline amount of power that APS and TEP would be required to  
21 acquire in the solicitation process. Decision No. 65154 left for this proceeding, however, the  
22 determination of the actual minimum amount of power to be acquired, the timing of the power  
23 procurement, and the form of the procurement. (Decision No. 65154 at 33)  
24  
25

26 The parties are not in agreement as to the interpretation of Decision No. 65154 regarding the  
27 amount of power that APS and TEP must solicit in the Track B procurement process. APS takes the  
28

1 position that it should not be required to solicit supply beyond that which its own resources and firm  
 2 contracts cannot provide. APS defines this supply as its “unmet needs,” and believes its calculations  
 3 of unmet needs, as set forth in its November 4, 2002, Needs Assessment filing, are in “strict  
 4 conformance” with Decision No. 65154. TEP takes a similar position, stating that its contestable  
 5 load for the initial competitive solicitation should include only TEP’s capacity and energy needs that  
 6 cannot be met by its existing assets. AUIA similarly argues that the utilities should not be required to  
 7 solicit any generation beyond any required power that cannot be produced from their own existing  
 8 assets, unless the utilities decide to retire some generating plants.  
 9

10 Staff and the merchant intervenors disagree with the interpretation that APS, TEP and AUIA  
 11 lend to Decision No. 65154’s language regarding the minimum amount of power that APS and TEP  
 12 must acquire. PGR argues, and Reliant agrees, that the Commission reference to “at a minimum” in  
 13 Decision No. 65154 is modifying what APS and TEP are required to acquire, and not the amount that  
 14 will be sent out for solicitation. Staff asserts that this proceeding is concerned with determining  
 15 contestable load amounts, rather than establishing unmet needs.<sup>3</sup>  
 16

17 b. “Economically”

18 Staff, in its pre-filed rebuttal testimony, proposed a modification to the language in the Staff  
 19 Report pertaining to the amount of capacity or energy that APS and TEP must acquire through  
 20 competitive solicitation. (Exh. S-4 at 11-12 (Rebuttal Testimony of Alan Kessler)) Staff proposed to  
 21 insert the word “economically” on page 4, line 20 of the Staff Report before the word “served.”<sup>4</sup>  
 22 Staff proposed this change in response to APS’ November 4, 2002 Needs Assessment, in which APS  
 23 proposed to procure a large portion of its required energy on the spot market, outside of the Track B  
 24

25 \_\_\_\_\_  
 26 <sup>3</sup> Staff explains that “unmet needs” describes the capacity and energy that the utility is not able to supply from its  
 27 own facilities, and that “contestable load” describes the amount of capacity and energy for which a competitive  
 28 alternative may be available. TEP similarly states that “unmet needs” connote those capacity and energy needs that  
 simply cannot be met by the utility’s existing assets, and that “contestable load” connotes the amount of capacity and  
 energy that must be put out to bid in the solicitation process.

1 competitive solicitation process.<sup>5</sup> Staff explained that it proposed this change to clarify that, during  
2 the development of the solicitation process, Staff's intention was to have the vast majority of  
3 reasonably expected purchases of capacity and energy acquired through the initial solicitation process  
4 Staff proposed. (*Id.* at 12) Staff believes the anticipated amount of "economy energy" APS  
5 identified in its Needs Assessment should be solicited on a firm or dispatchable basis, and then  
6 evaluated by the utility based on the information it will acquire as a result of the solicitation, to  
7 determine whether contracts for power are better alternatives than reliance on spot markets. (*Id.*)  
8 Staff emphasized that the utility should remain responsible for making, and justifying its decisions  
9 when evaluating bids. (*Id.*)  
10

11 APS argues that a requirement that it acquire, through competitive solicitation, needs not  
12 "economically" served by existing utility-owned generating capacity or through existing contracts is  
13 contrary to specific language in Decision No. 65154 and would subject APS to financial risk. AUIA  
14 argues that insertion of the term "economically" in the parameters of the competitive solicitation  
15 would dramatically alter the amount of utility load that could be subject to bid under the terms of  
16 Decision No. 65154. TEP is also concerned that such an approach may subject the entire load of a  
17 utility to competitive solicitation, and believes that it will complicate the process and interfere with  
18 an assessment of how a competitive solicitation may best be conducted in the future.  
19

20 Harquahala, PPL, PGR, Reliant, Sempra and SWPG support the use of the term  
21 "economically" as recommended by Staff. Harquahala believes the term "economically" should  
22 apply to both capacity and energy procurements, and is of the opinion that imposing an "economic"  
23 criteria for the solicitation will promote fiscally responsible choices, not financial risks. Sempra and  
24 SWPG believe inclusion of the term "economically" is consistent with the Commission's stated  
25

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26  
27 <sup>4</sup> During the hearing, Staff confirmed that in accordance with this change, the word "economically" should also be  
inserted in the Staff Report at page 6, line 5, before the word "served" and at page 35, line 5, before the word "supply."

28 <sup>5</sup> APS stated that these purchases would be "economy energy" purchases. This issue is discussed in a separate  
section below.

1 objective, in Decision No. 65154, of insuring just and reasonable rates for captive customers. PPL  
2 states that the concept is consistent with the goal of reduced costs to customers, and that allowing  
3 efficient new generation units to compete against less efficient units should result in consumer  
4 savings with less environmental impact. Staff asserts that to construe Decision No. 65154 as omitting  
5 considerations of cost when determining contestable load is logically inconsistent with the  
6 Commission's goal of providing ratepayers with reliable power at the lowest possible cost.

## 7 8 **2. Discussion/Resolution**

9 We do not believe requiring APS and TEP to solicit, through competitive solicitation, needs  
10 not economically served by existing utility-owned generating capacity or through existing contracts.  
11 is contrary to Decision No. 65154. In their arguments that Decision No. 65154 limits the competitive  
12 solicitation to "unmet needs," APS, TEP and AUIA offer no convincing reason for us to disregard  
13 our prior statements that "the minimum amount of power, the timing, and the form of procurement  
14 shall be determined in the Track B proceeding" (Decision No. 65154 at 33), and that "APS and TEP  
15 may decide to "retire or displace inefficient, uneconomic, environmentally undesirable plants."  
16 (Decision No. 65154 at 23, fn 8, emphasis added) Decision No. 65154 does not limit the  
17 Commission in the amount of power we may require APS and TEP to solicit in the competitive  
18 procurement process. At a minimum, as we stated in Decision No. 65154, APS and TEP must  
19 acquire, through this competitive solicitation, any required power that cannot be produced from their  
20 respective existing assets. Nothing in this Decision changes that requirement.

21  
22 The Commission's purpose in establishing this Track B proceeding was not to determine  
23 APS' and TEP's "unmet needs," but to determine the actual amount of power to be solicited in the  
24 competitive solicitation, which necessarily will include, but will not be limited to, their required  
25 power that cannot be produced from their respective existing assets. Based on the record in this  
26 proceeding, we believe that it is in the best interest of APS' and TEP's ratepayers for APS and TEP  
27  
28

1 to test the market in this solicitation, beyond the amount of required power that cannot be produced  
2 from their respective existing assets or existing contracts, to determine whether reliable generation is  
3 available at a lower cost than that produced by their own existing assets, or at a comparable level of  
4 cost, but with reduced adverse environmental effects, compared to their own existing assets. A  
5 broader solicitation will also further the goal of encouraging the development of a robustly  
6 competitive wholesale generation market in Arizona. The amount by which APS and TEP must test  
7 the market in this competitive solicitation, and which will include their required power that cannot be  
8 produced from their respective existing assets or existing contracts, will be referred to herein as  
9 "contestable load." We will require that the initial competitive solicitation be issued for the amount  
10 of APS' and TEP's contestable load, as set forth in this Decision, and that it not be limited to required  
11 power that cannot be produced from their respective existing assets or existing contracts. If the  
12 competitive solicitation for contestable load yields bids for capacity or energy beyond required power  
13 that cannot be produced from their respective existing assets or existing contracts, and if the utilities  
14 determine, after serious economic and technical analysis, that the offered capacity or energy would  
15 serve their customers more economically than their existing assets, then the utilities should make  
16 procurements accordingly, keeping in mind that the goal of the competitive solicitation is to provide  
17 ratepayers with reliable power at the lowest cost while furthering the Commission's goal of  
18 encouraging the development of a vibrant wholesale generation market in Arizona.

21 In regard to the APS' claim that expanding the solicitation beyond required power that cannot  
22 be produced from its existing assets or contracts would subject APS to financial risk, we note that  
23 since APS will make the decision as to how much competitive power to procure, beyond its  
24 requirements that cannot be produced from its own existing assets or contracts, any financial impact  
25 of such procurement is within APS' control.  
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1           **B.     Capacity and Energy to be Solicited (Contestable Load)**

2                   **1.     Determination of Contestable Load Estimates**

3                           a.     Positions of the Parties

4           APS and TEP took the position that contestable load (as defined herein, above) should consist  
5 only of required power that cannot be produced from their respective existing assets or existing  
6 contracts. In its Needs Assessment, APS proposed to procure only the amounts set forth in Schedule  
7 PME-1, attached to Mr. Ewen's Direct Testimony, Exh. APS-1, through the initial Track B  
8 solicitation. Staff and the merchant intervenors took the position that contestable load for the initial  
9 solicitation should include more capacity and energy than APS' and TEP's estimates of required  
10 power that cannot be produced from their respective existing assets or existing contracts, as  
11 represented in their respective Needs Assessments.  
12

13           The Staff Report included a table that provided estimated contestable loads for APS and TEP  
14 for the years 2003, 2004, 2005 and 2006, broken down into capacity and energy. (Exh. S-1 at 7)  
15 Staff states that it used the capacity requirement and an average system capacity factor information  
16 provided by the utilities to develop its estimates, which are not precise. (Exh. S-3 at 7 (Rebuttal  
17 Testimony of Alan Kessler)) Staff explained that under its approach, contestable load and energy  
18 would be adjusted during the Pre-Solicitation phase of the solicitation process (*see* Exh. S-1 at 12-16)  
19 to accommodate changes in projected load and system economics, with final quantification to occur  
20 prior to the issuance of the initial solicitation. (Exh. S-3 at 7) At the hearing, Staff presented its  
21 Revised Contestable Loads Estimate, Exh. S-5, which is an updated version of the Staff  
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1 Report estimates.<sup>6</sup> A significant portion of the increase in Staff's APS energy estimates from those in  
 2 the Staff Report results from the addition of "economy purchase" amounts. Those "economy  
 3 purchase" amounts are identical to the "economy energy" amounts appearing in Schedule PME-13 to  
 4 APS' Needs Assessment, Exh. APS-1. Staff subsequently attached an updated version of hearing  
 5 Exh. S-5 as Exhibit A to its Initial Closing Brief filed on December 18, 2002.<sup>7</sup>

6 PGR supported the numbers in Exh. S-5 as the minimum solicitation of capacity that should  
 7 be required. However, PGR believes that in order to be consistent with APS' prior positions in these  
 8 consolidated dockets, that a higher number for solicitation of energy is appropriate for APS, and that  
 9 the Commission should instead adopt the higher solicitation volumes contained in Exh. S-1, the Staff  
 10 Report. As justification for Commission adoption of the higher contestable load for APS, PGR  
 11 points to APS' stated plans at the August workshop, prior to Decision No. 65154, to displace 5,728  
 12 gigawatt hours ("GWH") of energy from its own generation with long-term procurement of energy  
 13 from its affiliate Pinnacle West Energy Corporation's ("PWEC") new combined cycle gas fired units  
 14 in 2003. (See Schedule PME-3R to Exh. APS-4 (Ewen Rebuttal Testimony)) Harquahala also  
 15 reasons that the discrepancy between APS' earlier plans to procure energy and capacity from its  
 16 affiliate PWEC, and the current plans to purchase comparable amounts of energy on the spot market,  
 17 as revealed in APS' Schedules PME-1 and PME-13 attached to its Needs Assessment, lends greater  
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 19  
 20

21 \_\_\_\_\_  
 22 <sup>6</sup> The Staff Report states that the table appearing at page 7 of Exh. S-1 (the Staff Report) was based on capacity  
 23 numbers, provided by APS at the August workshop, which Staff also used to derive the energy numbers. APS provided  
 24 revised capacity and energy numbers to Staff on October 23, 2002. Because there was not sufficient time for Staff to  
 25 review and analyze the revised information for inclusion in the Staff Report by the October 25, 2002 filing date, Staff  
 26 attached the revised APS information as Appendix Two to the Staff Report. At the hearing, Staff presented hearing Exh.  
 27 S-5 as a replacement for the table appearing on page 7 of Exh. S-1. Staff's witness stated that APS supplied all the parties  
 28 with additional new information at a November 6, 2002 workshop, that more additional information was received a few  
 days prior to the hearing, and that the new information was incorporated into Staff's preparation of Exh. S-5. (Tr. at 51-  
 52)

26 <sup>7</sup> This most recent of Staff's contestable load estimates incorporates the elimination, discussed at the hearing, of  
 27 215 MW from Staff's energy estimates for APS. For Staff's TEP estimates, the updated version of S-5 includes the  
 28 addition of previously unavailable local RMR generation estimates, and the addition of "economy purchases" to Staff's  
 energy estimates for TEP. In its Reply Brief, TEP argues that the new contestable load amounts in that exhibit have not  
 been subject to cross-examination or other inquiry and should not be adopted in this Decision, particularly since Staff  
 acknowledges those loads will be refined and adjusted in the Pre-Solicitation process.

1 credibility to the capacity and energy calculations for APS submitted by Staff, PGR and Harquahala.<sup>8</sup>  
 2 Harquahala believes that a specific number in terms of megawatts (representing capacity) and  
 3 megawatt-hours (representing energy) should be included in the Decision on this matter, and supports  
 4 using the numbers presented in Exh. S-5 as the minimum amounts for the utilities to competitively  
 5 procure.

6 APS stated in its brief that although it finds the numbers set out in Exh. S-5 to be acceptable  
 7 estimates of what they purport to be, with the caveat that reliability must-run generation ("RMR")  
 8 numbers may be revised upon completion of the ongoing RMR study,<sup>9</sup> the numbers are estimates  
 9 based on the information then currently available, and should not be viewed as any definitive  
 10 indication of what APS may procure through the solicitation process.

12 TEP advocates that the Commission should clearly set out the types of load and the  
 13 appropriate methodologies for determining contestable load, rather than adopting contestable load  
 14 numbers that will require updating, and believes that a focus on methodology in this Track B  
 15 Decision will meet the Commission's goals for a competitive solicitation. Staff's position is  
 16 somewhat aligned with APS' and TEP's on this specific point, insofar as Staff believes that while the  
 17 Commission will have to choose an appropriate number to represent the utilities' contestable loads,  
 18 those numbers should be targets, rather than absolute requirements. Staff recommends that the  
 19

21 <sup>8</sup> Schedule PME-3R to Exh. APS-4 (Rebuttal Testimony of Peter M. Ewen), and Exh. No. CCR-1 to Exh. Panda-2  
 22 (Direct Testimony of Craig R. Roach, PhD), depict APS' August Workshop estimates of the amount of APS generation it  
 23 planned to displace with energy from what APS termed "PWEC Dedicated Generation." Footnote 7 to Schedule PME-1,  
 24 and Schedule PME-13 to Exh. APS-1 (Direct Testimony of Peter M. Ewen) depict APS' Needs Assessment estimates of  
 25 potential economy energy purchases and for net unmet reliability needs. A comparison is reproduced here for the years  
 26 2003-2005:

	APS' August Workshop plans for PWEC displacement of APS generation energy	APS' November Needs Assessment Plans for potential economy energy purchases	APS' November Needs Assessment Plans for net unmet reliability needs
26	2003 5,728 GWH	3,705 GWH	639 GWH
27	2004 6,170 GWH	4,033 GWH	840 GWH
28	2005 7,217 GWH	6,695 GWH	1,228 GWH

28 <sup>9</sup> APS added that even though Staff estimates of RMR and economy energy may be reasonable, APS believes it is  
 inappropriate to include RMR and economy energy in the Track B solicitation process.

