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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission
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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 OF COMMENTS OF PANDA GILA RIVER, L.P. ON COMMISSION STAFF'S LIST OF TRACK B ISSUES**

Intervenor Panda Gila River, L.P. hereby provides Notice of Filing the Comments of Panda Gila River, L.P. on Commission Staff's List of Tract B Issues for the above-captioned dockets.

FENNEMORE CRAIG
A PROFESSIONAL CORPORATION
PHOENIX

RESPECTFULLY SUBMITTED this 1st day of July, 2002.

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Comments of Panda Gila River, L.P. on Commission
Staff's List of Track B Issues

1. **What types of competitive solicitation process(es) should be utilized?**

The competitive procurement process should involve a bid-based competitive solicitation and arms length bilateral contracts. The parties will discuss details of the competitive solicitation process at the workshops scheduled for July 24 and 25, but in general, Panda believes that the competitive solicitation should be a Request for Proposals ("RFP") for asset-backed offers to sell under longer-term contracts to provide firm capacity and energy, plus reserves. Other forms of competitive solicitation, such as various forms of auction, increase complexity without adding value to the process.

a. **When should the competitive solicitation process begin?**

As discussed in Panda's list of Track B issues and proposed procedural schedule, Panda believes that the parties and the Commission can fully consider and decide all Track B issues in time for a competitive solicitation to be issued no later than December 2002, which will allow deliveries of power starting in the peak summer season 2003. The "competitive solicitation process," however, includes development of the actual solicitation and the rules governing that solicitation. That process has already begun.

b. **How will the competitive solicitation(s) be disseminated?**

The competitive solicitation(s) will be developed by the parties in this Track B process. The UDCs should hold formal pre-bid meetings with potential bidders to discuss the terms of the solicitation. In addition, the UDCs should disseminate the RFP or notice of auction through usual and customary channels (such as announcements in local and national newspapers, and the trade press) used by the UDCs in other procurement processes. Although this proceeding is somewhat unusual, competitive procurement by utilities throughout the country is not.

c. **What percentage of a utility's power requirements should be obtained through the competitive solicitation process?**

Panda believes the Commission should enforce the Competition Rules as written, requiring utilities to competitively procure 100% of their Standard Offer Service requirements, with at least 50% through competitive solicitation. Such a solicitation will produce responses indicating when the

market can in fact provide for 100% of standard market needs. Panda does not believe there is any need to prejudge how much, or when, the market can deliver. By conducting a solicitation for 100% of needs over an extended period, the UDC, and the Commission, will be able to determine the least cost solution for Standard Offer customers.

d. **Should the percentage of a utility's power requirement obtained through the competitive solicitation process be established at one time or should it be phased-in?**

There may or may not be value in "phasing-in" procurement of a utility's entire requirements through a competitive solicitation process; a prudent procurement strategy will result in a diversified portfolio of power contracts (a) of varying duration and (b) with staggered on-line dates. In fact, in Panda's view staggered on-line dates would give the same result as a phased-in competitive solicitation process. For example, when the initial contracts expire, a new solicitation will be issued. It is conceivable, therefore, that a larger percentage of the initial contracts will be with affiliated generation in the near-term (if predictions that insufficient competitive generation is available, though unproven as of yet, are true), with increasing reliance on competitive suppliers going-forward.

e. **How will the competitive solicitation percentage be calculated?**

If the Commission enforces the Rules as written, there will be no need to calculate a "competitive solicitation percentage." The amount of power actually procured from competitive suppliers will be based on the bids received, scored objectively, and contracts awarded.

f. **Will a utility be subject to penalties if it does not meet the competitive solicitation percentage?**

No. Again, by enforcing the Rules as written, there will be no need for an enforcement mechanism. The Commission should require utilities to competitively procure 100% of their Standard Offer Service requirements, with at least half through competitive solicitation. If the process is administered impartially, a varying percentage of the portfolio will be from competitive suppliers (as opposed to affiliated generation). Panda does not support any deviation from the requirements of the Rules regarding the magnitude of the competitive solicitation.

g. **If a utility exceeds the annual competitive solicitation percentage, will the excess carry over to next year?**

There is no reason to have a carry-over mechanism if the Commission enforces the Rules as written. Utilities are required to procure at least half of their Standard Offer Service requirements through a competitive solicitation, but are free to procure more than half of their requirements through such a solicitation. Choosing to do so should provide no benefit for future years, however.

h. What requirements, if any, should be imposed on the purchase of power that is obtained outside of the competitive solicitation process?

