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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission  
**DOCKETED**

MAR 22 2012

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IN THE MATTER OF THE APPLICATION OF )  
 ARIZONA PUBLIC SERVICE COMPANY FOR ) DOCKET NO. E-01345A-10-0474  
 AUTHORIZATION FOR THE PURCHASE OF )  
 GENERATING ASSETS FROM SOUTHERN ) **ARIZONA COMPETITIVE POWER**  
 CALIFORNIA EDISON AND FOR AN ) **ALLIANCE'S EXCEPTIONS TO**  
 ACCOUNTING ORDER. ) **RECOMMENDED OPINION AND**  
 ) **ORDER.**

I.

INTRODUCTION

The ROO concludes that APS has satisfied the requirements of the "self-build" moratorium and the Commission's Best Management Practices for Procurement ("Best Practices"), and thus is not obligated to conduct an RFP. While the Alliance disagrees with this conclusion, the Alliance recognizes that even if the parties were to stipulate that both the "self-build" moratorium and the Best Practices RFP requirement applied to the transaction, the Commission has the authority to waive these requirements. The question is...why would the Commission want to waive the two requirements that the Commission itself established in order to protect the public?

The Commission has three options:

- The Commission can grant APS' request for an exemption from the RFP requirement, and authorize it to proceed in its negotiations with SCE to purchase SCE's ownership interest in Four Corners Units 4 and 5 without an RFP;

- The Commission can require APS to conduct an RFP and then--once the facts are all in—it can decide whether or not to authorize it to proceed with said negotiations;
- The Commission can decide that it doesn't think it's a good idea for APS to acquire a 750 MW Coal plant and reject APS' request.

Most of the hearing covered legal issues so the economics of the transaction are still in dispute. Evidence presented in the hearing indicated that the cost of the Four Corners coal plant itself exceeded the cost of comparable gas plant capacity. However, APS argues that coal is a much cheaper fuel than natural gas and the total cost of the Four Corners plant will be cheaper over its remaining life than a comparable natural gas plant. In order to reach this conclusion, APS has to make certain assumptions concerning the future price of natural gas as well as the future economic costs associated with coal. In the absence of an RFP, these assumptions are just that--assumptions, and not evidence.

In addition to legal and economic factors, the Commission will need to examine social factors in order to reach its decision. What will be the effect on the Hopi and Navajo Tribes if the Commission rejects the transaction outright? Will the plant close, or will it be purchased by other investors? What are the externality costs that are associated with coal, but are not imbedded in Coal's economic cost? These are policy questions that can't be answered by legal analysis, or even with an RFP.

The Commission will want to weigh legal, economic and social factors when it decides to approve or reject this purchase. The ROO concludes that the Commission has the authority to approve APS' request and forego the conduct of an RFP. The Alliance believes that in the absence of an RFP, the Commissioners do not have enough information to conduct a full economic analysis. The Alliance also believes that the social costs of the transaction will be difficult to quantify and—even with an RFP—each individual Commissioner ultimately will have to balance the social cost with the potential social benefits and come to an individual conclusion.

The Alliance believes that the most balanced solution is to require APS to conduct an RFP in order to provide the Commissioners with the economic information they will need in order to analyze the transaction. The Commissioners will then have to use their own individual standards and judgment to weigh the social costs and benefits.

In the alternative, the Commission could decide that, even if the coal plant were to win the RFP, that the risks of future environmental costs as well as the social costs associated with coal outweigh the possible economic advantage that the coal plant may provide.

Naturally, the Commission has the legal right to waive the Self Build Moratorium and the Best Practices requirement for an RFP and allow APS to purchase SCE's ownership interest in Four Corners Units 4 and 5. However, the Alliance believes that the Commission would be depriving itself of the tools that it needs in order to properly analyze the transaction.

The Alliance's arguments in that regard are further developed in the Memorandum of Points and Authorities set forth in Sections II and III below.

## II.

### **THE EVIDENTIARY RECORD DOES NOT CONTAIN SUFFICIENT INFORMATION TO ALLOW THE COMMISSION TO MAKE AN INFORMED DECISION AS TO WHETHER OR NOT IT WOULD BE IN THE PUBLIC INTEREST TO AUTHORIZE APS TO PROCEED WITH THE PROPOSED TRANSACTION WITH SCE.**

A substantial portion of the hearing time was spent on legal issues. Generally stated, it is the legal position of the Alliance that APS should not be granted an exemption from the "self build" moratorium and the RFP required by both the Best Practices and the Regulations at this time, because (i) APS has not adequately tested the competitive wholesale market and (ii) the SCE Four Corners purchase isn't a "genuine, unanticipated opportunity" which would warrant an

exception to the RFP requirement in this instance. Conversely, APS and several other parties contend that APS has satisfied the applicable requirements for an exception or exemption.

