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BEFORE THE ARIZONA CORPORATION COMMISSION RECEIVED

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2 WILLIAM A. MUNDELL
3 Chairman
4 JIM IRVIN
5 Commissioner
6 MARC SPITZER
7 Commissioner

Arizona Corporation Commission

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AZ CORP COMMISSION
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8 IN THE MATTER OF THE GENERIC
9 PROCEEDINGS CONCERNING ELECTRIC
10 RESTRUCTURING ISSUES

Docket No. E-00000A-02-0051

11 IN THE MATTER OF ARIZONA PUBLIC
12 SERVICE COMPANY'S REQUEST FOR A
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 VARIANCE OF CERTAIN ELECTRIC
22 COMPETITION RULES COMPLIANCE DATES

Docket No. E-01933A-02-0069

STAFF'S REPLY BRIEF

I. INTRODUCTION.

23 The Arizona Corporation Commission staff ("Staff") hereby files its reply brief in Docket No. E-00000A-02-0051, commonly referred to as "Track B." This brief addresses the following issues:
24 1) how the Commission should determine APS' and TEP's contestable loads; 2) whether the
25 Commission should provide expedited regulatory approval to contracts resulting from the Track B
26 solicitation; and 3) whether the Commission should include the standards of conduct as part of the
27 pre-solicitation materials to be reviewed by the independent monitor.

II. WHAT PORTIONS OF APS' AND TEP'S LOADS ARE CONTESTABLE FOR PURPOSES OF THIS INITIAL SOLICITATION?

28 In their briefs, both APS and TEP have argued that Decision No. 65154, the Commission's order in Track A, establishes that a utility's contestable load shall be its "unmet needs." (APS' Br. at 4; TEP's Br. at 3, 7). APS further contends that the Track A order specifically defines "unmet needs"

1 as the amount of power that the utility cannot produce from its own assets, without any reference to
2 cost. (APS' Br. at 4-5). Neither contention has merit.

3 **A. Decision No. 65154 Does Not Limit A Utility's Contestable Load To Its Unmet**
4 **Needs.**

5 Actually, the Commission in the Track A order never used the term "unmet needs," nor did it
6 establish an immutable method for determining a utility's contestable load. See Decision No. 65154
7 at 23. The utilities have construed the Commission's language in the Track A order as inflexible, as a
8 sort of straight-jacket from which no variations are permissible. Yet one need only read the language
9 of the Track A order to see that it does not create such an inflexible standard:

10 [E]ffective upon implementation of the outcome of Track B, we will require APS and
11 TEP to acquire, at a minimum, any required power that cannot be produced from its own
12 existing assets, through the competitive procurement process as developed in the Track B
13 proceeding. The amount of power, the timing, and the form of the procurement shall be
determined in the Track B proceeding.

14 Decision No. 65154 at 23 (emphasis added). The Commission's Track A order expressly defers the
15 question of how much power shall be solicited to Track B. Id. And by qualifying its statements with
16 the term "at a minimum," the Commission established a starting point, rather than the final word, on
17 how to calculate contestable loads.

18 This discussion is relevant to whether utility-owned reliability must run ("RMR") capacity
19 and energy should be included in the utilities' contestable loads. Both APS and TEP have argued that
20 incumbent-owned RMR generation should not be included because, by definition, utility-owned
21 RMR generation is not part of unmet needs. But Decision No. 65154 does not limit contestable load
22 to "unmet needs," and by focusing exclusively on the term "unmet needs," the utilities skew the
23 issues. In this proceeding, we should be more concerned with determining what the utilities' should
24 reasonably solicit, instead of mechanically calculating "unmet needs."

25 There are strong policy reasons for including utility-owned RMR in the utilities' contestable
26 loads. By including RMR capacity and energy in the initial solicitation, we will find out whether and
27 to what extent the market can provide solutions to transmission import constraints. (Tr. at 173-74,
28 277-78; Ex. S-4 at 6). This is consistent with the Commission's goals for the initial solicitation,

1 which include encouraging the development of a robust wholesale generation market and obtaining
2 benefits from new Arizona generation resources. Decision No. 65154 at 23-24. Unless the utilities
3 solicit for RMR, we will not know how the market will respond, and Arizona will lose a potential
4 benefit of competitive bidding. (Ex. S-4 at 3).

5 TEP contends that its RMR capacity and energy should not be contestable because there are
6 no realistic competitive short-term RMR solutions available for the TEP service area. (TEP's Br. at
7 9). First, it is clear that Staff Witness Smith did not agree with this conclusion: Mr. Smith testified
8 that he was aware of distributed generation and renewable facilities in the TEP service area. (Tr. at
9 279). He also testified that new generation combustion turbines could be installed "in a very short
10 period of time." (Tr. at 280). Finally, Mr. Smith testified that there is no way to know whether the
11 market can provide RMR solutions in the absence of an opportunity for bidding. (Tr. at 277-78).