Any such contracts must result from arms-length negotiations. If a utility cannot conduct arms-length negotiations with its affiliates, then the affiliate may not compete for bilateral agreements. Results of this solicitation will serve as a point of comparison for price and non-price terms of the negotiated contracts, but negotiation will allow flexibility in achieving other consumer benefits.

i. What are the time frames for initiating and completing the steps of the competitive solicitation process?

The competitive solicitation process was essentially initiated when the Commission created Track B, as the primary purpose for Track B is to develop rules and standards for competitive procurement, including competitive solicitation. Panda believes that a competitive solicitation may be issued, bids received and scored and contracts executed within six months. Thus a solicitation for delivery beginning summer 2003 should be issued no later than December 2002.

j. Who will determine the components of each utility's portfolio of competitively solicited purchases?

The UDCs must assemble a portfolio of competitively procured Standard Offer Service resources. The UDCs must work closely with an independent evaluator and Commission Staff to assure the application of the objective criteria developed in Track B. The UDCs should not be given authority to subjectively choose resources, which would allow preference for utility affiliates. Ultimately, because the UDCs will be regulated by the Commission, the Commission would have to approve pass-through of any contract costs to Standard Offer Service customers.

k. What are the criteria and process for determining which offer(s) in response to competitive solicitations should be selected by a utility?

Through Track B, the utilities and other interested parties will develop objective criteria for scoring bids and negotiating contracts. These criteria must include all price and non-price terms of the bids that affect ratepayers, including, but not limited to, capacity and energy prices, risk protection, reliability guarantees, contract terms, operating characteristics, enforceability provisions, fuel availability, transmission access , and creditworthiness. The scoring of bids should not include truly subjective criteria, such as alleged "unit commitment" to Arizona, on behalf of the affiliates of the UDCs. The bids should be scored by an independent third-party evaluator, who will present a short list of winners to the UDC, who will then negotiate the contracts with the winning bidders.

l. What mechanism will be in place for dispute resolutions related to competitive solicitations?

The competitive solicitation process should be administered by an independent evaluator, who should be the first recourse for aggrieved parties to appeal. In addition, Commission Staff should be available to mediate disputes, with the opportunity provided ultimately to petition the Commission for relief. If the process is fairly administered by a neutral third-party, such disputes should be minimized.

m. What protections will be in place to maintain the confidentiality of utility and participant information?

All parties participating in the competitive solicitation should sign a standard confidentiality agreement, which would limit access to confidential information to utility personnel (not the utility's affiliates), the independent evaluator and Commission Staff only. These agreements are standard procedure in utility procurement processes nationwide, and should be non-controversial.

n. In the event that a supplier of power defaults on the obligation to provide the power, how will replacement energy be obtained?

Replacement power would be obtained pursuant to the power supply agreement between the utility and the winning bidder. Replacement power provisions and the enforceability of such provisions should be one of the non-price terms scored in the solicitation process.

o. How should the competitive solicitation process factor alternative delivery and transmission points?

As discussed above, the scoring of bids should account for transmission access, including an assessment of transmission constraints and delivery via alternative transmission paths. All other things being equal, a bid that includes multiple delivery points or delivery over unconstrained transmission paths should be scored higher than a similar bid subject to transmission constraints and without transmission alternatives.

p. Will the competitive solicitation process utilize the "Western Systems Power Pool umbrella agreement" or similar agreements?

Panda generally supports the use of standard contracts where feasible, required for reliability purposes, and where agreed to by the parties, in order to expedite delivery under the initial agreements. The WSPP umbrella agreement is one such standard contract, and should be discussed by the parties along with other standard contracts.

q. What are the appropriate contract duration periods?

As testified to by Panda witness Dr. Roach in the Track A hearing, an optimal portfolio would include a mix of contracts with 5, 10 and 15-year terms. It may be appropriate to include some shorter contracts in the initial solicitation to allow additional generators to come on-line, but most contracts should remain long-term.

r. What are the appropriate delivery dates?

