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IN THE MATTER OF THE GENERIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING	[redacted]
IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR VARIANCE OF CERTAIN REQUIREMENTS OF A.A.C. 4-14-2-1606	DOCKET NO. E-01345A-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 COMPANY'S APPLICATION FOR A VARIANCE OF CERTAIN ELECTRIC POWER COMPETITION RULES COMPLIANCE DATES	E-00000A-02-0051 E-01345A-01-0822 E-00000A-01-0630 E-01933A-02-0069

REPLY BRIEF OF
PANDA GILA RIVER, L.P.
ON TRACK B ISSUES

I. INTRODUCTION

As expected following five days of hearing and reams of pre-filed testimony, the issues in this matter are well identified and the positions of various parties largely known. In this regard, the initial closing briefs of Arizona Public Service Company ("APS"), Tucson Electric Company ("TEP") and Arizona Corporations Commission staff ("Staff") identify the same critical issues for determination as the Closing Brief of Panda Gila River, L.P. ("PGR"), namely: APS and TEP contestable load, APS relations with its affiliate, the role of the Staff and independent monitor and Commission approvals.[1] Because the parties' positions were well identified, in this Reply Brief PGR will not rehash each of its prior positions, merely respond to those areas of APS's, TEP's and Staff's brief which either support PGR's position as to how these issues should be decided or advocates a different approach.

As an initial area of agreement, Staff's Brief notes that its "overriding goal is to establish a transparent process that will result in cost savings for ratepayers."[2] PGR wholeheartedly agrees with Staff's assertion that the described goal "is the standard that the Commission should use to evaluate every disputed issue in this proceeding."[3] As PGR has advocated since its initial intervention in this consolidated proceeding, the only way to fully explore and establish potential

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[1] APS Brief at 3; TEP Brief at 2; Staff Brief at 1-2. PGR does not agree with the way APS "rephrased and consolidated certain of the issues." APS Brief at 3. For example, APS characterized one issue as "Standards of conduct for utility-affiliate communications regarding the Track B solicitation." *Id.* The issue listed in the Third Procedural Order on Track B Issues as the "agreed upon . . . remaining areas in dispute" was "5. Affiliate Code of Conduct." Third Procedural Order on Track B Issues at 3. While Staff and APS preferred to address the issue narrowly as a communication issue, as identified in PGR's initial brief, the issue is much broader than simply whether APS communicates with its Affiliates during the Track B solicitation process.

[2] Staff Brief at 2, lines 5-6.

[3] *Id.* at lines 6-7. PGR's counsel supported this concept in his opening statement to the Track B Hearing, stating "The Commission already determined through Track A that a competitive solicitation is in the public interest and benefits ratepayers. Frankly, it's not important what's good for APS or what's good for even my client, although that is what I am here to advocate. The bottom line is what is good for ratepayers." Tr. at 31, lines 8-14.

ratepayer cost savings is to solicit, from the competitive market, alternatives to current ratepayer costs items. Likewise, the only way to actually achieve those cost savings is to purchase the resulting best deal for ratepayers in terms of reliability, price, and risk. The solicitation proposals of Staff and PGR would achieve this goal of identifying ratepayer savings; APS's and TEP's solicitation proposals would not.

II. THE CONTESTABLE LOAD FOR THE 2003-2006 SOLICITATION SHOULD INCLUDE CLAIMED RMR NEEDS AND OTHER POTENTIAL THIRD-PARTY PURCHASES

Staff's Brief reproduces the Capacity and Energy solicitation numbers set forth in Staff's hearing exhibit S-5. PGR supported those numbers as the minimum solicitation of Capacity but suggested that a higher Energy solicitation was appropriate for APS to be consistent with APS's prior positions in this consolidated docket. PGR believes that the record can support either Staff's current numbers or PGR's. The record cannot, however, support APS's position that it should be permitted to solicit only 1401 MW of capacity and 649 GWh of Energy through the Track B process while acquiring additional energy through alternative solicitations.

A. Contestable Load vs Unmet Needs

As an initial matter, as both PGR and Staff point out, the Commission must first distinguish between "unmet needs" and contestable load.[4] TEP and APS use the term "unmet needs" almost as a term of art to support their desire to limit any procurement to only that capacity or energy above the physical capabilities of their existing generation units. They argue that such a definition of "unmet needs" is consistent with Commission Decision 65154.[5] However, that term is nowhere to be found in Decision 65154. Rather, Decision 65154 unequivocally states that the

[4] Staff Brief at 2; PGR Brief at 5.

