

**ARIZONA CORPORATION COMMISSION  
MEETING MINUTES**

DATE: July 13, 2007

TIME: 10:00 a.m.—12:30 p.m.

PLACE: Carnegie Center, Main Floor. 1101 West Washington Street, Phoenix  
Arizona 85007

ATTENDANCE: See list of attendees in Attachment 1. No quorum of Commissioners.

TOPIC: RESOURCE PLANNING WORKSHOPS—Competitive Procurement Workshop  
No. 3

**MATTERS DISCUSSED:**

Ernest Johnson, the Director of the Utilities Division, welcomed everyone and introduced Staff that was in attendance, including Bing Young, Barbara Keene, Jerry Anderson, and Kevin Torrey.

As a preliminary matter, Mr. Johnson noted that the Commission’s Hearing Division had opened a docket regarding the Commission’s decision to review a portion of the Settlement Agreement from APS’ 2005 rate case. The July 10, 2007 Procedural Order states in part: “Please open a new Docket under the Arizona Public Service Company, as directed by Decision No. 69663, dated June 28, 2007, pertaining to the Hearing Division conducting a proceeding pursuant to ARS Section 4252, to consider modifying Decision Number 67744 relating to the self-build option.”

Mr. Johnson indicated that after today, Staff would begin to draft a Staff Report. That report would then be made available to the parties, who could comment on the report and propose any revisions. He stated that it was his inclination to have a Staff Report that recommends that there be a third party monitor to participate in solicitations. Mr. Johnson then asked if there were any comments about when it did not make sense to have a third party monitor.

Dick Kurtz from the Arizona Electric Power Cooperative (“AEPCO”) stated that AEPCO already had the RUS (Rural Utility Services) as a third party monitor, so they should not be subject to the third party monitor process. The second point was that short-term resource solicitations should be exempt.

Leland Snook of Tucson Electric Power (TEP) said that TEP has used third party monitors from time to time; for example, the renewables RFP that is being administered now has a third party monitor. He also indicated that when they have not been a bidder themselves, they have not used a third party monitor. Since the Track B process was complete, they have been going to the market for their needs, and they believe that using a third party monitor adds an unnecessarily

second layer of work. The third party monitors they have used, though, have worked out well and the processes have gone smoothly.

Pat Dinkel of Arizona Public Service (APS) stated that in their short-term hedging plans, APS has not been using a monitor since Track B. For a renewables RFP, APS is using an independent monitor, similar to TEP. Using an independent *evaluator*, though, adds unnecessary costs to the process. In situations such as the renewables RFP, the independent monitor should be privy to all the confidential information.

Mr. Johnson asked Mr. Dinkel what the distinction was between an independent *monitor* and an independent *evaluator*. Mr. Dinkel said he saw a distinction in roles played by an independent party in three different situations: an independent *monitor*, an independent *evaluator*, and an *auditor*. An *auditor* is a person who comes in after the fact and looks through papers and processes and talks to people, and then states whether he believes the utility had done things right. For the most part, an auditor's work is after the fact. The *monitor* tends to be a person who is there, shadowing the utility throughout the whole process. The *evaluator*, on the other hand, is a person who can do all of the analysis, may have an on-site office, and may try to replicate all of the analysis the utility performs. Mr. Dinkel said that in their renewables process, they have tried to create a situation that is the best of all those worlds. The monitor is involved during the process, but APS doesn't believe the evaluation process is that cost-effective for use of an evaluator. They don't believe that evaluators are necessary if there are established protocols set up. And while APS is using a monitor for the renewables RFP, they have not used a monitor in the six solicitations that have occurred since Track B. They see no additional value to having a monitor.