Setting aside the aforesaid legal argument(s) for discussion purposes, it is further the position of the Alliance that the instant proceeding should be “stayed” so that APS can conduct an actual RFP. APS characterizes this position as being overly concerned about “process.” However, the Alliance isn’t arguing for an RFP as a mere legal technicality. Rather, the Alliance believes that the current process - including hundreds of pages of testimony, a dozen witnesses and six (6) days of hearings - doesn’t answer the fundamental question: Should APS be allowed to consummate the proposed transaction with SCE? Ultimately, this is the question that the Commissioners will have to answer... unfortunately, much of the testimony serves to cloud the issue.<sup>1</sup> APS witness Judah Rose argued that the current transaction is a “once in a lifetime deal” and is comparable to buying a billion dollar asset for \$294 million. Yet the other non-SCE owners in Units 4 and 5 did not invoke their right of first refusal. Mr. Rose conjectures that the other owners did not exercise that right because of regulatory hardships such as tribal sovereignty, multiple owners and dealing with various regulatory commissions. In essence, he contends that they are leaving a \$700 million economic opportunity on the table because of regulatory inconveniences. Such an assertion strains credulity.

APS is concerned that if the transaction with SCE doesn’t go through, Units 4 and 5 will close. Yet if the deal is as good as APS says - once in a lifetime, cents on the dollar, cheaper than any gas plant has ever been sold - it would appear reasonable for the Commission to consider the possibility, and perhaps likelihood, that Warren Buffett, Boone Pickens, KKR or some other group of knowledgeable investors would swoop in and buy the plant if APS does not. In essence, APS is asking the Commissioners to believe that the purchase has tremendous economic benefit, but that sophisticated parties such as the other plant owners and Wall Street’s legendary investors would be unwilling to buy the plant in its entirety or at least SCE’s interest

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<sup>1</sup> In that regard, see testimony of Alliance witness Patterson at Tr. 952, l. 12 – Tr. 955, l. 9.

in Units 4 and 5.<sup>2</sup> So, is the proposed purchase a good deal or not? Without an RFP, which actually tests the market, the Commissioners won't know.

Meanwhile, APS estimates that an existing combined cycle replacement for Units 4 and 5 will cost around \$750 per KW. Is that a good price? And, does it actually reflect the current competitive market? Mr. Rose thinks that price cannot match or better the per kW value of the proposed transaction with SCE. However, the Entegra plant recently sold for about \$400 per kW for 500 MW-550 MW of capacity. That's a recent transaction from a local combined cycle plant, close to the Palo Verde Hub, with plenty of access to the Phoenix market...for about half of APS' derived "proxy" price. Is that a comparable transaction? Without an RFP, the Commissioners won't know. The Entegra gas plant and Units 4 and 5 can both be used as baseload plants. They can both get to market, and they have similar capacity. However, that's where the similarity ends.

APS argues that buying a gas plant would cause APS to be overexposed to natural gas price volatility. Conversely, the Alliance and the Sierra club believe that buying SCE's interest in the coal plant would cause APS to be overexposed to the risk of increased coal emission regulation and associated costs. How do these marginal economic factors affect the overall price of the capacity APS seeks to acquire? Without an RFP, the Commissioners won't know. Assuming that the Entegra deal is comparable to the proposed transaction with SCE, are there other plants available at a lower per kW cost? And, would some bidders offer PPAs that could mimic the output of Units 4 and 5 or Units 1-5 of the Four Corners Plant? Would gas plant owners provide tolling arrangements that mitigate gas volatility risk? While it's certain that the gas plant bids will eliminate the environmental risks associated with coal, will someone bid a package that provides baseload capacity using existing transmission, while mitigating gas volatility? And would that bid be at a price that the Commissioners find attractive? Without an RFP, the Commissioners won't know.

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<sup>2</sup> As Alliance witness Patterson noted, in so doing, APS is trying "to have it both ways." Tr. 960, l. 17-22.