[5] TEP Brief at 3, lines 5-6; APS Brief at 4, lines 17-19.

"amount of power . . . shall be determined in the Track B proceeding."[6] If the Commission intended the amount subject to procurement simply to be a reference to the nameplate capacity of existing units, there would be no need to determine through the Track B process, the amount of power to be procured.

The reliance of APS and TEP on footnote 8 to Decision 65154 likewise provides no support for their narrow interpretation of the amount of power to be identified as contestable and subject to solicitation. Footnote 8 clarifies "at a minimum" in the analysis section of the order by noting that "APS and TEP may decide to retire or displace inefficient, uneconomic, environmentally undesirable plants." Contrary to TEP and APS's asserts, the Commission's reference to "at a minimum" is modifying what APS and TEP are **required to acquire**, not the amount that will be sent out for solicitation. Decision 65154 makes it clear, in the very next sentence, that the amount of power to be solicited, shall be determined in Track B. What APS and TEP actually are required to acquire will depend on the bids received and as noted above, what is in the best interest of ratepayers.

B. Contestable Load For 2003 – 2006 Should Include Displacement Of Uneconomic, Inefficient Or Environmentally Undesirable Plants

Even if the Commission intended the reading of Decision 65154 advocated by APS and TEP, APS did in fact "decide to retire or displace inefficient, uneconomic, environmentally undesirable plants." At least it did prior to the November 4, 2002 submission of its "unmet needs" assessment. As pointed out by exhibit PME 3-R, APS expected to displace 5,728 GWhs of inefficient, uneconomic or environmentally undesirable plants with gas-fired generation from its unregulated affiliate.[7] APS's proposed affiliate PPA indicated that APS intended to make the displacement on a long term basis, potentially up to 29 years.

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[6] Decision 65154 at 33, lines 7-9 and 12-14.

[7] Exhibit PME 3-R to Ewen Rebuttal Testimony.

Finally, APS cites TEP and APS testimony as supporting the notion that the financial community is nervous about the Track B Order requiring too much energy to go out to bid[8] or rate base assets being displaced.[9] In fact, in April 2001, Pinnacle West was telling stock analysts that new merchant gas combined cycle units would be dispatched ahead of its existing combustion turbines, steamers and combined cycle units.[10] The expectation expressed at that time was that new combined cycle gas units would be dispatched as "base-load" units, not the peak products APS now seeks to solicit.[11]

Unlike its stated intent to displace thousands of gigawatt hours of energy from uneconomic or inefficient units through long term procurement of new gas-powered generation, APS now seeks approval to solicit a fraction of that energy through the Track B procurement and to undertake secondary solicitations relying on the spot market to displace the already identified uneconomic, inefficient or environmentally challenged units.[12] APS supports its proposal to solicit limited energy by suggesting that the Commission take a measured and conservative approach to competitive solicitation.[13] The Commission did just that in Decision 65154, finding that it was appropriate to "phase-in" competition, to "encourage development of a robust

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[8] APS Brief at 13. APS also cites to an analyst report that was not in the Track B record.

[9] *Id.* at 11.

[10] See chart attached as Appendix A and available on the Pinnacle West website at http://www.pinnaclewest.com/files/investors/01Apr10Part3Invest.pdf., page 15.

[11] *Id.*

[12] The full scope of the departure from prior energy needs numbers is reflected in the fact that APS proposed soliciting 270 MW of capacity at a 51% capacity factor as part of its Variance proposal, resulting in an energy procurement of 1206 GWh of energy; nearly double APS current proposal. Because the affiliate PPA proposed in the variance assumed inclusion of the PWEC merchant units (and presumably their 5,728 GWh of energy) in with APS existing units, as little as 8 months ago, APS was assuming a need for nearly 7,000 GWh of new gas-power generation to supplement or replace its existing generation.

[13] APS Brief at 2.

wholesale market for generation, and to obtain some of the benefits of the new Arizona generation resources . . . ."[14] Staff and PGR have suggested just such a conservative approach in this Track B proceeding, no longer advocating 100% competitive procurement, rather, advocating a solicitation for those GWh of energy that APS has already identified which can be obtained more economically, over the long term, from the merchant marketplace. As Staff's consultant and Panda's witness further explained, the Staff/PGR approach allows APS and TEP to get the best of both worlds, soliciting dispatchable capacity and energy to lock in ratepayer saving, while allowing economy (spot market) energy to be taken if it is cheaper than the energy secured at a pre-set price in winning bids.[15]

