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Executive Director

22

ARIZONA CORPORATION COMMISSION

DATE: January 31, 2006

DOCKET NO: E-00000A-02-0051 et al.
E-00000A-01-0630

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Teena Wolfe. The recommendation has been filed in the form of an Opinion and Order on:

GENERIC PROCEEDING

(ARIZONA INDEPENDENT SCHEDULING ADMINISTRATOR)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00 p.m.** on or before:

FEBRUARY 9, 2006

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

FEBRUARY 14 AND 15, 2006

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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WILLIAM A. MUNDELL
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KRISTIN K. MAYES

IN THE MATTER OF THE GENERIC PROCEEDING CONCERNING ELECTRIC RESTRUCTURING ISSUES.	DOCKET NO. E-00000A-02-0051
IN THE MATTER OF THE GENERIC PROCEEDING CONCERNING THE ARIZONA INDEPENDENT SCHEDULING ADMINISTRATOR.	DOCKET NO. E-00000A-01-0630 DECISION NO. _____ **OPINION AND ORDER**

DATE OF HEARING: September 5 (pre-hearing conference), 11, and 12, 2003

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Teena Wolfe

APPEARANCES:

Mr. Michael W. Patten, ROSHKA, HEYMAN & DeWULF, PLC, on behalf of Tucson Electric Power Company;

Mr. Michael Grant, GALLAGHER & KENNEDY, PA, on behalf of Arizona Electric Power Cooperative;

Ms. Karilee S. Ramaley, PINNACLE WEST CAPITAL CORPORATION, and Mr. Jeffrey B. Guldner, SNELL & WILMER, LLP, on behalf of Arizona Public Service Company;

Mr. C. Webb Crockett, FENNEMORE CRAIG, PC, on behalf of Arizonans for Electric Choice and Competition;

Mr. Daniel W. Douglass, LAW OFFICES OF DANIEL W. DOUGLASS, on behalf of Constellation NewEnergy, Inc. and Strategic Energy, LLC;

Mr. Scott S. Wakefield, Chief Counsel, on behalf of the Residential Utility Consumer Office;

Mr. Patrick J. Sanderson, on behalf of the Arizona Independent Scheduling Administrator Association; and

Mr. Jason Gellman, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

I. PROCEDURAL HISTORY

On July 24, 2001, at an Open Meeting of the Arizona Corporation Commission ("Commission"), the Commissioners directed the Hearing Division to open a docket concerning the Arizona Independent Scheduling Administrator ("AISA"). On August 24, 2001, pursuant to the Commissioners' direction, a Procedural Order was issued opening the above-captioned Generic Proceeding Concerning the AISA docket and setting forth a list of issues regarding the AISA for parties to address in written comments. That Procedural Order also directed the Commission's Utilities Division Staff ("Staff") to summarize the parties' comments and provide its own recommendations.

In accordance with the August 24, 2001 Procedural Order, comments were filed on September 4, 2001, by Arizonans for Electric Choice and Competition ("AECC"), Arizona Competitive Power Alliance ("Alliance"), Arizona Public Service Company ("APS"), APS Energy Services ("APSES"), Tucson Electric Power Company ("TEP"), Arizona Consumer-Owned Electric Systems, the Residential Utility Consumer Office ("RUCO"), Citizens Communications Company, Arizona Electric Power Cooperative, Inc. ("AEPCO"), and the Arizona Independent Scheduling Administrator ("AISA").

On November 13, 2001, Staff filed its summary of the comments and recommendations.

By Procedural Order issued February 8, 2002, the Generic Proceeding Concerning the AISA docket was consolidated with Docket Nos. E-00000A-02-0051, E-01345A-01-0822, E-01933A-02-0069, and E-01933A-98-0471.

On March 14, 2003, the Commission issued Decision No. 65743, its "Track B" Decision in these dockets. Among other issues addressed, Decision No. 65743 directed Staff to file an update to its November 2001 Staff Report in the AISA docket, and directed the Commission's Hearing Division to notice a proceeding in compliance with A.R.S. § 40-252 with notice and an opportunity to be heard to the affected parties concerning the continuation of the AISA.

A Procedural Order was issued on June 18, 2003 setting the hearing to commence on September 11, 2003, and establishing related procedural deadlines.

Notice of the hearing was published as required.