Amanda Ormond of the Ormond Group stated that she believed it was important that a utility use a monitor when they were bidding, or would potentially bid into their own RFP. But a big question is what authority does the monitor have? If the monitor is hired by the Company and gives into the Company on all issues, it doesn't really do much. If the monitor is hired by or reports to the ACC, then the Corporation Commission is in the loop, and the Commission knows that they have a recommendation, then this makes more sense. Even though costs are an issue, a big question for renewables is what is the benchmark price used? How are they projecting gas price costs, for example? But from her viewpoint, the value of having an outside evaluator is that you need an outside person who can double check the financial assumptions used for the benchmarks. What they are really looking for is a person who can delve into the financials and do the number crunching.

Mr. Young then asked for clarification as to how parties were using the terms "monitor" and "evaluator", and noted that in Track B, the language required a "monitor". However, several states which have adopted rules for resource solicitations use the word "evaluator" instead. Mr. Young wanted to know if, in the Track B process, the "monitor" APS used served more as a "monitor" as Mr. Dinkel described, or as an "evaluator". Did APS want any future "monitors" to have the same role as they did in Track B, or did they view that role differently for the future. Mr. Dinkel indicated that the monitor in Track "B" did in fact serve as a "monitor" as he uses the term. The monitor saw how APS performed the analysis—they just didn't do it themselves. Mr.

Dinkel stated that the monitors were in touch with them every day and were constantly observing what was going on, and that is the role that the monitor plays in the renewables RFP.

Mr. Dinkel said there were two questions in the process here. The first is the evaluation. If you really want someone to get into the numbers and perform the analysis independent of the company, you are talking about an evaluator. Track B used a consultant that was more analogous to a monitor. The other dimension of this is the frequency of the feedback and interaction. While the monitors are kept in the loop regularly, they don't have space in the utility offices and are not physically present. It all has to do with the level of rigor with which you expect the monitor/evaluator to be involved. Right now, the monitors are not producing, for example, weekly reports for the Commission. APS will ask the monitor to be available when the matter comes before the Commission, to attest whether the process was good or bad, and be an independent spokesperson.

Mr. Young asked if that "monitor" would have the ability to say, mid process, that he or she believed the process was going fundamentally wrong or needed revision? Mr. Dinkel stated that APS regularly consults with the monitor to solicit their opinion, and he expected that if the monitor had a problem with a major issue, mid process, that it would be reported and then taken up the chain of command. Mr. Dinkel said that APS understands that the independent monitor's efforts will eventually show up in a final "report card" to the Commission, so APS has an incentive to listen and try to resolve any issues that arise with the monitor.

Greg Patterson of the Arizona Competitive Power Alliance commented that there are different definitions since there are different roles that the independent parties play. There are two functions, primarily, for the monitor/evaluator. One is that the importance of the independent monitor is based on underlying protocols. The monitor enforces protocols. If the protocols are not there, there is no real need for a monitor. So in Track B, they had rules when APS was considering bidding—there were walls established within the Company, and the preparers of the bids and evaluators were separated. Those protocols are not going to be observed unless the Commission says that those things are not allowed—the utility will do what is in its best interest. The Commission must establish rules for the monitor to be able to follow them.

The second function according to Mr. Patterson involves, for example, the situation where the utility evaluates all of its purchase power options, and then decides that all of the purchased power options are too expensive, and decides to use a "self-build" option. At that point it is difficult for the Commission Staff to be able to go in and say anything, because there are so many assumptions that underlie what may make a purchase power option more expensive. For example, there are internal rate of return assumptions, risk assumptions, ancillary services assumptions, fuel assumptions, differences in the time period of the purchase power agreement, and so forth. So somewhere in this process you need an independent person who can look at these assumptions and "levelize" the playing field. These things need to be done before the Company goes to the Commission and says that a purchase power option is too expensive. The independent entity which would perform these assumptions would have to be more of an "evaluator", whereas the first function could be performed by more of a "monitor."

