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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

MAR 30 2007

MIKE GLEASON, Chairman  
JEFF HATCH-MILLER  
WILLIAM A. MUNDELL  
KRISTIN K. MAYES  
GARY PIERCE

DOCKETED BY  
*WJM* *NR*

IN THE MATTER OF THE APPLICATION OF  
ARIZONA PUBLIC SERVICE COMPANY FOR  
AUTHORIZATION TO ACQUIRE POWER  
PLANT.

DOCKET NO. E-01345A-06-0464

DECISION NO. 69400

OPINION AND ORDER

DATES OF HEARING:

August 29, 2005 (Procedural Conference), November 15, 2005 (Pre-Hearing Conference); January 3, 4, 5 and 8, 2007.

PLACE OF HEARING:

Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE:

Teena Wolfe

IN ATTENDANCE:

Kristin K. Mayes, Commissioner  
Mike Gleason, Commissioner

APPEARANCES:

Ms. Karilee S. Ramaley and Mr. Thomas L. Mumaw, PINNACLE WEST CAPITAL CORPORATION, and Ms. Deborah R. Scott, SNELL & WILMER, LLP, on behalf of Arizona Public Service Company;

Mr. Jay I. Moyes, MOYES, STOREY, on behalf of Arizona Competitive Power Alliance;

Mr. Lawrence V. Robertson, Jr., MUNGER CHADWICK, on behalf of Mesquite Power, LLC, Southwestern Power Group II, LLC and Bowie Power Station, LLC.;

Mr. Douglas V. Fant, LAW OFFICES OF DOUGLAS V. FANT, on behalf of Distributed Energy Association of Arizona; and

Mr. Christopher Kempley, Chief Counsel, and Ms. Janet Wagner, Senior Staff Counsel, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

1 **BY THE COMMISSION:**

2 **I. PROCEDURAL HISTORY**

3 On July 13, 2006, Arizona Public Service Company ("APS") filed with the Arizona  
4 Corporation Commission ("Commission") an Application for approval to purchase a new generation  
5 resource within APS' Yuma load pocket ("Application"). Attached to the Application is a copy of  
6 APS' September 19, 2005 Request for Proposal ("RFP") for Long-Term Capacity Supply in Yuma,  
7 Supplement to May 31, 2005 RFP. The Application was submitted pursuant to the requirements of  
8 Decision No. 67744 (April 7, 2005), and requests that the Commission authorize APS to acquire and  
9 own a peaking generation plant either through direct contracts with vendors and contractors ("direct  
10 build alternative") or through a contract with a developer ("developer build proposal" or "DG Power  
11 proposal"). In either event, APS will own the power plant in question. Pursuant to Section IX of the  
12 Settlement Agreement modified and adopted by Commission Decision No. 67744 ("Settlement"),  
13 APS may not acquire a power plant ("self-build") with an in-service date prior to January 1, 2015  
14 without prior Commission approval.<sup>1</sup>  
15

16  
17 Mesquite Power, LLC, Southwestern Power Group II LLC, and Bowie Power Station, LLC  
18 ("M/S/B") jointly requested intervention on July 28, 2006. The Competitive Power Alliance  
19 ("Alliance") requested intervention on August 10, 2006. APS opposed their intervention. After  
20 argument was heard on the motions to intervene filed by M/S/B and the Alliance, their requests to  
21 intervene were granted. The Distributed Energy Association of Arizona ("DEAA") requested  
22 intervention on September 22, 2006, and intervention was granted over APS' opposition.  
23

24 A Prehearing Conference was held on November 15, 2006. APS, M/S/B, the Alliance, and  
25 the Commission's Utilities Division Staff ("Staff") appeared through counsel. DEAA did not enter  
26

27 <sup>1</sup> Decision No. 67744, Attachment A (Proposed Settlement Agreement), pp. 16-18 (Section IX) as modified by Findings  
28 of Fact No. 33, pp. 38-39. A reproduction of Section IX of the Settlement with a note including Findings of Fact No. 33  
is attached to this Opinion and Order as Exhibit A.

1 an appearance. Following the Prehearing Conference, a Procedural Order was issued setting a  
2 hearing to commence on January 3, 2007, and setting associated procedural deadlines, including  
3 publication of notice of the Application and hearing, discovery deadlines, and dates for pre-filing  
4 testimony to be presented at hearing. Notice of the Application and hearing were published as  
5 required. No further intervention requests were received.

6 The hearing was held as scheduled on January 3, 4, 5 and 8, 2007 before a duly authorized  
7 Administrative Law Judge of the Commission. All parties appeared through counsel, presented  
8 testimony and evidence, and made closing arguments. The parties filed simultaneous Reply Briefs in  
9 response to closing arguments made on January 8, 2007, and the matter was taken under advisement.  
10 On January 29, 2007, a letter from Dale E. Fredericks, a witness who testified on behalf of the  
11 Alliance, was filed in the docket. On February 13, 2007, APS filed a letter in the docket indicating  
12 that it had entered into a memorandum of understanding with GE Packaged Power, Inc. to hold  
13 turbines and certain other major equipment for the new generation facility to be constructed in Yuma.  
14 APS' letter stated that the equipment purchase agreement anticipated by the memorandum of  
15 understanding will be assignable to a third party, which would allow a developer or a contractor hired  
16 by APS to pursue the construction of the new facility.