A hearing was held on September 11 and 12, 2003, as required by Decision No. 65743, before a duly authorized administrative law judge of the Commission. APS, TEP, AEPCO, AECC, Constellation New Energy, Inc. ("CNE"), RUCO and Staff appeared. TEP, AEPCO, APS, CNE, AECC, and Staff presented evidence. Following the hearing, on September 29, 2003, Staff docketed a supplemental filing regarding the costs incurred by the AISA for the filing of the AISA protocols before the Federal Energy Regulatory Commission ("FERC"). On October 6, 2003, AEPCO filed comments on Staff's supplemental filing. On October 23, 2003, counsel for AECC filed comments in response to AEPCO's October 6, 2003 filing.

On February 2, 2005, AEPCO docketed a Supplemental Filing and Request for Official Notice, requesting that the Commission take official notice of the Arizona Court of Appeals' January 25, 2005 mandate in *Phelps Dodge Corporation, et al. v. AEPCO, et al.,* 207 Ariz. 95, 83 P.3d 573 (2004)("*Phelps Dodge*").[1]

On February 18, 2005, a Procedural Order was issued directing that responses to AEPCO's February 2, 2005 filing be filed by Staff and by other parties who wish to be heard on the issue by March 11, 2005, and that responses include recommendations regarding the effect of the Arizona Court of Appeals' January 25, 2005 mandate in *Phelps Dodge* on these AISA proceedings

AECC, the Alliance,[2] AISA, APS, TEP, the Grand Canyon State Electric Cooperative Association, Inc., on behalf of Duncan Valley Electric Cooperative, Graham County Electric Cooperative, Inc., Mohave Electric Cooperative, Inc., Navaopache Electric Cooperative, Inc., Sulphur Springs Valley Electric Cooperative, Inc., and Trico Electric Cooperative, Inc. (collectively, "Cooperatives"), and Staff filed Responses as directed by the February 18, 2005 Procedural Order.

Following those filings, the matter was taken under advisement.

II. BACKGROUND OF THE AISA

As part of the development of Arizona's Retail Electric Competition Rules (A.A.C. R14-2-

[1]The January 25, 2005 mandate states that by order dated January 4, 2005, Arizona Supreme Court No. T-01-0001-CV, the Arizona Supreme Court denied the petition for review in that case.

[2] The Alliance's filing stated that its members include Calpine, Constellation New Energy, Duke Energy North America, LLC, New Harquahala Generating Company, LLC, PPL Montana, LLC, Sempra Energy Resources, Shell Trading, Southwestern Power Group II, LLC, and Strategic Energy.

1601 *et seq.*)("Rules"), it was determined that in order to have non-discriminatory retail access, Arizona would establish an independent scheduling administrator that would perform certain functions until such time as a Regional Transmission Organization ("RTO") was in place (May 30, 2003 Staff Report, Exh. S-1, at 1). Section 1609 of the Rules ("Rule 1609") required Affected Utilities owning or operating Arizona transmission facilities to form the AISA and make a filing for Federal Energy Regulatory Commission ("FERC") approval. The responsibilities of the AISA were set forth in Section (D) of Rule 1609, and included: 1) implementation and oversight of the nondiscriminatory application of operating protocols to ensure fair and equitable transmission access; 2) provision of a dispute resolution process to resolve any claims of discriminatory treatment in the reservation, scheduling, use and curtailment of transmission services; 3) calculation of Available Transmission Capacity ("ATC") for Arizona transmission facilities and development and operation of a statewide overarching Open Access Same-time Information Service ("OASIS"); 4) taking of transmission reservation and scheduling requests; and 5) implementation of a transmission planning process to assure adequate future capacity.

The AISA was formed, and through a stakeholder process, developed the AISA tariff which was approved by FERC. The AISA's Board of Directors determined that the implementation of the AISA Protocols Manual should be in a phased approach (Exh. S-1 at 2). Stage 1 of Phase I began upon FERC's acceptance and approval of the AISA tariff filing (*id.*). Phase I, Stage 1 AISA functions include Alternative Dispute Resolution ("ADR"); limited Protocols Manual oversight; and monitoring of OASIS and Allocated Retail Network Transmission ("ARNT") (*id.*at 3).

Stage 2 of Phase I will become effective only upon a determination of the AISA's Board of Directors that more staff is needed to move from a limited Protocols Manual oversight to a more active administration, which would include the monitoring by the AISA of compliance with FERC's standards of conduct related to access to transmission and the operation of the transmission system (*id.* at 2-3.). Phase II functions will be implemented only after action by the AISA Board of Directors (*id.* at 2). Phase II functions include monitoring of ATC releases and responsibility for OASIS/ATC calculations; utilization of standardized procedures for transmission reservation and scheduling; implementing a statewide transmission planning process; administering a statewide OASIS;

overseeing transmission provider determinations of total retail committed use reservations; and ARNT and Energy Imbalance ("EI") trading and ARNT auction settlement.