As with contract terms, delivery dates should be staggered to accommodate generators who are not yet on-line in January 2003. The initial contracts should commence no later than summer 2003.

s. Will demand-side management options be allowed to compete?

Demand-side options, which target reduced demand rather than increased supply, should be considered in developing the UDCs' requirements. It is unclear, how a demand-side option could "compete" in an RFP or auction process. Conceptually, demand side options, if sufficiently certain, could be used to meet peaking capacity requirements. As noted above, the available demand side options can be most readily determined through the competitive solicitation process. Demand side options also could be considered as a possibility for meeting the non-competitively bid portion of the competitive procurement process so long as the arrangements are sufficiently transparent to allow oversight.

t. Will the costs for local transmission upgrades for proposed projects be directly assigned to each bid or included as general transmission costs?

Transmission upgrades and cost responsibility will continue to be governed by the utilities' open access transmission tariffs ("OATT") and FERC pricing policy. If direct assignment of upgrade costs is appropriate under FERC policy, such costs should be included in the bid price. If, on the other hand, the cost of the transmission upgrade should be rolled-in to the transmission provider's cost of service, the bid should not include the costs of the upgrade, even in an imputed amount. This is an area where vertical market power and affiliate abuse issues must be closely monitored to ensure that cost responsibility for transmission upgrades is consistently treated and that affiliate generating facilities are not unfairly advantaged.

u. Will there be a price ceiling for bids?

No. However, as is common practice, the solicitation will allow for the rejection of all submitted bids. If only extreme prices are offered, all bids should be rejected. It is unlikely that this will occur given that Arizona will be a buyer's market; projections for capacity in Arizona are expected to exceed peak load in the future.

v. Will there be a maximum limit on the number of MW bid by an entity?

No. If the bidding process is objective and fairly administered by a neutral third-party (rather than by the UDC itself), there should be no need for bid caps. A fair process should, judging by recent solicitations in other states, result in far more MW bid than required, which will prevent above-market prices. If the Commission has evidence that bidders are colluding to increase bid prices, it, and possibly other state and federal agencies may take action under existing laws and regulations. The competitive market itself will act as a check on any exercises of market power and market manipulation.

w. How will the competitive solicitation process be evaluated for future improvements?

The competitive solicitation process will be ongoing, as the UDCs will assemble a portfolio of contracts of varying delivery dates and terms. Staff and the independent evaluator should remain involved, monitoring the process for signs that additional modifications are necessary. Furthermore, because the Commission will continue to regulate the UDCs, aggrieved parties may petition the Commission for changes to the rules or processes. Most importantly, all parties should see what works (i.e., what gets the best deal for consumers and request to make changes to the process to better serve this overarching goal in the future).

x. **Will the utilization of this process(es) develop an optimal portfolio resulting in the best price.**

Yes. As Panda witness Dr. Roach testified, the competitive market will result in the best combination of price and non-price terms and conditions, enforceability and risk management provisions. The competitive solicitation will act as a test for affiliate contracts, to ensure that the utilities and their affiliates do not harm ratepayers through sweetheart, self-dealing, above-market deals.

2. **What types of products will be subject to competitive solicitation?**

The focus should be on asset-backed offers to sell under longer-term contracts to provide firm capacity and energy, plus reserves. A portfolio of assets may be used and the form of the offer should allow for risk mitigation products such as call options.

a. **Will the competitive solicitation process include financial and physical options?**

Again, the preference is for asset-backed (i.e. physical) offers to sell firm capacity and energy, plus reserves. The full range of options should be considered to the extent they meet this standard. While markets involving such products may develop over time in Arizona and the broader WestConnect area, the initial solicitation should not include such options.

b. **Will the competitive solicitation percentage include standard block purchases through a broker or power pool?**

No. We see these as issues for the short-term market to be developed at a later date.

c. **How will power produced by "must-run" generators be considered in the competitive solicitation process?**

We presume this is asked in the context of a load pocket. For any power plant that may be called to serve a load pocket, the bid must include (a) the stated right of the UDC to call on that unit for such service and (b) the compensation for that right. As with all bids, the best offer will be accepted; with staggered on-line dates for the contracts, sufficient terms will be given for new plants to be built in load pockets, if appropriate.

d. **Should the competitive solicitation percentage consist of block energy purchases, purchases shaped like the utility's load, or a combination thereof?**

Panda prefers that asset-backed offers include the right to full or partial dispatchability so the UDC may shape purchases to load in real-time.

e. **What are the characteristics of the power to be bid (peak/off-peak, energy/capacity, etc.)?**

Firm capacity and energy will be solicited to assure reliable service to the UDCs' Standard Offers customers. It is expected that the capacity will be fully or partially dispatchable and, therefore, the offered energy price will dictate whether the plant is run in all-hours or only at-peak. Bidders should be free to offer peak-only power, or to limit their offers in other ways.