## 19 **II. BACKGROUND**

20 On May 31, 2005, APS issued an RFP seeking at least 1,000 MW of long-term energy  
21 resources for delivery beginning in 2007. The May 2005 RFP included a request for APS' needs for  
22 Yuma. APS determined that the proposals received under the May 2005 RFP did not meet Yuma's  
23 resource needs, and issued a supplemental RFP on September 19, 2005 seeking specific proposals for  
24 Yuma ("Yuma RFP"). The Yuma RFP sought proposals for both long-term purchased power  
25 agreements ("PPAs") and for asset ownership.  
26

27 The Yuma RFP had the following characteristics:  
28

- 1 1. It specified a need between 100 and 200 MW of capacity.
- 2 2. The generation had to be deliverable inside the Yuma load pocket.
- 3 3. The generation needed an in-service date between June 1, 2006 and June 1, 2008.
- 4 4. Any proposed PPAs had to be at least 10 years in duration.
- 5 5. Multiple units were identified as preferable to a single large unit for reliability reasons.
- 6 6. APS' existing Yucca Power Plant ("Yucca") site was offered as a potential site for any  
7 new generation, but the RFP indicated that it should not be inferred that the Yucca site  
8 was preferred by APS.
- 9 7. APS offered to take the lead in procuring the necessary gas transportation capacity  
10 necessary for a gas fired plant at the Yucca location.
- 11 8. APS initiated interconnection requests at Yucca that would be made available to a  
12 winning bidder if the Yucca site was selected.
- 13
- 14

15 In response to the Yuma RFP, APS received twenty-five proposals from eleven different  
16 entities. APS hosted a bidders' teleconference on September 21, 2005 and a tour of the Yucca site on  
17 September 27, 2005. Twenty-one entities participated in the teleconference and six attended the site  
18 tour. APS conducted a screening of all the proposals for reliability and price, and chose twelve  
19 proposals from five entities for further evaluation. Four of those proposals were for asset acquisitions  
20 and eight were for PPAs. APS provided the bidders for all twelve proposals an opportunity to refresh  
21 their pricing and evaluated all of the refreshed proposals. The proposal selected by APS as superior  
22 to the others was the DG Power proposal, for building two GE LM 6000 units (total capacity of 96  
23 MW) at the Yucca site and selling them to APS upon their completion. APS met further with DG  
24 Power to allow it to further refine its proposal. APS also prepared its own direct build alternative  
25 option.  
26

27 There was no dispute in this proceeding that a new generation resource is needed for Yuma.  
28

1 Neither was there any dispute that the Yuma RFP did not result in any long-term PPAs that were  
2 cost-competitive with the self-build alternatives. It was also undisputed that the prudence of any self-  
3 build option, either the developer build proposal or the APS direct build alternative, would be  
4 evaluated in a future rate proceeding.

5 The issues in dispute include whether APS has complied with the requirements of Decision  
6 No. 67744 and the Settlement it modified and adopted, and whether APS should have the authority to  
7 choose between the two self-build alternatives described in the Application.  
8

### 9 **III. NEED FOR SELF-BUILD IN THE YUMA LOAD POCKET**

10 Due to transmission constraints, a load pocket currently exists in the Yuma area.<sup>2</sup> There was  
11 no disagreement that growth in peak load in the Yuma area will need to be served with local  
12 generation. All parties, with the exception of DEAA, agree that APS should be allowed to self-build  
13 generation resources to serve the Yuma load pocket, as self-build is defined in the Settlement.  
14 According to the DEAA's reading of the Settlement, Commission approval of APS' request to self-  
15 build under either of APS' proposed alternatives would constitute a "revision or reversal" of the  
16 Settlement (*See, e.g.*, DEAA Reply Br. at 3). We disagree. A plain reading of Decision No. 67744  
17 and the Settlement clearly allows APS to self-build if APS obtains express Commission approval to  
18 do so. Decision No. 67744 also requires APS to address certain issues specified in the Settlement in  
19 any request for self-build authorization.  
20

### 21 **IV. WHETHER THE APPLICATION FOR SELF-BUILD APPROVAL MEETS THE** 22 **REQUIREMENTS OF THE SETTLEMENT AND DECISION NO. 67744**

#### 23 **A. Requirements of Section IX of the Settlement Agreement**

24 Section IX of the Settlement which was approved as modified by Decision No. 67744  
25 includes paragraphs 74-80, which are reproduced in Exhibit A, attached hereto and incorporated  
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27 <sup>2</sup> A "load pocket" exists when an area's total peak demand exceeds its total transmission import capability (Staff Report,  
28 Exh. S-1 at 3).

1 herein by reference. Paragraph 74 of the Settlement, as modified by Findings of Fact No. 33 of  
2 Decision No. 67744, defines "self-build" and precludes APS from pursuing a self-build option with  
3 an in-service date prior to January 1, 2015 without express Commission authorization. Paragraph 76  
4 affirms that APS retains its obligation to prudently acquire generating resources, which obligation  
5 may include seeking self-build authorization prior to 2015.

6 Paragraph 75 requires any APS application for self-build authority to address specific issues  
7 related to its efforts to obtain resources from the competitive wholesale market. Paragraph 77  
8 clarifies that those efforts do not preclude APS from negotiating bilateral agreements with non-  
9 affiliated parties. As part of any request for Commission authorization to self-build generation prior  
10 to 2015, APS must address its specific needs for additional long-term resources (Paragraph 75(a)); its  
11 efforts to secure adequate and reasonably-priced long-term resources from the competitive wholesale  
12 market to meet those needs (Paragraph 75(b)); the reasons why APS believes those efforts have been  
13 unsuccessful, either in whole or in part (Paragraph 75(c)); and the anticipated life cycle cost of the  
14 proposed self-build option in comparison with suitable alternatives available from the competitive  
15 market for a comparable period of time (Paragraph 75(e)).<sup>3</sup>

16  
17  
18 Paragraph 78 required APS, notwithstanding its ability to pursue bilateral agreements with  
19 non-affiliates for long-term resources, to issue an RFP or other competitive solicitation no later than  
20 the end of 2005; stated that no APS affiliate would participate in that RFP or other competitive  
21 solicitations for long-term resources without the appointment of an independent monitor; stated that  
22 APS is not obligated to accept any bid; and stated that renewable resources, distributed generation,  
23 and DSM would be invited to participate in that RFP or other competitive solicitation, and that such  
24

25  
26 <sup>3</sup> Paragraph 75 (d) of the Settlement also requires APS to also address the extent to which the request to self-build is  
27 consistent with any applicable APS resource plans and competitive resource acquisition rules or orders resulting from the  
28 workshop/rulemaking proceeding described in Paragraph 79 of the Settlement. However, because the  
workshop/rulemaking proceeding referenced in Paragraph 79 is not yet completed, Paragraph 75(d) does not apply in the  
context of this Application.