Ironically, while reminding the Commission of the Commission's concern about "the vagaries of the wholesale market"[16] APS seeks to rely on the vagaries of that market to a much greater extent than either Staff or PGR's proposal would require. In fact, one need go no further than APS's own description of its procurement proposal, first identified "in its rebuttal case,"[17] to see that it should be rejected. APS said this about its proposal:

> This experimental procurement program would only be continued after 2004 by express order of the Commission because of the very real potential of higher costs to consumers caused by this departure from the company's normal procurement practices.[18]

Based on APS's own description of its proposal, the proposal fails the Staff's test of a transparent process that will result in cost savings for ratepayers. The Commission should not approve a one year "experimental procurement program" in lieu of the "competitive procurement process

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[14] Decision 65154 at 23, line 26 through 24, line 2.

[15] Kessler, Tr. at 312, lines 4-9; Roach Direct at 12, line 20 through 13, line 2.

[16] APS Brief at 2.

[17] *Id.* at 12.

[18] *Id.*

developed [by the majority of participants] in Track B" as directed by the Commission.[19] A competitive procurement process that has no risk to ratepayers.[20]

C. **RMR Requirements Should Be Contestable**

Both APS and TEP raise objection to Staff's inclusion of claimed RMR generation in the determination of contestable load. Neither incumbent utility offers any assertion of ratepayer harm by such inclusion, simply asserting that it is a useless exercise as RMR service must be supplied by the existing APS or TEP units currently providing such service. PGR supports Staff's assertion that "by including RMR capacity and energy in the initial solicitation, we will find out whether and to what extent the market will provide solutions to transmission import constraints."[21] This, in fact, was the position advocated by PGR in the Track A proceeding and is the only way in which potential ratepayer savings can be identified. PGR agrees with APS however that this solicitation should be through a separate solicitation as part of Track B solicitation, specifically for RMR service in RMR hours.[22]

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[19] Decision 65154 at 30, directing the parties to continue their efforts in Track B to develop a competitive solicitation process.

[20] Tr. at 171, lines 5-9.

[21] Staff Brief at 4, lines 22-24.

[22] APS Brief at 10, lines 23-25. For example, if APS' forecast is correct, then in 2006, the in-Valley load pocket would need 493 MW of non-APS RMR capacity (plus the APS capacity if Staff's proposal is adopted) for only 159 hours. (Ewen Work papers at page 76) That 493 MW of capacity, in all other hours, should be included in the general solicitation. Thus bidders in the general solicitation would offer to sell capacity and energy knowing that other capacity and energy would be used to provide RMR service for 493 MW in 159 hours. In effect, this limited RMR service would be the small hole in the doughnut of year-round sales of capacity and energy by winning bidders. By carving out this RMR service, the Commission may open the door to even better deals from bidders because they will know that power can be sold elsewhere during those RMR hours; much like the doughnut shop can sell doughnut holes.

III. PGR SUPPORTS APS'S REQUEST THAT THE COMMISSION TAKE AN ACTIVE ROLE IN THE INITIAL PROCUREMENT

In its Brief APS asks for full authority to determine the products to be procured, the method of solicitation, the length of any contracts and whether to reject all bids.[23] At the same time, APS asserts that "it is reasonable for Staff to continue as a full partner in the actual Track B solicitation and to timely advise the Commission as to which contracts should or should not be approved by the Commission for subsequent full cost recovery."[24] PGR agrees that it is appropriate for Staff to be a "full partner" in Track B, as well as the independent monitor. Of course, the only way to achieve that proposed "full" partnership is to give each partner equal rights. PGR proposed just that by asking for a bid evaluation team, in which the incumbent utility, Staff and the independent monitor would each hold equal rights. However, to achieve partnership , the incumbent utility cannot expect the Commission to give it complete discretion on all aspects of the solicitation up to the receipt of bids, yet require the Staff and independent monitor to take ownership of the results.

As PGR's Brief pointed out, APS's affiliate has significant information that APS itself has asserted will allow it to obtain an unfair advantage in any solicitation conducted as a result of the Track B decision. PGR suggested that, for this reason, it was appropriate for the independent monitor to develop and run the initial solicitation for 2003 to 2006. While PGR continues to believe that this is the appropriate approach under the facts of this case, if the Commission adopts

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[23] APS Brief at 18-20. PGR is particularly concerned about giving APS sole discretion to determine the term of any contract given APS's stated intent to seek rate base treatment of the PWEC merchant generation. Davis Testimony in Docket E-01345A-02-0707 at 5, lines 12-13. Such a result would completely obliterate the Track B process and the instruction in Decision 65154 that those assets should not be treated as APS assets for the Track B solicitation, meaning the whole solicitation, not simply one year.