III. CURRENT STATUS OF THE AISA

The AISA's Board of Directors voted at the April 25, 2003 AISA Board Meeting to downsize the operations of the AISA, with the downsizing to take effect June 1, 2003 (Exh. S-1 at 3). The downsizing included the reduction of 1.25 full time employees, a reduction in office space, and reductions in insurance and accounting costs, resulting in a 54 percent reduction in the annual AISA budget from $322,650 to $154,270 (*id.*).

The AISA's Board of Directors voted at the May 14, 2003 AISA Board Meeting to modify its Articles of Incorporation to remove a sunset clause which previously indicated that the corporation would cease to exist on September 15, 2003. The new wording, approved by the Board of Directors, states that the AISA will exist until a FERC-approved Regional Transmission Organization is operational and serving Arizona (*id. at 2-3*).

IV. RECOMMENDATIONS/POSITIONS OF THE PARTIES AT THE HEARING

A. AEPCO

AEPCO believes that the AISA is not needed now and will not be needed in the future to facilitate retail competition, and that even though AISA has downsized its budget, it still provides no benefits to ratepayers (Tr. at 11). AEPCO's witness estimated at the time of the hearing that AEPCO had directly expended approximately $100,000 in forming and supporting the AISA, aside from amounts expended on staff time and related expenses (Direct Testimony of Larry D. Huff, Exh. AEPCO-1 at 3). AEPCO stated that continued involvement and funding by the Affected Utilities is not necessary to the continuation of the AISA (*id.* at 4), and argued that ratepayers should not be called upon to pay annually for the AISA if it is not necessary. AEPCO believes that the affected utilities have discharged their obligations in relation to the AISA under Rule 1609, because the AISA has been formed, the protocols have been designed and adopted by FERC, and an implementation plan has been filed.

AEPCO asserted that protocol oversight is not a necessary function of the AISA. AEPCO argued that the AISA is not needed to implement and oversee operating protocols because the

protocols have been incorporated into APS' and TEP's open access transmission tariffs ("OATTs"), and because its affiliate Southwest Transmission Cooperative ("SWTC") plans to incorporate the protocols in its OATT at such time that its member distribution cooperative service territories are opened for competition (Exh. AEPCO-1 at 7). AEPCO asserted that there has been no difficulty administering the protocols, which AEPCO believes worked satisfactorily when direct access was occurring in the year 2000. AEPCO also stated that oversight is unnecessary because utilities cannot unilaterally change the AISA protocols in their OATTs without FERC approval, and that the FERC approval process would provide notice and an opportunity for comment, objection, and intervention. AEPCO also argued that because Salt River Project does not utilize the AISA protocols, statewide protocol uniformity does not exist.

AEPCO further asserted that dispute resolution is not a necessary function of the AISA, because it is nonbinding, and dissatisfied parties can escalate disputes to FERC. AEPCO stated that under utilities' OATTs, over which FERC has jurisdiction, there is a local, mandatory, meet-and-confer process, and binding alternative dispute resolution. AEPCO stated that if disputes regarding retail distribution direct access issues arise, parties can bring complaints before this Commission under Section A of Rule 1609 which requires open and nondiscriminatory access to transmission systems, or as unbundled distribution tariff violations. AEPCO further asserted that FERC has a dispute resolution hotline, which AEPCO believes can be used to resolve disputes, and that the FERC formal complaint process is also available to aggrieved parties. AEPCO stated that while several hundred competitive customers went to direct access in 2000, the AISA was never called on to resolve a dispute at a time when AEPCO believes possible confusion or dispute over the protocols was at its greatest.

AEPCO recommended that the Commission issue an Order that AEPCO has fulfilled its responsibilities under Rule 1609 in relation to the AISA (Exh. AEPCO-1 at 4). AEPCO believes that its participation in the AISA imposes costs on its members and their member/owners without providing benefits (Exh. AEPCO-1 at 5). AEPCO concedes, however, that the AISA is an organization independent of the Commission or the Affected Utilities (AEPCO-1 at 6).

B. TEP

TEP stated that it has supported the AISA from its inception both financially and through participation on the AISA board, and that the AISA has played an important role in developing key protocols to facilitate retail direct access. TEP stated that given the ongoing review of the Electric Competition Rules and the background of the AISA, TEP supports Staff's recommendation that the AISA be continued at its reduced staffing level during the review of the Electric Competition Rules.