1 resources would be evaluated in a consistent manner with all other bids.

2 Paragraph 79 required Staff to schedule workshops on resource planning issues, and  
3 Paragraph 80 required APS to continue to use its Secondary Procurement Protocol except as modified  
4 by the Settlement or as authorized by the Commission.

5 **B. Section IX Issues in Dispute**

6 M/S/B and the Alliance assert that APS has not met the requirements of Paragraphs 75(c) and  
7 (e). As explained below, we find that it has.

8 **1. Paragraph 75(c)**

9  
10 M/S/B and the Alliance assert that APS has not met the requirement of Paragraph 75(c)  
11 because it has not shown that the Yuma RFP was unsuccessful in meeting APS' needs. They do not  
12 disagree with APS that the PPA bids received from the competitive wholesale market were not  
13 reasonably priced in comparison with the developer build proposal. They argue, however, that  
14 because the developer build proposal that was chosen by APS for further consideration emerged  
15 through the RFP process, the RFP was successful, even though the developer build proposal was not  
16 a competitive wholesale market proposal, like the rejected PPA bids. M/S/B argue that the language  
17 of the Yuma RFP supports their position because it requested competitive proposals for acquiring  
18 generation owned or constructed by others or proposals for long-term power purchases, and stated  
19 that APS would consider long-term PPAs or an asset purchase. In a filing made in this docket by  
20 Dale Fredericks, a principal with DG Power who testified at the hearing as a witness for the Alliance,  
21 Mr. Fredericks made the comment that because DG Power submitted many proposals pursuant to the  
22 Yuma RFP, including long-term PPAs, DG Power was a competitive wholesale market participant at  
23 all times.<sup>4</sup>

24  
25  
26 APS is requesting authority for an asset acquisition pursuant to a developer build asset  
27

28 <sup>4</sup> Mr. Fredericks' filed comments were not subject to cross examination.

1 acquisition proposal submitted in response to the Yuma RFP. It is uncontested that the bids from the  
2 competitive wholesale market for PPAs were not reasonably priced in comparison with the developer  
3 build proposal and APS' direct build alternative. In contrast with M/S/B's position that APS' choice  
4 to pursue the developer build alternative rendered the RFP "successful" such that APS cannot comply  
5 with the requirement of Paragraph 75(c), M/S/B also recommend that we clarify in this Decision that  
6 in future RFPs, "if an RFP finalist is a proposed asset acquisition, under that limited circumstance  
7 APS can request a waiver from compliance with the requirement of Paragraph 75(c)" (Tr. at 709-  
8 710). We do not believe such a waiver to be necessary. The fact that a competitive wholesale market  
9 participant submitted the developer build proposal in addition to its PPA proposals does not render  
10 the developer build proposal a "competitive wholesale market" bid under Paragraph 75 of the  
11 Settlement, regardless of whether asset purchase proposals were requested in the RFP. It would  
12 strain credulity to classify the one-of-a-kind DG Power developer build proposal as a proposed  
13 wholesale transaction. We find that APS has addressed, pursuant to Paragraph 75 of the Settlement,  
14 its efforts to secure the needed resources from the competitive wholesale market, and has shown that  
15 that the RFP was not successful in terms of its efforts to secure reasonably priced resources from the  
16 competitive wholesale market.

## 19 2. Paragraph 75(e)

20 Paragraph 75(e) of the Settlement requires APS to address the anticipated life-cycle cost of  
21 the proposed self-build option in comparison with suitable alternatives available from the competitive  
22 market. M/S/B argue that APS has not shown that it conducted a definitive life cycle cost  
23 comparison between its direct build alternative and the developer build proposal, which M/S/B argue  
24 is a "suitable alternative from the competitive market." M/S/B further argue that APS cannot satisfy  
25 the requirement of Paragraph 75(e) because APS does not have firm and final prices and terms and  
26 conditions which could affect prices for either of the self-build options described in the Application.  
27  
28

1 Finally, M/S/B claim that this Commission cannot make a determination on the Application without  
2 an anticipated life-cycle cost comparison between the developer build proposal and APS' direct build  
3 alternative.

4 Staff indicated in the Staff Report that it reviewed confidentially supplied detailed  
5 comparative cost analyses for all bids APS received in response to the Yuma RFP, and that according  
6 to its analysis, APS has met the requirements of Paragraph 75(e).

7  
8 M/S/B's argument regarding Paragraph 75(e) centers on its characterization of the developer  
9 build proposal as a "competitive market alternative." APS has shown, however, that the RFP was not  
10 successful in terms of its efforts to secure reasonably priced resources from the competitive  
11 wholesale market. Both options proposed by APS in this docket, the developer build proposal and  
12 the APS direct build alternative, are self-build options under Paragraph 75(e). No party alleges that  
13 APS failed to address the wholesale competitive market alternatives in the form of the PPA bids APS  
14 received in response to the RFP. The language of Paragraph 75(e) clearly does not require a life-  
15 cycle cost comparison between two alternative self-build options. M/S/B's argument that the  
16 Application fails to meet the requirements of Paragraph 75(e) must therefore be rejected. For the  
17 same reason, M/S/B's assertion that this Commission cannot make a determination on the  
18 Application without an anticipated life-cycle cost comparison between the developer build proposal  
19 and APS' direct build alternative is erroneous. The purpose of the requirement in Paragraph 75(e) is  
20 to aid in a determination of the merit of granting self-build authority when there are suitable  
21 alternatives to self-build available from the competitive market for a comparable period of time.  
22  
23

#### 24 V. CONDUCT OF THE SOLICITATION

25 M/S/B and the Alliance raised issues in this proceeding regarding the propriety of APS'  
26 conduct in its solicitation to meet its needs for the Yuma service area, and are of the opinion that an  
27 independent monitor should have been appointed to oversee the Yuma RFP because APS was  
28

1 preparing its direct build alternative estimate during the course of the RFP. M/S/B also raised issues  
2 regarding whether APS' Code of Conduct applied to the solicitation, despite the lack of participation  
3 of an APS affiliate.