1 Commission focus on determining an appropriate method for calculating contestable load instead of  
2 focusing on developing specific numbers, because it will be necessary to update the numbers prior to  
3 the solicitation.

4 RUCO believes that the solicitation requirements beyond APS' and TEP's immediate needs  
5 for the year 2003 should be determined by the Commission in an Integrated Resource Planning  
6 ("IRP") process. RUCO takes the position that the Commission should establish the amount of  
7 capacity, but not energy, for which the utilities should solicit bids. RUCO states that soliciting for  
8 capacity is more important, because once the utility has sufficient capacity, the dispatch of that  
9 capacity will be determined by the variable cost of each MW of capacity and the demand in each  
10 hour. The LAW Fund took no position on the contestable load for the initial solicitation, stating that  
11 it did not wish to delay the first round of solicitations, but advocated for mandatory inclusion of a  
12 Demand Side Management ("DSM") solicitation component and an environmental risk management  
13 policy in the second and subsequent solicitations.  
14

15  
16 b. Discussion/Resolution

17 At the hearing, Staff provided the following explanation of the purpose of its contestable load  
18 estimates:

19 Staff's recommendation that this amount be solicited is not a recommendation that  
20 necessarily the utilities purchase as a result of this first solicitation all of those  
21 supplies, both capacity and energy that are offered or that are being solicited for. They  
22 still have the obligation of evaluating those bids to see whether or not they are the  
23 most economical and reasonable products to serve their customers' needs.

24 (Tr. at 156)

25 We agree with Staff on this point. We believe that the solicitation process developed by the  
26 parties, as proposed by Staff, is a necessary step in our goal of encouraging the development of a  
27 healthy competitive wholesale generation market in Arizona. We also recognize that the  
28 responsibility of the utilities is to provide for the continuing need of its ratepayers to maintain a  
reliable supply of electricity at reasonable rates, and that this primary obligation exists, and will

1 continue to exist, whether a utility has an affiliate operating in the Arizona wholesale market or not.  
 2 TEP's position that we should only set out the types of load and the appropriate methodologies for  
 3 determining contestable load, rather than adopting specific contestable load numbers that will require  
 4 updating, might be acceptable under differing circumstances. However, at this time, we are faced  
 5 with the fact that although the parties to this matter spent months working out numerous issues  
 6 regarding the solicitation, they were unable to reach a consensus on contestable load amounts prior to  
 7 the hearing. Because it is our desire to provide the parties as much clarity as possible on the  
 8 parameters of the solicitation, we will adopt contestable load numbers for capacity and energy in this  
 9 Decision, and will set out the appropriate methodology for refining and adjusting them in the Pre-  
 10 Solicitation process. Our adoption of specific numbers for contestable load will not require the  
 11 utilities to accept bids that they judge to be uneconomic pursuant to the bid evaluation requirements  
 12 of this Decision.  
 13

14 The major areas of disagreement regarding determination of contestable load numbers  
 15 centered on whether contestable load should include RMR and economy energy purchases.  
 16

## 17 **2. Reliability Must-Run Generation ("RMR")**

18 Transmission constraints currently limit the capacity and energy that can be delivered from  
 19 particular generators over particular lines to load in the Phoenix, Tucson, and Yuma areas, and may  
 20 give rise to RMR requirements inside those load pockets. (Exh. S-4 at 3-4 (Rebuttal Testimony of  
 21 Jerry Smith))

### 22 a. Inclusion of RMR in the Solicitation

#### 23 1) Positions of the Parties

24 Staff believes that RMR should be included in the initial solicitation as contestable load,  
 25 because such inclusion will reveal whether and to what extent the market will provide solutions to  
 26 transmission import constraints (Tr. at 277-278). PPL, PGR, Harquahala, and WMGF are in  
 27  
 28

1 agreement with Staff.<sup>10</sup> Staff states that failure to include RMR in a utility's contestable load has the  
2 potential to diminish the benefits to be derived from competitive bidding, and would serve to  
3 encourage the utility to continue using generating plants within a constrained area, and not look to  
4 meet system needs from cheaper and cleaner sources. (Exh. S-4 at 3) Staff also believes that  
5 inclusion of RMR in contestable load will offer a market response reference regarding the relative  
6 economic and environmental merits of generation solutions to the transmission import constraint.  
7 (Exh. S-4 at 6) Staff states that there are three conditions under which RMR capacity and energy  
8 could be contestable: 1) if non-utility owned or non-rate based generation exists locally; 2) if remote  
9 generation has access to non-APS or non-TEP firm transmission capacity that would enable delivery  
10 to the local area; and 3) if owners of remote generation offer to finance transmission improvements to  
11 remedy the transmission constraint. (Exh. S-4 at 5) Staff asserts that units exist internal to the  
12 constraint that can bid, that transmission paths other than the incumbents' exist that could be used,  
13 and that, at least in the long term, transmission enhancements could accompany an RMR bid. (Staff's  
14 Initial Br. at 4, citing Tr. at 149-150, 151, 173-174, 279-280)

15  
16  
17 TEP opposes inclusion of RMR in the initial solicitation, as it believes that such a requirement  
18 goes beyond the intent of Decision No. 65154. TEP argues that RMR is not suitable for the proposed  
19 solicitation process, and that TEP cannot reasonably acquire RMR economically through that  
20 process. TEP claims that the vast majority of its RMR needs are for voltage stabilization of the  
21 system, and can only be served by TEP's local generation. TEP argues that given the nature of TEP's  
22 service area, no realistic short-term RMR solutions are available on a competitive basis, and that all  
23 three of Staff's factors on RMR contestability likely cannot be met for the TEP service area in the  
24 short term. TEP disagrees with Staff's position that inclusion of RMR in the solicitation may lead to  
25

26  
27 <sup>10</sup> PGR does not believe that it has yet been established that there presently should be either RMR capacity or  
28 energy requirements, as it has not been allowed to participate in the RMR studies, and has seen no evidence that would  
justify such requirements. However, PGR agrees that previously designated RMR capacity should be subject to  
competitive solicitation.

1 long-term transmission enhancements, arguing that long-term solutions are contrary to the generally  
2 anticipated 2003-2006 timeframe to be covered by the initial solicitation. TEP also believes that  
3 including RMR in contestable load may significantly delay the initial solicitation, due to the interest  
4 in RMR issues and the anticipated adjustment of RMR load numbers based on the January 2003  
5 RMR study results. TEP also argues that soliciting and analyzing bids for RMR capacity and energy  
6 involves issues beyond an analysis that focuses primarily on price. TEP urges that if the Commission  
7 decides that RMR capacity should be competitively bid, that such bidding be deferred.  
8

9 APS states that there is no precedent of which it is aware for bidding out company-owned  
10 RMR capacity, that Staff took the position in the Track A proceeding that RMR should not be  
11 divested, and that bidding APS-owned RMR runs the risk of ignoring the ancillary services benefits  
12 offered by such RMR units, such as spinning reserve and voltage support. APS points out that it has  
13 agreed to competitively bid for non-APS supplied RMR, and that this will allow for a "market test"  
14 as suggested by Staff and some of the intervenors. APS argues that although the likelihood of  
15 receiving a competing bid for the handful of hours served by APS-owned generation resources is  
16 slight, the continued non-contestability of existing APS generation has important symbolic  
17 significance in the financial community, and that there is no evidence on the record that making rate-  
18 based assets contestable will benefit customers.  
19

20 WMGF argues that whether APS-owned RMR does or does not provide ancillary services is  
21 not a matter that affects whether such generation should be contestable in the competitive solicitation  
22 process, because APS can simply include any required ancillary services in the bid solicitation, and  
23 can consider their value during the bid evaluation process.  
24

25 AUIA believes that inclusion of RMR in the 2003 solicitation does not serve a public purpose,  
26 is premature prior to completion of the required RMR studies, and may be destabilizing to utility  
27 finances.  
28

## 2) Discussion/Resolution

1  
2 The possibility that a competitive solicitation for RMR may result in less costly, more  
3 efficient, cleaner solutions to load pocket problems places the solicitation of RMR generation clearly  
4 within the public interest. In regard to the utilities' and AUIA's concern regarding the effect on  
5 utility finances, since APS and TEP will make the decision as to how much competitive power to  
6 procure beyond their requirements that cannot be produced from their own existing assets, any  
7 financial impact of such procurements is within their control. The RMR studies, discussed below,  
8 should be completed in time to have the required information available in time for the Pre-  
9 Solicitation review process as outlined in the Staff Report. Inclusion of RMR in this initial  
10 solicitation is therefore not premature.  
11

12 We agree with WMGF that whether APS-owned RMR does or does not provide ancillary  
13 services is not a matter that affects whether such generation should be contestable in the competitive  
14 solicitation process, because APS and TEP can simply include any required ancillary services in the  
15 bid solicitation, and can consider their value during the bid evaluation process.  
16

17 TEP argued that all three of the conditions under which RMR capacity and energy could be  
18 contestable likely cannot be met for the TEP service area in the short term. Staff's witness testified,  
19 however, that he was aware of distributed generation and renewable facilities in the TEP service area.  
20 (Tr. at 279) Until the solicitation occurs, it remains unknown whether, as TEP claims, RMR is  
21 suitable for the proposed solicitation process and can reasonably be acquired economically through  
22 that process. We believe that many of the issues TEP raised can and should be addressed in the Pre-  
23 Solicitation process proposed in the Staff Report following the completion of the RMR study, in  
24 which TEP is a participant. TEP's participation in that study should also provide TEP an opportunity  
25 to prepare for the additional issues it states are involved in the RMR solicitation process. Regarding  
26 the long-term solutions to load pocket problems, although the Staff Report does generally anticipate a  
27  
28

1 2003-2006 timeframe, longer term RMR solicitations or offers should not be discouraged. As with  
2 non-RMR bids, and consistent with our desire to encourage the development of a robust wholesale  
3 generation market in Arizona, we expect both TEP and APS to give serious consideration to longer-  
4 term bids as well as short term bids.

5 We find that it is reasonable and in the public interest that all generation that can reliably  
6 deliver energy into the load pockets, under the RMR conditions outlined by Staff, should be allowed  
7 to compete in a fair and open manner to supply energy and capacity to both APS and TEP. We will  
8 therefore require that RMR capacity and energy resources, including both utility owned and non-  
9 utility owned resources, be contestable in the competitive solicitation process to help resolve  
10 Arizona's load pocket problems in the most economical, efficient and environmentally friendly  
11 manner possible.  
12

13 b. Separate vs. concurrent solicitation of RMR capacity and energy

14 1) Positions of the Parties

15  
16 APS and TEP propose that if RMR capacity and energy must be solicited, that the solicitation  
17 should be conducted separately from the initial solicitation. APS believes that the unique delivery  
18 issues associated with non-APS owned RMR needs, which it does not oppose being made  
19 contestable, merit separate consideration. PGR agrees that a solicitation for RMR requirements  
20 should be conducted as part of the Track B solicitation, but separately from the solicitation for non-  
21 RMR requirements. PGR argues that by carving out RMR from the solicitation, that bidders may be  
22 able to make better deals for capacity and energy because they know that other capacity and energy  
23 would be used to provide RMR service during RMR hours.  
24

25 Staff believes that inclusion of RMR capacity and energy in the initial solicitation is necessary  
26 to determine to what extent the market will provide solutions to transmission import constraints.  
27 RUCO, in advocating for its least-cost planning process, asserts that RMR and non-RMR needs must  
28

1 be evaluated simultaneously, because the least-cost RMR and non-RMR portfolios will affect one  
2 another. Harquahala and PPL are also opposed to the RMR solicitation being addressed separately.

3 2) Discussion/Resolution

4 We agree with Staff that inclusion of RMR capacity and energy in the initial solicitation is  
5 necessary to determine to what extent the market will provide solutions to transmission import  
6 constraints. We also agree with RUCO that RMR and non-RMR needs should be evaluated  
7 simultaneously, in order to determine the utility's best least-cost portfolio. We will therefore require  
8 that RMR capacity and energy be included in the initial solicitation. We believe that the issue of  
9 whether RMR is included in the same RFP or auction block with non-RMR capacity and energy in  
10 this initial solicitation will be adequately addressed during the Pre-Solicitation process described in  
11 the Staff Report. Whichever means the utilities use to solicit RMR, they must adhere to the goal of  
12 obtaining reliable power for their customers at the most reasonable cost possible, while also keeping  
13 in mind the environmental effects of their procurement decisions.  
14

15 c. RMR Studies

16 APS, Salt River Project and the Western Area Power Administration are currently  
17 participating in RMR studies for the years 2003-2007 to be filed with the Commission by January 31,  
18 2003, and which are to include the identification of RMR hours, capacity and energy. (Tr. at 147,  
19 150; Exh. S-4 at 5) Staff states that the resulting study information will then be available to  
20 incorporate in the pre-solicitation activities of the 2003 competitive solicitation process. Staff  
21 anticipates that, once the RMR study reports are filed, parties will have an opportunity to comment  
22 on and critique them, and Staff would utilize those comments as a means of judging the merits of the  
23 study results. (Tr. at 151-152)  
24

25 PPL, Harquahala and PGR expressed concern that the merchant intervenors were not  
26 participants in the RMR studies. PGR requests that the Commission order that merchant intervenors  
27  
28

1 be allowed to participate and comment. Staff testified that the transmission providers are under a  
2 short time constraint to complete the study work, and that Staff believes that as long as the process  
3 ends up with the opportunity for comment and review that the public interest will be served. (Tr. At  
4 148) PPL believes that our Decision in this matter should address the substance and timing of non-  
5 utility participation in review and comment on the study, and that substantive response and  
6 modification, if called for by the “informed and credible” comments from recognized authorities, be  
7 required. PPL believes that the critical impact of the studies upon the competitive solicitation and its  
8 economic impacts on Arizona ratepayers mandate that such a meaningful “peer review” component  
9 be built into the process as part of our Decision in this matter, and further believes that once RMR  
10 conditions are quantified, that the Commission should continue to monitor the situation, as active  
11 monitoring may lead to a better understanding of the physical constraints and solutions to help  
12 resolve the RMR condition, and deter any unbiased operation of the system.  
13

14 We believe that the anticipated Staff and Independent Evaluator review of comments from  
15 non-utilities in response to the January, 2003 RMR studies will allow Staff and the Independent  
16 Evaluator to judge the merits of the study results and properly apply the results during the Pre-  
17 Solicitation process outlined in the Staff Report. PPL’s concerns regarding continuing monitoring of  
18 RMR conditions are being met by Staff’s ongoing BTA process. If PPL has specific continuing  
19 concerns, it may consult with Staff.  
20

21 d. RMR Bid and Management Protocols

22 Staff recommends that RMR capacity and energy be bid and managed in accordance with  
23 applicable Arizona Independent Scheduling Administrator (“AISA”) and West Connect protocols.  
24 (Tr. at 350-352) TEP claims that this creates a dilemma for TEP because it would require TEP to  
25 seek a market-based solution for RMR at the same time that TEP’s FERC Open Access Transmission  
26 Tariff (“OATT”) requires RMR to be provided at a cost basis. APS acknowledges that bidding RMR  
27  
28

1 could require amendments to OATT tariffs. (APS Initial Br. at 10) WMGF agrees with Staff, and  
2 points out that the AISA and West Connect protocols are known, and would limit the price for the  
3 utility to incremental cost until WestConnect is operational, when market prices would be allowed.  
4 (Tr. at 350-352)

5 A utility's existing OATT can be amended if it becomes necessary to do so in order to allow a  
6 utility to charge lower rates to its customers as a result of a favorable RMR bid. It is highly unlikely  
7 that the Federal Energy Regulatory Commission ("FERC") would be opposed to a utility obtaining  
8 the benefit for its customers of lower RMR costs, if the utility were to receive a bid lower than its  
9 incremental RMR costs. The RMR bid and management protocols should conform to the AISA or  
10 WestConnect protocols, whichever protocols are in place on a given date. We believe that  
11 contracting parties can adequately and effectively deal with the hypothetical event (*see* Tr. at 352)  
12 that neither set of protocols are in effect at some time in the future.  
13

