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Arizona Corporation Commission

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

<p>8 <b>IN THE MATTER OF THE</b></p> <p>9 <b>COMPETITION IN THE PROVISION</b></p> <p>10 <b>OF ELECTRIC SERVICES</b></p> <p>11 <b>THROUGHOUT THE STATE</b></p> <p>12 <b>OF ARIZONA</b></p>	<p>) <b>DOCKET No. U-0000-94-165</b></p> <p>)</p> <p>) <b>SRP'S RESPONSE TO REQUEST FOR</b></p> <p>) <b>COMMENTS ON ELECTRIC</b></p> <p>) <b>INDUSTRY RESTRUCTURING</b></p>
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14 The Salt River Project Agricultural Improvement and Power District ("SRP")  
15 submits its response to the Commission's request for comments on electric industry  
16 restructuring. SRP's response to the specific questions raised by the Commission is contained in  
17 and attached hereto as Exhibit A.

18 SRP is submitting these comments as part of its voluntary participation in this  
19 docket proceeding. As an agricultural improvement district, SRP "is a public, political,  
20 . . . subdivision of the state, and a municipal corporation to the extent of the powers and  
21 privileges . . . granted generally to municipal corporations by the constitution and statutes."  
22 A.R.S. § 48-2302. As such, SRP is not a "public service corporation" subject to the jurisdiction  
23 of this Commission. See Rubenstein Construction Co., v. Salt River Project Agricultural  
24 Improvement & Power District, 76 Ariz. 402, 265 P.2d 455 (1954); Menderson v. City of  
25 Phoenix, 54 Ariz. 280, 283, 76 P.2d 321, 322 (1938); Ariz. Const., Art. 13, §7 and Art. 15, §2.  
26 By voluntarily submitting these comments and participating in this docket proceeding, SRP

1 does not waive any of its rights and immunities as a political subdivision of this State or  
2 recognize this Commission's jurisdiction over its activities and business.

3 Furthermore, SRP recognizes that the Arizona legislature has recently established  
4 a working group to investigate issues relating to the restructuring of the electric industry and  
5 make recommendations to the legislature as to how restructuring should be accomplished in  
6 Arizona. SRP's restructuring proposal submitted in this proceeding is premised on the existing  
7 statutory framework and could be affected by future legislative programs.

8 Finally, as stated in the attached Exhibit A, SRP does not believe that  
9 establishment of a physical pilot program is necessary or particularly helpful. Nonetheless, SRP  
10 management, as distinguished from its Board of Directors, has submitted general comments  
11 regarding the scope and characteristics of a physical pilot program, should this Commission  
12 decide to proceed with such a pilot program. If this Commission determines that initiation of a  
13 pilot program is advisable, any voluntary participation by SRP in such a program, assuming it  
14 had the requisite constitutional, legislative and regulatory authority, would need to be first  
15 authorized by SRP's Board of Directors.

16 Respectfully submitted this 28 day of June, 1996.

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***EXHIBIT A***

## **COMPETITION IN THE ELECTRICITY MARKET**

### ***SRP's Position On Industry Restructuring and Customer Choice***

The restructuring of the electric industry is being discussed throughout our nation. The catalyst for these discussions is the desire of electricity customers for a choice of provider, lower cost electricity service, and enhanced service options.

SRP's mission is to be the best water and power organization, dedicated to improving service, lowering costs, resource stewardship, and market focus through involved change-oriented employees.

### **SRP Supports Customer Choice Of Generation Provider**

In keeping with this mission and SRP's long history of meeting customer needs and expectations, SRP's board of directors supports an electric industry in which customers are free to choose the generation provider that delivers the highest value products and services.

Industry restructuring should not introduce new rules to limit or eliminate the number or types of providers in the marketplace. To do so would reduce competition in the electricity market.

Choice of generation supplier should begin by the year 2000, and, when appropriate, should be phased-in for all customers thereafter. This schedule allows adequate time to consider the economic, social, financial, technical, operational, system planning and environmental implications of an industry restructuring.