Tom Alston of the Arizona Solar Industries Association stated that he had been involved with looking at how the resource planning process has been conducted in other states, and one of the things that seems to be repeatedly stressed is how does one value the price of natural gas? What they would like to see is a guideline that is based on a natural gas futures index. Prices in the futures index are often much higher than the natural gas prices that are used in resource planning. By using a futures index, the market has factored in many of the externalities associated with shipping and supply.

Greg Patterson stated that although this was the last workshop on resource procurement, there were parallel workshops being conducted on resource planning in general, and that he encouraged all parties interested in renewables to closely follow those workshops.

Ted Roberts of Mesquite Power and Sempra then stated that from their perspective as a merchant and developer, the size of the solicitation ought to determine the level of discretion and the amount of subjectivity that the utility has in the evaluation of bids. He agreed that when TEP and APS have short-term, small solicitations, it may not be practical or advisable. But in more significant solicitations, the independent monitor is a “third eye” to make sure bidder information is not used improperly or inappropriately, and that the utility is not given access in its proposal to information that the bidders have not been given. Independent monitors give more comfort to bidders that they are or will be treated fairly in this process.

Tom Wray of Southwestern Power stated that a situation when a monitor might not be needed would be when replacement power was necessary in an emergency situation, but in non emergency situations, a monitor should always be employed. He stated that if the utility was not bidding into the RFP, that he believed such was a distinction without a difference. The reason was that the utility is the provider of last resort for the customer, and they are required to always find the lowest cost source of power. Because of that, the utility was always really a bidder. Such is how they operate and have to operate, due to their obligations underlying their CC&Ns. If the independent monitor is worth anything at all—and he believed they were—they should be employed in all situations that don’t amount to an emergency.

Mr. Snook stated that he thought it wasn’t always appropriate to use an RFP for sources of power. As an example, he noted that TEP had purchased a generating unit that was built by another developer that had financial trouble—and that TEP was able to get this asset much cheaper than anyone else could have provided it. They also have purchased combustion turbines on the “grey” market. Thus they have come across opportunities that an RFP wouldn’t have linked itself to, and thus a complete RFP requirement would not have allowed for taking advantage of these unique opportunities. As had been noted, TEP knows that ultimately they will have to justify any such purchases to the regulators and thus will have to take the risk, so the utility will not likely do something that isn’t in the ratepayers interest anyway, if they go outside of the RFP for these types of opportunities. Combustion turbines and peaking facilities tend to be “cookie cutter” facilities where the costs are generally easy to estimate. But as they get into renewables and base-load resources, they may not have the experience and ability to make easy comparisons. Additionally, base load resources take a lot of time to develop and may not lend themselves to the RFP process.

Mr. Dinkel agreed and said that as products become less standard, it is much harder to bid them. A base load project that may take 10 or 15 years to develop and may involve a lot of transmission planning for years, extensive permitting—these are just not things that can be done through a typical RFP project. Arizona has been lucky the last few years since there has been an oversupply of existing resources, so we have had more standard and “liquid” type products which can be more easily compared. This oversupply of resources will dry up in two to five years, and APS will have to be looking at developing these resources that involve a lot of long range planning, and RFPs don’t work for those sorts of resources. The scope of the solicitation requirement is very important and should not extend to long-term resources.

Ms. Ormond said these long-term resources should be dealt with in the context of the integrated resource planning process. One question Ms. Ormond raised was who chooses the independent monitor? Who hires the monitor is critical, and she believes that the Commission ought to oversee the choosing of the monitor. There also ought to be points during the process where the Commission Staff has the opportunity to come in and evaluate—it is in no one’s interest to complete the process and then have it attacked and have to start over again.

Mr. Patterson said that he had heard that in the Track B process credit issues were used to weed people out of the process, but the independent monitor was able to address the situation, and in the long run both APS and the bidders were happy. Even though Track B was expensive from the monitor point of view, the independent monitor’s report at the end said that the total savings had been \$148 million, so \$200,000 for a monitor is well worth the cost.

Ms. Ormond stated that she doesn’t believe that an independent evaluator is necessary if proper procedures are put into place and the monitor’s role is proper.