14 e. Yuma area

15 WMGF disagrees with APS' position that existing transmission counterflows in the Yuma  
16 area, which result from two Yuma area generators selling power into California (Tr. at 667), obviate  
17 the need for APS to solicit RMR generation for the Yuma area. WMGF claims that because APS'  
18 customers have no assurance that this no-cost transmission "service" will be available when needed,  
19 that APS should not be allowed to use the existence of the counterflows in the competitive  
20 solicitation evaluation process.  
21

22 APS responds that the fact that APS can take advantage of local generation support provided  
23 by two non-APS units that sell outside the Yuma area, at no cost to APS customers, so that APS can  
24 use local generation only when necessary, does not support requiring APS to buy products from  
25 WMGF that it does not need. APS views the WMGF project as one of several possible future  
26 resources for meeting load-serving obligations in Yuma, but states that the proposed WMGF project  
27  
28

1 is by no means the only option APS has to address future load-serving capability at Yuma. (Exh.  
 2 APS-7 at 6 (Rebuttal Testimony of Thomas Glock)) APS states that it would not want to foreclose  
 3 other options by committing now to a project that does not have either a Certificate of Environmental  
 4 Compatibility or any financing, particularly given today's difficult credit environment. (*Id.*)

5 The same solicitation parameters for RMR capacity and generation will apply to APS for the  
 6 Yuma area as for the Phoenix area. A determination of whether RMR in the Yuma area is  
 7 contestable will be dependent upon the results of the forthcoming RMR studies, and Staff and the  
 8 Independent Evaluator's review of comments filed on those results. If there is contestable load in the  
 9 Yuma area, as determined in the Pre-Solicitation process by Staff and the Independent Evaluator after  
 10 their review of comments submitted on the RMR study results, APS will be required to solicit bids.  
 11 WMGF may make a proposal to APS, and as with all bids received, it will be up to the utility to  
 12 determine whether it is in the best interests of its ratepayers to procure a product or products from  
 13 WMGF in this solicitation.  
 14

### 15 **3. Economy Energy – Solicitation versus Spot Market Purchases**

#### 16 a. APS

17  
 18 In its Needs Assessment, APS proposed to procure only the amounts set forth in Schedule  
 19 PME-1 attached to Mr. Ewen's Direct Testimony, Exh. APS-1, through the initial Track B  
 20 solicitation. APS proposed to displace production<sup>11</sup> from its existing generating assets and its SRP  
 21 T&C contract not by solicitation in the Track B process, but only by purchases made outside the  
 22 solicitation process, in the same manner that it currently makes such purchases. (Exh. APS-1 at 22-  
 23 23; Exh. APS-2 at 13-14) APS showed these amounts in Schedule PME-13 to APS-1, which is titled  
 24 "Potential Economy Energy Purchases."<sup>12</sup> APS explained that it currently determines whether to  
 25

26  
 27 <sup>11</sup> Schedule PME-1 already reflects APS' plans to retire the 4MW Childs/Irving hydro facilities at the end of 2004  
 and to place the older West Phoenix steam units 4 and 6 in cold reserve for the years 2003 through 2012. (Exh. APS-1 at  
 18)

28 <sup>12</sup> These amounts are also reproduced for the years 2003-2005 in footnote 8, above.

1 secure economy energy and other short-term purchases on a daily basis, based on a comparison of the  
2 anticipated market price of power and forward gas prices. (Exh. APS-2 at 13-14) In rebuttal  
3 testimony, APS proposed a compromise involving bidding 50 percent of its Needs Assessment  
4 forecast economy energy needs for the upcoming 12 months, outside the initial solicitation process,  
5 through a series of quarterly auctions held on the first business day of the month preceding each  
6 quarter, with the balance of APS' economy and other short-term energy needs being acquired from  
7 non-affiliates or through "blind" procurements using electronic trading platforms or independent  
8 brokers, also outside the initial solicitation process. (Exh. APS-5 at 10-13 (Carlson Rebuttal  
9 Testimony)) APS argued that this would be the "least-harmful" way to test the viability of a formal  
10 solicitation process for "economy energy."  
11

12 Staff, Harquahala, and PGR are opposed to both of APS' proposals. Staff characterized the  
13 type of purchase described by APS as spot market purchases, and stated that it is not opposed to APS  
14 acquiring energy on the spot market, as long as APS makes every effort to solicit for all of its needs  
15 in a fair and transparent solicitation. (Exh. S-3 at 8-9) Staff believes that the initial solicitation  
16 should include all the additional capacity that APS and TEP believe they will need for the period  
17 covered by the solicitation, and all of the energy that they expect to purchase from third parties for  
18 the specified time period, in order to determine market prices for both capacity and energy and to  
19 then assess the risks of alternative supply scenarios. (*Id.*) Staff believes that such a solicitation will  
20 reveal whether there is energy on the market that is priced in a way to make the spot market  
21 unattractive. (*Id.* at 10) Staff explained that a utility might find that firm energy is available at prices  
22 that make the potential benefits of the spot market, with its price volatility, unattractive, and might  
23 also find that dispatchable energy is available at prices below the utility's marginal costs of  
24 generation. (*Id.*) Staff believes that under those circumstances, locking in dispatchable energy  
25 during the initial solicitation will assure some consumer benefits while still allowing the utility to  
26  
27  
28

1 maintain the flexibility to go to the economy market when circumstances dictate. (*Id.*) PPL also  
 2 believes that utilities should be allowed to make economy purchases, but that they should not use this  
 3 practice as a means of avoiding and frustrating the essence of the competitive solicitation  
 4 requirement. PPL argues that the Commission should require APS to bid almost all of the economy  
 5 energy purchases identified in the Needs Assessment.

6 PGR claims that a comparison of Schedule PME-1 to Exh. APS-1, which appears in APS'  
 7 Needs Assessment, to an APS Load and Resource Forecast table presented at the August 13 and 14,  
 8 2002 workshop<sup>13</sup> demonstrates that APS, with its economy energy plan, hopes to subvert the  
 9 solicitation and instead purchase from PWEC's Redhawk plant at spot market prices. (Exh. Panda-2  
 10 at 15) PGR states that these two documents evidence a change from an APS proposal, in August  
 11 2002, to acquire energy on the basis of a 38 percent to 41 percent average annual capacity factor, to a  
 12 6 percent capacity factor<sup>14</sup> in APS' Schedule PME-1. (*Id.*) PGR's witness stated that APS' August  
 13 workshop table shows that what APS termed "PWEC Dedicated Generation,"<sup>15</sup> with 1,700 MW of  
 14 capacity, would generate 6,170 GWH of energy in 2004 to displace APS generation, which equates to  
 15 a 41 percent capacity factor in that year. (*Id.*) PGR's witness pointed out that in November's  
 16 Schedule PME-1, for the same year 2004, and for approximately the same amount of capacity (1,634  
 17 MW), APS used a capacity factor of only 6 percent to reach its energy estimate of only 840 GWH for  
 18 acquisition in the solicitation for 2004, and to possibly acquire 4,033 GWH of energy as "economy  
 19 energy purchases." (See Schedule PME-1, fn 7, Schedule PME-13 to APS-1, Exhibit CCR-1 to Exh.  
 20 Panda-2 and Schedule PME-3R to Exh. APS-4) PGR asserts that APS reduced its planned capacity  
 21  
 22  
 23  
 24  
 25

26 <sup>13</sup> The referenced table is reproduced in Exh. No. CCR-1 attached to hearing Exh. Panda-2 (Direct Testimony of  
 Craig R. Roach, PhD). See also footnote 8, above.

27 <sup>14</sup> "Capacity factor" is the percentage of hours a generating unit is actually in operation out of the hours it is  
 available.

28 <sup>15</sup> Identified on Exhibit CCR-1 to Exh. Panda-2 as West Phoenix CC Units 4 & 5, Saguarao CT Unit 3, and  
 Redhawk CC Units 1&2.

1 factor for its energy solicitations when it became clear that PWEC's generation units might not  
2 supply the energy to displace APS generation.

3 Harquahala, PGR, and PPL are also opposed to APS' proposed "compromise" to bid 50  
4 percent of its forecast "economy energy" needs outside the initial solicitation process, through a  
5 series of quarterly auctions. Harquahala asserts that APS' compromise solicitation process is an  
6 attempt to delay significant competitive procurement until after APS can make its case for including  
7 the PWEC units in rate base in the upcoming rate case. Reliant, however, in line with its position that  
8 an auction should be held for at least one-third of the utilities' contestable load, supports the  
9 Commission requiring adoption of APS' proposal for both APS and TEP to solicit economy energy.  
10 Reliant suggests that if the auction process provides Arizona's consumers the benefits desired by the  
11 Commission, that the Commission consider it as its policy for Arizona and possible future expansion  
12 beyond 50 percent of economy energy. AUIA argues that APS should have the choice of meeting its  
13 energy requirements in the manner of its choosing.  
14

15 APS believes that the appropriate benchmark for determining whether pre-bidding economy  
16 purchases is better for customers is not simply whether a generator can beat a current estimate of the  
17 future operating costs of a particular APS generator. Rather, APS argues, the correct questions are  
18 whether 1) placing restrictions on how APS procures economy energy in Track B and 2) requiring the  
19 procurement to occur far earlier than would otherwise be the case yield a better result than simply  
20 continuing with an already proven and successful economy energy program.  
21

22 The Commission does not discourage the appropriate use of economy purchases for utilities to  
23 reduce energy costs to customers. The utilities should retain the ability to fill unplanned or  
24 unexpected needs from the spot market when appropriate. However, the record in this proceeding  
25 demonstrates that prior to Decision No. 65154, APS was considering a procurement strategy that was  
26 not dependent upon spot market purchases for such a large amount of its energy needs, but instead  
27  
28

1 anticipated displacement of APS generating assets with power from its affiliate, PWEC. We do not  
2 believe that including in contestable load what APS has termed "economy energy" amounts to  
3 "placing restrictions on how APS procures economy energy" or "requiring procurement far earlier  
4 than would otherwise be the case." Rather, inclusion of these amounts simply requires that APS  
5 solicit bids, in a fair and transparent process, for this energy. This solicitation is necessary so that  
6 APS can determine, in its expertise, whether the procurement of such energy might yield a better  
7 result than relying on the spot market. APS has previously made such a determination, as evidenced  
8 by its prior plans to purchase a comparable amount of energy from its affiliate PWEC. (see Tr. at  
9 525, 526) Without soliciting and evaluating bids from wholesale generators who have expressed a  
10 keen interest in supplying APS' anticipated energy needs, APS will forego the opportunity to  
11 compare the costs of such procurement at today's wholesale prices to its proposed economy energy  
12 program. If APS determines that any or all bids received will not yield a better result than spot  
13 market purchases, APS may reject them. We are requiring APS to solicit bids for this "economy  
14 energy" amount to further the Commission's goal, as set forth in Decision No. 65154, of encouraging  
15 the development of a robust wholesale generation market in Arizona while at the same time  
16 protecting Arizona ratepayers. In preparing the solicitations and in evaluating the bids received to  
17 determine the wisest procurement strategy, the utilities must keep those goals in mind.

20 APS' proposal of a quarterly auction process for solicitation of economy energy purchases, as  
21 a compromise to including the disputed economy energy in contestable load, is not the "least-  
22 harmful" way to test the viability of a formal solicitation process for economy energy. Based on the  
23 record in this proceeding, we find that postponing the solicitation of this portion of APS' contestable  
24 load may well prove harmful to the overall success of the solicitation process. The initial solicitation  
25 should include all anticipated third-party purchases in order to provide the utilities with the widest  
26 array of bids from which to compare and choose. Such a solicitation will best serve the goal of  
27  
28

1 encouraging the development of a competitively robust wholesale generation market in Arizona  
2 without harming ratepayers.

3 b. TEP

4 TEP urges that unplanned economy energy purchases should be excluded from contestable  
5 load, and agrees with Staff's position that utilities should retain their ability to fill unplanned or  
6 unexpected needs from the spot market when appropriate. TEP does not believe that it will derive  
7 any better-than-market benefits by bidding out economy energy through the formal solicitation  
8 process, particularly if it cannot accurately identify when it will need a certain amount of spot energy.

9  
10 As we stated above, the Commission does not discourage the appropriate use of economy  
11 purchases for utilities to reduce energy costs to customers. We note that, unlike the case with APS'  
12 Needs Assessment, no party to this proceeding presented evidence controverting TEP's estimates of  
13 future economy energy purchases as they appeared in TEP's Needs Assessment. We also note that  
14 Staff's Exhibit S-5 as prepared for the hearing included economy energy numbers for APS, but not  
15 for TEP. Staff's witness testified that Exhibit S-5 did not include TEP's economy energy purchases  
16 as contestable load because the figures supplied by TEP did not include any portion of their capacity  
17 and energy as being required to be met by economy purchases, and that TEP's figures included  
18 "strictly truly economy purchases where they would be displacing other resources because of the  
19 economics involved." (Tr. at 316) Staff modified its position to include TEP's economy energy  
20 figures in Staff's contestable load estimates for TEP only in order to be "consistent between the two  
21 companies." (Tr. at 317) We find that TEP should not be required to incur the costs of soliciting its  
22 "strictly truly economy purchases" solely for the purpose of maintaining an appearance of  
23 consistency, when the record clearly reflects differing circumstances for APS and TEP.<sup>16</sup> We will  
24 therefore not require TEP to include the amounts appearing on Staff's revised Exhibit S-5 as  
25  
26  
27

28 <sup>16</sup> TEP currently does not have an affiliate offering power on the wholesale generation market.

1 economy purchases in its contestable load during the initial solicitation. This is consistent with our  
2 treatment of APS.

#### 3 4. Capacity to be Solicited

##### 4 a. APS

5 Staff accepted APS' projected unmet capacity needs as set forth in Schedule PME-1 attached  
6 to its November 4, 2002 Needs Assessment, but added 15 percent reserves for all load.<sup>17</sup> APS  
7 acknowledged that inclusion of reserves on all load, and not just APS load, could be appropriate.  
8 (Exh. APS-4 at 13-14) Staff also added APS' RMR capacity for the Phoenix area to its solicitation  
9 recommendation, but did not include RMR capacity for the Yuma area in its calculation due to the  
10 unavailability of the Yuma area data. Staff recommends that the final APS capacity solicitation  
11 amounts be appropriately updated by the RMR capacity amount for the Yuma area when the results  
12 of the RMR study are available, which should be on or before January 31, 2002. As currently set  
13 forth in its updated version of hearing Exhibit S-5, Staff recommends that APS solicit bids for 2,460  
14 MW of capacity in 2003; 2,734 MW of capacity in 2004; 2,854 MW of capacity for 2005; and 2,950  
15 MW of capacity for 2006, with those numbers to be updated by the results of the RMR study.  
16  
17

18 PGR and Harquahala support Staff's recommended capacity solicitation amounts for APS.

19 We find Staff's capacity estimates above to be reasonable, and find it reasonable for the RMR  
20 updates to be made during the Pre-Solicitation process set forth in the Staff Report. We will  
21 therefore require that APS' minimum capacity solicitation amounts conform to Staff's estimates as  
22 set forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR  
23 amounts as determined by Staff and the Independent Evaluator following their receipt and review of  
24  
25

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26  
27 <sup>17</sup> Staff agreed with PGR witness Roach's observation that reserves provided by bidders could easily be counted  
28 against requirements. Staff stated that recognizing bidders' reserves will also make it easier for the Staff and the  
Independent Monitor to compare the merits of alternative bids during the bid evaluation.

1 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in  
2 the Staff Report.