TEP recommended, however, that should the AISA's functions be expanded [beyond the current Phase I, Stage 1 AISA functions] prior to completion of the Rules' review, that a cost-benefit analysis be required to address whether such expansion is appropriate. TEP's witness testified that the transmission planning function contemplated by Rule 1609 is being performed by the Central Arizona Transmission Study ("CATS") process, the Western Area Transmission Study ("WATS") group and the SSG-WI Planning Work Group. He stated that the need for the AISA to engage in transmission planning is precluded by the work being done by those organizations, and that it would probably not be cost effective for the AISA to perform a transmission planning function (Tr. at 42).

TEP also stated that as the AISA developed protocols to enable retail competition that are now incorporated into both TEP's and APS' OATTs, suspension of the AISA during the consideration of the Rules would not necessarily injure retail electric competition, in the event the Commission decides that the current cost of the AISA exceeds the benefits that it is providing. TEP added that other dispute mechanisms exist to resolve future disputes if any actually arise prior to completion of the Rules review.

C. APS

APS stated that it has actively supported and it continues it support the AISA. APS also stated that it provided the bulk of the AISA's initial funding; helped to develop the AISA direct access protocols; has incorporated those protocols into its FERC-approved OATT; and that APS continues to be the largest ongoing contributor of funding for the AISA.

APS pointed out that the AISA has accomplished the important goal of developing the direct access protocols, and that from its inception, the AISA was intended to be a transitional entity that ultimately would be superseded by an RTO. According to APS, other goals set out in Rule 1609 are

being phased in by APS and other western utilities. APS stated that it and a number of utilities throughout the western United States have agreed to implement an independently operated OASIS in order to streamline nondiscriminatory access to transmission and promote bilateral energy markets through the west, and that this common OASIS should increase effectiveness and ease of use by providing a common energy bulletin board to facilitate transactions, ancillary services and congestion management throughout the western states. APS asserted that the common OASIS not only accomplishes the goal set out in Rule 1609 of an overarching statewide OASIS, but expands that OASIS to cover several states, including Arizona, and stated that it includes significant public power entities both in Arizona and outside of Arizona that would not be required to participate, and are not participating, in the AISA.

APS agreed with Staff that in light of continually changing circumstances, and in light of the divergent views and opinions of the parties, the purpose and role of the AISA going forward should be objectively reevaluated when the Commission undertakes its review of the Electric Competition Rules. APS stated that it therefore supports the Staff recommendation to continue with the downsized AISA until the review of the Electric Competition Rules is completed, and that it looked forward to participating in that process.

D. AECC

AECC stated that it is a coalition of a number of entities, which includes industrial users, large commercial users, medium and small businesses, and various associations, and by its participation, the business community was represented in this proceeding, and is in support of the continuation of the AISA. AECC stated that if the Commission is to keep retail electric competition as a consumer choice in Arizona, it is essential that the AISA organization continue to exist so that the consumers of the State of Arizona will receive the advantages that were negotiated and bargained for.

AECC believes that the AISA benefits consumers by facilitating open, nondiscriminatory access to the transmission system, which is key to competition, because it insures a fair allocation of transmission capacity. AECC stated that as a result of AECC's participation in settlement negotiations with APS, and TEP, provisions in the APS and TEP [stranded costs] settlement

agreements, as approved by the Commission, require the utilities to continue to support the AISA.

Regarding dispute resolution, AECC stated that disputes may not have arisen yet, due to competition within the State of Arizona being deterred by the existence of stranded cost charges. AECC believes that when competition begins, it will be more desirable to have the ability to resolve disputes locally, before the AISA as a neutral third party, as opposed to having a federal agency involved.

AECC does not believe the evidence presented in this proceeding is sufficient to warrant the elimination of the AISA. AECC would prefer that the AISA continue until such time as there is an RTO, in accord with the original intent of the organization of the AISA. However, in the alternative, AECC joins APS and TEP in their support of Staff's recommendation to continue the AISA in a downsized mode until the AISA can be reviewed along with a review of the Electric Competition Rules.

E. CNE

CNE echoed AECC's position that AISA represents the fruits of a rather hard-fought stakeholder process, and stated that it would be extremely time-consuming and costly to try to replicate that effort. CNE stated that in comparison to the AISA, access to the FERC as a vehicle for dispute resolution offers in many ways a more costly and time-consuming methodology, which in itself could offer a barrier to competition. CNE also believes that it would be difficult in the absence of AISA to get the investor-owned utilities to modify their OATTs; that the potential therefore exists for a growing inconsistency among the tariffs of the utilities; and that coping with that inconsistency would be a barrier to competition.