Mr. Johnson then asked for comments on what the parties feel that the role of the Commission is. When is it appropriate for the Commission to be involved, and when should they stay out?

Ms. Ormond said that the overall issue is fairness, and that having a monitor and the Commission looking over the shoulder is more likely to result in fairness. But a major concern that she has is that the Commission doesn’t have the staffing to really be that involved with the process.

One merchant stated that one big advantage a monitor has is that the monitor can notify Staff of problems in the process, and thus only involve the Staff when problems arise to a certain level of concern.

Mr. Patterson stated that the incentives of the utility companies don’t always drive companies to make procurement decisions that are best for consumers and the overall policy of the state. This was disputed by Mr. Dinkel who said there was no basis for this observation. Mr. Patterson offered this example: if the Commission decides that solar energy is the Commission’s policy, it is not in APS’ interest to buy solar energy absent a direct order of the Commission that says that the Company needs to buy “X” number of megawatts as renewables. Solar energy could be deemed more expensive. If the Commission decides carbon is important, and wants the carbon footprint decreased, the Commission could direct more emphasis on natural gas, nuclear or solar, and less emphasis on coal plants. Yet this is against APS’ interest, since that power is more

expensive. Thus the utilities and the Commission's interests may not necessarily be the same, and the Commission may have to step in and direct the Companies to buy more of another resource, and assure them of financial recovery if they do so. Additionally, we need an IRP process because the incentives between the companies and the Commission are not always aligned. It is in the companies' interest to have as many assets as possible in rate base, thus we get gold-plated systems. It is the Commission's responsibility to balance the needs between reliability and excess capacity, for example. These are areas where incentives of the utility differ from those of the Commission and its ratepayers. This is the advantage of having the IRP process to create this balance.

Ms. Ormond pointed out that we don't really have an IRP process in Arizona, at least now. Mr. Patterson noted that we have another workshop going on in order to get an IRP process set up.

Mr. Wray mentioned the book by Professor Phillips, sort of a "Bible" for regulators, called "The Economics of Regulation" in which Phillips stated that "regulation is a miserable substitute for competition." Mr. Wray stated that the Commission has gone on record numerous times stating that they believe that with a strong wholesale competitive market, there are benefits to ratepayers. What the Commission needs to do is make sure that this belief is manifest in actions through the procurement process. So we need to figure out a system that is fair to all parties, and that the system will be as transparent as possible.

Mr. Dinkel addressed the question as to what role the Commission should have in the process. First of all, he stated that APS cares about more than just costs. They understand that they make decisions that impact the environment and communities for decades into the future. APS wants to work together with Staff to develop an IRP process where the tradeoffs can be considered. They want to be on the same page as Staff and the Commission; they don't want Staff to be surprised. While Staff doesn't need to be sitting in all of their meetings, they want to make sure that there is enough discussion with Staff about what is happening, that Staff is not caught off guard. If a monthly letter from an independent monitor to Staff would help, then they would support this. They would rather not operate in an environment where they are subject to post-decision prudence determinations. That is not going to get APS where it needs to go when it is considering some of the huge investments it needs to make in the future.

Mr. Dinkel said that in looking at other jurisdictions, selecting a monitor is a harder process than would be normally recognized. The "cream of the crop" best people are often employed by developers or utilities, because they have credibility. So there are good, independent people out there, but these people have to maintain their cash flow, so they have to take on lots of clients. APS needs monitors who understand policy, procedure, economics, environmental issues, etc., and APS has had a hard time getting enough of a list of people who can actually do this sort of work. APS believes that there needs to be a discussion about which people would be acceptable for doing the monitoring work. At the end of the day, Staff needs to be comfortable with the people that are on that list. It should be a joint effort.