3 b. TEP

4 In order to reach its recommended capacity solicitation for TEP, Staff accepted TEP's retail  
5 monthly peak hour demand forecast as set forth in Exhibit 5 attached to TEP's November 4, 2002  
6 Needs Assessment, and subtracted the transmission import limit for the Tucson area. Staff's resulting  
7 recommended capacity solicitation for TEP thus consists solely of RMR capacity being supplied by  
8 local units. Staff recommends that TEP solicit bids for 758 MW of capacity in 2003; 824 MW of  
9 capacity in 2004; 861 MW of capacity for 2005; and 898 MW of capacity for 2006.  
10

11 We find Staff's capacity estimates above to be reasonable, and find it reasonable for the RMR  
12 updates to be made during the Pre-Solicitation process set forth in the Staff Report. We will  
13 therefore require that TEP's minimum capacity solicitation amounts conform to Staff's estimates as  
14 set forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR  
15 amounts as determined by Staff and the Independent Evaluator following their receipt and review of  
16 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in  
17 the Staff Report.  
18

19 **5. Energy to be Solicited**

20 a. APS

21 Staff recommends that APS solicit energy for each year 2003, 2004, 2005 and 2006 that  
22 equals the sum of APS' unmet energy needs from Schedule PME-1 of its Needs Assessment; APS'  
23 Phoenix supplied RMR energy from work papers supplied to the parties with its Needs Assessment;  
24 APS' Yuma supplied RMR energy as determined in the RMR study due January 31, 2002; and APS'  
25 "potential economy energy purchases" as set forth in Schedule PME-13 of its Needs Assessment.  
26 Staff's recommended energy solicitation amounts, which it states require adjustment to include APS'  
27  
28

1 Yuma supplied RMR energy, are 4,381 GWH of energy for 2003; 4,963 GWH of energy for 2004;  
2 8,088 GWH of energy for 2005; and 8,680 GWH of energy for 2006.

3 RUCO takes the position that whatever solicitation process is used, the bids solicited by each  
4 distribution utility should not be limited with respect to the total amount of energy requested.

5 Harquahala fully supports the Commission requiring APS to solicit at least the quantities of  
6 energy contained in Exh. S-5. PGR believes that APS should be required to solicit energy in at least  
7 the amount APS previously anticipated would be supplied by PWEC's combined cycle units (*see* Tr.  
8 at 184-185) and prefers that the energy numbers appearing in Exh. S-1 be used for APS in lieu of the  
9 lower energy numbers appearing in Exh. S-5 or in the updated version of S-5 attached to Staff's  
10 Initial Brief.

12 We note that Staff testified that it anticipates that irrespective of the size of the actual  
13 solicitation, based on the amount of capacity and energy that is available at this time, that either size  
14 minimum solicitation [S-1 or S-5] would yield bids for capacity and energy significantly in excess of  
15 either amount appearing in S-1 or S-5, and the utility would still have a sufficient array of capacity  
16 products and energy products from which to select so that it could make the right procurement  
17 decision. (Tr. at 172-173) We agree with that statement, and therefore find that there is no need to  
18 require that the contestable energy numbers be set at Staff's estimates appearing in Exh. S-1.

20 We find Staff's energy estimates above to be reasonable, and find it reasonable for the RMR  
21 updates to be made during the Pre-Solicitation process set forth in the Staff Report. We will  
22 therefore require that APS' minimum energy solicitation amounts conform to Staff's estimates as set  
23 forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR amounts  
24 as determined by Staff and the Independent Evaluator following their receipt and review of  
25 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in  
26 the Staff Report.  
27  
28

b. TEP

1  
2 In formulating its recommendation for the amount of energy that TEP should solicit, Staff  
3 utilized the energy amount included in Exhibit 2 attached to TEP's Needs Assessment, added local  
4 RMR generation and economy purchases supplied from information provided by TEP based on a  
5 November 2, 2002 load forecast. Staff states it is likely that the energy solicitation numbers it  
6 recommends for TEP will require adjustment as a result of the RMR study, and that its adjusted  
7 energy numbers could potentially be as high as 1,000 GWH annually. Staff's recommendation, based  
8 on the information available, for TEP's energy solicitation is as follows: that TEP should solicit bids  
9 for 443 GWH of energy for 2003; 688 GWH of energy for 2004; 596 GWH of energy for 2005; and  
10 561 GWH of energy for 2006.  
11

12 With the exception of the economy energy amounts, we find Staff's energy estimates above to  
13 be reasonable, and find it reasonable for the RMR updates to be made during the Pre-Solicitation  
14 process set forth in the Staff Report. We will therefore require that TEP's minimum energy  
15 solicitation amounts conform to Staff's estimates as set forth in its December 18, 2002 revision to  
16 Exh. S-5, with the exception of the amounts appearing as economy purchases, and with the addition  
17 of the necessary RMR amounts as determined by Staff and the Independent Evaluator following their  
18 receipt and review of comments to the January, 2003 RMR Study Results, during the Pre-Solicitation  
19 process set forth in the Staff Report.  
20

**III. SOLICITATION/PROCUREMENT PROCESS****A. Solicitation Method - Auction vs. RFP**

21  
22  
23  
24 The Staff Proposed Solicitation process includes procedures for both a descending clock  
25 auction and a Request for Proposal ("RFP") process.

26 Reliant advocates that APS and TEP be required to solicit at least one-third of their  
27 contestable load through an auction process. Reliant believes that such a requirement would not only  
28

1 ensure that the utilities receive the lowest price for the product being solicited, but would ensure that  
2 all competitors are offered a fair opportunity to participate and that the Commission is provided a  
3 complete array of potential responses. Reliant claims the benefit of an auction is that it induces  
4 vigorous competition for standard products. Reliant also asserts that the capacity products described  
5 by TEP and APS in this proceeding are either already standard products or can be easily standardized  
6 for procurement from today's wholesale electric markets.

7  
8 RUCO argues that Reliant's auction methodology is flawed because an auction alone will not  
9 reveal whether a winning bid can fit within a least cost portfolio of resources; and only a system  
10 dispatch model can provide that answer. (Exh. RUCO-2 at 6-7 (Rebuttal Testimony of Dr. Richard  
11 A. Rosen))

12 PPL asserts that, as long as the principles of maintaining an open, transparent and unbiased  
13 solicitation process are observed, the utilities should be allowed to establish the method of  
14 solicitation, depending on which method the utility deems most appropriate for the type of product  
15 being solicited.

16  
17 APS states that, at this time, it favors an auction for future procurements, but that there is  
18 insufficient time to develop an auction and accommodate all of the variables that require resolution  
19 prior to the first solicitation.

20 We believe that the various types of bids that the parties propose in this proceeding will  
21 encompass numerous variables, and agree with APS' assessment that there is insufficient time to  
22 develop an auction to account for all those variables while meeting the deadline for the first  
23 solicitation. Despite the fact that the parties have worked toward general agreement regarding this  
24 solicitation, there is no general agreement of the parties on standard products, and such agreement  
25 would be a requirement of a fair, open and transparent solicitation process through an auction. It is of  
26 great importance that the utilities have the maximum amount of information available through bids in  
27  
28

1 order to determine which procurement will best serve the ratepayers' interests, and it appears that an  
2 RFP will be the better means of providing the utilities with the broadest array of responses from  
3 which to choose.

4 **B. Who may participate in the solicitation**

5 The LAW Fund asserts that all interested parties should be allowed to review and comment on  
6 the bid solicitation materials; that the load forecast, resource plan and needs assessment should be  
7 available for review by all interested parties; and that all interested parties should be allowed to  
8 attend bidders conferences. (Exh. LAW-1 at 11-12 (Direct Testimony of Dr. David Berry)) The  
9 LAW Fund believes that expanding the review to include other parties could allow interested parties  
10 other than bidders to identify provisions in the draft solicitation that needlessly restrict creative bids  
11 or dissuade potential bidders. (*Id.*)

12  
13 The Staff Proposed Solicitation Process allows prospective bidders, and interested persons  
14 who agree to keep certain information confidential, to review and comment on the bid solicitation  
15 materials (Exh. S-1 at 8), to provide comments to the utility, the Independent Monitor or the Staff  
16 regarding the completeness or quality of the information provided and the process being employed or  
17 the decisions made regarding execution of the solicitation process (*id.*), and the opportunity to ask  
18 questions directly of the utility as well as to identify any deficiencies in the solicitation documents or  
19 supporting data. (*Id.* at 9) We believe that in conjunction with the utilities' November Needs  
20 Assessment filings, the Staff Proposed Solicitation Process adequately addresses the other issues  
21 raised by the LAW Fund for purposes of this initial solicitation. In a section below, we discuss other  
22 issues raised by the LAW Fund that may be addressed in subsequent solicitations. Depending on the  
23 outcome of the workshops that the LAW Fund has recommended, the issue of non-bidder  
24 participation for limited purposes may be revisited.  
25  
26  
27  
28

1           **C.     Product Definition**

2                   **1.     Unit-Contingent Bids**

3           PGR requests that the Commission require APS to solicit asset-backed, dispatchable unit-  
 4 contingent bids and enter into traditional pay-for performance PPAs to meet the majority of its needs.  
 5 Harquahala supports PGR's request.<sup>18</sup> PGR asserts that APS' proposed affiliate PPA<sup>19</sup> anticipated  
 6 the same unit-contingent portfolio that PGR is advocating in this proceeding. PGR believes that APS  
 7 is likely to get better bids at lower prices for direct solicitation for unit contingent capacity and  
 8 dispatchable energy than it would get if such bids were submitted as non-conforming bids in an RFP  
 9 for other products. PGR points to APS' acknowledgement that it may not have time to consider bids  
 10 not conforming to specific parameters of the products it decides to solicit (*see* Exh. APS-3 at 5) as  
 11 support for its request that the Commission require APS to solicit the unit-contingent portfolio that  
 12 PGR advocates. Further, PGR claims that it is only through solicitation of these products that APS  
 13 and Staff can determine which portfolio of products is in the best interests of APS ratepayers.  
 14

15                   **2.     Length of Contracts**

16           PPL asserts that in order to maximize the consumers' benefits from the current wholesale  
 17 market, the utilities should seek some medium- and long-term contracts to lock in longer-term  
 18 benefits of the current price situation. Sempra and SWPG likewise argue, in agreement with WMGF,  
 19 that a well-conceived power procurement process should require that current market circumstances  
 20  
 21  
 22  
 23

24 <sup>18</sup> PGR proposes two types of bids: One would be a unit contingent offer with an availability guarantee of 95  
 25 percent, and the second would be a firm LD offer that would include a 100 percent availability guarantee backed up by  
 26 the requirement to pay for replacement capacity and energy if the 100 percent guarantee is not met (liquidated damages).  
 27 PGR further recommends that the remaining amount of capacity to be procured should be met by seasonal firm LD call  
 28 options. "Call options" means the utility has the right, but not the obligation, to call on the bidder during the summer  
 months for either 16 peak hours in a day or in just 6 super-peak hours. All the calls are under day-ahead scheduling and  
 once called to run, the unit would be guaranteed to run for the full 16 or 6 hours.

<sup>19</sup> On October 18, 2001, APS filed a Request for a Partial Variance to A.A.C. R14-2-1606(B) and for Approval of a  
 Purchase Power Agreement, Docket No E-01345A-01-0822, requesting authority to enter into a purchase power  
 agreement with its affiliate PWEC.

1 be considered and evaluated to determine if longer-term contract offerings could be used to lock in  
2 reasonable rates for electric consumers regardless of what happens in the volatile spot price  
3 wholesale market during the next few years, and recommend that a solicitation process be adopted  
4 that expressly considers intermediate and long-term contracts. Reliant generally agrees with PGR,  
5 Sempra, SWPG, WMGF and PPL that the Commission's Decision in this matter should encourage  
6 APS and TEP to solicit a variety of products with varying terms.

7  
8 WMGF asserts that a failure to seriously consider long-term contract proposals would be  
9 contrary to the Commission's stated intent in establishing the Track B solicitation process, which is  
10 to encourage the development of a robust wholesale market for generation in Arizona. to allow  
11 consumers the benefits of new Arizona generation resources, while protecting ratepayers. Staff  
12 agreed with WMGF that Arizona is currently experiencing low electricity prices due in part to  
13 reduced demand for electricity coupled with a surplus of generation. (Tr. at 250-252) WMGF argues  
14 that by developing a well-balanced portfolio of contracts, including some long-term contracts, which  
15 would lock in current low electricity prices in this "buyers' market," the utilities will protect  
16 ratepayers by shielding them from an uncertain future. WMGF recommended that the Decision in  
17 this matter include language stating that ratepayers are best served if the utilities acquire through the  
18 competitive solicitation process a well-balanced mixture of contracts, including contracts with terms  
19 of up to 15 to 20 years, in order to protect ratepayers from future market price uncertainty, and to  
20 allow new and proposed generating projects the opportunity to meaningfully participate in the  
21 competitive solicitation process, since new power generation projects require long-term off-take  
22 contracts to satisfy lenders' requirements.

23  
24  
25 TEP believes that longer-term agreements should be considered, at the utility's discretion, in  
26 the solicitation process to enable necessary transmission infrastructure to be built and to insure that  
27  
28

1 the output from power plants located in Arizona stays in Arizona to meet its growing demand. (Exh.  
2 TEP-2 at 10 (Rebuttal Testimony of David Hutchens))

3 PGR raised its concern with giving APS sole discretion to determine the term of any contract  
4 given APS' stated intent to seek rate base treatment of the PWEC generation, and asserts that such a  
5 result would "completely obliterate" the Track B process and the instruction in Decision No. 65154  
6 that those assets should not be treated as APS assets for the Track B solicitation.

7  
8 The Staff Report states while during 2003 each utility is anticipated to primarily require  
9 peaking capacity and energy with contract terms of one to three years, that each utility must  
10 demonstrate that its power supply portfolio contract durations are adequately diversified and that its  
11 portfolio's structure mitigates both cost and reliability risks appropriately, and that if, in the judgment  
12 of the utility, market conditions or economic opportunities dictate contract terms longer than three  
13 years, it will be the responsibility of the utility to enter into such contracts as are reasonable. (Exh. S-  
14 1 at 6)

15  
16 APS stated that it presently proposes to target its solicitation for the 3-4 years that Staff  
17 acknowledged was most likely appropriate. APS also stated that while it will consider bids for longer  
18 than the period covered by the initial solicitation, it does not believe that it should be required to  
19 solicit for such products. APS argues that increasing risks are associated with longer-term contracts,  
20 such as counter-party credit risk, regulatory risk, the potential implications of FERC's Standard  
21 Market Design ("SMD") initiative, changes in future system needs, and potential customer attrition to  
22 Direct Access in later years.

### 23 24 **3. Discussion/Resolution**

25 The evidence presented on the record in this proceeding supports a finding that both APS and  
26 TEP should seriously evaluate and consider a well-balanced mixture of contracts, including long-term  
27 contracts, in the competitive solicitation in order to protect ratepayers from future upswings in power  
28

1 prices. In making its determination regarding the appropriate resource portfolio in the best interests  
2 of its customers, APS should bear in mind the Commission's instruction in Decision No. 65154 that  
3 the PWEC assets that it may seek rate base treatment for in the future should not be treated as APS  
4 assets for the Track B solicitation. The Commission expects the utilities to make procurement  
5 decisions that further the goal of encouraging the development of a vibrant wholesale generation  
6 market in Arizona.

