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June 11, 2002

E-00000A-02-0051  
E-01345A-01-0822  
E-00000A-01-0630  
E-01933A-02-0069  
E-01933A-98-0471

Docket Control  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85007

Re: Tucson Electric Power Company's Rebuttal Testimony Track A Issues  
(Docket No. E-00000A-02-0051)

Docket Control:

Enclosed please find an original and 18 copies for filing of:

1. Rebuttal Testimony of Steven J. Glaser
2. Rebuttal Testimony of James Pignatelli
3. Rebuttal Testimony of Michael J. DeConcini

Please do not hesitate to contact me if you have any questions.

Sincerely,

Raymond S. Heyman  
For the Firm

RSH/srs  
enclosures  
cc: All parties of Record

Arizona Corporation Commission

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BEFORE THE ARIZONA CORPORATION COMMISSION

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WILLIAM A. MUNDELL  
CHAIRMAN  
JIM IRVIN  
COMMISSIONER  
MARC SPITZER  
COMMISSIONER

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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  
VARIANCE OF CERTAIN REQUIREMENTS  
OF A.A.C. 4-14-2-1606

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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. E01933A-02-0069

**REBUTTAL TESTIMONY OF STEVEN J. GLASER**

**TUCSON ELECTRIC POWER COMPANY**

**TRACK A ISSUES**

Arizona Corporation Commission  
**DOCKETED**

June 11, 2002

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**REBUTTAL TESTIMONY OF STEVEN J. GLASER**

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priced at the lower of “cost” or “market price”; and (b) sales or transfers from TEP to its affiliates should be priced at the higher of “cost” or “market price.”

Q: What is the basis for your disagreement with the affiliate transaction recommendation?

A: I believe that the affiliate transaction recommendation places an unfair disadvantage on incumbent utilities and their affiliates. As Mr. Pignatelli indicated, TEP believes that if the Commission is going to establish a competitive electric market place, then all participants should operate on a “level playing field”. This means that no participant should have an unfair advantage or disadvantage over the others. I do not believe that it is fair to single out incumbent utilities (such as TEP) and their affiliates and impose conditions for the price that can be charged for transactions between them that is different from the rest of the participants in the competitive market place. The Commission has implemented Affiliate Transaction Rules and approved Codes of Conduct as well as policies and procedures to ensure that dealings between incumbent utilities and their affiliates are undertaken in an “arms’ length” fashion. Therefore, transactions between incumbent utilities and their affiliates should be no different than transactions between non-affiliated participants in the competitive market place. The affiliate transaction recommendation is unnecessary and would only create an artificial constraint on the economic value of transactions between TEP and its affiliates. This could impair the incumbents and their affiliates in the competitive market place because, under the affiliate

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transaction recommendation, no other participants in the competitive electric market place would be so limited.

I also believe that the affiliate transaction recommendation would send the wrong pricing signals to retail electric customers. As Mr. Pignatelli discusses, in a true competitive electric market place, the price of retail electric power will be subject to wholesale market volatility. And as I will address in more detail, TEP believes that one way this volatility can be mitigated is through the implementation of fuel adjustment mechanisms. However, TEP does not believe that the affiliate transaction recommendation will properly provide for the recovery of the wholesale market's price for electric power.

Q: Mr. Glaser, was the issue of pricing transactions between TEP and its affiliates discussed during the TEP Stranded Cost proceedings?

A: Yes, it was. In Decision No. 62103, the Commission approved the TEP Settlement Agreement. Pursuant to Section 12 (c) of the TEP Settlement Agreement, the Commission granted TEP a waiver that permits TEP and its affiliates to charge market price for sales, services and transfers.

**III. TIMING OF TEP TRANSMISSION INVESTMENTS.**

Q: Mr. Glaser, Commission Staff witness Jerry Smith has suggested that TEP "...play[ed] the waiting game and defer[ed] transmission investments by relying on

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RMR generation opportunities.” Do you agree with this suggestion?

A: I agree with what I believe to be Mr. Smith’s premise that transmission system adequacy and reliability are necessary components that must be in place in order for electric competition to function, but I do not believe that characterizing TEP as having played a waiting game accurately portrays how TEP has planned its transmission line and power plant construction.