Mr. Young asked Mr. Dinkel if there wasn't a whole group of people out there who do this sort of work, based on the fact that some states have rules requiring independent monitors in all cases. Mr. Dinkel responded by saying, like any other type of consulting, that there are people

doing this, but the problem is did they help you in evaluating a project that you did a year ago? Or did they help one of the bidders put together a bid? Have they worked for the bidders in other places? In many of these instances they wind up not really able to use them, because they are not truly independent. It is hard to find qualified people who don't have a vested interest somewhere.

Mr. Snook stated for the record that TEP is using ACCION. They have used them since the Tract B process and continue to use them. TEP would be satisfied if the Commission maintained a list of approved monitors from which it could choose.

Mr. Wray said it is disingenuous to state that there are only a handful of people who know about the power industry, and therefore we have to go to say the pharmaceutical industry to find someone who is independent. This is absurd. There is a prevailing belief among many in the room that an independent monitor is always justified. The question we need to ask is when they are never justified.

Ms. Ormond stated that the utilities should generate a list of viable candidates that can be reviewed by the Commission. The next question is who writes the check to the monitor? Who writes the check makes a difference. If the Commission writes the check, then the monitor is a contractor of the Commission; this would make her feel far more comfortable.

Mr. Johnson pointed out that for the Track B procurements, the Commission Staff selected ACCION as the consultant, but the checks were written by the utilities. The client, however, was the Commission itself.

Mr. Wray stated that in Cochise County right now there is a consultant who is working for and reporting to the county, even though the consultant is being paid by the merchant. The idea that this consultant is being obedient and servile to the merchant is absurd.

Mr. Johnson said if, following the workshop, anyone wanted to provide written comments, particularly as to when a monitor should NOT be used, they would be welcomed. He then noted that he had heard phrasing used to describe "protocols" versus "rules." Mr. Johnson asked the parties if it was not the case that most or all of the parties did not want the Commission to promulgate rules on this issue. One element of the Staff report will say that a monitor should be used, except in "X" circumstances. The Staff report would also indicate a policy statement in which the Commission could indicate its "desires." Mr. Johnson is trying to stay away from "mandates" and "standards," because that would imply that we are in a rulemaking process. If the Commission has a policy, does that mean the utility has to follow it? No. The utility has the prerogative to ignore it, though it should know what it may have set itself up for. If the parties think this is a hollow approach and not sufficient, then we do need a prescriptive process, through the adoption of rules.

Ms. Ormond said that she wanted to have the ability to come back to the Commission if something was not being followed. She is not sure a "policy" is good enough. She does not know whether in the general resource planning process, these procurement issues will all "roll up" into whatever rules are developed or adopted there. She would prefer that.

Mr. Johnson stated that he expected that the concepts adopted here in terms of a process would eventually be rolled up into the IRP rulemaking process. Staff will be assessing the existing resource planning rules, and determining which rules make sense and which don't.

Ms. Ormond then noted that the whole process of getting IRP up and running again is going to take time, and the concern she has is that the utilities have major resource acquisition decisions to make in the very short term, and that IRP may takes years to get going. Mr. Johnson said that timing is a concern, and that is why in the procurement scenario, we are trying to find a way to address these issues that does not involve rulemaking, since that will likely take more than a year.

Ms. Ormond and Mr. Patterson both expressed support for the view that rules for procurement eventually be rolled up into the IRP process. Mr. Patterson indicated, however, that for the time being, he liked the idea of a policy, where the utilities would violate the policy at their own risk. With regard to APS, the 40-252 hearing will now look at modifying the Settlement Agreement from the APS rate case. Although looking at the 40-252 only directly impacts APS, it is a step in the right direction.

Mr. Wray stated that delay is an ally of the incumbent utilities. If you roll up enough delay in the procurement process, you create an emergency scenario, in which "latches" open up and the utility is able to do things that they wouldn't have normally been able to do. If the procurement procedure is rolled up into the IRP process, it is important to consider the timing required to administer a proper procurement process.