7  
8 **D. Bid Evaluation**

9 **1. Production Modeling (Bid Evaluation)**

10 **a. Positions of Parties**

11 Sempra and SWPG advocated that the utilities perform a system-integrated analysis of bids  
12 received using computer programs and modeling. They believe that such analysis would provide  
13 some form of preliminary yardstick by which to measure the reasonableness of APS' and TEP's  
14 actions. Staff's witness testified that it believed such a program would be an integral part of the  
15 preparation of a needs assessment. (Tr. At 93) Both APS and TEP confirmed their intention to rely  
16 on production modeling to evaluate the economics of bids and existing assets. (Tr. at 479, 489, 490,  
17 Exh. APS-5 at 21) Sempra and SWPG assert that a longer time frame than that appearing in the Staff  
18 Report may be required for the utilities to evaluate competitive proposals as to price and  
19 deliverability using a system integration analysis, but do not believe that the time required need  
20 extend the overall timeline beyond what the Staff Report contemplates. RUCO also believes that the  
21 utilities must perform production cost simulations of the various combinations of resources to obtain  
22 the least-cost result, and that the utilities will likely need 6-8 weeks to adequately review available  
23 options before determining the most prudent course of action. (Exh. RUCO-2 at 7 (Rebuttal  
24 Testimony of Dr. Richard A. Rosen))  
25  
26  
27  
28

b. Discussion/Resolution

1  
2 During the workshop process, the participants reached a consensus in developing the  
3 Solicitation Timelines appearing in the Staff Report at pages 27-29. The record reflects that APS and  
4 TEP were active participants in the workshops wherein the timelines were developed, and that APS  
5 and TEP plan to utilize production modeling to evaluate the bids received. We therefore believe that  
6 Sempra, SWPG, and RUCO's concerns will be adequately addressed. As to Sempra and SWPG's  
7 assertion that the described analysis would provide some form of preliminary yardstick by which to  
8 measure the reasonableness of APS' and TEP's actions, we agree. As we have emphasized, the  
9 utilities will be responsible for determining the best resource mix to provide reliable power to their  
10 customers at the most reasonable cost possible, while taking environmental concerns into account.  
11

**2. RUCO - Least Cost Planning/Integrated Resource Planning**a. Positions of Parties

12  
13  
14 RUCO believes that a comparison to the utilities' cost to generate power themselves is  
15 appropriate to determine the reasonableness of bids received from independent power producers.  
16 Based on its belief that such bids can serve as a baseline for evaluating bids from the unregulated  
17 market, RUCO has called for a requirement for cost-of-service proxy bids, for new self-built  
18 generation and transmission, from the incumbent utilities for purposes of such comparison. The  
19 vehicle RUCO proposed for such comparison is the re-institution of a traditional integrated resource  
20 planning ("IRP") process, in which the Commission would review the utilities' resource planning in  
21 advance, such as the process in place at the Commission prior to Arizona's move toward the  
22 restructuring of the Arizona electricity markets. RUCO believes that an added benefit of a new IRP  
23 process would be that Demand-Side Management, transmission and generation resources (including  
24 both RMR and non-RMR generation) could be evaluated simultaneously, and that IRP provides a  
25 framework for addressing environmental implications, as well as cost implications, of resource  
26  
27  
28

1 planning. In addition, RUCO asserts that an IRP process can address a number of other complex  
2 issues, including the reasonableness of prices, the reliability and deliverability of the supply, the  
3 creditworthiness of the counterparties, and short and long term impacts on customers.

4 RUCO proposed that because the time required for the institution of an IRP process exceeds  
5 the time remaining for a solicitation of the utilities' 2003 requirements, that the utilities procure only  
6 enough power for their 2003 capacity growth needs in the initial solicitation. Then, RUCO envisions  
7 that the IRP process would take place, which process would include a determination of the total  
8 present value of revenue requirements ("PVRR")<sup>20</sup> for all possible, technologically compatible  
9 resource portfolios and a comparison of each portfolio's PVRR to the PVRR of all other such  
10 portfolios over the relevant planning period. RUCO believes the planning horizon over which the  
11 PVRR should be measured should extend over 20, and perhaps 30 years. RUCO believes that after  
12 the bids are evaluated, the utilities should reject, as imprudent, market bids that exceed the utilities'  
13 cost of service proxy bids; acquire the mix of the remaining market bids that would result in the least  
14 cost to consumers; and if the remaining bids do not meet the utilities' needs, the utilities should  
15 acquire the mix of merchant-bid and utility self-build resources that will result in the least cost to  
16 consumers.  
17  
18

19 Staff states that a responsible utility should use least cost planning principles to develop its  
20 overall portfolio. Staff also states that least cost planning principles are present in the Pre-  
21 Solicitation process outlined in the Staff Report, which requires each utility to prepare load  
22 assessments, needs assessments, price forecasts, and various other documentation that Staff and the  
23 Independent Monitor would review. In response to RUCO's position that the Commission should be  
24 more involved in the planning process, Staff states that whatever the merits of RUCO's suggestions  
25  
26

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27 <sup>20</sup> RUCO emphasizes that there is a difference between PVRR and Harquahala's recommended net present value of  
28 rate impacts for bid evaluation, which RUCO does not believe minimizes the total cost of a given resource portfolio to  
consumers.

1 on this issue may be, a decision on institution of an IRP process is beyond the scope of this  
2 proceeding.

3 APS supports Staff's position on IRP, and adds that while it is a significant issue, it should  
4 not complicate an already complex solicitation process with an already challenging implementation  
5 timeline. APS comments that an IRP process, if done in the future, would necessarily be limited and  
6 constrained by procurement decisions previously made in the initial solicitation.

7  
8 The LAW Fund opposes the use of either PVRP or the net present value of rate impacts test  
9 proposed by Harquahala to determine resource portfolio, because the tests may not accurately reflect  
10 the benefits of DSM or correctly incorporate environmental impacts of power production.

11 Reliant agrees that the competitive solicitation should result in a least-cost mix of supplies for  
12 the benefit of Arizona's consumers, but asserts that it is the utilities' responsibility to determine this  
13 mix and that a time-consuming IRP process is not necessary. Reliant agrees with Staff that RUCO's  
14 suggestions are beyond the scope of this proceeding, but is supportive of APS' proposal that, to the  
15 extent the Commission wishes to consider the issue further, additional workshops be scheduled to  
16 address it.

17  
18 b. Discussion/Resolution

19 We do not disagree with the goals of RUCO's proposed institution of an IRP process, and we  
20 expect that the utilities will use least cost planning principles to develop their overall portfolios. We  
21 believe that the Staff Proposed Solicitation Process, its bid evaluation criteria (*see* Exh. S-1 at 18) and  
22 the utilities' stated intentions to utilize production modeling to evaluate the bids received, will  
23 encompass the majority of the IRP concepts advocated by RUCO, and will not require the  
24 Commission to be an active participant in the utilities' planning and procurement processes. We find  
25 that based on the record in this Track B proceeding, re-institution of an integrated resource planning  
26 process is not necessary at this point in time. However, we do not wish to completely rule out the  
27  
28

1 possibility that an IRP process may for some reason become desirable or necessary in the future. We  
 2 will therefore require that Staff file a report in these dockets informing the Commission of its position  
 3 at that time on the advisability of the institution of a formal Commission IRP process.

4 **3. LAW Fund - Demand Side Management ("DSM") and Environmental**  
 5 **Risk Management**

6 a. Environmental Risk Management

7 The LAW Fund asserts that environmental improvement will not be achieved through the  
 8 resource acquisition process, or will occur only by happenstance, unless the Commission takes  
 9 explicit, proactive steps to ensure that environmental factors are integrated into the competitive  
 10 solicitation process.<sup>21</sup> The LAW Fund proposed a series of steps to Commission adoption of an  
 11 environmental risk management policy through a series of workshops and hearings. (See Exhibit  
 12 DB-3 to Exh. LAW-1 (Direct Testimony of Dr. David Berry)) The LAW Fund states that as a  
 13 practical matter, the Commission's desire to implement Track B expeditiously means that there will  
 14 not be time to integrate consideration of environmental performance into the first round of  
 15 competitive solicitation, but urges the Commission to act now to ensure that an environmental risk  
 16 management policy is in place in time for the second and subsequent solicitations.  
 17

18 b. DSM

19 The LAW Fund believes that cost effective DSM is a resource that can help meet the demand  
 20 for electric energy services at lower cost than conventional generation resources, and that because  
 21 DSM displaces electricity and generally has a stable cost, it helps consumers and utilities avoid  
 22 fluctuations in the price of electricity and natural gas used to generate electricity. The LAW Fund  
 23 states that DSM may reduce or eliminate the need for more transmission or distribution capacity, may  
 24 avoid transmission constraints, and can reduce the environmental impacts of electricity consumption,  
 25  
 26

27 \_\_\_\_\_  
 28 <sup>21</sup> The LAW Fund noted that other than the APS plans to retire the Childs/Irving hydro facility and the older West Phoenix units, there are no current plans to retire any other environmentally undesirable units.

1 including compliance costs associated with future environmental regulation. (See Exh. LAW-1 at 2)  
2 The LAW Fund proposed a series of steps to Commission adoption of a Demand Side Management  
3 Policy through a series of workshops and hearings. (See Exhibit DB-2 to Exh. LAW-1 (Direct  
4 Testimony of Dr. David Berry)) As with its recommendations regarding Commission institution of  
5 an Environmental Risk Management policy, the LAW Fund advises that the DSM policy process be  
6 begun quickly so that it can be comprehensively reviewed and completed in time to be applied as  
7 inputs to the second and subsequent rounds of competitive solicitations.  
8

9 Staff states that bidders are free to submit bids that include DSM and environmental risk  
10 management in response to a utility solicitation, but that such bids should not be required in the initial  
11 solicitation. Sempra and SWPG agree.

12 c. Discussion/Resolution

13 We appreciate the concerns of the LAW Fund regarding DSM and environmental risk  
14 management policy. While we do not discourage the consideration of DSM in the initial solicitation,  
15 we agree that workshops to address DSM issues and the development of a DSM acquisition process  
16 are in the public interest. Likewise, we believe that workshops on the development of an  
17 environmental risk management policy will provide a forum for a discussion of the costs and benefits  
18 of environmental mitigation. We will therefore require that Staff facilitate a workshop process to  
19 explore the development of a DSM policy and an environmental risk management policy, with such  
20 exploration to include an examination of the possible costs and benefits of the respective policies, and  
21 to file a report informing the Commission of the progress achieved in the workshops, including a  
22 Staff recommendation on whether hearings should be held as suggested in Exhibits DB-2 and DB-3  
23 to Exh. LAW-1.  
24  
25

26 In a somewhat related recommendation, the LAW Fund has recommended that Staff and the  
27 Independent Monitor be required to provide, as part of their reports pursuant to the Staff Proposed  
28

1 Solicitation Process, environmental information including information on air emissions and water  
2 usage of the resources acquired and of the utilities' entire portfolios. The LAW Fund believes that  
3 this information would be instructive for the Commission to evaluate whether the competitive  
4 solicitation process would result in improved environmental performance.

5 This initial solicitation will largely be concerned with currently planned and existing  
6 generation supply, the environmental effects of which have already been largely determined. We  
7 believe that even without the additional requirement that the LAW Fund wishes us to impose, that the  
8 duties of the utilities, the Staff and the Independent Evaluator will be very time-consuming in this  
9 initial solicitation, and we do not believe that the extra burden that the recommended requirement  
10 would place on the process would yield results justifying the burden. This issue should instead be  
11 examined in the workshop addressing environmental risk management.  
12

#### 13 4. Environmental Portfolio Standard ("EPS")

14 WGMF asserts that generators with a renewable resource component should be permitted to  
15 make proposals in the competitive solicitation, and that such proposals should receive appropriate  
16 credit in recognition of the "added value" they provide the utilities in meeting their renewable  
17 resource requirements under the EPS. WGMF urges that the Decision in this matter specifically state  
18 that such proposals may be submitted, that the utilities should consider these proposals in meeting  
19 their unmet renewable resource needs under the EPS, and that the utilities should explicitly credit  
20 such proposals with the added value they provide the utility in meeting its renewable energy  
21 requirements under the EPS.<sup>22</sup>  
22

23  
24 APS agrees that proposals may be submitted to meet APS' needs as part of the general  
25 procurement process, but does not believe that it should be required to include its EPS requirement in  
26

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27 <sup>22</sup> WGMF asserts that the Commission should adopt the following method for calculating such a credit: add  
28 monies collected by the utility from its ratepayers under the EPS surcharges, and divide this amount by the total MWH  
that APS must purchase from renewable energy providers in compliance with the EPS.

1 the solicitation, or that renewable proposals should receive any preference in the general procurement  
2 process. (Tr. at 691, 699) APS noted at the hearing that it currently has an EPS RFP outstanding.

3 Staff states that bidders are free to submit bids that include renewable resources in response to  
4 a utility solicitation, but that such bids should not be required in the initial solicitation.

5 We agree with APS and Staff. While we are not opposed to the concept of a utility giving a  
6 preference to environmentally-friendly generation in its bid evaluation, we do not believe at this time  
7 that the record in this proceeding supports the imposition of such a requirement.  
8

### 9 5. Ability to Reject All Offers

10 Staff states that the utilities should have the right to reject all bids if the bids do not  
11 reasonably meet the needs of the utility and its customers, and that since the utilities are obligated to  
12 supply electricity to their customers in a prudent manner, they will have an obligation to reject  
13 uneconomic bids.

14 PGR agrees with Staff that the utilities should be able to reject all bids if it is truly in the  
15 ratepayers' interest. PGR urges that the Commission articulate clear expectations of the  
16 circumstances under which the utilities will be expected to contract with bidders, such as when the  
17 utilities can "lock in" ratepayer savings. Harquahala supports PGR in this. AUIA urges that the  
18 utilities be given the flexibility to carry out the responsibilities for which they will be held  
19 accountable.  
20

21 We agree with Staff and AUIA, and will again clarify that the utilities have the right to reject  
22 all bids exceeding their requirements that cannot be produced from their own existing assets, if the  
23 bids do not reasonably meet the needs of the utility and its customers. We do expect the utilities to  
24 give serious consideration to all bids received, including long- and short-term bids, which  
25 consideration should include sound economic and deliverability analysis of the bids. The utilities'  
26 goal should be to obtain for their customers the least-cost mix of reliable power over the long term,  
27  
28

1 while being mindful of the environmental effects of their procurement decisions, as well as whether  
2 their procurement decisions will further the goal of encouraging the development of a competitive  
3 wholesale generation market in Arizona. While we are not requiring APS and TEP to accept bids in  
4 the solicitation process beyond their requirements that cannot be produced from their own existing  
5 assets, APS and TEP should be on notice that the Commission will closely scrutinize the offered bids  
6 and the utilities' procurement decisions based on those bids for conformity with those goals.

