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BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

IN THE MATTER OF THE GENERIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING ISSUES	Docket No. E-00000A-02-0051
IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR A VARIANCE OF CERTAIN REQUIREMENTS OF A.A.C. R14-22-1606	Docket No. E-01345A-01-0822
IN THE MATTER OF THE GENERIC PROCEEDING 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	[illegible]

TRACK B REPLY BRIEF OF THE LAND AND WATER FUND OF THE ROCKIES

The Land and Water Fund of the Rockies' (LAW Fund) recommendations in this proceeding are simple and direct: the Arizona Corporation Commission (Commission) in its Track B order should initiate separate proceedings to develop Commission policy on demand-side management (DSM) and environmental risk management. The LAW Fund is ***not*** asking the Commission to adopt specific DSM or environmental risk management

policies in its Track B order or to apply specific policies to the initial competitive solicitation; rather, the LAW Fund is requesting the Commission now establish the ***process*** for analyzing and developing Commission policy on these issues, to be applied to second and subsequent solicitations.

Notwithstanding the straightforward nature of the LAW Fund's recommendations, the post-hearing briefs of Staff, Arizona Public Service Company (APS) and Sempra Energy Resources (Sempra) indicate some confusion as to exactly what the LAW Fund is requesting that the Commission do in its Track B order. To dispel any remaining confusion, this reply brief repeats the LAW Fund's recommendations, followed by a discussion of why the objections of Staff, APS and Sempra are misplaced.[1]

Overview of LAW Fund's Recommendations

Dr. David Berry, testifying on behalf of the LAW Fund, recommended that the Commission initiate *separate* proceedings to develop Commission policy on DSM and environmental risk management. Those separate proceedings would consist of a series of stakeholder workshops, followed by Commission hearings leading to the development of Commission policy on these issues. *See* Berry Direct, Exhibits DB-2 and DB-3 (LAW-1). He suggested that the Commission consider these issues in separate proceedings in order not to slow down the first round competitive solicitation. He encouraged the Commission to start the process quickly, though, so that DSM and environmental risk management policies can be comprehensively reviewed and completed in time to be applied, as inputs, to the second and subsequent rounds of

[1] Sempra raises the same objections as Staff on DSM and environmental risk management in its post-hearing brief. Sempra's objections should be rejected for the reasons discussed herein with respect to Staff's comments.

1 competitive solicitations, taking into account the time needed to refine the solicitation
2 process for the second round. *See id*, at pp. 2-5; Tr. (Vol.IV), pp. 821-822.
3 Staff's argument – that, given the tight time frame governing the initial
4 solicitation, the issues of DSM and environmental risk management are beyond the scope
5 of this proceeding – misinterprets the LAW Fund's recommendations (Staff Initial
6 Closing Brief, at p. 9). The LAW Fund recognizes the Commission's desire to conduct
7 the first round solicitation expeditiously, and it does not seek to slow down the first round
8 solicitation. Accordingly, the LAW Fund's recommendations do not affect the timing or
9 the substance of the first round solicitation. Rather, the LAW Fund is recommending that
10 a separate process be established now to ensure that DSM and environmental risk
11 management policies are in place in time for inclusion in the second and subsequent
12 solicitations.
13 Staff's contention (Staff's Initial Closing Brief, at p. 9) that DSM and
14 environmental risk management are outside the scope of these proceedings is inconsistent
15 with the Administrative Law Judge's (ALJ) Third Procedural Order on Track B Issues in
16 this docket. In that Procedural Order, at p. 8, the ALJ specifically stated that the hearing
17 should cover the issues identified by the parties, including DSM and management of
18 environmental risk as proposed by the LAW Fund. Further, Commissioner Spitzer
19 questioned RUCO's counsel during opening statements about the benefits to ratepayers
20 of DSM and about the environmental consequences of utility resource acquisition
21 decisions. Tr. (Vol.I), pp. 40-43. Thus, the LAW Fund's recommendations on DSM and
22 environmental risk management are properly within the scope of this proceeding.

APS also appears to misapprehend what the LAW Fund is asking the Commission to do in its Track B order. APS recommends against the adoption of the LAW Fund's recommendations because the record is not adequately developed. *See* APS Post-Hearing Brief, at p.22. Yet, as stated previously, the LAW Fund has not requested that the Commission adopt specific policies on DSM or environmental risk management in its Track B order. Rather, the LAW Fund requests that the Commission initiate workshops and hearings precisely in order to create the extensive record necessary for the development of thoughtful Commission policy on these issues. *See* Tr. (Vol.IV), at p.823. APS does state that, if the Commission wishes to consider these issues, it would not oppose further workshops. *See* APS Post-Hearing Brief, at p.23. The LAW Fund is encouraged by APS's willingness to participate in workshops on these issues (or, at a minimum, its lack of opposition to them), and would look forward to working with APS and other parties at the workshops to develop sound DSM and environmental risk management policies.