Ms. Ormond had a concern that while there was a target date for winding up this procurement phase, that there was no timeframe envisioned for completing the IRP workshops. Mr. Johnson noted that while the IRP workshop/proceedings did not have an "established" timeline, the message he has gotten is that he needs to move the IRP forward.

Mr. Johnson then asked for any comments or issues that need to be discussed or talked about as we go into the drafting phase of the Staff report. Ms. Ormond said she would like to see a draft protocol that the utilities should follow.

Mr. Johnson said he was inclined to put out a "draft" Staff report, in which the parties could comment within a 10-day period, take exceptions or add their support. Ms. Ormond said that she was hoping the report would contain specifics that they could react to, not just a summary of the discussions.

Mr. Dinkel wanted to discuss the recoverability issue, as it relates to bidder fees. It may not be possible that the bidders will cover the costs of the monitor, as had been the case in Track B.

Mr. Patterson said that he believed that the independent monitor was a cost of the project. Such fees could be capitalized and added on to the cost of the project, or they could be done as an expense, such as a design phase of the project. He would hate to see independent monitor fees and bid fees turned into a means to impact the process. Too high a bid fee would have a chilling

effect on parties wanting to bid. The utility should be reimbursed for the costs of using the independent monitor process.

Mr. Dinkel indicated that the APS PSA mechanism was a good “overflow” mechanism, in which costs not covered by bidders fees could be reimbursed. Barbara Klemstine of APS stated that it should be specifically addressed how the utility would recover 100 percent of its costs, since this was a mandated cost.

Mr. Johnson did not necessarily believe that “100%” of the costs were absolutely recoverable. However, these issues can be addressed in another open docket. These issues are too large and complicated to be completely dealt with in this phase of this proceeding. Staff does believe that some level of bidding fees is acceptable—you should “pay to play”—however, bidders fees should not be a deterrent to participation.

Ms. Ormond raised the question of how we define what a long-term resource is, and how solicitations for these should proceed as part of this procurement process. Mr. Dinkel said that one approach that would work is that there could be a three-year “action plan” that would be part of the IRP process.

Mr. Johnson indicated that if any party wanted to file additional comments within the next 10 days, they could do so, and they would be encouraged to file the comments with Docket Control. Following this, Staff would develop a draft Staff Report, and issue it, with a 10-day comment period. Mr. Johnson’s intent was to have the final report ready for the Commission’s consideration at the end of September.

Bing E. Young  
Utilities Division

**Note: The above minutes summarize the discussions in the workshop but are not intended to represent a verbatim transcript.**

Attachment 1

Attendees at the Resource Planning Workshop (Procurement Issues)  
July 13, 2007

Name	Organization
Amanda Ormond	Ormond Group
Barbara Keene	Commission Staff
Barbara Klemstine	Arizona Public Service Company
Bing Young	Commission Staff
Dan Austin	Strategy Integration for Comverge
Dave Couture	Tucson Electric Power/Unisource Energy Services
David Leevan	Global Energy
Deb Scott	Arizona Public Service Company
Debbie Lindeman	Tucson Electric Power Company
Dick Kurtz	Arizona Electric Power Cooperative
Eric Bronner	Gila River Power
Ernest Johnson	Director, Utilities Division, Commission Staff
Erinn Andreasen	Arizona Public Service Company
Greg Patterson	Arizona Competitive Power Alliance
Jana Brandt	Salt River Project
Jerry Anderson	Commission Staff
Kevin Torrey	Commission Staff
Leland Snook	Tucson Electric Power/ Unisource Energy Services
Loren H. Locher	El Paso Natural Gas
Mike Sheehan	Tucson Electric Power Company
Pat Dinkel	Arizona Public Service Company
Stephen Ahearn	Residential Utility Consumers Office
Ted Roberts	Mesquite Power and Sempra
Tom Alston	American Solar Industries Association
Tom Wray	Southwestern Power
Victor Aguirre	Tucson Electric Power Company