TEP supports coordinated transmission planning and has been an active participant in the Central Arizona Transmission Study and Western Electric Coordinating Council proceedings.

In practice, TEP determines its transmission needs and proposes new transmission lines in a manner similar to the process Mr. Smith discusses in his initial testimony. To date, TEP’s construction of reliability must-run (“RMR”) units has been based on the economics of each such unit compared with the construction of new transmission facilities.

Also, when determining what type of facility to construct, TEP considers other important elements such as the fact that local generation alternatives provide additional capacity, energy and voltage support that a transmission alternative cannot provide.

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I believe that the transmission systems of vertically integrated utilities were not designed, nor should they have been designed, simply to maximize the ability of outside generation sources to compete to serve load within the load pocket.

**IV. ENSURING THAT CONSUMERS WILL RECEIVE RELIABLE ELECTRIC SERVICE AT JUST AND REASONABLE RATES.**

Q: Mr. Glaser, Commission Staff witness Matthew Rowell, in his initial testimony identified Staff's overriding goal as ensuring that consumers will receive reliable electric service at just and reasonable rates. Do you agree that this should be the overriding goal of electric competition?

A: Yes, I do. TEP has always stressed the importance of providing its customers with safe, reliable and fairly priced electric service. TEP has stressed the need to preserve its ability to continue to do so throughout the electric competition proceedings.

I also agree with the Commission Staff that in a competitive electric market place, Utility Distribution Companies ("UDCs") should be allowed the flexibility to obtain power in a variety of ways, including Requests For Proposals ("RFPs") and bilateral contracts, in order to achieve the best overall price for their Standard Offer customers.

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I believe that it will be important for the Commission and the UDCs to address the potential volatility of purchase power costs and how that will affect the rates paid by Standard Offer customers. I think that one of the best mechanisms for matching current electric power procurement costs with electric power use is through a Purchase Power and Fuel Adjustment ("PPFA") mechanism.

Q: Why would a PPFA mechanism be appropriate for UDCs to use in connection with their Standard Offer customers?

A: I concur with Mr. Pignatelli that as the competitive electric market matures, retail electric rates should reflect a market price rather than be set pursuant to a cost-based methodology. To me the concepts of a competitive market place and cost-based rates set by the Commission are not compatible. The potential volatility in electric power prices is one of the characteristics of a competitive market place that is different from a regulated ratemaking environment. Having said that, I do not think that it is in the best interest of retail electric customers to be subject to sudden swings in rates. I believe that electric customers want stability in their rates. I also believe that these aspects of the competitive market place are ones that the Commission must carefully examine as it re-evaluates the benefits and drawbacks of electric competition. In that regard, I join with Mr. Pignatelli in asking the Commission to look at the threshold issue of whether electric competition is, at this time, in the best interest of Arizona and, if so, then to make specific findings as to the expected benefits. This will help all of the participants in the electric industry

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have a common understanding and goals to work towards in connection with a competitive market place.

I do believe that properly designed wholesale competition is the appropriate starting point for electric competition, whether it is implemented now or in the future. I think that if the Commission determines that it is going to proceed and implement electric competition then it should approve an appropriately designed PPFA mechanism to help mitigate the potential negative impact of significant price volatility to UDCs' Standard Offer customers. I would propose that the PPFA mechanism be designed to minimize the effect of electric power price swings over time by "banking" purchase price deviations above and below a pre-determined base cost and then, once an established level has been attained in the account, recovering or returning the bank balance amounts over a specified period of time.

As TEP witnesses have previously testified, TEP desires that if electric competition is implemented in the State, it be designed to meet the public's best interests and not jeopardize TEP's ability to provide safe, reliable and fairly priced electric service.

Q: Does that conclude your rebuttal testimony?  
A: Yes it does.

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

WILLIAM A. MUNDELL  
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MARC SPITZER  
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IN THE MATTER OF THE GENERIC  
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COMPLIANCE DATES

Docket No. E01933A-02-0069

**REBUTTAL TESTIMONY OF JAMES S. PIGNATELLI**

**TUCSON ELECTRIC POWER COMPANY**

**TRACK A ISSUES**

**June 11, 2002**

**REBUTTAL TESTIMONY OF JAMES S. PIGNATELLI**

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wholesale electric generation. There is very little support for the concept of across-the-board retail competition.

