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AZ CORP COMMISSION
DOCUMENT CONTROL

IN THE MATTER OF THE GENERIC
PROCEEDINGS CONCERNING
ELECTRIC RESTRUCTURING

DOCKET NO. E-00000A-02-0051

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

DOCKET NO. E-01933A-98-0471

ISSUES 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

NOTICE OF FILING WITNESS
SUMMARY

Intervenor Panda Gila River, L.P. hereby provides notice of filing the Witness Summary
of Craig R. Roach, Ph.D. concerning the "Track A" issues in the above-captioned dockets.

Arizona Corporation Commission
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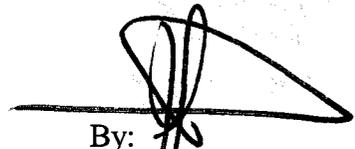
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RESPECTFULLY SUBMITTED this 17th day of June, 2002.

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See attached for filing and service list.

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DOCUMENT CONTROL

6 IN THE MATTER OF THE GENERIC
7 PROCEEDINGS CONCERNING ELECTRIC
8 RESTRUCTURING

DOCKET NO. E-00000A-02-0051

8 IN THE MATTER OF ARIZONA PUBLIC
9 SERVICE COMPANY'S REQUEST FOR
10 VARIANCE OF CERTAIN
11 REQUIREMENTS OF A.A.C. 4-14-2-1606

DOCKET NO. E-01345A-01-0822

11 IN THE MATTER OF THE GENERIC
12 PROCEEDINGS CONCERNING THE
13 ARIZONA INDEPENDENT SCHEDULING
14 ADMINISTRATOR

DOCKET NO. E-00000A-01-0630

13 IN THE MATTER OF TUCSON ELECTRIC
14 COMPANY'S APPLICATION FOR A
15 VARIANCE OF CERTAIN ELECTRIC
16 POWER COMPETITION RULES
17 COMPLIANCE DATES

DOCKET NO. E-01933A-98-0471

16 ISSUES IN THE MATTER OF TUCSON
17 ELECTRIC POWER COMPANY'S
18 APPLICATION FOR A VARIANCE OF
19 CERTAIN ELECTRIC COMPETITION
20 RULES COMPLIANCE DATES

DOCKET NO. E-01933A-02-0069

20 SUMMARY OF DIRECT AND REBUTTAL TESTIMONY OF
21 CRAIG R. ROACH, Ph.D.
22 ON "TRACK A" ISSUES

23 ON BEHALF OF
24 PANDA GILA RIVER, L.P.

25 June 17, 2002
26

1 **SUMMARY OF THE DIRECT TESTIMONY OF CRAIG R. ROACH, Ph.D.**

2 **CONCLUSIONS AND RECOMMENDATIONS**

3 Dr. Roach's primary conclusions are that: (a) APS has generation and transmission market
4 power; (b) if APS is allowed to unconditionally transfer its generation facilities to an Affiliate, it
5 will also be transferring its market power to that Affiliate; and (c) because the Commission will
6 have less authority after the transfer to prevent harm to consumers from the exercise of market
7 power by that Affiliate, the Commission must ensure that, prior to such transfer, APS' market
8 power is mitigated.

9 Accordingly, to mitigate that market power Dr. Roach recommends that the Commission
10 prohibit the asset transfer until APS has plans in place to competitively procure, or has
11 competitively procured, 100% of its Standard Offer service requirements. In addition, the
12 Commission should (a) require APS to establish short-term energy markets, including a real-time
13 balancing market; (b) require APS to provide an opportunity for all generators selected by
14 competitive procurement or by the short-term markets to be designated Network Resources; and
15 (c) require APS to issue RFP(s) for generation within the constrained Valley region.

16 **QUANTITATIVE EVIDENCE OF MARKET POWER**

17 At present, FERC tests for market power by means of the Supply Margin Assessment
18 (SMA) test for areas outside FERC-approved, operational Regional Transmission Organizations.
19 The SMA seeks to determine if a supplier is "pivotal" in a market. In this case "pivotal" means
20 that the supplier's capacity is essential to meeting the market's peak load. Dr. Roach conducted
21 an SMA for both the APS Market as a whole and for a more narrow geographic market defined as
22 the APS Valley Market. In both cases, in the absence of the opportunity to compete that would be
23 created by competitive procurement, the SMA shows APS has generation market power.

