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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

2002 DEC 31 A 11:14

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Chairman

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AZ CORP COMMISSION
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JIM IRVIN

Commissioner

DEC 31 2002

MARC SPITZER

Commissioner

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IN THE MATTER OF THE GENERIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING.

DOCKET NO. E-00000-02-0051

IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR VARIANCE OF CERTAIN REQUIREMENTS OF A.A.C. R14-2-1606

DOCKET NO. E-01345-01-0822

IN THE MATTER OF THE GENERIC PROCEEDINGS CONCERNING THE ARIZONA INDEPENDENT SCHEDULING ADMINISTRATOR.

DOCKET NO. E-00000A-01-0630

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

DOCKET NO. E-01933A-02-0069

IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR APPROVAL OF ITS STRANDED COST RECOVERY

HARQUAHALA GENERATING COMPANY'S REPLY IN SUPPORT OF ITS CLOSING BRIEF ON TRACK B ISSUES

Harquahala Generating Company, L.L.C. ("HGC") hereby submits its Reply in Support of Its Closing Brief on Track B Issues to the Arizona Corporation Commission (the "Commission"). This Reply responds to issues raised by Arizona Public Service Company ("APS") in its Initial

1 Post Hearing Brief on Track B Issues (“APS Initial Brief”) and supports several points raised by
2 HGC as well as Reliant, PPL, and Panda Gila River, L.P. in their respective briefs.

3 **I. REPLY TO APS.**

4 In its Initial Brief, APS complains that the proposed procurement process lacks the
5 “flexibility” that has enabled APS “to acquire needed and economical resources for its customers
6 at reasonable prices” and that it is solely responsible for the previous rate decreases Arizona
7 consumers have experienced. (APS Initial Brief at p. 2) APS cautions the Commission to take a
8 “measured and conservative” approach before making any changes. (*Id.*) However, what APS
9 claims has worked well in the past in a heavily regulated market is not conducive to establishing a
10 competitive wholesale market.
11

12 In addition, HGC believes that the Commission, not APS, deserves the vast majority of
13 credit for ensuring that APS’ retail customers have historically enjoyed reasonably priced power.
14 The Commission has been overwhelmingly successful in securing reasonable cost power for
15 APS’ retail customers during its tenure.¹ HGC urges the Commission to remain vigilant in
16 protecting APS’ retail customers from APS’ new, more complicated and integrated proposals.
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23 ¹ For example, recently the Commission rejected Pinnacle West’s proposal for a high cost Purchased Power
24 Agreement (“PPA”), which would have saddled APS’ retail customers with high cost power for up to three decades
25 when much lower priced power is currently available in large quantities for a similar duration. This is but the most
26 recent of the Commission’s successful efforts to mitigate APS’ high cost generation projects and proposals over the
past several decades. The Commission’s similar efforts trace back to the Palo Verde Nuclear Power Plant project in
which APS initially requested a 55% rate increase in 1984. The Commission ultimately mitigated that rate increase
to well under 20%.

1 ISSUE NO. 1 – UNMET NEEDS

2 A. *Calculation of unmet needs*

3 APS argues that its calculation of unmet needs is the more appropriate estimate (1)
4 because of the lack of credible alternative calculation being put forth and (2) the fact that Tucson
5 Electric Power Company (“TEP”) calculated its Track B unmet needs in the same manner. (APS
6 Initial Brief at p. 4) Neither of these arguments, however, provides any reasonable basis for
7 adopting APS proposed calculation for the upcoming solicitation.
8

9 First, as HGC pointed out in its Closing Brief, HGC, Panda and Staff each submitted
10 alternative calculations of APS’ unmet needs during the evidentiary hearing. While APS may not
11 find these alternative calculations acceptable, they are certainly credible. Not only did all three
12 parties reach substantially similar results but also APS fails to contradict or otherwise note any
13 serious flaw in the alternative calculations.² On the other hand, HGC and Panda directly
14 contradicted both the specific elements of the APS calculation and the final total of each of the
15 elements. (See, e.g., Tr. vol. V at pp. 860-64, 904-06)
16

17 Second, the fact that TEP calculated its unmet needs in the same manner is not convincing
18 given the fact that TEP has many of the same interests at stake as APS. Although APS makes
19 every effort to demonstrate that its calculation of unmet needs “precisely follow[s] both the
20 Commission’s Decision No. 65154 (September 10, 2002) and the Staff’s Report’s direction (P.
21 Ewen Rebuttal Test. at pp. 2-3)” (APS Initial Brief at p.4), it fails to discredit the alternative
22

23 _____
24 ² APS commented on HGC’s Exhibit H-2 but failed to contradict its contents. Exhibit H-2 displayed market bids for
25 facilities such as Harquahala Generating Plant on an all-in basis beating the incremental costs of an older generation
26 facility at any gas prices in excess of \$2 per MMBTU. Exhibit H-2 demonstrates that an older unit’s costs need not
be removed from rate base in order for the new unit to beat it. Again, no party in this proceeding has indicated that
APS’ losing units would be removed from rate base.