CNE argued that the fundamental issue in this proceeding, however, is not dispute resolution or the ease or difficulty of utilities modifying their OATTs, but whether or not Arizona wants to foster and encourage retail competition and provide its ratepayers with customer choice and the cost savings that schools, universities, and hospitals can obtain through participating in retail competition. CNE asserted that the organizations that say AISA is not needed are organizations that will be adversely impacted by competition. CNE stated that it wishes to be an active market participant and bring cost savings to customers in Arizona. CNE recommended that the AISA be retained and

maintained.

F. RUCO

RUCO stated that it could support Staff's proposal to maintain the abbreviated AISA pending the Commission's reevaluation of the Rules. RUCO added that its support is qualified in that it could not support the maintenance of the AISA in perpetuity if the Rules review is an extremely lengthy process.

G. Staff

Staff stated that while the existence of the AISA is not in itself sufficient to ensure the development of retail competition, Staff believes that keeping the AISA is necessary to ensure retail competition. Staff stated that the AISA was designed to be the body to ensure that the ongoing need for equitable access to transmission is met until the establishment of an RTO; that an RTO does not currently exist, and that it does not appear that Arizona will have a fully operational RTO prior to 2011. Staff stated that fair, equal, nondiscriminatory access to transmission and localized, expedient dispute resolution regarding transmission access are essential elements necessary to retail competition, and the AISA was designed to address these functions (Tr. at 31). Staff stated that it does not believe that the utilities' adoption of the AISA protocols in their FERC OATTs completes the ongoing AISA process of ensuring fair and equitable access to retail transmission.

Staff acknowledged the existence of several different ways to address dispute resolution, including calling a FERC hotline, utilizing a formal dispute resolution at FERC, or utilizing a local dispute resolution process in Arizona over the protocols developed by the AISA. Staff believes that there is merit in having the AISA deal with dispute resolution over the AISA protocols in order to enable retail competition in Arizona.

Staff stated that in addition to the two essential functions of ensuring fair and equitable access to retail transmission and provision of local dispute resolution, the AISA, pending a fully operational RTO, can offer a measure of uniformity in utilities' OATTs, which Staff believes is important in order to give competitive providers the confidence they will need to enter the Arizona market.

Staff stated that it does not disagree that the AISA may need to be examined to determine what may need to be modified, or whether some of what were envisioned to be essential functions of

the AISA, such as transmission planning or a statewide OASIS, can be performed by entities other than the AISA. Staff stated that it is important, however, that the essential functions are being carried out in order to ensure that retail competition can occur.

V. POST-HEARING FILINGS

On February 2, 2005, AEPCO docketed a Supplemental Filing and Request for Official Notice, and served each party listed on the June 18, 2003 Procedural Order. By its filing, AEPCO requested that official notice be taken of the Arizona Court of Appeals' January 25, 2005 mandate in *Phelps Dodge*. The Court of Appeals' January 25, 2005 mandate states that by order dated January 4, 2005, Arizona Supreme Court No. T-01-0001-CV, the Arizona Supreme Court denied the petition for review in *Phelps Dodge*. AEPCO took the position that in light of the fact that the Court of Appeals opinion declaring the AISA requirements of A.A.C. R14-2-1609 to be invalid has become final, this proceeding on the AISA is now moot.

Parties filing responses to AEPCO's post-hearing filing include the Alliance,[3] AISA, APS, AECC, the Cooperatives, TEP, and Staff.

The Cooperatives requested in their filing that the Commission adopt AEPCO's position that this proceeding is now moot.

APS stated that it has actively supported formation of the AISA, and that APS provides funding for the AISA and helped develop the AISA direct access protocols. APS does not believe that the court's invalidation of the specific regulation relating to the AISA, in and of itself, necessarily moots the issues raised in this proceeding.

TEP stated that *Phelps Dodge* makes it clear that the provisions of Rule 1609 that provide for the creation of the AISA are not valid or enforceable. TEP stated that this calls into question the status of the sections of the TEP 1999 Settlement Agreement in Decision No. 62103 relating to the AISA, and TEP's duties and responsibilities in connection therewith. TEP asserted that it is appropriate for the Commission to provide notice of the steps it will take, if any, regarding: 1) the AISA-related Electric Competition Rules; and 2) any terms of settlement agreements (such as the

[3] The Alliance's post-hearing filing stated that its members include Calpine, Constellation New Energy, Duke Energy North America, LLC, New Harquahala Generating Company, LLC, PPL Montana, LLC, Sempra Energy Resources, Shell Trading, Southwestern Power Group II, LLC, and Strategic Energy.