4 Paragraph 78(b) of the Settlement precludes any APS affiliate from participating in an RFP or  
5 competitive solicitation without the appointment of an independent monitor by the Commission or  
6 Commission Staff. No APS affiliate participated in the Yuma RFP. M/S/B and the Alliance contend,  
7 however, that an independent monitor appointed by Staff should have overseen the Yuma RFP  
8 process in a manner similar to that used in the Track B competitive procurement process. M/S/B  
9 request clarification that Paragraph 78(b)'s requirement for the appointment of an independent  
10 monitor will apply to all future RFPs or other competitive solicitations in which APS develops and  
11 uses a direct build estimate (which M/S/B characterize as a "competitive bid or proposal"), regardless  
12 of whether the estimate is developed by an APS affiliate or internally within APS itself. M/S/B  
13 believe that such an independent monitor should oversee the separation of APS' functions in  
14 conducting such RFPs and APS' development of its own direct build alternatives.  
15

16  
17 M/S/B and the Alliance argue that there will be a "chilling" effect on the competitive  
18 wholesale market if APS is granted authority to go forward with its direct build alternative, and to  
19 proceed in a similar manner without an independent monitor in connection with future RFPs and  
20 other competitive procurements. M/S/B contend that without participation of an independent  
21 monitor, members of the competitive wholesale market would have no incentive to compete in future  
22 APS RFPs, and that such a situation would deprive APS' ratepayers of the benefit of a vibrant  
23 competitive wholesale market. M/S/B assert that the competitive market includes developers such as  
24 DG Power.  
25

26 APS contends that testimony presented in this proceeding regarding how the market will or  
27 might react if APS is allowed to consider its direct build alternative is conjectural, and points out that  
28

1 while it has stated in each of its RFPs that it would compare bids to a direct build alternative, APS  
2 has generally had excellent response to its RFPs. APS argues that the Yuma RFP clearly stated that  
3 “[to] ensure that Proposals will provide customer benefits, APS will compare Proposals with the  
4 benefits, including costs and reliability, of internally estimated new-build alternatives at the Yucca  
5 site” (citing Exhibit B to the Application, at 12). APS’ witness also testified that during verbal  
6 conversations with bidders, APS gave them notice of its intention to prepare a direct build cost  
7 estimate (Tr. at 62-63). Staff agrees with APS that bidders in the RFP were on notice that their bids  
8 would be subject to comparison with an APS-generated cost estimate, and point out that Mr.  
9 Fredericks on behalf of DG Power concedes that he knew such a comparison would be performed  
10 and that he thought it appropriate.

12 APS claims that the arguments advanced by M/S/B and the Alliance that an independent  
13 monitor should have been appointed to oversee the Yuma RFP process overlook the following facts  
14 which distinguish the Yuma RFP from the Track B solicitation, which was overseen by an  
15 independent monitor: 1) no APS affiliate participated in the RFP; 2) the parties to the proceeding  
16 that led to the Track B procurement process were agreed that Tucson Electric Power Company’s  
17 (“TEP”) competitive procurement process did not require an independent monitor because TEP  
18 did not have a competitive affiliate participating; and 3) APS has no incentive to “win” an RFP,  
19 because regardless of whether APS pursues the developer build proposal or the APS direct build  
20 alternative, APS will receive the benefits of plant ownership, including rate basing the asset. APS  
21 points out that M/S/B and the Alliance actively participated in the Track B proceeding and did not  
22 object to the fact that no independent monitor was appointed to oversee TEP’s procurement process.  
23 APS argues that it is unreasonable for M/S/B and the Alliance to now assert that APS, which was in  
24 the same position in the Yuma RFP as was TEP in Track B, should be treated differently.

27 Staff states that while it agrees with APS that the Settlement does not require the appointment  
28

1 of an independent monitor regarding the APS direct build alternative, Staff does not agree with APS  
2 that this conclusion can be reached solely on the basis of the fact that APS is not an affiliate of itself  
3 (Staff Reply Br. at 9). Staff contends that the limited nature of the options available to satisfy the  
4 power supply needs identified within the Yuma load pocket make the comparisons between a  
5 developer build proposal and a direct build alternative fairly simple in this case, but that in a more  
6 complex situation than the Yuma RFP, in which greater needs were identified, or where need exists  
7 outside a load pocket, Staff's analysis of how APS conducted its direct build alternative analysis  
8 would likely require more detailed review (*Id.*). Staff stated that this particular instance where  
9 peaking generation is necessary within a load pocket is therefore not indicative of what might occur  
10 in other situations (*Id.*).  
11

12 Paragraph 80 of the Settlement requires APS to continue to use its Secondary Procurement  
13 Protocol except as modified by the express terms of the Settlement or unless otherwise authorized by  
14 the Commission. M/S/B argue that because the Yuma RFP was conducted after the RFP required by  
15 Paragraph 78, the Secondary Procurement Protocol applied, and that the Secondary Procurement  
16 Protocol requires APS and any affiliate providing capacity or energy as a result of the Secondary  
17 Procurement Protocol to comply with the applicable Codes of Conduct. M/S/B assert that APS'  
18 Code of Conduct<sup>5</sup> should apply to the Yuma RFP despite the fact that APS did not have a  
19 Competitive Electric Affiliate as defined in the Code of Conduct participating in the Yuma RFP, and  
20 that APS' activities in connection with the development and use of its direct build alternative may  
21 have violated the spirit, if not the actual language, of APS' Code of Conduct.<sup>6</sup> M/S/B contend that  
22 APS' development and use of its direct build alternative are "tantamount to those in which a  
23 'Competitive Electric Affiliate' [as defined in APS' Code of Conduct] of APS would engage in  
24  
25

26 \_\_\_\_\_  
27 <sup>5</sup> APS' current Code of Conduct was approved in Decision No. 68741 (June 5, 2006).