1 calculations set forth by Staff, Panda and HGC. APS cites several statements from the
2 Commission's Order that, according to APS, "indicate that the Commission wanted to move
3 cautiously and did not intend for APS to subject more of its energy and capacity needs to the
4 procurement process than was reasonable to begin the transition to competition." (APS Initial
5 Brief at p. 5). But APS makes no suggestion that the alternative calculations contradict Decision
6 No. 65154 or otherwise unreasonably subject more of APS' energy and capacity needs to the
7 procurement process than is reasonable to begin the procurement process. In fact, the opposite is
8 true.
9

10 To demonstrate what is and what is not reasonable, HGC has attempted below to put into
11 perspective some of the key numbers set forth in this proceeding:

- 12 • A.A.C. R 14-2-1606(B) and the APS Settlement Agreement require a minimum
13 competitive procurement of **50%** in 2003. For APS, a competitive procurement of
14 50% equals **12,372** GwH.
- 15 • Staff Exhibit S-5 calls for only **4,381** GwH in 2003 for APS, which equals a
16 competitive procurement of merely **18%**.
- 17 • APS' calculation in Schedule PME-1 calls for only **639** GwH in 2003, which
18 equals a competitive procurement of only **3%**.
- 19 • Harquahala Generating Plant, a 1092 Mw facility can produce approximately
20 **8,609** GwH (Broderick Direct Test. at p. 14) or **35%** and more than **13** times the
21 quantity APS is currently seeking.
- 22 • The new generation industry in Arizona represents at least **107** times the quantity
23 APS is seeking.
24
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1 These figures indicate how far Staff and the new generation community have *already*
2 compromised their own proposals from that of the Electric Competition Rules. The figures
3 further demonstrate that APS is proposing to competitively procure only a small portion of that
4 operation which the Commission established in 1999 and upon which the new generators relied in
5 developing their projects.
6

7 B. *Economy energy purchases*

8 The largest current discrepancy between the APS October 2002 forecast and the HGC,
9 Panda and Staff calculations is the treatment of economy energy purchases. APS proposes to
10 calculate the full physical capability of its existing generation, regardless of the cost and delayed
11 procurement of these volumes. According to APS, there is no precedent for procuring economy
12 energy competitively anywhere else in the country. (APS Initial Brief at p. 12). But neither is
13 there any precedent for requiring the local utility to run at full capability regardless of cost. APS'
14 "full capability" concept will be outrageously costly and therefore contrary to the public interest.
15

16 Although APS proposes a temporary "compromise," which involves bidding 50% of
17 forecast estimated economy energy needs for the next 12 months through a series of quarterly
18 auctions, this proposal is equally inappropriate. (APS Initial Brief at p. 12)³ HGC believes that
19 APS' "compromise" is merely an attempt to delay significant competitive procurement until after
20 APS can make its case for including the Pinnacle West units in rate base in the upcoming rate
21 case. With billions of dollars already invested in the Arizona market, merchant generators cannot
22 afford to further compromise on competitive procurement to only 3% of the requirement set forth
23 in R14-2-1606(B). Staff Exhibit S-5 is already a cautious and conservative approach and should
24

25 _____
26 ³ It is noteworthy that APS rejects procuring economy energy competitively because there is no "precedent" for
doing so but then offers an equally unprecedented "experimental" option for economy energy purchases.

1 therefore serve as the minimum quantity. To compromise further will only reduce consumer
2 benefits.

3 Finally, HGC again recommends that the Commission impose an “economic” criteria for
4 the upcoming solicitation by inserting the word “economically” wherever the sentence “...that
5 cannot be *economically* produced from its own assets...” occurs in the Order. Although APS
6 claims that using the term “economically” in the Order “ignores current market conditions and
7 would subject APS to more financial risk instead of less” (APS Initial Brief at p. 6), it offers no
8 support for or examples of the “financial risks” it perceives. On the contrary, imposing an
9 “economic” criteria for the solicitation will promote fiscally responsible choices, not financial
10 risks.
11 risks.