24 **MARKET POWER AND THE AFFILIATE PPA**

25 Market power in this case means that, for a sustained period of time, Standard Offer
26 customers would pay higher prices, face greater risks, and suffer lower reliability with PWEC

1 service than they would if served by competing suppliers. As explained in Dr. Roach's Testimony
2 in the variance proceeding, this would have been the fate of Standard Offer customers had the
3 Affiliate PPA with PWCC been approved. The Affiliate PPA, with a potential 29-year term,
4 underscores precisely why the Commission must be concerned with market power, even with a
5 cost-plus contract between APS and an Affiliate. Even under a cost-plus contract, APS can
6 simply bequeath its market power to an Affiliate and ignore the competitive challenge from
7 several thousand megawatts of new merchant generators and, thereby, deny the ratepayer benefits
8 that would result from that challenge.

9 Unless the price and non-price terms of the Affiliate PPA are subject to competitive
10 challenge, Dr. Roach concludes that the Affiliate PPA is not mitigation for market power as APS
11 suggests.

12 **TRANSMISSION MARKET POWER**

13 Dr. Roach concludes that APS has transmission market power. APS is a transmission
14 monopoly; no competitor can build transmission facilities into or within the APS control area. No
15 competitor can import power into or distribute power within APS' control area without APS'
16 consent. In addition, APS is regulated by FERC as a transmission monopoly and is not part of an
17 operational RTO, as required by FERC.

18 The specific mitigation for transmission market power that Dr. Roach has in mind is that
19 the Commission must ensure that all generators within APS' control area have the opportunity to
20 be treated comparably to APS' own generation by ensuring that these generators can be studied as
21 and designated Network Resources.

22 **SUMMARY OF THE REBUTTAL TESTIMONY OF CRAIG R. ROACH, PH.D.**

23 **CONCLUSIONS AND RECOMMENDATIONS**

24 Dr. Roach stands by the recommendations made in his Direct Testimony.
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1 **RESPONSE TO STAFF**

2 Dr. Roach agrees with Staff that APS possesses generation and transmission market
3 power. He believes that the best way to address market power concerns is for the Commission to
4 adopt his recommendations, most notably to require APS to competitively procure (through a
5 combination of bilateral purchases and a bid solicitation process) 100% of its Standard Offer
6 Service Requirements.

7 Dr. Roach agrees with Staff that utilities should submit a market power study and
8 mitigation plan. Dr. Roach, however, believes that the record in this proceeding already contains
9 market power studies (e.g., APS' and Dr. Roach's Supply Margin Assessments) as well as
10 recommendations for mitigation.

11 Dr. Roach does have concerns about the Staff's implementation of the "enhanced prudence
12 standard" and inclination to intervene in short-term markets. He believes that prudence is
13 determined on the basis of the information known or knowable at the time of the decision, thus the
14 prudence of a transaction is not something that ought to be revisited by the Commission on an
15 ongoing basis during the transaction's term. With regard to short-term markets, his advice is for
16 Utility Distribution Companies to rely on the short-term market for an insubstantial (up to 5%)
17 portion of their capacity needs. In short, his recommendation is to stay out of the short-term
18 markets rather than attempt to make the short-term market more appealing artificially through
19 price caps and the like.

20 **RESPONSE TO APS**

21 Dr. Roach agrees with APS that competitive procurement is the *quid pro quo* for the asset
22 transfer. In fact, he believes that Staff is fair to highlight the contradiction in APS' market power
23 testimony as compared to its statements in connection with its request for a variance from
24 1606(B). Staff points out, when speaking of market power, APS says that a huge number of
25 competitors exist. And, yet, when it came time to address the issue of whether APS could comply
26 with 1606(B), APS declared that no competitors existed.

1 Dr. Roach disagrees with APS' contention that, in the absence of competitive
2 procurement, APS lacks generation and transmission market power; the refusal to conduct
3 competitive procurement is, in-and-of-itself, an exercise of market power by APS. A long-term
4 affiliate PPA can be mitigation for market power if, and only if, the price and non-price terms of
5 that PPA have been tested against competitive procurement.

6 While the results of Dr. Roach's and APS' SMA analysis are largely similar, there are
7 important differences that have broader implications. Dr. Roach believes that these differences
8 show the importance of a clear understanding of how transmission constraints affect competition,
9 and how that effect might differ between competition through competitive procurement for
10 longer-term PPAs as opposed to competing in a spot market.

11 **RESPONSE TO RUCO**

12 Dr. Roach concludes that the concerns expressed by RUCO's witness are largely irrelevant
13 because they are largely an argument against FERC policies and do not address the issues of asset
14 transfer and competitive procurement which have been set for this proceeding.

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