28 <sup>6</sup> M/S/B state in their Reply Brief that they developed this additional line of argument after making their closing statement. Thus, the other parties have had no opportunity to respond to M/S/B's detailed arguments based on specific provisions of the Code of Conduct.

1 competition with third-party entities from the competitive market.” (M/S/B Reply Br. at 10). Based  
2 on this argument, M/S/B go on to argue that specific provisions of the Code of Conduct should have  
3 applied to the Yuma RFP. M/S/B assert that APS personnel involved in preparation of its direct bid  
4 proposal should have had no contact with APS personnel conducting the RFP or advising APS in the  
5 RFP.<sup>7</sup> The Alliance expressed similar dissatisfaction with the fact that an APS employee who had  
6 access to confidential bids worked to prepare APS’ direct build alternative estimate, and that APS did  
7 not complete the direct build alternative estimate until after the selection of DG Power as the superior  
8 bid in the RFP process. The Alliance is also critical of APS’ actions in first publicly announcing in  
9 early 2006 that DG Power had been selected as a result of the Yuma RFP, but then requesting  
10 Commission authority to proceed with either the DG Power developer build proposal or the APS  
11 direct build alternative.  
12

13 M/S/B argue that due to “uncertainty” whether APS has complied with the requirements of its  
14 Code of Conduct, APS should be denied authority to proceed with its direct build alternative.  
15

16 APS’ witness testified that APS began preparing its direct build alternative cost estimate  
17 before the Yuma RFP was issued (Tr. at 66, 120), and that the direct build alternative cost estimate  
18 was prepared based on independent proposals from third party vendors and equipment manufacturers  
19 without the use of information from the bids it received in response to the RFP (Tr. at 67, 128). APS  
20 also presented testimony regarding its public announcement in Yuma regarding DG Power using a  
21 powerpoint presentation (*See* Hearing Exh. Alliance-1). APS’ witnesses testified that during the  
22 presentation, APS indicated that DG Power had been selected as the sole remaining Yuma RFP  
23

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24  
25 <sup>7</sup> M/S/B object to the fact that an APS generation employee was both a member of APS’ Yuma RFP bid evaluation team  
26 and primarily responsible for APS’ direct build alternative, and that this employee had contact with personnel conducting  
27 the solicitation and one or more respondents to the Yuma RFP. While M/S/B is critical of APS for failing to produce this  
28 employee as a witness to testify as to his state of mind and substantiate other APS witness’ assurances that this employee  
did not act as a conduit for improperly sharing competitive information (M/S/B Reply Br. at 12-13), it is critical to note  
that neither did M/S/B make a request to the Commission that this witness be made available in order to substantiate their  
allegations that APS acted improperly.

1 bidder with which APS was negotiating (Tr. at 263, 268), and that APS had not determined at that  
2 time whether DG Power was the best alternative to pursue (Tr. at 476-477). APS argues that as it  
3 stated in the Application, even though its direct build alternative cost estimates initially appeared to  
4 be more economic than the developer build proposal, APS wished to wait until both the direct build  
5 and developer build cost estimates could be finalized to make its determination regarding which  
6 option to pursue (Application at 5-6). APS' witness testified that APS has no interest in choosing a  
7 direct build alternative over a developer build proposal (Tr. at 130-131, 681).  
8

9 While M/S/B and the Alliance repeatedly attempted to characterize APS' direct build  
10 alternative as a "competitive bid," and the developer DG Power as a member of the "competitive  
11 market" subject to the protections of Section IX of the Settlement, the record in this case does not  
12 support such characterizations. As we stated earlier, the DG Power developer build proposal cannot  
13 be classified as a wholesale transaction. No APS affiliate participated in the Yuma RFP. The  
14 evidence in this proceeding does not support M/S/B's implications that APS somehow violated the  
15 "spirit" of its Code of Conduct by its development and use of its direct build alternative estimates.  
16 No record evidence supports M/S/B's and the Alliance's assertions that APS acted improperly in the  
17 course of preparing its direct build alternative estimates.  
18

19 Section IX of the Settlement, approved as modified in Decision No. 67744, included  
20 provisions allowing APS to negotiate bilateral agreements with non-affiliated parties. We find that  
21 the record in this case reflects that although the developer build proposal was originally received in  
22 the same RFP process as the rejected PPA bids, APS' negotiations with DG Power more resembled  
23 bilateral agreement negotiations. We agree with Staff that the limited nature of the options from  
24 which APS could choose to meet the needs of the Yuma load pocket rendered the Yuma solicitation  
25 process somewhat unique. Under differing circumstances, APS might wish to consider seeking the  
26 appointment of an independent monitor, but in this case, the record does not show that an  
27  
28

1 independent monitor should have been appointed to oversee the Yuma solicitation process.

2 **VI. WHETHER APS SHOULD BE ALLOWED TO CHOOSE BETWEEN THE**  
3 **DEVELOPER BUILD PROPOSAL OR ITS DIRECT BUILD ALTERNATIVE**

4 The Alliance believes that only the developer build proposal should be approved, because it  
5 was the only successful result of the Yuma RFP, and that APS' direct build alternative would be  
6 justifiable only if the RFP had not produced the developer build proposal. M/S/B believe that APS'  
7 request for approval of the direct build alternative is premature and request that it be denied. M/S/B  
8 request that the developer build proposal be approved, and assert that it would also be appropriate for  
9 this Commission to direct APS to proceed with the implementation of the developer build proposal.  
10 M/S/B argue that what APS seeks is actually a variance to the procedure and requirements for  
11 obtaining an exception to the self-build moratorium, rather than an exception to the moratorium itself,  
12 and that the Application asks the Commission to "relinquish to APS the final decision-making role as  
13 to whether an exception to the moratorium should be granted." (M/S/B Reply Br. at 19). The  
14 Alliance takes a position similar to M/S/B that APS' Application should not be approved at all in its  
15 present form, but that because denial at this time would delay the addition of needed generation  
16 resources in Yuma, the Commission should consider granting APS authority to proceed with the  
17 developer build proposal only. The Alliance argues that allowing APS to choose between the  
18 developer build proposal and its own direct build alternative would render the procurement process  
19 little more than a tool for APS to test the market. The Alliance also argues that if APS' application is  
20 granted without qualification, that in future RFPs, up until the time APS signs a final bidding  
21 contract, whether with a winning PPA bidder or a winning bidder to build a new plant, APS will  
22 always be able to opt for its own direct self-build option. The Alliance argues that APS will thereby  
23 be able to effectively avoid the competitive marketplace by reverting to its own proposals to build  
24 new plant as if there were no moratorium at all.  
25  
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27