7  
8 **IV. AFFILIATE PARTICIPATION/STANDARDS OF CONDUCT**

9 **A. APS**

10 **1. Information sharing between APS and its affiliates**

11 PGR, Reliant, and Harquahala believe that information sharing between APS and its affiliates  
12 may create an unfair competitive advantage to PWEC, and recommend that measures be taken to  
13 prevent such sharing. PGR points out that Pinnacle West Capital Corp. ("Pinnacle West") has all  
14 APS unit cost information, as it has been performing APS' generation dispatch on unit commitment  
15 decisions (Tr. at 604-606), and would continue to have access to such information under the terms of  
16 the "confidential information" and "shared services" sections of the proposed Code of Conduct that  
17 APS has filed pursuant to Decision No. 65154. (Tr. At 607) Reliant also recognized that such  
18 information sharing gives the competitive electric affiliate an advantage during dispatch protocol.  
19 Reliant recommended that the Commission require APS to adopt a Code of Conduct prohibiting its  
20 affiliates that intend to participate in the solicitation from handling system dispatch, risk management  
21 or contract management for APS or receiving information from APS (directly or indirectly) that  
22 would advantage them in the solicitation process. Reliant stated that if such information sharing  
23 cannot be avoided, the remedy should be that in the short term, all participants in the competitive  
24 process should be provided the same information about APS and its products as is available to  
25 PWEC.  
26  
27  
28

1  
2           **2.     APS conduct of its solicitation process**

3           PGR has requested that the Independent Monitor run the solicitation process for APS, and  
4 Harquahala has stated its agreement with PGR on this point. PGR believes that the contemplated  
5 participation of APS' merchant affiliate in the proposed solicitation makes third-party independent  
6 management of the APS solicitation necessary, and further submits that on the basis of the testimony,  
7 actions and filings by APS regarding its affiliate,<sup>23</sup> that the showing referred to in the Staff Report has  
8 been made that an independent party should manage the APS solicitation and have the final say in  
9 determining the acceptable products and winning bidders. PGR asserts that it is only through such  
10 oversight that the Commission can ensure that ratepayer benefits are not displaced by affiliate  
11 preferences.  
12

13           The Staff Proposed Solicitation Process provides that absent evidence of abuse, the utility will  
14 be responsible for preparing the solicitation and conducting the solicitation process. (Exh. S-1 at 8)  
15 It also provides that if the Commission finds that the utility failed to conduct an appropriate  
16 solicitation, the Commission may order that a new solicitation be conducted by an independent party.  
17 (*Id.* at 12) Staff also addressed this issue in the section of its Staff Report addressing unresolved  
18 issues, and is of the opinion that the judgment of a third party should not, in the ordinary situation, be  
19 substituted for that of the utility. (Exh. S-1 at 37) Staff believes, however, that the Commission  
20 should, through the Staff and an Independent Monitor, review the actions of the utility and be  
21 prepared to appoint a third party to conduct the solicitation should the utility fail to conduct a fair and  
22 transparent solicitation. (*Id.*) In particular, Staff believes that should there be any evidence of  
23  
24  
25

26 \_\_\_\_\_  
27 <sup>23</sup> PGR believes that APS' pending \$500 million refinancing proposal, if approved, would provide a significant  
28 competitive advantage to APS' merchant affiliate, and in addition, if APS had \$500 million invested in PWEC, that APS  
would have a substantial interest in assuring that PWEC is successful in the competitive solicitation. Harquahala claims  
that APS' stated intent, in the financing request, to request rate base treatment of PWEC assets in the upcoming rate case,  
if granted, would provide a year-round capacity payment to those affiliate assets.

1 improper contact between the utility and an affiliate, the Commission should have a third party  
2 conduct the solicitation if it is determined that the contact was a material violation of the standard of  
3 conduct. (*Id.*)

4 Staff believes that the Commission should leave the obligation to appropriately conduct the  
5 solicitation and to select bids with the utility (Tr. at 192), that the utility has the expertise to best  
6 determine the products that it needs to fulfill its obligations to its customers to provide reliable  
7 service at reasonable cost, (Tr. at 188-189, 303) and that as compared to Staff and the Independent  
8 Monitor, the utility is best-positioned to make an informed decision when it evaluates bids. (*Id.*)  
9 Staff believes that the oversight provided by the Independent Monitor as well as Staff participation  
10 provide an appropriate level of involvement to ensure that the utilities act in the best interests of  
11 customers.  
12

13 APS agrees with Staff that the utility needs to be the decision-maker on the products, process  
14 and selection of winning bids. APS responds to PGR and Harquahala that the fact that APS has  
15 publicly filed the financing application, and has publicly discussed its intent to seek rate base  
16 treatment of the PWEC assets in the upcoming rate case, does not mean that APS will conduct the  
17 solicitation unfairly or in bad faith.  
18

### 19 3. Standards of Conduct

20 The Staff Report outlines a process by which Staff believes a utility should submit a draft  
21 standard of conduct to Staff and the Independent Monitor, and following a discussion of changes, the  
22 draft should be shared with prospective bidders. The Staff Report process outline includes  
23 completion of a draft standard of conduct completed by the end of January 2003. (Exh. S-1 at 37-38)  
24 The Staff Report sets forth the minimum requirements for an acceptable standard of conduct, and will  
25 include monitoring by Staff and the Independent Monitor of the solicitation process. (*See id.*) Staff  
26 testified that the standard of conduct is intended to ensure that the utility and its affiliate have  
27  
28

1 procedures in place to provide for separation of information, rather than complete separation of  
2 function. (Tr. at 139-140)

3 PGR believes that it is necessary as part of this Track B proceeding to ensure that adequate  
4 protections are written into the Track B process and coordinated with the Code of Conduct, which, as  
5 PGR notes, is still subject to a separate hearing. PGR believes that the Track B standards of conduct  
6 must, in coordination with APS' Code of Conduct, at a minimum: 1) eliminate all affiliate  
7 preferences; 2) require APS to treat all suppliers, both affiliated and non-affiliated, in a non-  
8 discriminatory fashion; 3) keep the utility and its affiliate completely separate during the solicitation  
9 process; and 4) contain effective enforcement and penalty provisions.  
10

11 Staff stated that it recognizes that there are shared services between APS and Pinnacle West  
12 that cannot realistically be separated or reorganized in time for the first solicitation. (Tr. at 139-140)  
13 Staff states in its Reply Brief that although it would be ideal for the Commission to review the  
14 standards of conduct in a separate proceeding, the timing for the Track B solicitation does not allow  
15 enough time to complete such a proceeding. Staff proposed that the standards of conduct be  
16 addressed in the Pre-Solicitation materials, rather than by Commission order.  
17

18 Reliant is generally supportive of Staff's position regarding Standards of Conduct outlined in  
19 the Staff Report, except to the extent it could be construed as allowing APS and Pinnacle West to  
20 share services related to system dispatch, risk management or contract management. Reliant asserts  
21 that these areas provide access to information that creates an unfair competitive advantage to the  
22 affiliate and must not be permitted.  
23

24 APS' witness testified that the separation of Pinnacle West employees who are dispatching  
25 the system and who would thereby know APS' costs of generation, from Pinnacle West employees  
26 who are bidding the PWEC facilities, is a work in progress and remains to be developed through this  
27 process, and that Pinnacle West is in the process of providing some physical separation between areas  
28

1 in Pinnacle West Marketing and Trading ("M&T") that deal only with APS and areas that deal with  
2 other aspects of M&T operations. (Tr. at 608-609) APS also testified at the hearing that the  
3 standards of conduct it anticipated working through with Staff would have a separation of functions  
4 at Pinnacle West between those people who are responsible for commitment of dispatch and  
5 management of the APS resources, and those people who are responsible for those same functions for  
6 non-APS assets. (Tr. at 606) In its Reply Brief, APS stated that it is identifying the team of  
7 employees that will conduct the solicitation and will take steps to ensure that they do not share  
8 inappropriate information with employees of APS affiliates who may be directly involved in the  
9 preparation of a bid in the solicitation process.  
10

#### 11 **4. Equal Treatment of PWEC and other bidders**

12 PGR takes the position that if an incumbent utility's affiliate will bid in a Commission  
13 mandated competitive solicitation, the incumbent utility must treat the affiliated and non-affiliated  
14 generation equally in all respects. PGR believes that this equal treatment should apply to capacity,  
15 gas, or electric transmission, and that if APS' affiliate is to bid in the solicitation, then APS must  
16 make gas capacity held by APS for the benefit of Arizona consumers available to any merchant  
17 bidder on the same terms as would be available to APS' affiliate. Thus, before any APS affiliate  
18 could bid with gas capacity belonging to APS, that gas capacity would be made available to all  
19 bidders on equal terms, such as through a tolling arrangement. Harquahala also believes that the  
20 Commission should require APS to offer to all the merchants any El Paso gas capacity either it or  
21 Pinnacle West has.  
22

23  
24 APS responded that APS and PWEC are co-shippers on a transportation service agreement  
25 ("TSA") with El Paso Natural Gas, each with their own individual rights, and the determination of  
26 those respective rights is currently before the Federal Energy Regulatory Commission ("FERC").  
27 (Tr. at 615) APS also stated that, although it does not believe it is required to offer its own gas  
28

1 transportation capacity to anyone just because they want it (Tr. at 614), APS does believe that the  
2 TSA allows it to use its own gas capacity through a tolling arrangement with any generator. (Tr. at  
3 616-618, *see also* Exh. PGR-1)

#### 4                   **5.       Discussion/Resolution**

5           We agree that the standards of conduct developed in this proceeding will be material to the  
6 Code of Conduct hearing which shall be scheduled to take place as soon as practicable after the initial  
7 solicitation, and that the experience of the initial solicitation will provide insight to the requirements  
8 of a working Code of Conduct an current environment that includes the availability to regulated  
9 utilities of both affiliated and non-affiliated generation resources. We will therefore direct Staff,  
10 following completion of the initial solicitation, to file reports in these dockets on the Codes of  
11 Conduct previously filed by APS and TEP. The Staff Reports should include an analysis of the  
12 standards of conduct developed in this proceeding, their applicability to the respective Codes of  
13 Conduct filed by TEP and APS, and recommendations regarding their incorporation into the Codes of  
14 Conduct. Hearings will be scheduled on the Codes of Conduct following the filing of those Staff  
15 Reports.           Hearings will be scheduled on the Codes of Conduct following the filing of those Staff  
16 Reports.  
17

18           We agree with Staff that the oversight provided by the Independent Monitor, as well as Staff  
19 participation in the solicitation process, will aid in assuring that the utilities act in the best interests of  
20 customers, while furthering the Commission's goal of encouraging the development of a vibrant  
21 wholesale generation market in Arizona. We also acknowledge and appreciate APS' assurances that  
22 it is identifying the team of employees that will conduct the solicitation and that it will take steps to  
23 ensure that they do not share inappropriate information with employees of APS affiliates who may be  
24 directly involved in the preparation of a bid in the solicitation process. The standards of conduct  
25 should go far toward alleviating the concerns of the merchants who face competition from APS'  
26 affiliate in the APS solicitation process. However, the content of the standards of conduct are not in  
27  
28

1 the record of this proceeding. In addition, we have not completed our review of APS' revised Code  
2 of Conduct, which APS filed as required. We therefore find it necessary to set forth some guidelines  
3 to clarify the Commission's position that no exercise of affiliate preferences will be tolerated in the  
4 solicitation process.

5 We note that the Staff Proposed Solicitation Process provides for the establishment by the  
6 utility of a system for logging all contacts between utility personnel and bidders and potential  
7 bidders. (See Exh. S-1 at 20) We will require that APS keep detailed records of any and all contacts  
8 with all non-APS entities, including but not limited to M&T, PWEC and Pinnacle West, regarding  
9 this initial and subsequent solicitations up through the time that the procurement process is complete.  
10 These records shall be subject to the same maintenance and availability requirements as those  
11 described on pages 26 and 27 of the Staff Report.

13 In addition, the record in this proceeding supports a requirement that APS's parent and  
14 affiliates, including but not limited to M&T, PWEC and Pinnacle West, who may be involved in the  
15 preparation of a bid in the solicitation process shall not have contact with employees that will conduct  
16 the solicitation. We do not wish to harm APS customers by depriving APS of access to needed  
17 expertise provided by Pinnacle West "shared services," such as consulting legal counsel or in-house  
18 environmental experts, the examples provided by APS in its Reply Brief. However, we see no reason  
19 to allow APS's parent and affiliates, including but not limited to M&T, PWEC and Pinnacle West,  
20 access to such expertise if such access could provide even an appearance of impropriety in the  
21 solicitation process. We will therefore require that for the purposes of the solicitation and  
22 procurement, APS shall prohibit personnel who provide advice to APS in the solicitation process  
23 from communicating with personnel working for APS's parent or affiliates who may be involved in  
24 the preparation of a bid in the solicitation process. If APS affiliates, including but not limited to  
25  
26  
27  
28

1 M&T, PWEC and Pinnacle West, require access to expertise that is dedicated to APS in the  
2 procurement process, they can obtain such expertise elsewhere, at their own expense.

3 The time remaining for the initial solicitation process does not allow for a hearing on the  
4 Codes of Conduct as requested by Reliant. We believe that the requirements for standards of conduct  
5 set forth in the Staff Proposed Solicitation Process, along with the additional requirements stated  
6 above, should provide adequate safeguards to address the merchants' concerns.

7  
8 We believe that a requirement that an incumbent utility treat affiliated generation equally in  
9 all respects with non-affiliated generation in the solicitation process would logically extend to any  
10 contractual arrangements associated with the bidding and procurement process, including natural gas  
11 tolling, that the incumbent utility enters into with any affiliated entity involved in the solicitation and  
12 procurement process.

13 While we adopt these guidelines, they do not constitute an all-inclusive list of the restrictions  
14 on the type of activities that APS and its affiliates must prevent. In determining whether an act or  
15 communication is appropriate, the APS employee should evaluate whether the act or communication  
16 would further the Commission's goal of encouraging the development of a robust wholesale  
17 generation market in Arizona. We want to make clear that any preferential or discriminatory activity  
18 by APS, its parent or affiliates that interferes with a fair, unbiased solicitation process, whether  
19 specifically delineated or not in the standards of conduct, the Code of Conduct, or this Decision, will  
20 not be tolerated, and that we will closely scrutinize the solicitation process for signs of any such  
21 abuse.  
22

23  
24 **B. TEP**

25 Because TEP does not have an affiliate that will bid in the upcoming competitive solicitation  
26 process, TEP proposed that its Wholesale Marketing department be allowed to conduct the  
27 competitive solicitation. (Exh. TEP-1 at 8-9 (Testimony of David Hutchens regarding Needs  
28

1 Assessment and Procurement Proposal), Exh TEP-2 at 5-6, 12 (Direct Testimony of David  
2 Hutchens)) TEP requested that the Commission waive the applicability of Section IV.C, paragraph 1,  
3 lines 10-19 of the Staff Report with respect to TEP, thus allowing TEP's Wholesale Marketing  
4 department to be involved in the solicitation process. (Exh. TEP-2 at 12) Staff had no objection to  
5 TEP's request for a waiver of this paragraph of the Staff Report's Solicitation Process for the initial  
6 solicitation (Tr. at 89-90), and no other party to the proceeding objected to TEP's request. TEP  
7 acknowledged that if at some point in the future there is a TEP affiliate that could participate in a  
8 competitive solicitation on TEP contestable load, then appropriate steps should be taken to address  
9 the specific affiliate concerns. Based on this acknowledgement, and on the fact that TEP does not  
10 have an affiliate that will bid in the upcoming competitive solicitation process, we find that it is  
11 reasonable to grant TEP's request to allow TEP's Wholesale Marketing department to be involved in  
12 the solicitation process.  
13

14 **C. Protocol for Short-Term Energy Procurement by APS and TEP**

15 Harquahala recommended that in order to limit any advantage PWEC might receive from  
16 APS, that a protocol be adopted to guide APS' procurement of short-term energy. APS has stated  
17 that it increasingly uses "blind" procurement techniques for short-term economy purchases. (Exh.  
18 APS-5 at 10-13 (Rebuttal Testimony of Thomas J. Carlson)) We believe that it would be wise for  
19 APS to adopt the practice of using such "blind" procurement techniques, such as electronic trading  
20 platforms or independent brokers, for all its short term purchases with the exception of emergency  
21 purchases. We will require APS to file, for Commission approval, a draft protocol adopting such a  
22 practice.  
23

24  
25 TEP does not currently have an affiliate offering power on the wholesale market. However, if  
26 it does in the future, TEP should also adopt the practice of using "blind" procurement techniques,  
27 such as electronic trading platforms or independent brokers, for all its short term purchases with the  
28

1 exception of emergency purchases. We will therefore require that, if a competitive affiliate of TEP  
2 will offer power on the wholesale market, TEP shall file, for Commission approval, 60 days prior to  
3 the commencement of such offer, a draft protocol adopting such a practice.

4 **V. PRUDENCY REVIEW**

5 The Staff Proposed Solicitation Process provides that after the completion of each utility's  
6 initial solicitation, Staff will commence a review of the utility's power supply portfolio to examine  
7 the prudence of that utility's planning and procurement practices, and to determine the effectiveness  
8 and efficiency of the solicitation process employed.