3. **What transmission constraints have been identified or anticipated by the utilities that will affect delivery of competitively procured power?**

Staff has identified a number of existing or potential transmission constraints that could affect delivery of power by any seller into identified load pockets. Panda witness Dr. Roach discussed delivery of power into the "Valley constrained area" in his testimony in Track A.

a. **To what extent would transmission constraints affect delivery of competitively procured power?**

Most parties, including Panda, recognize that some degree of load pocket conditions exist during limited periods of the year. Therefore, transmission constraints and alternative delivery paths should be one factor considered by the independent evaluator. However, the presence of constraints in the near-term should not, standing alone, disqualify a given bid. Consideration should be given to a bidder who has secured the necessary transmission rights to ensure firm delivery of its power and to bidders that have available to it alternative paths for delivery.

b. **How and when could the constraints be resolved?**

Constraints will be addressed in large part by designating winning generators as "Network Resources" under the transmission provider's transmission tariff. These resources could then displace existing network resources, even if no transmission capacity appears to be available. APS Witness Cary Deise testified in the Track A proceeding that there would not be upgrades necessary under such circumstances. Any generators upgrades that are necessary for interconnection would be undertaken pursuant to the final order issued in the FERC Interconnection NOPR. Remaining constraints will be addressed through existing planning and upgrade mechanisms, first by the utilities and later by an operational RTO.

Generators who otherwise face constrained transmission paths may be willing to help fund the necessary upgrades. This competitive solicitation process should not be limited to generators. Merchant transmission projects should also be allowed to bid-in to alleviate identified constraints. The Commission should, however, continue to study transmission constraints on the state's system, and require transmission providers to construct needed improvements to the transmission system. (Panda acknowledges that it is not likely to be cost-effective to remove all such constraints).

c. **How will constraints be reflected in bid evaluation?**

As discussed above, constraints should be one factor considered by the independent third-party evaluator, but not necessarily the most important one, as methods exist for managing congestion, and future RTO(s) will offer additional congestion management options, such as freely tradable transmission rights.

4. **What issues will affect the participants to the competitive solicitation process?**

Competitive sellers will only participate, and the competitive solicitation will only succeed, if the process is developed by all interested stakeholders and implemented through an impartial, transparent process supervised by an independent third party evaluator. Thus, all "issues" affecting participants come down to whether all participants can participate in developing the solicitation, whether all bidders are treated equally in submitting and evaluating bids, and whether the process is managed by an independent party to ensure no participant is favored over any other.

a. **How will potential suppliers become qualified participants in the competitive solicitation process?**

The competitive solicitation process should include pre-bid meetings between potential bidders and the UDCs, and transparent and objective creditworthiness standards. A pre-qualification process is not needed, the bid evaluation itself will weed out unqualified bidders.

b. **Will potential suppliers be required to obtain authorization from the Commission?**

No, formal Commission approval is not necessary. Again, the bid evaluation itself will weed out unqualified bidders.

c. **Will potential suppliers be required to submit proposal fees or bonds?**

Panda anticipates that bidders will pay reasonable proposal fees, and that the creditworthiness standards may require bonds in certain circumstances.

d. How will utility affiliates be treated in the competitive solicitation process?