Environmental Risk Management

Dr. Berry submitted testimony on the public interest in the environmental aspects of utility resource acquisition.[2] He also gave several examples of the types of environmental risk management policies that could be considered at the workshops and hearings the LAW Fund has proposed.[3] However, the LAW Fund is not proposing a specific environmental risk management policy for adoption or requesting that the

[2] The public interest in the environmental aspects of utility resource acquisition include a) the Commission's previous statements on environmental matters; b) the recovery, through rates, of the costs of meeting environmental targets and requirements; and c) the environmental externalities of power production imposed on society and the ecology of the state. *See* Berry Direct, at pp. 6-9.

1 Commission adopt a specific policy on environmental risk management in its Track B
2 order.[4] Rather, Dr. Berry's testimony provides the evidentiary basis for the Commission
3 to conclude in its Track B order that it is in the public interest to develop an
4 environmental risk management policy. Based on this conclusion, the Commission, in its
5 Track B decision, should order that separate proceedings be initiated to develop an
6 environmental risk management policy, to be applied to second round and subsequent
7 solicitations.

8 Staff's acknowledgment (Staff's Initial Closing Brief, at p. 9) that bidders are
9 free to submit bids that include environmental risk mitigation is an inadequate substitute
10 for the Commission taking explicit, proactive steps to establish an environmental risk
11 management policy. Dr. Berry submitted testimony on the public interest to ratepayers
12 of managing environmental risks and proactively addressing the environmental
13 implications of utility resource acquisition decisions. Berry Direct, at pp. 6-9. Dr. Berry
14 warned that competitive solicitations arising from Track B would accomplish these
15 public interest objectives only by happenstance unless the Commission directly addresses
16 environmental issues. *Id.* at p. 8. He reasoned that, without explicitly considering the
17 environmental impacts of resource alternatives, it is unknown what the effect would be
18 on environmental performance, but that it is entirely possible that environmental
19 performance might deteriorate. Tr. (Vol.IV), at p. 827, lines 19-25.

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[3] Examples include shadow prices or adders to reflect environmental impacts or costs of compliance with future regulatory requirements, environmental performance goals, and the allocation of environmental risks among utilities, ratepayers and power producers. *See* Berry Direct, at DB-3; Tr. (Vol.IV), at pp. 828-829.
[4] The LAW Fund does request that the Commission require explicit consideration of the risk of future climate change regulations at the workshops and hearing. Again, the LAW Fund is not requesting that the Commission adopt a specific policy on climate change in its Track B order, only that the Commission require consideration of climate change issues at the workshops and hearing.

Staff would have the Commission passively leave it up to individual bidders to decide whether to include environmental risk management in their bids. Naturally, bidders whose prices would increase if they took into account the cost of offsetting or avoiding environmental impacts will not consider or report those environmental impacts if bids are to be selected on the basis of price alone. Nor would utilities have any reason to consider the environmental impacts of their resource choices if they expected that they would be penalized for selecting higher priced but cleaner resources. The result will be increased environmental risks to ratepayers and/or greater environmental impacts on Arizona. Staff's proposal is also deficient because the information upon which to compare resource alternatives would be incomplete, and the Commission would have no policy in place on how to evaluate the relative merits of competing bids based on their environmental risks and impacts or on the weight that should be attributed to environmental factors. Finally, the Commission would not have a policy in place on the retirement of "environmentally undesirable plants." *Cf.* Decision No. 65154, at p. 23, note 8. Staff's proposal would accomplish environmental improvements only by happenstance, if at all.

Demand-Side Management

Dr. Berry testified on the public interest in utility acquisition of DSM.[5] He also identified several components to an effective DSM policy.[6] However, the LAW Fund is

[5] Dr. Berry testified that cost effective DSM is a resource that can help meet the demand for electric energy services at lower cost than conventional generation resources. Thus, the public interest in DSM is to ensure that consumers' electric energy services bills are as low as possible. In addition, because DSM displaces electricity generation and generally has a stable cost, it helps consumers and utilities avoid fluctuations in the price of electricity and natural gas used to generate electricity. Further, DSM may reduce or eliminate the need for more transmission or distribution capacity, may avoid transmission constraints, and can reduce the environmental impacts of electricity consumption, including compliance costs with future environmental regulations. *See* Berry Direct, at p. 2.

not proposing a specific DSM policy for adoption or requesting that the Commission adopt specific DSM requirements in its Track B order. Rather, Dr. Berry's testimony provides the evidentiary basis for the Commission to conclude in its Track B order that cost-effective DSM acquisition is in the public interest. Based on this conclusion, the Commission, in its Track B decision, should order separate proceedings to develop Commission policy on DSM.