28 APS and Staff both disagree with the Alliance and M/S/B, and instead argue that APS should

1 be allowed to choose between the two options. APS believes it should be authorized to select the  
2 most economical and best fitting alternative for its customers after receiving final firm pricing and  
3 key terms and conditions on the alternatives, and argues that neither the Settlement nor Decision No.  
4 67744 make a distinction between the two self-build options for which APS is requesting approval.  
5 APS emphasizes that its obligation to procure the most economical resources to benefit customers  
6 was not changed by the Settlement or Decision No. 67744. APS argues that the arguments of M/S/B  
7 and the Alliance ignore the critical provision of Paragraph 76 of the Settlement, which provides that  
8 nothing in Section IX shall be construed as relieving APS of its existing obligation to prudently  
9 acquire generating resources, including but not limited to seeking self-build authorization prior to  
10 2015. APS further argues that Paragraph 76 reflects the underlying intent of the Settlement and  
11 Decision No. 67744 to provide the most reliable and economic resources for the benefit of customers,  
12 and that M/S/B and the Alliance are seeking to shift that balance in favor of their own competitive  
13 interests, at the expense of a potential increase in costs to customers. APS contends that even if this  
14 Commission were to accept the arguments of M/S/B and the Alliance, this proceeding is not the  
15 proper forum for making such a change to the Settlement or Decision No. 67744, because many of  
16 the interested parties are not present (APS Reply Br. at 9).

19 APS argues that its ability to consider a direct build alternative provides value to APS and its  
20 customers by providing an incentive for bidders to submit their most economic proposals. APS  
21 asserts that acceptance of M/S/B's and the Alliance's arguments that APS should not be allowed to  
22 choose its direct build alternative would create unreasonable leverage on behalf of third party  
23 developers, and that this would in turn likely increase the ultimate cost to customers (APS Reply Br.  
24 at 12, Tr. at 329-330). Staff similarly contends that without the direct build alternative available,  
25 APS would have little leverage in negotiations on the developer build proposal, which could lead to  
26 APS paying a higher than necessary price for the generation resource (Tr. at 630-631). Staff  
27  
28

1 argues that under the circumstances of this particular power acquisition, an internally generated cost  
2 estimate was essential, and states that Staff believes the way it was conducted was reasonable and not  
3 unfair to any of the parties.

4 Staff asserts that Decision No. 67744 and the Settlement contemplate the possibility of self-  
5 build by APS, and that because no PPA received in response to the RFP was competitively priced,  
6 APS should be allowed to proceed with either the developer build alternative or its direct build  
7 alternative based on an assessment of all the complex circumstances surrounding the final contract  
8 available in the two competing circumstances, including both price and risk elements. Staff states  
9 that APS should not be limited in its choice of self-build alternatives, but should be required to  
10 review the final contract numbers and decide the more prudent course of action for its customers and  
11 itself, as prudence will be considered in the rate proceeding where APS seeks to include the  
12 alternative it selects in rates.  
13

14 The disagreement in this case stems from the parties' differing views concerning whether the  
15 developer build proposal at issue in this case constitutes a competitive wholesale market resource.  
16 As stated previously, we find that it does not. There is no disagreement that due to the particular  
17 facts associated with the Yuma area resource needs, the Yuma RFP was unsuccessful in producing  
18 adequate and reasonably-priced long-term resources from the competitive wholesale market in the  
19 form of PPAs.  
20

21 It is ultimately APS, and not competitive wholesale power providers, or in this instance, a  
22 third party developer, who must bear the responsibility for APS' choice in contracting or acquisitions.  
23 Paragraphs 76 and 77 of the Settlement, which were adopted by Decision No. 67744, clearly reflect  
24 the parties' understanding of this concept. Allowing APS to develop its direct build cost estimates  
25 only for the purpose of evaluating bids to acquire generation resources, but not allowing APS to  
26 implement its cost estimate if APS deemed it necessary, could prevent the utility from making a  
27  
28

1 prudent choice in acquiring the generating resources necessary to serve its customers. APS must be  
2 allowed to make the choice it deems most prudent, because it must defend that choice when  
3 requesting the proper rate treatment. It is therefore appropriate that APS be authorized to choose its  
4 preferred option when definitive pricing and contract terms are available and APS has had the  
5 opportunity to balance the costs and risks between the two options. The Application will therefore be  
6 granted.

## 7 **VII. OTHER ISSUES**

### 8 **A. Procedural Recommendations/ Precedential Effect on Self-build Moratorium**

9 M/S/B request recognition of confusion as to the administration of Decision No. 67744 and  
10 Article IX of the Settlement, and that this decision set forth a specific procedural process similar to  
11 the one followed in this proceeding, including a right of intervention and an evidentiary hearing, to  
12 govern any future requests for an exception to the self-build moratorium. APS argues that  
13 Commission rules already address intervention, and that whether a hearing is required and the type of  
14 hearing to be held should be determined based on the nature of the issues. We agree with APS that  
15 our rules adequately address intervention, and also agree that the need for an evidentiary hearing may  
16 not be present in every application for authority to self-build. We therefore do not find it appropriate  
17 to impose specific procedural requirements at this time on a possible future dispute regarding the  
18 requirements of Section IX of the Settlement.  
19  
20

21 This is the first time APS has requested self-build authority pursuant to Decision No. 67744.  
22 Due to the unique nature of the need for generation resources for the Yuma area, the issues presented  
23 by the Application, the first of its type, are very likely not indicative of issues that may arise in any  
24 future request for authority to self-build. Our decision in this matter is based on the unique facts of  
25 this case. The fact that the Yuma RFP requested proposals for both PPAs and asset acquisitions to  
26 meet the unusual requirements for the Yuma load pocket may have created some ambiguities that  
27  
28

1 would not have been present had APS chosen to proceed differently, by issuing separate RFPs for  
 2 PPAs and asset acquisitions. APS may wish to bear this in mind in future RFP planning in order to  
 3 avoid such possible ambiguities in future solicitations.