TEP 1999 Settlement Agreement) that are based upon the invalidated AISA-related Rules.

The Alliance stated that its members believe retail access will provide significant consumer benefits, and that retail access cannot exist without non-discriminatory open access to transmission. The Alliance stated that such access cannot exist without an independent, authoritative, FERC-empowered, Commission-supported agency, and that until an RTO is operational, the AISA is that agency. The Alliance asserted that dissolving the AISA would be a step backward in competition in electricity and non-discriminatory access, and that it would be a mistake for the Commission to discontinue support of the AISA.

The AISA stated that the *Phelps Dodge* decision has no effect upon the legal status of the AISA as a FERC-regulated entity operating exclusively under a FERC-approved tariff, and that the issues raised in this docket remain extant. The AISA pointed out that when FERC approved its tariff, it was aware of the ongoing litigation regarding the validity of Rule 1609 in the *Phelps Dodge* case, and that FERC specifically found that the AISA had an independent right to seek FERC approval of its tariff, regardless of the continued validity of Rule 1609. The AISA also stated that *Phelps Dodge* has no impact on either the continued economic viability of the AISA does not lessen in any way the continued public benefits associated with maintaining Commission support of the AISA. The AISA stated that the obligations of APS and TEP to continue their support of the AISA, to comply with the AISA's Protocols Manual, which they have incorporated as part of their OATTs, and to fund the activities of the AISA are not affected by *Phelps Dodge's* invalidation of Rule 1609, and that APS and TEP currently provide 90% of the AISA's annual funding.[4]

AECC asserted that AEPCO is incorrect in claiming that this proceeding is moot following the finality of *Phelps Dodge*, and that the Commission's consideration of the AISA in this docket remains relevant as a matter of public policy. AECC stated that the AISA exists to support the Commission's policy of providing customers with retail choice, and that the invalidation of Rule 1609 eliminated neither the AISA nor the obligations of APS and TEP to participate in the AISA pursuant to their respective settlement agreements that the Commission approved in 1999. AECC

[4] The AISA stated in its filing that the balance of the funding is currently provided by AEPCO and UNS Electric, Inc.

pointed out that the settlement agreements' AISA provisions do not reference Rule 1609 and are not dependent in any way on a specific mandate in the Electric Competition Rules to participate in the AISA. AECC stated that while *Phelps Dodge* may have precluded the Commission from mandating participation in the AISA for a utility not otherwise so obligated, the Commission is not precluded from supporting the continuation of the AISA as a matter of public policy, or from requiring the parties to approved settlement agreements to adhere to the terms of the agreements. AECC asserted that the implementation and oversight of operating protocols for retail access service is best administered and modified by an independent body such as the AISA rather than through unilateral OATT filings by individual transmission providers. AECC believes that although the underlying economics have not supported using direct access service in Arizona in recent years, it remains a valuable option going forward. AECC recommended that the Commission issue the following findings in this docket:

1. The AISA is a FERC-jurisdictional entity that was created to ensure non-discriminatory access to transmission for retail access service in Arizona in furtherance of the Commission's policy of offering the choice of retail direct access service to customers.

2. APS and TEP have entered into Commission-approved Settlement Agreements with parties that obligate APS and TEP to support the AISA, independent of the requirements in A.A.C. R14-2-1609.

3. The AISA ensures non-discriminatory access to transmission for retail service in Arizona in the absence of a Regional Transmission Organization.

4. The AISA Board has responded to the current lack of retail direct access activity in Arizona by downsizing the AISA to the minimum size practicable that still retains the critical mass needed to keep the entity intact. This approach appropriately keeps the option of direct access available to Arizona customers, to be utilized as the opportunity to shop improves.

5. The continued participation of APS and TEP in the AISA, in compliance with their respective Settlement Agreements, is in the public interest.

6. APS, TEP, and other Affected Utilities shall continue to be allowed to recover the prudent costs of participation in the AISA, as provided in the applicable cost recovery mechanisms approved by the Commission in

other dockets.

Staff stated that the issue in this proceeding – whether to continue the AISA – is still open and not rendered moot by *Phelps Dodge*. Staff stated that APS and TEP have existing obligations to support the AISA that are independent of Rule 1609, and that those obligations therefore survive *Phelps Dodge*. Staff asserted that while *Phelps Dodge* invalidated the administrative rule that required the establishment of the AISA, it did not invalidate the AISA itself, which exists independently of A.A.C. R14-2-1609 (C) through (J). Staff further stated that even if the Commission were to decide to withdraw support for the AISA, it is likely that FERC action may be required to completely terminate the AISA, and that such action would likely have to be initiated by the AISA's Board of Directors.