Also, almost every participant recognizes that the divestiture and competitive solicitation requirements in the Electric Competition Rules need to be modified.

Consequently, the parties also seem to agree that we should not rush to implement electric competition, but we must have a comprehensive and coordinated process to review and revise the current Electric Competition Rules.

**II. DETERMINATION OF THE NEED AND BENEFITS OF COMPETITION.**

**Q:** What do you mean that there must be a well-defined procedure for re-evaluating the need for electric competition and the Electric Competition Rules?

**A:** It seems to me that a philosophical shift has taken place among the parties with regards to the scope and benefits of electric competition. Almost all of the parties that filed initial testimony now believe that the Commission should focus on competition in the electric power wholesale market. I seem to recall that in the mid-1990s, when the benefits of electric competition were being presented and debated, that the primary advantages were said to be the availability of greater choice and lower rates for retail electric customers. I believe that the benefits to the retail customer were the primary motivation for the Commission to enact the Electric Competition Rules.

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In my initial testimony I recommended that the Commission re-evaluate the benefits of electric competition. My belief that this seminal issue must be analyzed is strengthened by the positions of the other parties, who are now urging the development of a competitive wholesale market before any retail competition occurs. Indeed, it seems to me that the most logical starting point for the Commission's re-evaluation of electric competition would be to determine what the benefits are and if they outweigh any drawbacks.

My concern is that there is no procedure in place for the Commission to take evidence on this issue. Neither the Track A issues nor the Track B issues address the benefits and drawbacks of electric competition. I am not aware of any stage in the re-evaluation process where the Commission has provided for the determination of (a) whether electric competition, as it is now defined and has been implemented, is in the public interest; and (b) what the benefits of competition, as it is now defined, will be.

Q: Mr. Pignatelli, does your recommendation indicate that TEP does not support the implementation of electric competition in Arizona?

A: No, not at all. TEP has always indicated its support for electric competition that is properly designed and implemented so as to meet the public interest. TEP's involvement in prior competition-related proceedings and in this docket has centered on making sure that all parties have a fair and level playing field and that

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there is a realistic and meaningful benefit to Arizona ratepayers. My recommendation that the Commission analyze whether electric competition, as it is being discussed today, is in the public interest and that the anticipated benefits be memorialized is wholly consistent with TEP's prior involvement in the electric competition process. In fact, in my initial testimony I also suggest that if the Commission proceeds with electric competition, then it should include not only wholesale generators but retail customers with loads of 3 MW or greater.

**III. DIVESTITURE AND COMPETITIVE SOLICITATION.**

**Q:** Mr. Pignatelli, please summarize your understanding of the parties' positions on the divestiture and competitive solicitation requirements of the Electric Competition Rules?

**A:** In my initial testimony I addressed the TEP Request for Variance, which seeks to temporarily suspend the deadlines for divestiture and procurement of electric power through a competitive solicitation process pending the resolution of the Commission's re-evaluation of the Electric Competition Rules. I should note that Commissioner Spitzer has requested that an Open Meeting be scheduled to consider the TEP Request for Variance. TEP hopes that the matter is resolved prior to the hearing scheduled on the Track A issues.

Previously, APS sought a variance from certain provisions of A.A.C. R14-2-1606 and (in A.C.C. Docket No. E-01345A-01-0822) filed testimony specifically related

1 to its request. Commission Staff has indicated that it does not support requiring  
2 utilities to transfer their assets, but would not object to allowing discretionary  
3 transfers contingent upon the completion of Commission's market power studies.  
4 RUCO recommends that if the Commission decides to keep the divestiture  
5 requirement that the deadline should be postponed until at least January 1, 2004.  
6 Panda Gila River L.P. recommends that the Commission prohibit the transfer of  
7 generation assets to affiliates until the affiliates face a competitive challenge and  
8 believes that the deadlines can be extended. Reliant Resources, Inc. proposes that  
9 the generation assets be transferred together with an auction for a portion of the  
10 output of the capacity represented by the transferred assets.

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15 Q: What does TEP believe the Commission should do with the divestiture and  
16 competitive solicitation requirements of the Electric Competition Rules?