To be sure, there are some questions that even an RFP can't answer. After all, the Commissioners will have to assess non-economic factors such as the value to the Navajo community of keeping Units 4 and 5 open compared to the value to the environment of closing them - but without an RFP, the Commissioners will have no meaningful information base from which to begin their evaluation of non-economic factors. To date, the hearing has focused in large measure on the aforesaid legal arguments because in the absence of an RFP, that's all we can do. RFP responses - not expert witnesses - will provide the information that the Commissioners require in order to make an informed decision on APS' Application.<sup>3</sup>

As Alliance witness Patterson observed, in summarizing the benefits that a properly structured and serious RFP could provide the Commission in connection with a final decision in the instant proceeding:

“The Commission needs to have enough information with which to make a decision; and therefore, if the Commission is open to alternatives, then the Commission is going to want to know what the economic factors are of those alternatives. Then once it has that, it's going to take its noneconomic factors, such as Tribal economic development or the future costs of coal, and it's going to weigh them in.

But we believe that the Commission should have a real economic proposal in front of them instead of simply debating experts who say what Mr. Rose says or what other people say.” Tr. 963, l. 13-24<sup>4</sup>

In that regard, he further testified that a properly conducted RFP would enable both APS and the Commission to determine “fairly quickly” or within six months

“ . . . whether this transaction should proceed or whether it should be a gas plant.” Tr. 968, l. 2 – Tr. 969, l. 24. Also, see Tr. 976, l. 9 – Tr. 977, l. 3; and, Tr. 997, l. 14 – Tr. 998, l. 11 in this regard.

Finally, he noted that

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<sup>3</sup> In this regard, see testimony of Alliance witness Patterson at Tr. 955, l. 22 – Tr. 963, l. 24. Also, see his testimony at Tr. 974, l. 20 – Tr. 975, l. 8; Tr. 985, l. 6 – Tr. 993, l. 17; Tr. 997, l. 5-13; and, Tr. 1005, l. 11 – Tr. 1008, l. 7.

<sup>4</sup> Mr. Patterson's involvement with electric utility industry power issues for 20 years, coupled with his previous service as (i) a member of the Arizona Legislature for four (4) years, (ii) Director of RUCO for five (5) years, (iii) Chief of Staff in the Arizona Senate for two (2) years, and (iv) Executive Director of the Alliance for ten (10) years, provides him with a uniquely qualified background as a witness in the instant proceeding to comment upon such issues from a public policy and public interest perspective. In this regard, see Tr. 971, l. 22 – Tr. 972, l. 24. Also, see Tr. 973, l. 14-19.

“. . . the RFPs that APS has [i.e. usually conducts] are much broader than the Alliance membership.” Tr. 975, l. 16-17.

Thus, both APS and the Commission would be in a position to determine what the response of the entire competitive wholesale market was to the RFP which the Alliance believes should be conducted in connection with the instant proceeding, and not just response(s) received from members of the Alliance.

### III.

#### **THE CONDUCT OF AN RFP OR OTHER FORM OF COMPETITIVE SOLICITATION AT THIS TIME WOULD APPEAR TO BE BENEFICIAL FOR APS IN CONNECTION WITH A FUTURE PRUDENCY DETERMINATION BY THE COMMISSION**

The Alliance believes that the Commission should base all prudence determinations on information that was available to the parties at the time of the transaction - not on information that comes to light, or economic events that occur, between the time of the purchase and the subsequent determination of prudence. When parties - or Commissioners - believe that a transaction may risk being imprudent, they have the responsibility to raise that concern while the utility is contemplating the transaction. That time is now and the Alliance is raising that concern. APS' purchase of SCE's interest in Units 4 and 5 at Four Corners entails risk and could have unfortunate results for APS ratepayers absent an RFP, unless the Commission properly conditions any decision authorizing APS to proceed with the transaction.

#### **A. APS SHAREHOLDERS SHOULD BEAR THE RISK OF INCREMENTAL COAL-RELATED ENVIRONMENTAL COSTS THAT APS HAS REFUSED TO QUANTIFY OR ACKNOWLEDGE.**

While APS is factoring in the costs of currently known environmental costs of approximately \$300 million, the company has made no provision for the cost of as yet unquantified future regulation. While much of the future cost of coal regulation is unquantifiable, it is by no means unforeseeable. Congress may be less likely to impose a carbon tax than it was a few years ago, however, the Environmental Protection Agency ("EPA") - with

the full backing of the United States Supreme Court - has the ability to impose substantial additional carbon costs even in the absence of additional legislation. The EPA is currently using that power to the fullest extent possible.<sup>5</sup> If APS insists on going ahead with this transaction and continues to refuse to test the market through an RFP process, then the Commission should consider requiring that any environmental costs over and above those which have been disclosed in its Application should be borne by APS shareholders, not ratepayers - and the Commission should make this fact clear in any order that authorizes APS to proceed with the transaction.