VI. CONCLUSION

In promulgating the Retail Electric Competition Rules, we expressed support for the development of a FERC-approved RTO, Independent System Operator (ISO), or, absent an RTO or ISO, an AISA, because "such organizations are necessary in order to provide nondiscriminatory retail access and to facilitate a robust and efficient electricity market"(A.A.C. R14-2-1609(C)). Following promulgation of Rule 1609, the AISA formed, formulated its tariff in a stakeholder process, submitted that tariff to FERC, and received tariff approval of the tariff from FERC. Also following promulgation of Rule 1609, APS and TEP entered into settlement agreements that contained provisions relating to their participation in and support of the AISA.[5]

Subsequent to the AISA's formation, FERC's approval of the AISA tariff filing, and Commission approval of the APS and TEP settlement agreements, the Arizona Court of Appeals held in *Phelps Dodge* that the promulgation of A.A.C. R14-2-1609 (C) through (J), which call for the creation of the AISA, lacked authority.

We agree with APS that *Phelps Dodge*'s invalidation of the specific regulation relating to the AISA does not in and of itself necessarily moot the issues raised in this proceeding. While we agree that *Phelps Dodge* may have rendered the provisions of Rule 1609 that provide for the creation of the AISA invalid or unenforceable as a rule requirement, the ruling came after the AISA was formed and

[5] Decision No. 61973 (October 6, 1999)(APS); Decision No. 62103 (November 30, 1999)(TEP).

had its tariff filing approved by FERC, and does not render the independent existence of the AISA invalid. While *Phelps Dodge* may preclude this Commission from mandating participation in the AISA for a utility not otherwise so obligated, we are not precluded from supporting the continuation of the AISA as a matter of public policy.

We find that *Phelps Dodge* has no impact on the continued economic viability of the AISA, and that it does not reduce the continued public benefit associated with maintaining Commission support of the AISA at its current level of operations. The AISA currently provides the important public benefit of keeping the possibility of retail access available to Arizona consumers at a minimal cost, by providing potential competitors with the necessary assurance that they will have fair and equitable access to transmission until an RTO is formed and approved by FERC to take over that function. The AISA provides this assurance by providing limited AISA Protocols Manual oversight and monitoring of OASIS and ARNT, and by providing a local, independent dispute resolution forum that parties may choose to avail themselves of in the event of a dispute over the protocols, OASIS, or ARNT. As Staff noted, however, while the AISA is essential to allowing the development of retail competition, the existence of the AISA has not been sufficient in itself to ensure retail competition. In recognition of the current lack of retail electric competition, the AISA is currently operating in a downsized mode which is less costly than its operations were at the beginning of this proceeding. As we noted above, the AISA's downsizing resulted in a 54 percent reduction in the annual AISA budget from $322,650 to $154,270.

TEP recommended that should the AISA's functions be expanded beyond the current Phase I, Stage 1 AISA functions prior to completion of the Rules' review, that a cost-benefit analysis be required to address whether such expansion is appropriate. Staff stated that Stage 2 of Phase I of the AISA will become effective only upon a determination of the AISA's Board of Directors that more staff is needed to move from a limited Protocols Manual oversight to a more active administration, which would include the monitoring by the AISA of compliance with FERC's standards of conduct related to access to transmission and the operation of the transmission system. As TEP is a member of the AISA, TEP has the ability to request a cost-benefit analysis prior to an AISA Board determination that expansion is appropriate.

TEP asserted that it is appropriate for the Commission to provide notice of the steps it will take, if any, regarding 1) the AISA-related Electric Competition Rules; and 2) any terms of settlement agreements (such as the TEP 1999 Settlement Agreement) that are based upon the invalidated AISA-related Rules. Staff stated that its review of the Electric Competition Rules is ongoing, and that it plans to address AISA-related rules during that review. The outcome of that proceeding is unknown, and parties wishing to submit comments on that proceeding should make their filings in the rulemaking docket. Regarding the terms of the TEP 1999 Settlement Agreement, appropriate Commission action will be taken if the Commission receives a specific request regarding Decision No. 62103 from a party to that Decision.

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

FINDINGS OF FACT

1. On August 24, 2001, pursuant to the Commissioners' direction to the Hearing Division at a July 24, 2001 Open Meeting of the Commission, a Procedural Order was issued opening the above-captioned Generic Proceeding Concerning the AISA and setting forth a list of issues regarding the AISA for parties to address in written comments. The Procedural Order also directed Staff to summarize the parties' comments and provide its own recommendations.