12 Most important, however, is TEP's emphases upon the alleged lack of short-term RMR
13 solutions. (TEP's Br. at 9). Staff identified three conditions under which RMR capacity and energy
14 could be contestable, only two of which focus on existing facilities. (Ex. S-4 at 5). The third
15 condition considers whether owners of remote generation may offer to finance transmission
16 improvements to remedy the transmission constraint. Id. Admittedly, transmission improvements
17 are likely to require long-term planning. Nonetheless, TEP is not precluded from considering long-
18 term contracts in the initial solicitation. In fact, Staff has emphasized the utilities' responsibility to
19 develop portfolios that are reasonable and prudent. (Ex. S-1 at 3-4, 27). A reasonable portfolio may
20 include a mixture of short-term, intermediate, and long-term contracts.

21 In summary, TEP's focus upon the alleged lack of short-term RMR solutions entirely misses
22 the point: without testing the market, we will not know what solutions the market may be able to
23 provide, either short-term or long-term. The Commission should require all RMR capacity and
24 energy to be included in a utility's contestable load.

25 **B. Even If The Commission Were To Conclude That Contestable Load Should Be**
26 **Limited To A Utility's "Unmet Needs", There Is No Reason To Determine**
27 **"Unmet Needs" Without Reference To Reasonable Costs.**

28 Staff believes that "unmet needs" should be defined as the difference between a utility's
capacity and energy requirements and the amount of capacity and energy that it has available to it at a

1 reasonable cost. (Ex. S-3 at 6). By contrast, APS believes that “unmet needs” represent the
2 difference between a utility’s forecasted load and all the capacity and energy that it is physically
3 capable of generating, regardless of cost. (Tr. at 156, 184; Ex. S-3 at 7). This distinction is relevant
4 to determining how much energy APS and TEP should be required to solicit.

5 To construe Decision No. 65154 as omitting considerations of cost when determining
6 contestable load is logically inconsistent with the Commission’s goal of providing ratepayers with
7 reliable power at the lowest possible cost. Decision No. 65154 specifically acknowledges this
8 concept by recognizing that APS and TEP may decide to retire or displace “inefficient, uneconomic,
9 environmentally undesirable plants.” Decision No. 65154 at 23, fn 8. If the utilities know that it is
10 not economic to run certain plants, they should acknowledge as much in their calculations of unmet
11 needs. APS recognizes that its unmet needs will increase due to the retirement of a plant; it should
12 similarly acknowledge that its unmet needs will increase if it displaces energy from a plant. (See
13 APS’ Br. at 11-12).

14 APS claims that Staff’s proposal requires APS to solicit for economy energy. (APS’ Br. at
15 12). But Staff is not suggesting that at all. (Tr. at 321-22). As Staff Witness Kessler explained at the
16 hearing,

17 [w]e are asking you to solicit for energy equal in amount or greater than . . . the amount
18 of what you would otherwise anticipate you might have as economy energy to determine
19 whether or not there are deals available today that are equal to or better than what your
20 forecast of the economy energy markets might be in the future that might provide some
opportunity to lock in some of those savings at a time when the market appears to be
favorable for buyers.

21 (Tr. at 322).

22 APS’ forecasts show that it anticipates displacing energy from some of its existing generating
23 units with economy energy purchased on the spot market. (Tr. at 152-53). Staff is not suggesting
24 that APS forego displacing expensive energy with cheaper spot market energy. (Ex. S-3 at 8). Staff
25 is merely suggesting that, in addition to this practice, the utility should also solicit for all of the
26 energy that it expects to purchase from third parties during the period covered by the solicitation.
27 (Tr. at 156). Only in this way can the utility determine whether there is energy on the market that
28 may make the spot market unattractive. (Ex. S-3 at 10; Tr. at 106).

1 Finally, Staff is not suggesting that the Commission require the utilities to purchase all of the
2 energy for which they solicit. (Tr. at 156). The utilities should have the right to reject all bids if the
3 bids are not the most economic way to meet their needs.

4 Both APS and TEP should be required to solicit for all of the energy that they expect to
5 purchase from third parties during the period covered by the solicitation. This is somewhat different
6 from Staff's initial position on this issue, in which it treated TEP differently than APS. In its initial
7 closing brief, filed on December 18, 2002, Staff included numbers for TEP's economy energy as part
8 of TEP's contestable load. (Staff's Initial Br. at 3). TEP—and other parties for that matter—may
9 complain that Staff has not timely filed these numbers and that it is too late for Staff to amend its
10 position. (See Tr. at 963). However, if the Commission chooses to adopt a consistent approach for
11 both APS and TEP, these adjustments are necessary. (Tr. at 316-17). Finally, considering the
12 updating that will be necessary as a result of the RMR study, the utilities' needs assessments, and
13 other pre-solicitation materials, it is reasonable to include these adjustments for TEP's economy
14 energy estimates. (See Tr. at 91-92, 97).