Utility affiliates should be treated like any other bidder in the solicitation process. The Commission should enforce the strict functional separation between UDC personnel and affiliate personnel using the Codes of Conduct approved in Track A. In addition, the independent third-party evaluator should have primary responsibility for issuing, administering and scoring the solicitation, to prevent any potential affiliate abuse. For the non-bid (but competitively procured) Standard Offer Service requirements, utility affiliates should only be permitted to participate if the utility and the affiliate prove that arms-length negotiations are possible and have occurred. The testimony in the Track A hearing of APS witness Jack Davis clearly indicates that it is unlikely arms-length negotiations can occur between APS and its affiliates. It is critical that the Commission enforce strict functional separation to prevent affiliate abuse. The Commission should not permit utilities and their affiliates to negotiate "non-arms length", sweetheart, above-market, self-dealing contracts like the proposed APS/PWCC PPA.

e. How will utility-owned generating units be treated in the competitive solicitation process?

If the competitive solicitation process is properly designed and fairly administered, it will mitigate market power concerns and allow utilities to transfer their generation assets to one or more affiliates. Consequently, there will be no utility-owned units. As already noted, affiliate-owned units should be treated the same as any other generator in the bid process.

f. Will the Commission keep a list of qualified suppliers?

As discussed above, prior Commission approval of suppliers is unnecessary. Therefore, keeping a list of approved suppliers is likewise unnecessary. The Commission could, however, keep a list of disqualified suppliers if the Commission finds, after notice and an opportunity to be heard, that the supplier intentionally violated the Commission's bidding rules.

5. How will the cost of procured power be recovered by the utility?

Costs of prudent competitive purchases will be passed through to Standard Offer Service customers under rates approved by the Commission. This rate could include a purchase power or fuel adjustment clause, although certain forms of competitive contracts (i.e. with fixed or fixed formula rates) will make automatic adjustment clauses less necessary.

a. **What will be the scope, terms, and effect of a utility's purchase power adjustment clause?**

The prudence of purchases will be established through competitive procurement. In this sense, purchase costs can be expected to be passed-through the fuel adjustment clause routinely. However, the UDC's prudence in administering its portfolio of contracts should be subject to periodic audit and review (e.g. if the UDC is economically dispatching the resources).

6. **If a competitive bid process is adopted, will least-cost planning be used for the evaluation of all competitive bids?**

The competitive bid process will result in contracts that provide the greatest benefit at the least cost. In this sense, the results may approximate the results from traditional "least cost planning," although the methodology will be different.

a. **If not, how will the bids be evaluated?**

Bids will be evaluated with the goal of getting the best deal for ratepayers in terms of low price, low risk, and high reliability. In this sense, the bid process is "least cost-planning." However, instead of comparing hypothetical alternatives, the RFP will assess real-world alternatives backed by businesses' commitments.

b. **Will a least-cost planning framework be used to evaluate the benefits of more transmission given the location of existing and planned generating units?**

Yes. The bid process will consider fully the transmission costs of new and planned generation.

7. **How will the potential for the exercise of market power be assessed for competitive bids, in order to determine whether or not the bids are reasonably competitive?**

As Panda witness Dr. Roach testified in Track A, the competitive bid process will itself mitigate market power. The UDC will retain the right to reject any and all

bids, which will eliminate the ability of sellers to exercise market power by submitting above-market bids.

a. If there are not enough competitive bids, will there be a re-bid?

Yes. The right to reject all bids is maintained. However, recent experience in the states of Colorado, Virginia and New Jersey demonstrates that it is far more likely that a UDC will receive more MW bid than needed, rather than vice-versa. Therefore, Panda does not believe that a re-bid will be either necessary or appropriate. If the independent third-party evaluator determines that one or more parties acted in "bad faith", then Panda does agree that a re-bid would be appropriate if approved by the Commission. The avowed interest of multiple generators and the presence of affiliate-owned generation make it highly unlikely that a re-bid will be required due to an insufficient number of bids.

b. Will the utilities be obligated to calculate a price baseline derived from a least-cost plan consisting of self-built generation at regulated prices in order to determine if the "competitive" bids are likely to save ratepayers money?

No. The bid (or bids) from affiliates is the self-build option. That is, there is no need to calculate a hypothetical baseline price. The UDC's affiliate can submit a bid, which is the self-build option; and if it wins, the UDC's affiliate will be held to its bid, like any other non-affiliated generator. As discussed above, a proper competitive solicitation mitigates market power and permits the functional separation of generation and UDC functions. Competitive solicitation will result in lower prices, less risk and better non-price terms than traditional cost-plus regulation, and studies to describe a self-build "backstop" would be an unnecessary waste of resources.

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