2. On September 4, 2001, comments were filed by AECC, the Alliance, APS, APSES, TEP, Arizona Consumer-Owned Electric Systems, RUCO, Citizens Communications Company, AEPCO, and the AISA.

3. On November 13, 2001, Staff filed its summary of the comments and recommendations.

4. By Procedural Order issued February 8, 2002, the Generic Proceeding Concerning the AISA docket was consolidated with Docket Nos. E-00000A-02-0051, E-01345A-01-0822, E-01933A-02-0069, and E-01933A-98-0471.

5. On March 14, 2003, the Commission issued Decision No. 65743, its "Track B" Decision in these dockets. Among other issues addressed, Decision No. 65743 directed Staff to file

an update to its November 2001 Staff Report in the AISA docket, and directed the Commission's Hearing Division to notice a proceeding in compliance with A.R.S. § 40-252 with notice and an opportunity to be heard to the affected parties concerning the continuation of the AISA.

6. Notice of the hearing was published as required.

7. A hearing was held on September 11 and 12, 2003, as required by Decision No. 65743. APS, TEP, AEPCO, AECC, CNE, RUCO and Staff appeared. TEP, AEPCO, APS, CNE, AECC, and Staff presented evidence.

8. Following the hearing, on September 29, 2003, Staff docketed a supplemental filing regarding the costs incurred by the AISA for the filing of the AISA protocols before the FERC.

9. On October 6, 2003, AEPCO filed comments on Staff's supplemental filing.

10. On October 23, 2003, counsel for AECC filed comments in response to AEPCO's October 6, 2003 filing.

11. On February 2, 2005, AEPCO docketed a Supplemental Filing and Request for Official Notice, requesting that the Commission take official notice of the Arizona Court of Appeals' January 25, 2005 mandate in *Phelps Dodge*.

12. On February 18, 2005, a Procedural Order was issued directing that responses to AEPCO's February 2, 2005 filing be filed by Staff and by other parties who wish to be heard on the issue by March 11, 2005, and that responses include recommendations regarding the effect of the Arizona Court of Appeals' January 25, 2005 mandate in *Phelps Dodge* on these AISA proceedings.

13. AECC, the Alliance, AISA, APS, TEP, the Cooperatives and Staff filed Responses to AEPCO's February 2, 2005 filing.

14. The AISA ensures non-discriminatory access to transmission for retail service in Arizona in the absence of a FERC-approved RTO.

15. The AISA Board has responded to the current lack of retail direct access activity in Arizona by downsizing the AISA to the minimum size practicable that still retains the critical mass needed to keep the entity intact. This approach appropriately keeps the option of direct access available to Arizona customers, to be utilized as the opportunity to shop improves.

16. APS, TEP, and other Affected Utilities should continue to be allowed to recover the

prudent costs of participation in the AISA, as provided in the applicable cost recovery mechanisms approved by the Commission in other dockets.

17. Staff's recommendation to continue support for the AISA in its current downsized mode pending Commission review of the Retail Electric Competition Rules is reasonable and should be adopted.

CONCLUSIONS OF LAW

1. The AISA is a FERC-jurisdictional entity that was created to ensure non-discriminatory access to transmission for retail access service in Arizona in furtherance of the Commission's policy of offering the choice of retail direct access service to customers.

2. The AISA exists independently of A.A.C. R14-2-1609 (C) through (J).

3. The Commission has jurisdiction over the subject matter of this proceeding.

4. *Phelps Dodge* does not preclude Commission support for the continuation of the AISA as a matter of public policy.

ORDER

IT IS THEREFORE ORDERED that the Affected Utilities as defined by the Commission's Retail Electric Competition Rules shall continue to be allowed to recover the prudent costs of participation in the Arizona Independent System Administrator, as provided in the applicable cost recovery mechanisms approved in other Commission dockets.

IT IS FURTHER ORDERED that the Commission's Utilities Division Staff shall include, in its recommendations to the Commission resulting from its review of the Retail Electric Competition Rules, a recommendation regarding provisions concerning the Arizona Independent System Administrator.

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IT IS FURTHER ORDERED that consistent with this Decision, Docket No. E-00000A-01-0630 is hereby closed.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____, 2006.

BRIAN C. McNEIL
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

TW:mj

SERVICE LIST FOR: THE GENERIC PROCEEDING CONCERNING ELECTRIC RESTRUCTURING ISSUES and THE GENERIC PROCEEDING CONCERNING THE ARIZONA INDEPENDENT SCHEDULING ADMINISTRATOR

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