### **Distribution Monopolies Will Remain**

SRP's board believes that the electricity industry should be characterized by a fully competitive generation market in which all customers will eventually have choice of generation provider; a federally-regulated, tariff-based "open access" transmission system; distribution service territories operating under the existing regulatory framework and territorial agreements; and a fully-competitive market for energy services.

Distribution systems will remain monopolies and will be managed and operated by traditional suppliers under existing state laws, regulatory structures, tax obligations and public responsibilities. Existing territorial agreements and Commission-granted certificates of convenience and necessity will remain in effect for distribution services.

Traditional distribution suppliers will ensure reliable operation of the electrical system.

## **SRP Will Continue As A Political Subdivision**

SRP will continue as a political subdivision of the state of Arizona ("Traditional SRP"). Traditional SRP will provide a full range of electricity service to retail customers (should they choose SRP for their generation needs) within its existing service territory. Traditional SRP will do business under existing state law and regulatory structures, and in particular, will continue to fulfill its responsibilities for the storage and delivery of water within its traditional water service area.

Assuming appropriate statutory and regulatory requirements provide for reciprocal service among electric utilities, customers in SRP's service territory would be free to choose an alternative supplier for their electricity supply and energy services needs.

The continued operation of SRP and other non-public service corporations within traditional territories under existing state law and regulatory structures is appropriate. The different structures of industry participants, investor-owned and public power utilities, result in certain tax and financial benefits and burdens that differ for each participant. Each structure carries with it its own set of advantages and disadvantages that result in roughly equal competitive positions for both structures.

## **SRP will form an Affiliate to Compete Outside Its Service Territory**

To facilitate the implementation and acceptance of retail competition in Arizona, SRP will form an affiliate to do business outside its traditional service area. The affiliate will be subject to equivalent rules and requirements as other players in the competitive sector, including appropriate tax obligations and regulatory requirements.

SRP's board plans to operate as a traditional supplier within SRP's service territory and to form an affiliated power marketer to compete outside its service territory in the retail wheeling arena.

As customers choose alternate suppliers, SRP will contract with its non-traditional affiliate to market surplus, including the output of assets stranded by these customers, putting resources to effective use. SRP's affiliate will compete for retail customers with other competitive, non-traditional suppliers. It will be subject to equivalent rules and requirements as other players in the competitive sector, including appropriate tax obligations and regulatory requirements. It will not be bound by agreements pertaining to service area. SRP's affiliate will contract for additional resources to maximize the value of resources contracted from Traditional SRP.

All competitive suppliers will participate in the market under laws, rules and structures applicable specifically to the competitive sector. They will have the ability to compete and provide generation and energy services to all customers and will acquire new resources to do so. In the public interest, all market participants must comply with reliability criteria established by the North American Electric Reliability Council (NERC) and the Western Systems Coordinating Council (WSCC).

SRP believes the foregoing is a fair and balanced structural outline, preserving the benefits of traditional suppliers (delivery, reliability, obligation to serve), embracing the benefits of competitive suppliers (choice and competition), and enabling existing traditional suppliers to compete in the competitive sector, on equal footing, with all participants. Work is continuing on defining the details of this proposed approach.

## **SRP PROPOSAL FOR A RETAIL WHEELING PILOT PROGRAM**

**If a pilot program were implemented, how should it be implemented? We are seeking specific proposals on implementing the activities listed on Attachment A in a pilot program. Your suggestions could be formulated as tariffs or rules which would then be implemented by the Commission and by utilities, other suppliers of electricity, and consumers.**

Choice of generation supplier should begin by the year 2000, and should be appropriately phased-in for all customers thereafter. This schedule allows adequate time to consider the economic, social, financial, technical, operational, system planning and environmental implications of an industry restructuring.

In keeping with this timetable, SRP management proposes the Commission establish a Working Group on a Pilot Retail Wheeling Program in Arizona. The Working Group should be made up of industry experts from Arizona utilities, Commission Staff, RUCO, new market players and representatives from each of the major customer classes. The Working Group should review the issues involved and simulate the elements of a pilot program.