[24] *Id.* at 15, lines 1-3.

the "full partnership" approach with an evaluation team and equal voting rights, PGR's concerns are lessened.

IV. CODE OF CONDUCT

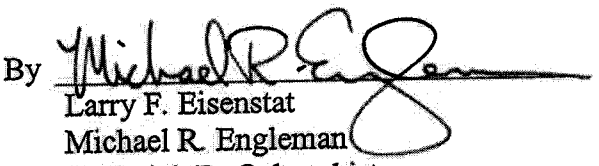
APS's Brief fails to adequately address the Code of Conduct issues identified in the Third Procedural Order on Track B Issues, the hearing and PGR's Brief. As outlined in PGR's Brief, the existing Code of Conduct and the Track B Standards of Conduct must work together to assure that incumbent utility affiliates have no advantage that was created solely as a result of the relationship with the incumbent utility. This tightening of the Code of Conduct and Standards of Conduct will help ensure that ratepayers "obtain some of the benefits of the new Arizona generation resources."[25]

V. CONCLUSION

For the foregoing reasons, the Commission should approve the Track B solicitation process as outlined in PGR's Closing Brief

[25] Decision 65154 at 24, lines 1-2.

RESPECTFULLY SUBMITTED, Tuesday, December 31, 2002

By 

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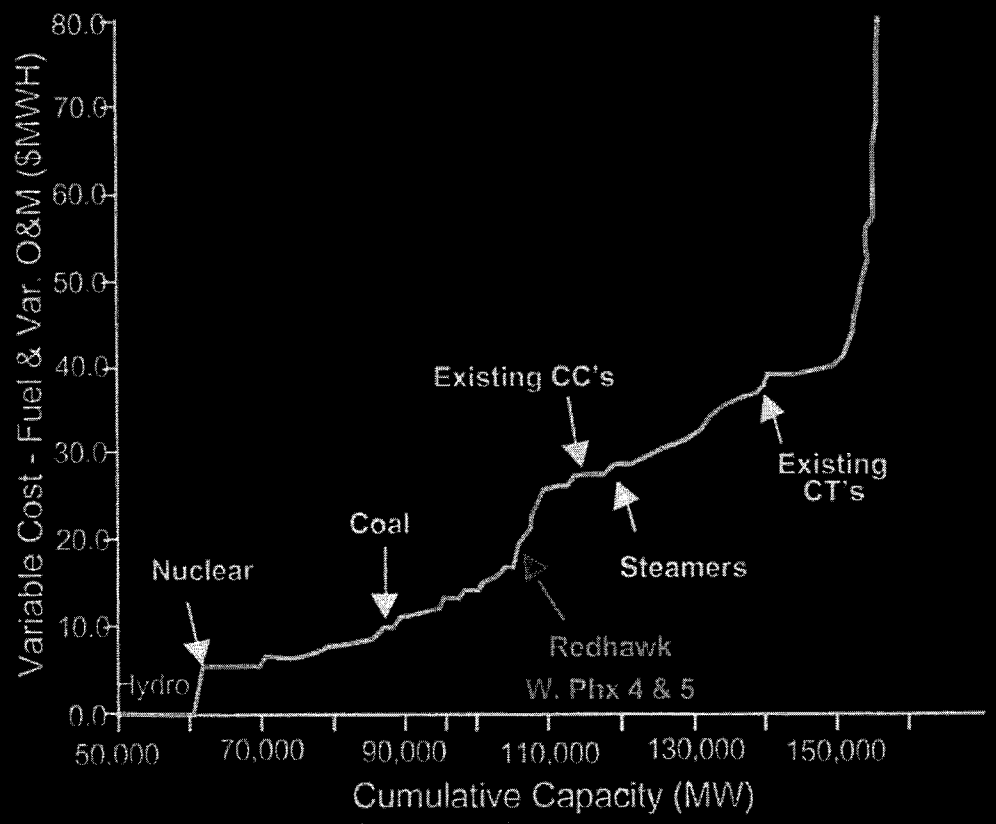
APPENDIX A

Generation Assets Provide Low Cost Dispatch Diversity in the WSCC

- Palo Verde first nuke dispatched
- Coal plants favorably dispatched as baseload
- Older gas units are comparably low cost and highly flexible for Q3 load and cycling
- New combined-cycle units baseload dispatched