17 A: Other than to grant the TEP Request for Variance, I do not believe that I can answer  
18 this question in a definitive manner at this point in the proceedings. The various  
19 options are obvious. The Commission can abandon the requirements, postpone the  
20 requirements, modify the requirements or keep the requirements intact. My  
21 difficulty in selecting an appropriate option to recommend is that I do not know the  
22 context in which the Arizona electric industry will be operating in the future.  
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25 While TEP has applauded the Commission for undertaking its re-evaluation of  
26 electric competition, the inherent uncertainty of where this process will ultimately  
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lead has placed TEP in a difficult position. The current Electric Competition Rules (and the TEP Settlement Agreement) require TEP to divest its generation assets on or before January 1, 2003. We have taken steps toward the divestiture. However, at the same time, we have been concerned that TEP would spend significant resources to divest its generation assets and begin the competitive solicitation process only to have the Commission determine that these actions were no longer necessary or relevant to the future Arizona electric industry. TEP is not only concerned with the economic impact of this scenario, but with the effect that divesting the generation assets may have on the Commission's jurisdiction. As I have mentioned previously, those reasons are the basis for the TEP Request for Variance.

The initial testimony has heightened my concern over the uncertainty of the Arizona electric market. The parties have submitted a variety of proposals, which could lead the Commission to take action, including the repeal or significant modification of the divestiture and competitive solicitation requirements.

**IV. WHOLESALE ELECTRIC POWER MARKET.**

Q: Mr. Pignatelli, after reviewing the initial testimony, do you believe that the Commission should focus on strengthening the wholesale electric generation market?

A: Yes, I do. As I previously mentioned, the majority of the initial testimony concentrated on what needed to take place in the wholesale electric power markets

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in order to implement competition in Arizona. TEP witness Mr. DeConcini addressed the topic in his initial testimony and will discuss it some more in his rebuttal testimony.

Q: Is it reasonable to anticipate that under a competitive regime, that electric customer rates will remain "cost-based"?

A: No, I do not think that it is reasonable to anticipate that. It seems to me that as the competitive marketplace develops, customer rates will reflect market forces rather than be "cost-based", which is a ratemaking principle tied to the monopolistic-regulated regime. Mr. Glaser, in his rebuttal testimony will address mechanisms, such as fuel clauses that might help stabilize the rates that are charged to electric customers.

Q: Does this conclude your testimony?

A: Yes, it does

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COMPLIANCE DATES

Docket No. E01933A-02-0069

**REBUTTAL TESTIMONY OF MICHAEL J. DECONCINI**

**TUCSON ELECTRIC POWER COMPANY**

**TRACK A ISSUES**

**June 11, 2002**

**REBUTTAL TESTIMONY OF MICHAEL J. DECONCINI**

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1     **II.     MARKET POWER.**

2     **Q:**     Mr. DeConcini did you review the discussions in the initial testimony  
3             regarding Market Power?

4     **A:**     Yes, I believe that every participant had at least one witness that discussed  
5             market power.  
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8     **Q:**     Please define Market Power as you use that term.

9     **A:**     I define Market Power as the ability of a market participant, or group of  
10            participants, to directly (horizontal market power) or indirectly (vertical  
11            market power) influence the price of a good or service. In the context of the  
12            initial testimony, market power referred to electric power.  
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16     **Q:**     Did all the participants share the same view as to whether (post-divestiture)  
17             utility generation affiliates would have market power?

18     **A:**     No, they did not. The initial testimony contained a wide variety of market  
19             power indices and tests, which came to different conclusions. It seems to  
20             me that the manner by which to determine market power must be more  
21             clearly defined. Obviously, if market power is something that is going to be  
22             monitored then there needs to be uniformity in its definition, determination  
23             and resolution.  
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1 Q: What is your opinion on the Market Power issue?

2 A: I believe that depending on how you define market power every utility could  
3 be expected to be deemed to have market power and that there will be times  
4 during a day at some time of the year that a utility's existing generation  
5 resources will be required to meet local must-run requirements for system  
6 reliability reasons ("RMR generation").  
7

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9 However, I should point out that at the same time there will be existing  
10 utility generation resources that could not cause market power. For  
11 example, TEP owns small portions of other remote generation facilities that  
12 would not be able to exhibit market power due its (small) ownership  
13 percentages and the number of other participants at those sites<sup>1</sup>.  
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16  
17 Q: Are there ways to mitigate the perceived risks of RMR Market Power?