In addition, the Working Group should obtain, study and analyze the results of pilot programs in other states to obtain the answers necessary to implement choice of generation provider in Arizona.

The Working Group should be established by December 31, 1996, and should develop, implement and evaluate a simulated program and provide results to the Commission by January 1, 1998.

SRP management believes that a simulated pilot program, as described above, will allow for a more orderly introduction of customer choice than the implementation of a physical pilot program. A physical pilot program is not the most effective means of investigating and addressing issues arising from retail wheeling. A simulated pilot program does not present any constitutional, statutory and regulatory issues which might be raised if a physical pilot is adopted. The combination of information from pilot programs currently underway in other states and experience from a simulated pilot program should allow the successful introduction of retail electric competition in Arizona in a timely and cost-effective manner. In addition, a physical program may develop customer expectations that are unachievable in a fully competitive market

## **SRP Recommendations if ACC Proceeds With Physical Pilot Program**

If the Arizona Corporation Commission believes and decides that a physical pilot program is necessary, SRP management proposes that the Commission establish a Working Group as described above. The Working Group should formulate a mutually agreeable pilot program that will enable the Commission to identify problems with open access and be in a position to develop solutions for these problems.

The Working Group should be established by December 31, 1996, and should provide a detailed recommendation to the Commission by January 1, 1998. The Commission should take appropriate action for a retail wheeling pilot program to start June 1, 1998. The timetable for restructuring the electric industry in Arizona should be adjusted accordingly.

The following framework is proposed for consideration by the Working Group.

### **Framework for Retail Wheeling Pilot Program**

#### **PHASE-IN**

The physical pilot program should be phased-in, starting with industrial customers. If a successful pilot of industrial customers is accomplished, then the pilot should be expanded to include commercial, and with continued success should be further expanded to include all customers.

#### **SIZE:**

The physical pilot program should be limited to a specific number of customers.

	<b>Number</b>
<b>Industrial</b>	10 customers
<b>Commercial</b>	25 customers
<b>Residential</b>	100 customers

Total participation would be limited to 25 megawatts in 1st year and 50 megawatts in 2nd year. All schedules from supplier to local utility must be scheduled on a whole megawatt basis.

**TERM:**

The pilot program would commence June 1, 1998, and last for two years.

**SELECTION:**

Use a lottery system. Announce the pilot and have customers submit an application answering specific questions about the location of load, etc. Allow enough time to advertise the pilot, develop and send out applications, receive responses, pick those selected and notify those selected through direct contact and local advertising.

**ENERGY SUPPLY:**

A list of potential generation suppliers must be available to those selected. For the pilot program, one utility should solicit bids for suppliers and post these bids. The suppliers would provide energy and capacity needed to meet the specific program the customer has signed up for and deliver it to the host utility using Western Systems Coordinating Council scheduling procedures.

**OPTIONS:**

All options should be evaluated by the Working Group, with close consideration of the costs and benefits of each option. The following options should be considered by the Working Group.

a) Standard kWh Meter

Energy from supplier would be scheduled on a static basis and would meet at least part of the forecasted energy needs of customer.

The local host utility would continue to provide regulation, backup reserves, transmission, distribution, etc.

b) New Time of Use Meter

Computers belonging to the by host utility would interrogate and record usage.

Schedule from suppliers would change hourly to meet changing customer demand but would be static during each hour.

The local "host" utility would continue to provide regulation, backup reserves, transmission, distribution, etc.

c) New Telemetry System

The wholesale supplier and local utility would transmit usage instantaneously on a dynamic basis. Usage must be greater than 1 megawatt and would be tracked on a whole megawatt basis.

The local "host" utility would provide essentially "zero" load regulation. Regulation is provided by the wholesale supplier.

For the pilot program, the local "host" utility would continue to provide backup reserves, transmission, distribution, etc. In the future, backup reserves, which should be provided as a separate ancillary service, must be paid for and customers must have a meter with remote disconnect capability.