9  
10 APS proposes that after bid evaluation is complete, provisional contracts would be awarded to  
11 bidders, and that the Commission should either affirmatively approve such contracts within 15 days  
12 or alternatively, deem them as being approved if the Independent Monitor's report concludes that the  
13 solicitation was effective and fair. (Exh. APS-3 at 6-7 (Direct Testimony of Steven M. Wheeler))  
14 APS proposes that in either event, Commission approval should constitute a finding that the utility  
15 acted prudently and reasonably in entering into the approved contracts, both individually and  
16 collectively. (*Id.* at 7) APS proposes that such a finding should also provide for full and timely cost  
17 recovery, either through a purchase power adjustment mechanism or some similar procedure. (*Id.*)

18  
19 TEP believes that the Commission approval process and cost-recovery mechanism for  
20 purchases made under the solicitation process should be addressed in this proceeding. (Exh. TEP-2 at  
21 10 (Direct Testimony of David Hutchens)) TEP states that it is critical that the utility knows what the  
22 approval process will be at the beginning of the process because it will affect procurement decisions  
23 and other issues in the proceeding, and the process should provide a specific timeline for contract  
24 approval and the ability of the utility to reject accepted bids if the Commission does not find those  
25 contracts reasonable and prudent. (*Id.* at 11)

1 Staff believes that the requested expedited contract approval would not be in the public  
2 interest and is unnecessary and inappropriate. (Exh. S-2 at 2 (Direct Testimony of Ernest G.  
3 Johnson)) Staff states that while it is committed to assisting the Commission in its efforts to  
4 transition to and facilitate a robustly competitive wholesale electric market in Arizona, that this is not  
5 the time to adopt an expedited approval process, and further, that expedited approval is not a  
6 necessary component to facilitating the envisioned robustly competitive wholesale electric market.  
7 (*Id.* at 2-3) Staff believes that in light of the oversupply of generation that currently exists in  
8 Arizona, in-state generators will be compelled to bid for contestable load, and that out-of-state  
9 suppliers may also find the solicitation process amenable and contestable load desirable, such that  
10 expedited approval is not required to attract bidders at this time. (*Id.* at 3) Staff believes that  
11 granting expedited approval would shift the risk of cost recovery away from the utility onto  
12 consumers. (*See Id.*)  
13

14 Staff states that ultimately, the Commission must evaluate whether the utility was prudent in  
15 its selection of its portfolio as a whole and whether the utility solicited the right products (Tr. at 78-  
16 79, 107-108), and argues that neither of these factors is addressed by an expedited approval process  
17 that assumes the prudence of any contract that results from a competitive bid.  
18

19 RUCO generally shares Staff's concerns about prematurely declaring contracts prudent, but  
20 states that the traditional IRP process, which it advocates, is sufficient to assure the Commission that  
21 the utility has engaged in prudent planning. (Exh. RUCO-1 at 33-34 (Direct Testimony of Dr.  
22 Richard A. Rosen), RUCO-2 at 7-8 (Rebuttal Testimony of Dr. Richard A. Rosen)) Even if an IRP  
23 process would assure prudent planning, however, RUCO states that implementation of the plan  
24 should still be subject to prudence review only in a proceeding that determines final cost recovery.  
25

26 Sempra and SWPG generally agree with the balance that Staff's position strikes between  
27 allowing the utility to conduct the competitive solicitation and make the final bid selections, and  
28

1 providing for continuing Commission oversight and subsequent prudency review. They believe that  
2 because the utility must implement and live with the results of a given power procurement decision, it  
3 is appropriate that the utility perform a significant role in the making of such decision. Sempra and  
4 SWPG believe that the utility should be held accountable for the results of its decision and its  
5 compliance or lack of compliance with the Commission-approved competitive procurement process,  
6 and that the contemplated subsequent prudency review is the appropriate setting for such  
7 accountability to be determined.  
8

9 Reliant asserts that the role and responsibilities of the Independent Monitor provide sufficient  
10 safeguards in the solicitation process to allow the Commission to make a prudency determination of  
11 the solicitation process, products, and outcome within 5 to 30 days. Reliant argues that with  
12 extensive participation by Staff, the Independent Monitor, and other participants throughout this  
13 process, the Commission will already have access to the knowledge of all facets of the solicitation by  
14 the time the procurement takes place. Reliant cites regulatory uncertainty, and higher bids, as a  
15 drawback to the Commission's failure to provide a quick prudency review of contracts.  
16

17 AUIA disagrees with Staff's position regarding the prudency review of utilities' procurement  
18 decisions, and argues that the Commission should adopt an expedited approval process. AUIA also  
19 argues, however, in support of its position that the utilities should be allowed to choose their manner  
20 of solicitation, that the Commission should heed the Staff's imperative that the utility should be left  
21 with the ultimate decision-making authority regarding its needs and the ultimate responsibility to act  
22 prudently. (AUIA Br. at 9, citing Exh. S-2 at 4 (Rebuttal Testimony of Ernest G. Johnson))  
23

24 APS asserted that Commission and Staff assurance of cost recovery is especially appropriate  
25 given that the Commission has mandated this procurement through a formal process and on a  
26 schedule not entirely of the Company's choosing, and which is in contrast to the flexibility allowed in  
27 the current version of A.A.C. R14-2-1606(B). (Exh. APS-3 at 7 (Direct Testimony of Steven M.  
28

1 Wheeler)) We disagree with the premises of that assertion. Firstly, we disagree with APS' argument  
2 that the Track B solicitation process restricts the manner by which APS procures power. We strongly  
3 agree with Staff, and AUIA, that the utility should have decision-making authority regarding its  
4 needs and the responsibility to act prudently, and our Decision in this matter adopts Staff's wise  
5 recommendation to leave the responsibility and choice of procurement squarely in the lap of the  
6 utility. Secondly, the Track B solicitation process is, rather than a "mandated procurement," the  
7 means by which this Commission is dealing with the fact that leading up to our determination, in  
8 Decision No. 65154, to stay the requirements of A.A.C. R14-2-1606(B)<sup>24</sup>, APS had chosen not to  
9 commence the competitive bid process that rule required, but had chosen instead to propose a  
10 variance from the rule in order to allow it to enter into a purchase power agreement with its affiliate  
11 PWEC.  
12

13 To the extent that the utilities need guidance as to review of their procurement decisions,  
14 among the issues the Commission may look to are: 1) whether the process was fair and non-  
15 discriminatory, or whether it favored an affiliate; 2) evidence to support a determination that the  
16 decision was in the best interests of the ratepayers; and 3) whether the utility's decision facilitated  
17 the development of a competitive wholesale generation market in Arizona.  
18

19 We believe that the solicitation process outlined in the Staff Report and clarified in this  
20 Decision can encourage the development of a robust wholesale market while providing benefits to  
21 Arizona consumers, without the Commission's direct involvement through the requested expedited  
22 prudence review, in the solicitation process. We agree with Staff that expedited approval of contracts  
23 is not necessary for the protection of either the utilities or the merchants, and further, that such  
24 expedited approval would pose a substantial risk to consumers. We recognize that the utilities have  
25  
26

27 <sup>24</sup> A.A.C. R14-2-1606(B) provides: After January 1, 2001, power purchased by an investor owned Utility  
28 Distribution Company for Standard Offer Service shall be acquired from the competitive market through prudent, arm's  
length transactions, and with at least 50% through a competitive bid process.

1 developed great expertise in energy procurement decisions under the vertically-integrated utility  
 2 model, and believe that they should utilize that expertise in the solicitation process that has been  
 3 developed in this proceeding in order to take advantage of the existence of the new supply of  
 4 competitive generation resources.

5 **VI. THE STAFF REPORT AS GUIDE FOR THE SOLICITATION PROCESS**

6 We find that the record in this proceeding supports Commission adoption of the section of the  
 7 Staff Report entitled Detailed Staff Proposed Solicitation Process, Exh. S-1, pages 6-27.<sup>25</sup> In our  
 8 discussion, we have addressed certain issues on which the parties were unable to reach consensus in  
 9 the workshop process. The Detailed Staff Proposed Solicitation Process shall be interpreted in  
 10 keeping with our resolution of those issues as set forth in our discussion herein.

11 **VII. REVIEW OF SOLICITATION PROCESS**

12 The Staff Proposed Solicitation Process adopted herein provides that after the completion of  
 13 each utility's initial solicitation, Staff will commence a review of the utility's power supply portfolio  
 14 to examine the prudence of that utility's planning and procurement practices, and to determine the  
 15 effectiveness and efficiency of the solicitation process employed.

16 The Staff Proposed Solicitation Process adopted herein also contemplates that Staff will  
 17 commence a proceeding to review the solicitation process, address the planning for future  
 18 solicitations, and recommend such changes to the process as may be appropriate. Sempra and SWPG  
 19 recommended that a Decision in this matter expressly indicate that all future competitive solicitations  
 20 will be conducted with the same openness and opportunity to participate as have characterized the  
 21 current Track B proceeding, and that merchant plant competitors and other interested persons who  
 22  
 23  
 24

25  
 26 <sup>25</sup> Reliant has requested that the Commission adopt, as part of Appendix One to the Staff Report, its amended  
 27 description of the Texas competitive process to more accurately reflect the situation in Texas. As Reliant notes, its  
 28 suggested change to the Staff Report was not opposed by any party. While the inclusion in the Staff Report of Appendix  
 One was generally helpful in providing a broad overview of competitive solicitation for wholesale generation supply in  
 selected states, we do not find it necessary to adopt or endorse Appendix One. Therefore, we will note Reliant's request,  
 but we find that it is unnecessary to adopt Reliant's amended description for purposes of our Decision in this matter.

1 were not in a position to participate in the initial solicitation in 2003 should not be precluded from  
2 participation in subsequent competitive procurements. We see no reason why future competitive  
3 solicitation would not be as open as the initial solicitation, and therefore see no need to make such an  
4 explicit finding here. However, if Sempra and SWPG wish to formally raise that issue, they may  
5 raise it in the solicitation process review proceeding described above.

6 We will require that Staff file a report in these dockets informing the Commission of its  
7 progress in the contemplated reviews described above and at page 27 of the Staff Report, Exh. S-1.

8  
9 **VIII. AISA**

10 The AISA has yet to be examined in these dockets. We will therefore direct Staff to file a  
11 report in these docket on the issue that includes a description and analysis of the function of the AISA  
12 and a recommendation to the Commission regarding whether a hearing should be held on that matter.

13 \* \* \* \* \*

14 Having considered the entire record herein and being fully advised in the premises, the  
15 Commission finds, concludes, and orders that:

16 **FINDINGS OF FACT**

- 17 1. On October 18, 2001, Arizona Public Service Company filed a Request for a Partial
- 18 Variance to A.A.C. R14-2-1606(B) and for Approval of a Purchase Power Agreement.
- 19 2. By Procedural Order issued January 22, 2002, the Commission opened this generic
- 20 docket on electric restructuring (Docket No. E-00000A-02-0051).
- 21 3. On January 28, 2002, Tucson Electric Power Company filed a Request for Variance
- 22 (Docket No. E-01933A-02-0069).
- 23 4. Intervention was granted to numerous parties.
- 24 5. On March 19, 2002, Panda Gila River, L.P. filed a Request for Order to Show Cause.
- 25 6. On March 22, 2002, Staff filed its Staff Report in the generic docket.
- 26 7. On April 25, 2002, the Commission held a Special Open Meeting at which the
- 27 Commission directed that certain issues be addressed in the Generic Docket.

28

1           8.     By Procedural Order issued on May 2, 2002, a hearing was set on the issues identified  
2 by the Commission as "Track A" issues. Track B, Competitive Procurement, was also established.

3           9.     The May 2, 2002 Procedural Order also directed that Track B proceed concurrently  
4 with Track A, and instructed interested parties to file by May 13, 2002, a list of proposed issues for  
5 consideration, and a procedural timetable (including comment periods) for the Track B issues.

6           10.    On May 13, 2002, TEP, APS, the Arizona Competitive Power Alliance, RUCO, and  
7 Staff filed Track B proposals in compliance with the May 2, 2002 Procedural Order. Staff indicated  
8 in its filing that it anticipated awarding a contract to an Independent Evaluator on or around July 8,  
9 2002.

10          11.    On May 31, 2002, Staff filed a list of issues for comment of the other parties.

11          12.    On June 20, 2002, based on the proposals submitted on May 13, 2002, the First  
12 Procedural Order on Track B Issues established a procedural schedule that included workshops, as  
13 proposed by Staff, on July 24 and 25, 2002. The First Procedural Order stated that the balance of the  
14 procedural schedule would be dependent upon the Commission's Decision on the Track A issues, the  
15 consensus reached by the parties during the workshops or otherwise, and whether a hearing on any  
16 Track B issues became necessary. The First Procedural Order set a deadline for the parties to  
17 respond to Staff's May 31, 2002 list of issues by July 1, 2002, which response was to include any  
18 competitive solicitation issues not addressed in Staff's May 31, 2002 filing, and also set a deadline of  
19 July 17, 2002, for Staff and the Independent Evaluator to file a list of issues to be addressed at the  
20 July 24 and 25, 2002 workshops.

21          13.    Hearings were held on the Track A issues during the last two weeks of June, 2002, and  
22 Decision No. 65154 was issued on September 10, 2002, in these dockets. In addition to its  
23 determination of Track A issues, Decision No. 65154 ordered the parties to continue their efforts in  
24 Track B to develop a competitive solicitation process that can begin by March 1, 2003.

25          14.    The parties held an additional Track B workshop on August 13 and 14, 2002.

26          15.    On September 16, 2002, Staff filed a Request for Procedural Order asking that a  
27 hearing be set to commence on November 20, 2002, following a third and final two-day workshop to  
28 be held on September 26 and 27, 2002.

1           16.    APS and PGR filed responses to Staff's request indicating their agreement that a  
2 hearing would likely be necessary to achieve a resolution of the Track B issues. While APS agreed  
3 with the procedural schedule proposed by Staff in its Request, PGR requested a scheduling  
4 conference so that all parties might comment on dates to be included in any procedural order and on  
5 issues to be addressed at the hearing.

6           17.    The Second Procedural Order on Track B Issues was issued on September 24, 2002  
7 and required the parties to file, by October 1, 2002, their proposed schedules for the conduct of a  
8 hearing to be held following the third workshop, and a list of the specific issues the parties believed  
9 remained to be addressed at the hearing.

10          18.    A procedural conference was held as scheduled on October 2, 2002.

11          19.    The Third Procedural Order on Track B Issues, issued on October 9, 2002, required  
12 APS and TEP to file a needs assessment and procurement proposal, sufficient to inform the  
13 Commission in its determination of the minimum amount of power, the timing, and the form of  
14 procurement as required by Decision No. 65154.

15          20.    Public notice of the proceedings on the Track B issues was published in newspapers of  
16 general circulation in the APS and TEP service areas statewide between November 4 and 6, 2002.  
17 No further intervention requests were filed following the publication.

18          21.    The hearing was held as scheduled. Mr. Bob Liden of Stirling Energy Systems  
19 provided public comment at the hearing. No other parties appeared to provide public comment on the  
20 Track B issues. Witnesses testified on behalf of Staff, APS, TEP, Harquahala, PGR, Reliant, Sempra,  
21 WMGF, the LAW Fund and RUCO.

22          22.    AUIA, PPL, and SWPG did not present witnesses, but participated in the hearing.

23          23.    APS, TEP, AUIA, Harquahala, PGR, PPL, Reliant, Sempra/SWPG, WMGF, the LAW  
24 Fund, RUCO and Staff filed Initial Briefs on December 18, 2002.

25          24.    APS, TEP, Harquahala, PGR, Reliant, Sempra/SWPG, WMGF, the LAW Fund,  
26 RUCO and Staff filed Reply Briefs on December 31, 2002.

27          25.    The solicitation process developed by the parties, as set forth in the Detailed Staff  
28 Proposed Solicitation Process appearing at pages 6-27 of the October 25, 2002 Staff Report, is a

1 necessary step in the Commission's goal of encouraging the development of a competitive wholesale  
2 generation market in Arizona while protecting Arizona's ratepayers, and should be adopted.