In his testimony, Dr. Berry discussed several aspects of current DSM policy in Arizona as justification for why workshops and a hearing on DSM are warranted. He explained that current utility DSM programs fall well short of capturing the full cost-effective DSM potential in Arizona. He also testified that DSM should be acquired separately from supply-side resources rather than through an all-source solicitation. A separate DSM acquisition process is desirable in order to attract DSM vendors and to reflect the different attributes of the two resource types. Berry Direct, at p. 4. The Commission should reject Staff's passive approach which contends that the Commission need not address the LAW Fund's recommendation because bidders are free to include DSM in their bids (Staff's Initial Closing Brief, at p. 9). Staff wrongly assumes that an all-source solicitation process with no direction regarding DSM will magically result in the lowest cost mix of supply-side and demand-side resources. It will not. To develop a process that will more realistically result in the lowest cost mix of resources, the LAW Fund suggests that the structure of a DSM solicitation process be one of the issues discussed at the LAW Fund's proposed DSM workshops and hearing. *See* Berry Direct, Exhibit DB-2.

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[6] Those components include a solicitation process separate from supply-side solicitations, target levels of cost effective DSM (kW and kWh savings), and implementation timetables for APS and TEP.

APS states that it has long supported cost-effective DSM, but it correctly notes that there currently is no funding mechanism in place for DSM, nor is there a regulatory process in place for evaluating the cost-effectiveness of DSM. APS Post-Hearing Brief, at p.22. Yet, APS' concerns, while valid, do not provide a basis for objecting to the LAW Fund's recommendations; rather, they point towards the need for additional proceedings on DSM. Recognizing this, the LAW Fund has proposed workshops and a hearing on DSM precisely for the purpose of evaluating the types of issues raised by APS. *See* Tr. (Vol.IV), at p. 822, line 25 – p.823, line 9. Indeed, on cross-examination, APS witness Steven Wheeler acknowledged that the issues raised by APS could be addressed in the context of the workshops and hearing recommended by the LAW Fund. *See* Tr. (Vol.III), p. 640, line 11 – p. 641, line 12.

WHEREFORE, the LAW Fund requests that the Commission establish separate proceedings on DSM and environmental risk management, and that it adopt the LAW Fund's recommendations concerning the Staff Report.

RESPECTFULLY SUBMITTED this 30th day of December 2002.

Bart P. Miller on behalf of Eric Guidry

Eric C. Guidry, Esq.
Energy Project Staff Attorney
Land and Water Fund of the Rockies
2260 Baseline Road, Suite 200
Boulder, CO 80302
(303) 444-1188 x226
eguidry@lawfund.org

Original and 19 copies of the foregoing filed with Docket Control, Arizona Corporation Commission, 1200 W. Washington Street, Phoenix, AZ 85007, on the 30th day of December 2002, and copies mailed to the following Track B parties:

Raymond S. Heyman
Michael Patten
Roshka Heyman & Dewulf
400 E. Van Buren, Suite 800
Phoenix, Arizona 85004

Thomas Mumaw
Pinnacle West Capital Corp.
400 N. 5th St., Station 8695
Phoenix AZ 85504

Jeffrey B. Guldner
Snell & Wilmer
One Arizona Center
Phoenix AZ 85004

Walter W. Meek, President
Arizona Utility Investors Association
2100 N. Central, Suite 210
Phoenix AZ 85004

Roger K. Ferland
Quarles & Brady Streich Lang
Renaissance One
Two North Central
Phoenix AZ 85004-2391

Jay L. Shapiro
Fennemore Craig
3003 N. Central. Suite 2600
Phoenix AZ 85012-2913

Scott S. Wakefield
RUCO
1110 W. Washington, Suite 220
Phoenix AZ 85007

Christopher C. Kempley, Esq.
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 W. Washington
Phoenix AZ 85007

Janet Wagner
Arizona Corporation Commission
1200 W. Washington
Phoenix AZ 85007

Paul R. Michaud
Martinez & Curtis, P.C.
2712 North 7th Street
Phoenix Arizona 85006

Lawrence V. Robertson. Jr.
Munger Chadwick, PLC
National Bank Plaza
333 North Wilmot, Suite 300
Tucson AZ 85711

William P. Sullivan
Martinez & Curtis, P.C.
2712 North 7th Street
Phoenix Arizona 85006

Michael R. Engleman
Dickstein Shapiro Morin & Oshinsky
2101 L Street NW
Washington DC 20037

Jay I. Moyes
Moyes Storey
3003 N. Central Ave., Suite 1250
Phoenix Arizona 85012

Lori Glover
Director of Industry Affairs
Stirling Energy Systems
2920 E. Camelback Rd. #150
Phoenix AZ 85016

Penny Anderson