**B. IF NATURAL GAS PRICES REMAIN LOWER THAN APS' PROJECTIONS, THEN APS' SHAREHOLDERS SHOULD BEAR THE DIFFERENCE BETWEEN THE VALUE OF GAS PLANTS AT THE LOWER PRICE AND THE COST OF SCE'S INTEREST IN THE FOUR CORNERS PLANT.**

In order to make its case that the Four Corners purchase is economically advantageous when compared to capacity from a natural gas fired plant, APS has projected substantial increases in gas prices. These price increases may indeed occur. However, if APS does not conduct an RFP, then the Commissioners will never know if a seller was willing or able to provide an alternative that would have mitigated these potential price increases. In the absence of an RFP, the Commission may wish to consider requiring that it should be APS shareholders that bear the risk that APS' assumptions are wrong. If natural gas prices are lower - or even less volatile - than those presented in the APS testimony, and absent an RFP, then the Commissioners could deem the excess price paid for the Four Corners plant to be imprudent.

**D. THE RFP REQUIREMENT IN THE BEST PRACTICES AND REGULATIONS PROVIDE A SAFE HARBOR TO ENSURE THAT THE COMMISSIONERS WILL MAKE THEIR ULTIMATE PRUDENCE DETERMINATION ON INFORMATION THAT WAS AVAILABLE AT THE TIME OF THE**

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<sup>5</sup> In that regard, it should not be assumed that President Obama's recent communication to the EPA directing it to suspend the previously contemplated promulgation of additional air quality regulations forever removes the prospect of such regulations and related costs for coal-fired generation.

**TRANSACTION, NOT AT THE TIME OF THE SUBSEQUENT PRUDENCE  
HEARING.**

The Best Practices and Regulations - with their RFP, independent monitor and bidder protections - provide enough information that the Commissioners can be sure that the company and parties had access to all commercially available information at the time of the transaction. If the Best Practices and Regulations are followed, and an appropriate RFP is conducted, then the Commission can project its confidence in the transaction vis-à-vis the ultimate prudence determination by providing an accounting order strong enough and strict enough to convince APS' auditors and the financial community that the regulatory asset is indeed worthy of capitalization. Further, if APS conducts an RFP, and the proposed transaction with SCE is shown to be superior, then the Commission should consider being willing to approve the purchase, write the accounting order and ultimately deem the asset to be prudently acquired and reflected in rates.

**IV.**

**CONCLUSION**

The Alliance believes that the evidentiary record in the instant proceeding currently does not contain sufficient information to allow the Commission to reach a well-informed decision as to whether or not APS should be authorized to consummate the proposed transaction with SCE. In that regard, the Alliance believes that this informational deficit could be remedied by the Commission issuing an appropriate<sup>6</sup> order or decision directing APS to promptly and properly conduct an RFP for offers from the competitive wholesale market for base load generating capacity approximately equivalent to that APS is proposing to acquire from SCE. The response(s) to such an RFP, or lack thereof, would provide the Commission with that information necessary to reach a well-informed and final decision on APS' Application.<sup>7</sup>

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<sup>6</sup> As Alliance witness Patterson observed, the range of orders and decisions available to the Commission (and Hearing Division) in this instance includes the issuance of a preliminary order directing APS to conduct an RFP prior to the issuance of either a Recommended Opinion and Order by CALJ Farmer or a final decision by the Commission. Tr. 997, l. 14 – Tr. 998, l. 11 (Patterson).

<sup>7</sup> In that regard, APS witness Guldner acknowledged during cross-examination that APS' contractual arrangement with SCE does not automatically terminate if the proposed transaction does not close by either October 2012 or December 2012. Tr. 873, l. 5 – Tr. 874, l. 16 (Guldner). Also, see Exhibit APS-16, Item Nos. 19 and 20 in this

Alternatively, in the event that the Commission should determine to issue a decision authorizing APS to proceed with consummation of the transaction with SCE, the Commission may wish to consider incorporating as conditions some of the considerations discussed in Section III above.

Dated this 22<sup>nd</sup> day of March 2012.

Respectfully submitted,



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Original and thirteen (13) copies of the foregoing will be filed on the 22<sup>nd</sup> day of March 2012 with:

Docket Control Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

A copy of the same will be served by e-mail or First class mail that same date on:

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regard. Further, while either APS or SCE could terminate the agreement any time after January 1, 2013, Mr. Guldner agreed that

“ . . . the then surrounding circumstances would be very pertinent to whether or not either party was inclined to exercise their right to terminate the contract.” Tr. 874, l. 17 – Tr. 875, l. 19.

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