12
13 C. *Reliability must-run (“RMR”) generation*

14 APS and non-APS RMR should neither be excluded from the solicitation (APS Initial
15 Brief at p. 9) nor addressed separately (*Id.* at p. 8), as APS recommends in its Initial Brief.
16 Although APS claims that it is unaware of any such precedent for including RMR generation (*Id.*
17 at pp. 9-10), Mr. Broderick has repeatedly testified to his experience with the Colorado
18 competitive procurement process as the appropriate precedent. (T. Broderick Direct Test. at pp.
19 23-24) In 1999, PG&E National Energy Group sited, developed and constructed its 111 MW
20 Plains End facility in less than 12 months inside suburban Denver and inside its load pocket. The
21 Public Service Company of Colorado, the local utility, did not separate nor exclude its existing
22 assets or contracts from impact in this procurement. In fact, these assets were explicitly included
23 in order to protect the retail customers. As a result, the Plains End facility was economically
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1 justified and has allowed the local utility to reduce operation of its existing RMR assets in the
2 area.

3 ISSUE NO. 2 – ROLES OF THE COMMISSION, COMMISSION STAFF
4 AND THE INDEPENDENT MONITOR

5 Regarding the Commission's role in the procurement process, APS has substantially
6 overstated the significance of obtaining the Commission's prompt approval of the contracts
7 resulting from the initial Track B proceeding. (APS Initial Brief at p.13) APS believes that
8 Commission approval of the Track B procurement process will benefit customers by eliminating
9 regulatory risks and by giving them consumer confidence. While HGC agrees that Commission
10 approval will promote confidence in the process, it also believes that market prices are so low at
11 this point that consumers will benefit more by simply beginning the initial procurement process
12 immediately.
13

14 ISSUE NO. 4 – PROCUREMENT ISSUES

15 APS continues to seek "business as usual treatment" for its secondary solicitations, which
16 it believes Staff has endorsed. (APS Initial Brief at p. 19). APS mischaracterizes Staff's position
17 on this issue insofar as Staff's position was made prior to APS unveiling its plan to procure nearly
18 everything on a secondary basis.
19

20 **II. REPLY TO RELIANT ENERGY**

21 HGC endorses Reliant (Reliant's Initial Brief, section V) in its request for safeguards for
22 any economy energy purchase. Furthermore, HGC supports the specific process for procuring
23 any economy interchange as described by Mr. Kebler (Direct Test. at p. 7).
24
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1 **III. REPLY TO PPL.**

2 HGC supports PPL's call for Western Area Power Association ("WAPA") to participate
3 actively in the transmission study now underway and that WAPA's transmission capacity be
4 included in that study. In addition, HGC shares PPL's concern that these studies are not being
5 performed in an open manner.
6

7 **IV. REPLY TO PANDA GILA RIVER, L.P.**

8 HGC supports Panda's call for an RFP for the majority of APS' needs through asset-
9 backed, dispatchable, unit-contingent bids (Panda's Initial Brief at p. 2). In addition, Panda has
10 called for the Independent Monitor to conduct the initial solicitation. While Staff has not yet
11 accepted this recommendation to-date, HGC can join Panda in supporting this recommendation
12 given APS' past actions in this proceeding. HGC further supports Panda's recommendation (Id.
13 at p. 5) that the Track B Order articulate clear expectations of the circumstances under which the
14 incumbent utility will be expected to contract with bidders. Finally, HGC supports Panda's
15 recommendation for using the higher solicitation volumes contained in Staff's October 25, 2002
16 report (Id. at p.
17

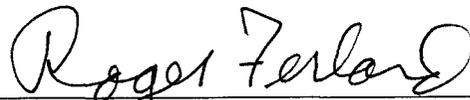
18 **V. CONCLUSION.**

19 HGC stands firm on all the positions argued in its Closing Brief. In addition the foregoing
20 recommendations, HGC urges the Commission to mitigate the preferential treatment APS'
21 affiliate will receive in the upcoming solicitation. APS continues to treat its affiliate's generation
22 far differently than other entities such as HGC. The most recent example is APS' attempts to
23 resolve with Staff the rate basing of affiliate plants in the upcoming APS rate case. Rate basing
24 would provide a year around capacity payment to those affiliate assets. On the other hand, APS
25
26

1 would offer the other merchant generators only the opportunity to bid on the miniscule amount
2 APS has proposed to solicit in Track B, placing them in a far inferior position. Finally, with
3 regard to "production modeling," HGC urges the Commission to require that the Independent
4 monitor have the proper experience necessary to monitor APS in this process and the
5 appropriateness of offering APS' El Paso gas allocation to all bidders (or to no bidders).
6

7 RESPECTFULLY SUBMITTED this 31st day of December, 2002.

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22 By Sarah Menne
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