3         26. APS and TEP are responsible for providing for the continuing need of their ratepayers  
4 to maintain a reliable supply of electricity at reasonable rates.

5         27. The issues that the parties were unable to reach a consensus agreement on in the Track  
6 B workshop processes, and which therefore require a Commission resolution, are as follows: 1) the  
7 solicitation and bid process to be approved, including whether to institute an integrated resource  
8 planning process; 2) the amount of capacity and energy to be solicited; 3) the bid evaluation method  
9 to be approved, including whether APS and TEP are required to accept any bids; 4) affiliate  
10 participation in the bid process; 5) the Commission's prudence review of contracts resulting from the  
11 bid process; and 6) the direction of future proceedings, including DSM and environmental risk  
12 mitigation programs.

13         28. Decision No. 65154 set the minimum baseline amount of power that APS and TEP  
14 would be required to acquire in the competitive solicitation, but left for this Track B proceeding the  
15 determination of the actual minimum amount of power to be acquired, the timing of the power  
16 procurement, and the form of the procurement.

17         29. Decision No. 65154 does not limit the amount of power that the Commission may  
18 require APS and TEP to solicit in the competitive solicitation.

19         30. APS and TEP shall test the market in this solicitation, beyond the required power that  
20 cannot be produced from their respective existing assets or existing contracts, to determine whether  
21 reliable generation is available at a lower cost than that produced by their own existing assets, or at a  
22 comparable level of cost, but with reduced adverse environmental effects, compared to their own  
23 existing assets. The amount by which APS and TEP must test the market in this competitive  
24 solicitation, and which will include required power that cannot be produced from their respective  
25 existing assets or existing contracts, is their contestable load.

26         31. If the competitive solicitation for contestable load yields bids for capacity or energy  
27 beyond required power that cannot be produced from APS' and TEP's respective existing assets or  
28 existing contracts, and if APS and TEP determine, after serious economic and technical analysis of all

1 bids, including long-term and short-term bids, that the offered capacity or energy would serve their  
2 customers more economically than their existing assets, then APS and TEP shall make procurements  
3 accordingly, keeping in mind that the goal of the competitive solicitation is to provide ratepayers with  
4 reliable power at the lowest cost, while considering the environmental effects of their procurement  
5 decisions and whether their decisions further the Commission's goals of encouraging the  
6 development of a robust competitive wholesale generation market.

7       32. Transmission constraints currently limit the capacity and energy that can be delivered  
8 from particular generators over particular lines to load in the Phoenix, Tucson, and Yuma areas, and  
9 may give rise to RMR requirements inside those load pockets.

10       33. Inclusion of RMR in contestable load should increase the benefits to be derived from  
11 competitive bidding by providing a market response reference regarding the relative economic and  
12 environmental merits of competitive generation solutions to Arizona's load pocket problems.

13       34. All generation that can reliably deliver energy into load pockets, under the RMR  
14 contestability conditions set forth in Findings of Fact No 35 below, shall be allowed to compete in a  
15 fair and open manner to supply energy and capacity to both APS and TEP in the solicitation process.

16       35. RMR capacity and energy should be contestable under the following conditions: 1) if  
17 non-utility owned or non-rate based generation exists locally; 2) if remote generation has access to  
18 non-APS or non-TEP firm transmission capacity that would enable delivery to the local area; and 3)  
19 if owners of remote generation offer to finance transmission improvements to remedy the  
20 transmission constraint.

21       36. APS, Salt River Project and the Western Area Power Administration are currently  
22 participating in RMR studies for the years 2003-2007 to be filed with the Commission by January 31,  
23 2003, and which are to include the identification of RMR hours, capacity and energy.

24       37. It is reasonable for Staff and the Independent Evaluator to review the January, 2003  
25 RMR study results, and comments to those results, and to thereafter make necessary revisions to the  
26 RMR amounts appearing in Staff's contestable load estimates during the Pre-Solicitation process set  
27 forth in the Staff Report.

28       38. The utilities shall evaluate RMR and non-RMR bids concurrently, in order to

1 determine their best least-cost portfolio.

2 39. The protocols applicable to RMR bids and contract management shall be the AISA or  
3 WestConnect protocols, whichever are in effect on a given date.

4 40. APS shall solicit capacity in amounts conforming to, at a minimum, Staff's estimates  
5 as set forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR  
6 amounts as determined by Staff and the Independent Evaluator following their receipt and review of  
7 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in  
8 the Staff Report.

9 41. TEP shall solicit capacity in amounts conforming, at a minimum, to Staff's estimates  
10 as set forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR  
11 amounts as determined by Staff and the Independent Evaluator following their receipt and review of  
12 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in  
13 the Staff Report.

14 42. APS shall solicit energy in amounts conforming to, at a minimum, Staff's estimates as  
15 set forth in its December 18, 2002 revision to Exh. S-5, with the addition of the necessary RMR  
16 amounts as determined by Staff and the Independent Evaluator following their receipt and review of  
17 comments to the January, 2003 RMR Study Results, during the Pre-Solicitation process set forth in  
18 the Staff Report.

19 43. TEP shall solicit energy in amounts conforming to, at a minimum, Staff's estimates as  
20 set forth in its December 18, 2002 revision to Exh. S-5, with the exception of the amounts labeled as  
21 economy purchases, and with the addition of the necessary RMR amounts as determined by Staff and  
22 the Independent Evaluator following their receipt and review of comments to the January, 2003 RMR  
23 Study Results, during the Pre-Solicitation process set forth in the Staff Report.

24 44. The utilities shall use least cost planning principles to develop their overall portfolios.  
25 In determining the appropriate resource portfolio in the best interests of their customers, APS and  
26 TEP shall seriously consider a well-balanced mixture of contracts, including long-term contracts, in  
27 order to protect ratepayers from future upswings in power prices.

28 45. APS and TEP shall have the right to reject all bids if the bids do not reasonably meet

1 the needs of the utility and its customers, after sound economic and deliverability analysis of all bids  
2 received, including long- and short-term bids. The utilities' goal should be to obtain for their  
3 customers the least-cost mix of reliable power over the long term, while being mindful of the  
4 environmental effects of their procurement decisions, as well as whether their procurement decisions  
5 will further the goal of encouraging the development of a competitively robust wholesale generation  
6 market in Arizona. While we are not requiring APS and TEP to accept bids in the solicitation process  
7 beyond their requirements that cannot be produced from their own existing assets, APS and TEP  
8 should be on notice that the Commission will closely scrutinize the offered bids and the utilities'  
9 procurement decisions based on those bids for conformity with those goals.

10 46. APS buys power on the wholesale market, and its affiliate offers power on the  
11 wholesale market.

12 47. Merchant generators have expressed concern that allowing Pinnacle West to share  
13 services with APS related to system dispatch, risk management or contract management would  
14 provide APS' competitive affiliates access to information that would impermissibly create an unfair  
15 competitive advantage to the affiliate.

16 48. APS stated that it is working with Staff to establish the standards of conduct required  
17 by the Staff Proposed Solicitation Process, and is identifying the team of employees that will conduct  
18 the solicitation and will take steps to ensure that they do not share inappropriate information with  
19 employees of APS affiliates who may be directly involved in the preparation of a bid in the  
20 solicitation process.

21 49. While we acknowledge and appreciate APS' efforts regarding standards of conduct,  
22 the fact that the standards of conduct are not a part of the record in this proceeding necessitate the  
23 establishment of guidelines to clarify the Commission's position that no exercise of affiliate  
24 preferences will be tolerated in the solicitation process.

25 50. APS shall treat affiliated generation equally in all respects with non-affiliated  
26 generation in the solicitation process. This requirement extends to any contractual arrangements  
27 associated with the bidding and procurement process, including natural gas tolling, that APS enters  
28 into with any affiliated entity involved in the solicitation and procurement process.

1           51.    APS shall keep detailed records of any and all contacts with all non-APS entities,  
2 including employees of and contractors for its parent and all affiliates, including but not limited to  
3 M&T, PWEC and Pinnacle West, regarding this initial solicitation, and subsequent solicitations, up  
4 through the time that the procurement process is complete. These records shall be subject to the same  
5 maintenance and availability requirements as those described on pages 26 and 27 of the Staff Report.

6           52.    Employees of and contractors for APS's parent and affiliates, including but not limited  
7 to M&T, PWEC and Pinnacle West, who may be involved in the preparation of a bid in the  
8 solicitation process, shall not have contact with employees that will conduct the solicitation.

9           53.    For the purposes of the solicitation and procurement, APS shall prohibit all personnel  
10 who provide advice to APS in the solicitation process from communicating with any personnel  
11 working for or contracted to APS's parent or affiliates who may be involved in the preparation of a  
12 bid in the solicitation process.

13           54.    APS shall adopt the practice of using "blind" procurement techniques, such as  
14 electronic trading platforms or independent brokers, for all its short term purchases with the  
15 exception of emergency purchases. APS shall file a draft protocol adopting this practice, for  
16 Commission approval, by March 30, 2003.

17           55.    While we adopt the guidelines set forth in Findings of Fact Nos. 50-54 above, they do  
18 not constitute an all-inclusive list of the restrictions on the type of activities that APS and its affiliates  
19 must prevent. In determining whether an act or communication is appropriate, the APS employee  
20 shall evaluate whether the act or communication would further the Commission's goal of  
21 encouraging the development of a robust competitive wholesale generation market in Arizona. We  
22 want to make clear that any preferential or discriminatory activity by APS, its parent or affiliates that  
23 interferes with a fair, unbiased solicitation process, whether specifically delineated or not in the  
24 standards of conduct, the Code of Conduct, or this Decision, will not be tolerated, and that we will  
25 closely scrutinize the solicitation process for signs of any such abuse.

26           56.    TEP buys power on the wholesale market, but currently has no affiliate offering power  
27 on the wholesale market.

28           57.    TEP requested that the Commission waive the applicability of Section IV.C, paragraph

1 1, lines 10-19 of the Staff Report with respect to TEP, thus allowing TEP's Wholesale Marketing  
2 department to be involved in the initial solicitation process.

3 58. Because TEP does not have an affiliate that will bid in the upcoming initial  
4 competitive solicitation process, we find that it is reasonable to, and shall, grant TEP's request to  
5 allow TEP's Wholesale Marketing department to be involved in this initial solicitation process.

6 59. In the event a TEP affiliate does plan to offer power on the wholesale market, TEP  
7 shall adopt the practice of using "blind" procurement techniques, such as electronic trading platforms  
8 or independent brokers, for all its short term purchases with the exception of emergency purchases.  
9 TEP shall file a draft protocol adopting this practice, for Commission approval, 60 days prior to a  
10 TEP affiliate offering any power on the wholesale market.

11 60. Based on the record in this proceeding, it is not necessary at this time to institute a  
12 formal Commission IRP process. However, an IRP process may for some reason become desirable  
13 or necessary in the future. We will therefore direct Staff to file a report in these dockets, by  
14 November 3, 2003, informing the Commission of its position at that time on the advisability of the  
15 institution of a formal Commission IRP process.

16 61. Based on the record in this proceeding, it is not necessary at this time to require that  
17 APS or TEP solicit DSM bids, but this finding does not prohibit the submission of such bids.

18 62. It is reasonable for the Commission to hold workshops to explore the development of  
19 a DSM policy and an environmental risk management policy, with such exploration to include an  
20 examination of the possible costs and benefits of the respective policies. We will therefore direct  
21 Staff to facilitate a workshop process to explore the development of a DSM policy and an  
22 environmental risk management policy, with such exploration to include an examination of the  
23 possible costs and benefits of the respective policies, and to file a report, by July 31, 2003, informing  
24 the Commission of the progress achieved in the workshops, including a Staff recommendation on  
25 whether hearings should be held as suggested in Exhibits DB-2 and DB-3 to Exh. LAW-1.

26 63. The Codes of Conduct have not yet been addressed in these dockets. We will  
27 therefore direct Staff to file reports in these dockets, not later than April 1, 2003, on the Codes of  
28 Conduct previously filed by APS and TEP. The Staff Reports should include, but not be limited to,

1 an analysis of the standards of conduct developed in this proceeding, their applicability to the  
 2 respective Codes of Conduct filed by TEP and APS, and recommendations regarding their  
 3 incorporation into the Codes of Conduct. Hearings will be scheduled on the Codes of Conduct  
 4 following the filing of those Staff Reports.

5 64. The issue of the AISA has yet to be examined in these dockets. We will therefore  
 6 direct Staff to file a report in these docket on the issue by July 31, 2003, that includes a description  
 7 and analysis of the function of the AISA and a recommendation to the Commission regarding  
 8 whether a hearing should be held.

9 65. Expedited approval of procurement contracts entered as a result of the competitive  
 10 solicitation would pose a substantial risk to consumers and is not necessary at this time for the  
 11 protection of either the utilities or the merchants.

12 66. The review processes set forth in the Staff Report at page 27, including the prudence  
 13 review, are reasonable. We will require that Staff file a report in these dockets by July 15, 2003, or  
 14 earlier, informing the Commission of its progress in the contemplated reviews described at page 27 of  
 15 the Staff Report.

#### 16 CONCLUSIONS OF LAW

17 1. The Commission has jurisdiction over these proceedings.

18 2. Notice of these proceedings was given as required by law.

19 3. Pursuant to Article 15, § 3 of the Arizona Constitution, the Commission has full power  
 20 to make and enforce reasonable rules, regulations, and orders for the convenience, comfort, and  
 21 safety, and the preservation of the health, of the employees and patrons of public service  
 22 corporations.

23 4. Pursuant to A.R.S. § 40-361, every public service corporation shall furnish and  
 24 maintain such service, equipment and facilities as will promote the safety, health, comfort and  
 25 convenience of its patrons, employees and the public, and as will be in all respects adequate,  
 26 efficient, and reasonable.

27 5. Pursuant to A.R.S. § 40-321 and 40-331, the Commission has broad authority to  
 28 regulate the service and facilities of public service corporations in order to protect the public.

1           6.       It is reasonable and in the public interest to require that APS and TEP test the market  
2 in this solicitation, beyond the required power that cannot be produced from their respective existing  
3 assets or existing contracts, to determine whether reliable generation is available at a lower cost than  
4 that produced by their own existing assets, or at a comparable level of cost, but with reduced adverse  
5 environmental effects, compared to their own existing assets.

6           7.       It is reasonable and in the public interest to require APS to solicit for capacity and  
7 energy in the amounts referenced in Findings of Fact Nos. 40 and 42 above.

8           8.       It is reasonable and in the public interest to require TEP to solicit for capacity and  
9 energy in the amounts referenced in Findings of Fact Nos. 41 and 43 above.

10          9.       It is also reasonable and in the public interest to require APS and TEP to determine,  
11 after serious economic and technical analysis, using least cost planning principles, whether bids  
12 offered in the solicitation, including both long- and short-term bids, would serve their customers  
13 more economically than their existing assets, and to make procurements accordingly, with the right to  
14 reject all bids if necessary, keeping in mind that the goal of the competitive solicitation is to provide  
15 ratepayers with reliable power at the lowest cost, while considering the environmental effects of their  
16 procurement decisions, as well as whether their decisions further the Commission's goal of  
17 encouraging the development of a robust competitive wholesale generation market.

18          10.      Imposition of the conduct requirements set forth in Findings of Fact Nos. 50-55 and  
19 59 is reasonable and necessary in order to protect the integrity of the solicitation process and the  
20 public interest.

21          11.      It is reasonable and in the public interest to allow TEP's Wholesale Marketing  
22 department to be involved in the initial solicitation process, as TEP has no affiliate offering power on  
23 the wholesale market at this time.

24          12.      It is not in the public interest for the Commission to review the prudence of  
25 procurement contracts resulting from this solicitation on an expedited basis.

26          13.      The record in this proceeding supports Commission adoption of the Detailed Staff  
27 Proposed Solicitation Process appearing at pages 6-27 of the October 25, 2002 Staff Report.

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