15 **III. SHOULD THE COMMISSION PRE-APPROVE OR APPROVE ON AN EXPEDITED**
16 **BASIS THE CONTRACTS RESULTING FROM THE INITIAL SOLICITATION?**

17 Some parties contend that the Commission should promptly determine that any contracts
18 resulting from the upcoming solicitation are prudent if the utility follows the process established by
19 the Commission in Track B. (See, e.g., Reliant's Br. at 12; APS' Br. at 13-14). They argue that such
20 prompt approval will reduce regulatory uncertainty and thereby reduce or eliminate any risk premium
21 that may otherwise be included in the bids. In Staff's opinion, expedited approval is not necessary
22 for the protection of either the utilities or the merchants; conversely, it poses a substantial risk to
23 consumers. (Ex. S-2 at 3; Tr. at 125, 165).

24 The lack of expedited regulatory approval will not necessarily result in higher prices. (Tr. at
25 125, 166). Because of the oversupply of generation that currently exists in Arizona, Staff believes
26 that merchant generators will be motivated to bid for APS' contestable load. (Ex. S-2 at 3).
27 Expedited approval is simply not required to attract bidders at this time. (Tr. at 114-15; Ex. S-2 at 3).
28

1 On the other hand, expedited regulatory approval could foreclose the Commission from determining
2 that a particular contract is imprudent. (Tr. at 126).

3 Both the Commission and its staff lack experience in evaluating the results from this kind of
4 procurement. (Tr. at 74-75, 110-11). Under these circumstances, it is advisable to allow for a
5 thorough and unhurried prudence review. (Tr. at 125, 165, 300).

6 **IV. WHAT STANDARDS OF CONDUCT SHOULD GOVERN THE SOLICITATION?**

7 Staff has recommended that each utility form a team of employees to conduct the solicitation.
8 (Ex. S-1 at 38). Each utility should also prepare a draft standard of conduct as part of its pre-
9 solicitation materials. Id. These draft standards of conduct will be reviewed by Staff and the
10 independent monitor; they will also be released to bidders for comment. Id. Although it would be
11 ideal for the Commission to review these standards of conduct in a separate proceeding, the timing
12 for the Track B solicitation does not allow enough time to complete such a proceeding.

13 Panda suggests that the Commission should formally reconcile the standards of conduct for
14 Track B with the Codes of Conduct that the utilities were required to file as a result of Track A.
15 (Panda's Br. at 19). Panda also requests that the Commission formally require the Track B standards
16 of conduct to eliminate all affiliate preferences, to require APS to treat all suppliers in a non-
17 discriminatory fashion, and to keep the utility and its affiliate completely separate during the
18 solicitation process. Id. Although Panda's requests might represent the ideal, they may not be
19 practical. Staff recognizes that there are shared services between APS and Pinnacle West that cannot
20 realistically be separated or reorganized—at least in time for the first solicitation. (Tr. at 139-40).

21 Unfortunately, it is impractical for the Commission to address all of Panda's requests in this
22 proceeding. The Codes of Conduct required by Track A are not even at issue here. Instead, Staff
23 proposes that the standards of conduct be addressed in the pre-solicitation materials, rather than by
24 Commission order.

25 **V. SHOULD THE UTILITIES HAVE THE DISCRETION TO DETERMINE THE
26 PARAMETERS OF A SECONDARY SOLICITATION IF THE TRACK B
SOLICITATION DOES NOT PRODUCE ACCEPTABLE BIDS?**

27 APS argues that it should be given the authority to determine the parameters of a secondary
28 solicitation if the Track B process fails to result in contracts to cover all of the Company's needs.

1 (APS' Br. at 19). Staff believes that it is too early for the Commission to answer this question. We
2 simply do not have the facts before us to evaluate whether it will be reasonable to allow APS to make
3 these determinations. For example, we do not know why or in what specifics the Track B process
4 may fail, we do not know the magnitude of any potential failure, and we do not know whether the
5 utility will have behaved appropriately in rejecting bids. Without this and other information, it is
6 simply too early to conclude that any secondary solicitations will be left to the utility's unfettered
7 discretion.

8 **VI. CONCLUSION.**

9 Staff recommends the following:

10 A. The Commission should resolve the remaining disputed issues in this
11 proceeding in accordance with the recommendations set forth in Staff's initial
closing brief, filed in this docket on December 18, 2002.

12 B. The Commission should conclude that Decision No. 65154 does not establish
13 an inflexible method for determining a utility's contestable load for purposes of
the initial solicitation.

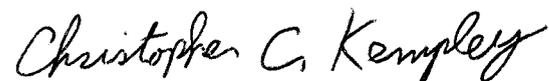
14 C. When determining a utility's contestable load, the Commission should
15 calculate "unmet needs" in a manner that recognizes the amount of capacity and
energy available to the utility at a reasonable cost.

16 D. The Commission should refuse to provide for pre-approval or expedited
17 approval for contracts that result from this solicitation.

18 E. The Commission should allow the utilities' standards of conduct to be
19 reviewed by the independent monitor in concert with the other pre-solicitation
materials.

20 F. The Commission should refrain from authorizing the utilities to determine the
21 details of any secondary solicitations at this time.

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

23
24 

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