4 **B. Submission of cost data**

5  
 6 M/S/B recommend that if APS is granted authority to make the final decision regarding how  
 7 to proceed, that APS be required to submit cost data upon which its final decision is based in  
 8 connection with any future rate base request. It is reasonable to require in this proceeding that APS  
 9 retain its final direct build alternative estimates and final refreshed bid information, in the event this  
 10 information will be needed in a future prudence evaluation.

11 \* \* \* \* \*

12 Having considered the entire record herein and being fully advised in the premises, the  
 13 Commission finds, concludes, and orders that:

14 **FINDINGS OF FACT**

15 1. APS is a public service corporation principally engaged in furnishing electricity in the  
 16 State of Arizona. APS provides either retail or wholesale electric service to substantially all of  
 17 Arizona, with the major exceptions of the Tucson metropolitan area and about one-half of the  
 18 Phoenix metropolitan area. APS also generates, sells and delivers electricity to wholesale customers  
 19 in the western United States.

20 2. A new generation resource is needed for APS' Yuma service area.

21 3. Due to transmission constraints, a load pocket currently exists in the Yuma area, and  
 22 the need for generation resources in Yuma at this time is for peaking generation within a load pocket.

23 4. APS is obligated to prudently acquire resources to meet the needs of its customers.

24 5. On July 13, 2006, APS filed the Application with the Commission, pursuant to the  
 25 requirements of Decision No. 67744.

26 6. Intervention was granted to M/S/B, the Alliance, and DEEA.

27 7. By Procedural Order issued November 20, 2006 a hearing was set to commence on  
 28 January 3, 2007.

1 8. Notice of the Application and hearing were published as required. No further  
2 intervention requests were received.

3 9. A hearing was held on the Application on January 3, 4, 5 and 8, 2007. M/S/B, the  
4 Alliance, DEAA and Staff appeared through counsel and presented evidence.

5 10. The parties filed simultaneous Reply Briefs in response to closing arguments made on  
6 January 8, 2007, and the matter was taken under advisement.

7 11. On January 29, 2007, a letter from Dale E. Fredericks, a witness who testified on  
8 behalf of the Alliance, was filed in the docket.

9 12. On February 13, 2007, APS filed a letter in the docket indicating that it had entered  
10 into a memorandum of understanding with GE Packaged Power, Inc. to hold turbines and certain  
11 other major equipment for the new generation facility to be constructed in Yuma. APS' letter stated  
12 that the equipment purchase agreement anticipated by the memorandum of understanding will be  
13 assignable to a third party, which would allow a developer or a contractor hired by APS to pursue the  
14 construction of the new facility.

15 13. Pursuant to Section IX of the Settlement Agreement modified and adopted by  
16 Commission Decision No. 67744, APS may not acquire a power plant ("self-build") with an in-  
17 service date prior to January 1, 2015 without prior Commission approval. Decision No. 67744  
18 requires APS to address certain issues specified in the Settlement in any APS request for self-build  
19 authorization.

20 14. The Application requests authority to self-build a peaking generation plant either  
21 through APS' direct build alternative or through a contract with DG Power, a developer. Under  
22 either alternative, APS will own the power plant.

23 15. On May 31, 2005, APS issued an RFP seeking at least 1,000 MW of long-term energy  
24 resources for delivery beginning in 2007. The May 2005 RFP included a request for APS' needs for  
25 Yuma. APS determined that the proposals received under the May 2005 RFP did not meet Yuma's  
26 resource needs, and issued the Yuma RFP on September 19, 2005 seeking specific proposals for  
27 Yuma. The Yuma RFP sought proposals for both long-term purchased power agreements and for  
28 asset ownership.

1           16.     Self-build is the preferred result over any purchased power agreement provided by the  
2 wholesale market in response to APS' RFP process for the Yuma service area need.

3           17.     Decision No. 67744 and the Settlement do not support a distinction between APS'  
4 direct build and the developer build alternatives proposed by APS in its request for authority to self-  
5 build.

6           18.     The prudence of any self-build alternative approved in this proceeding will be  
7 evaluated in a future APS rate proceeding.

8           19.     The developer build alternative for which APS is requesting authority is not a  
9 competitive wholesale market resource within the meaning of Paragraphs 74-76 of the Settlement.

10          20.     APS provided adequate notice to potential bidders that APS would consider a direct  
11 build alternative.

12          21.     APS could have rejected all bids received in response to the Yuma RFP.

13          22.     Evidence was presented regarding APS' estimates of the differences in annual revenue  
14 requirements associated with both APS' direct build alternative and the developer build alternative.  
15 There was no dispute on the methodology used to make the comparison. However, because both  
16 proposals were not complete, cost estimates were not finalized, and the cost differential could not be  
17 known with certainty. The rate base implications of one proposal over the other are therefore  
18 unknown at this time, and can only be estimated. In addition, rate base implications are not  
19 necessarily the only factors that will be considered in future prudence determinations. The evidence  
20 presented regarding estimated differences in annual revenue requirements is therefore not dispositive.

21          23.     Although the developer build proposal was originally received in the same RFP  
22 process as the rejected PPA bids, APS' negotiations with DG Power more resembled bilateral  
23 agreement negotiations.

24          24.     Decision No. 67744 and the Settlement approved as modified by Decision No. 67744  
25 do not preclude APS from negotiating bilateral agreements with non-affiliated parties.

26          25.     The Application complies with the requirements of Decision No. 67744 and the  
27 Settlement adopted as modified therein.

28          26.     Due to the unique nature of the need for generation resources for the Yuma area, the

1 issues presented by the Application, the first of its type, are very likely not indicative of issues that  
2 may arise in any future APS request for authority to self-build.