18 A: Yes, this is not a new concept. Generally, RMR Market Power issues are  
19 addressed in the "must-run generation" protocol of the Arizona Independent  
20 Scheduling Administrator ("AISA"). I believe that if the Commission  
21 determines that the AISA protocol is inadequate protection from RMR  
22 Market Power, then another solution would be for the TEP generation  
23 affiliate to supply the RMR capacity and energy to TEP's UDC affiliate  
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27 <sup>1</sup> TEP owns 7.5% of the Navajo Generating Station and 11.7% of Generation in the Four  
Corners/San Juan area.

1 under a cost-based PPA approved by the Commission. This PPA would be  
2 in place until the Commission determines that Market Power is eliminated  
3 through other means (e.g. transmission and/or generation additions, RTO or  
4 other market protocols/ rules, etc.).  
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7 TEP realizes that this solution may require the formation of more than one  
8 generation affiliate or subsidiary. In my initial testimony I mentioned that  
9 this was an option that TEP was considering.  
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12 **III. WHOLESALE COMPETITION.**

13 Q: What did the participants say about competition and the wholesale electric  
14 power market?  
15

16 A: It seems that all of the parties agreed that there must be real competition in the  
17 wholesale electric power market before there can be meaningful retail electric  
18 competition.  
19

20  
21 Q: Did all of the participants agree about the current state of the wholesale electric  
22 power market?  
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24 A: No. There were differing views as to the current functionality and competitiveness  
25 of the wholesale markets; however, most participants agreed that the current state  
26 was not sufficient to support retail competition.  
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Q: Did the participants propose changes to the wholesale electric power market to make it more competitive?

A: Yes, it seems to me that most of the changes addressed how to (a) ensure equal access to transmission; (b) establish market rules and monitoring to mitigate market power; and (c) stimulate wholesale competition through competitive bidding.

Q: Do you support any of the changes to the wholesale electric power market proposed in the initial testimony?

A: Yes, there are several components of various proposals that I can support. For example, I agree with the recommendation of Panda Gila River L.P.'s witness Dr. Craig Roach's a UDC's should be permitted to procure a portfolio of competitive supplies in order to limit its exposure to the price volatility of the "spot markets". I also agree with Commission Staff witness Ms. Erinn Andreasen's recommendation to establish an "Electric Competition Advisory Group" that would address such issues as market power measurement. I support Reliant Resources, Inc.'s witness Mr. Curtis Kebler's recognition of the interrelation between the Track A and Track B proceedings. And, I support Commission Staff witness Mr. Matthew Rowell's statements that (a) the overriding goal of Staff should be to ensure that electric customers receive reliable electric service at just and reasonable rates; (b) the "financial health of the UDC's cannot be forgotten"; and (c)

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that "Staff does not intend for its recommendations to impose undue restrictions on the UDC's", but rather "believes that the UDC's must be afforded a great deal of flexibility in order for them to procure (or produce) power in a just and reasonable manner".

**IV. RECOMMENDATIONS REGARDING ASSET TRANSFER & TIMELINE.**

**Q:** What are TEP's recommendations for moving forward with asset transfer and retail competition?

**A:** I want to join with Mr. Pignatelli and Mr. Glaser to strongly urge the Commission to grant the TEP Request for Variance to ensure that this Track A proceeding, the Track B proceeding and any other proceedings that are necessary to complete a thorough re-evaluation or the Electric Competition Rules are not impeded by the premature divestiture of generation assets and implementation of competitive solicitation.

By granting the TEP Request for Variance, the Commission will help to afford TEP sufficient time to act in compliance with the ultimate divestiture and competitive solicitation requirements ordered by the Commission. This will allow TEP to effect the transfer of its assets, negotiate PPA's and implement the competitive bidding protocols according to the requirements that ultimately result from these proceedings.

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Although I realize that some of these issues will be addressed in the Track B proceeding, it is important to note that the introduction of a competitive solicitation process should be designed such that the utilities are able to create diverse portfolios for their power supply in order to mitigate price volatility which will ultimately be borne by the customers.

Q: Does this conclude your rebuttal testimony?

A: Yes, it does.