3 27. APS should be required to retain its final direct build alternative estimates and final  
4 refreshed bid information from DG Power for use by the Commission in the event the information is  
5 required for a future prudence evaluation.

6 28. It is in the public interest to approve the Application.

7 **CONCLUSIONS OF LAW**

8 1. APS is a public service corporation within the meaning of Article XV of the Arizona  
9 Constitution and A.R.S. §§ 40-222, 250, 251, 321 and 361.

10 2. The Commission has jurisdiction over APS and the subject matter of the Application.

11 3. Notice of the Application was provided in accordance with the law.

12 4. Approval of the Application is in the public interest.

13 **ORDER**

14 IT IS THEREFORE ORDERED that the Application filed by Arizona Public Service  
15 Company to purchase a new generation resource within its Yuma load pocket meets the requirements  
16 of Decision No. 67744 and the Settlement Agreement adopted as modified by that Decision.

17 IT IS FURTHER ORDERED that the Application is hereby approved.

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1 IT IS FURTHER ORDERED that Arizona Public Service Company shall retain its final direct  
2 build alternative estimates and final refreshed bid information from DG Power for use by the  
3 Commission in the event the information is required for a future prudence evaluation.

4 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

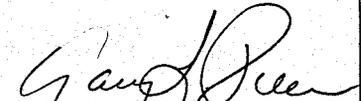
5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

6  
7   
8 CHAIRMAN

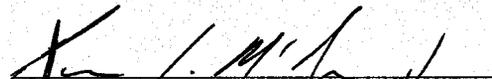
COMMISSIONER

9   
10 COMMISSIONER

  
COMMISSIONER

  
COMMISSIONER

11  
12 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive  
13 Director of the Arizona Corporation Commission, have  
14 hereunto set my hand and caused the official seal of the  
15 Commission to be affixed at the Capitol, in the City of Phoenix,  
16 this 30<sup>th</sup> day of March, 2007.

17   
18 BRIAN C. McNEIL  
19 EXECUTIVE DIRECTOR

20 DISSENT \_\_\_\_\_

21 DISSENT \_\_\_\_\_

1 SERVICE LIST FOR: ARIZONA PUBLIC SERVICE COMPANY

2 DOCKET NO.: E-01345A-06-0464

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### IX. Competitive Procurement of Power

74. APS will not pursue any self-build option having an in-service date prior to January 1, 2015, unless expressly authorized by the Commission. For purposes of this Agreement, "self-build" does not include the acquisition of a generating unit or interest in a generating unit from a non-affiliated merchant or utility generator, the acquisition of temporary generation needed for system reliability, distributed generation of less than fifty MW per location, renewable resources, or the up-rating of APS generation, which up-rating shall not include the installation of new units.

(Note: The definition of "self-build" appearing in paragraph 74 of the Settlement as reproduced above was modified by Findings of Fact No. 33 in Decision No. 67744 as follows:

"33. We are modifying the definition of "self-build" to include the acquisition of a generating unit or interest in a generating unit from any merchant or utility generator, and we will require APS to obtain the Commission's expressed approval for APS' acquisition of any generating facility pursuant to a RFP or other competitive solicitation issued before January 15, 2015. Our determination herein should not be construed as signaling in any manner the ultimate regulatory treatment that can or will be accorded to any generating facility or interest in a generating facility ultimately acquired by APS.")

75. As part of any APS request for Commission authorization to self-build generation prior to 2015, APS will address:

- a. The Company's specific unmet needs for additional long-term resources.
- b. The Company's efforts to secure adequate and reasonably-priced long-term resources from the competitive wholesale market to meet those needs.
- c. The reasons why APS believes those efforts have been unsuccessful, either in whole or in part.
- d. The extent to which the request to self-build generation is consistent with any applicable Company resource plans and competitive resource acquisition rules or orders resulting from the workshop/rulemaking proceeding described in paragraph 79.
- e. The anticipated life-cycle cost of the proposed self-build option in comparison with suitable alternatives available from the competitive market for a comparable period of time.

76. Nothing in this section shall be construed as relieving APS of its existing obligation to prudently acquire generating resources, including but not limited to seeking the above authorization to self-build a generating resource or resources prior to 2015.

77. The issuance of any RFP or the conduct of any other competitive solicitation in the future shall not, in and of itself, preclude APS from negotiating bilateral agreements with non-affiliated parties.

78. Notwithstanding its ability to pursue bilateral agreements with non-affiliates for long-term resources, APS will issue an RFP or other competitive solicitations(s) no later than the end of 2005 seeking long-term future resources of not less than 1000 MW for 2007 and beyond.

- a. For purposes of this section, "long-term" resources means any acquisition of a generating facility or an interest in a generating facility, or any PPA having a term, including any extensions exercisable by APS on a unilateral basis, of five years or longer.
- b. Neither PWEC nor any other APS affiliate will participate in such RFP or other competitive solicitation(s) for long-term resources, and neither PWEC nor any other APS affiliate will participate in future APS competitive solicitations for long-term resources without the appointment by the Commission or its Staff of an independent monitor.
- c. Nothing in this section shall be construed as obligating APS to accept any specific bid or combination of bids.
- d. All renewable resources, distributed generation, and DSM will be invited to compete in such RFP or other competitive solicitation and will be evaluated in a consistent manner with all other bids, including their life-cycle costs compared to alternatives of comparable duration and quality.

79. The Commission Staff will schedule workshops on resource planning issues to focus on developing needed infrastructure and developing a flexible, timely, and fair competitive procurement process. These workshops will also consider whether and to what extent the competitive procurement should include an appropriate consideration of a diverse portfolio of short, medium, and long-term purchased power, utility-owned generation, renewables, DSM, and distributed generation. The workshops will be open to all stakeholders and to the public. If necessary, the workshops may be followed with rulemaking.

80. APS will continue to use its Secondary Procurement Protocol except as modified by the express terms of this Agreement or unless the Commission authorizes otherwise.