**COST OF PILOT:**

Customers requiring special metering should pay for that metering, if they are to benefit from lower energy rates. Given the timeframe of the pilot program and the number of meters involved, participants should lease meters in order to have a truer indication of the costs involved.

**BILLING:**

Customer bills would be modified to reflect unbundled services. Charges from the generation supplier should be clearly separated from the local utility charges. Local "host" utility ancillary costs would be included in the customer's monthly bill.

**Conclusion**

SRP management believes that a simulated pilot program will allow for a more orderly introduction of customer choice than the implementation of a physical pilot program. If the Arizona Corporation Commission believes and decides that a physical pilot program is necessary, SRP management believes that the aforementioned process elements are essential to a physical pilot program. Participation by SRP in a physical pilot program is subject to appropriate legal authority, and approval by SRP's Board of Directors.

**SRP RESPONSE TO ARIZONA CORPORATION COMMISSION  
QUESTIONS REGARDING ELECTRIC INDUSTRY  
RESTRUCTURING**

**A1. Affected Utilities. Which utilities should open their markets to competition?**

Every utility should have the option of participating in the competitive market place. No utility should be precluded from offering choice of generation provider to customers in its service area if it chooses to do so.

However, reciprocity must apply. Utilities who offer choice of generation providers to customers must have reciprocal rights to compete for customers in the service territories of all other utilities who choose to participate, either directly or through an affiliated power marketer. The absence of reciprocity would severely hamper the competitive market and could lead to unfair competitive advantage by some players.

Industry transformation should not introduce new rules to limit, eliminate or restrict the number or types of providers in the marketplace. To do so would reduce competition in the electricity market and reduce the range of choices available to customers.

The continued operation of SRP and other non-public service corporations within traditional territories under existing state law and regulatory structures is appropriate. The different structures of industry participants, investor-owned and public power utilities, result in certain tax and financial benefits and burdens that differ for each participant. Each structure carries with it its own set of advantages and disadvantages that result in roughly equal competitive positions for both structures.

**A2. Scope of Restructuring.**

**a. How much of the utilities' markets should be opened to competition?**

SRP believes that the electricity industry will be characterized by a fully competitive generation market in which all customers will eventually have choice of generation provider; a federally-regulated, tariff-based "open-access" transmission system; distribution monopoly service territories operating under the existing regulatory framework; and a fully-competitive market for energy services.

- b. **Which consumers should be allowed to shop around for power and energy? Consider both geographic areas and consumer classes.**

SRP believes that all customers eventually, and when appropriate, should have choice of generation provider.

- c. **Should utility customers served under existing contracts be eligible to participate in the competitive market prior to expiration of the existing contracts?**

Customers with existing contracts should participate in the competitive market upon expiration of the contracts unless otherwise mutually agreed by the customer and the contracting utility.

- d. **If divestiture were undertaken, how should it be accomplished?**

SRP does not support mandatory divestiture. SRP believes that in a fully competitive marketplace, market forces would be sufficient to ensure that utilities and other industry participants make appropriate decisions to successfully provide reliable, competitively priced electricity to customers.

### **A3. Term of Restructuring.**

- a. **When should competition start?**

Choice of generation supplier should begin by the year 2000, and should, when appropriate, be phased-in for all customers thereafter. This schedule would allow adequate time to consider the economic, social, financial, technical, operational, system planning and environmental implications of an industry restructuring. All suppliers who intend to participate in the competitive market, when such market is implemented, should have the opportunity to begin participating at the same time. This will ensure that customers of all entities that choose to participate will have choice of generation supplier at the same time, and no supplier, or customer, is disadvantaged..

- b. **If competition is in the form of a pilot or phase-in, how long should the pilot or phases run? Please describe the phases of a phase-in. Please consider that many larger customers of utilities are currently under contract and may not be able to shop around until those contracts expire.**

See previous comments on pilot program.

- c. **If competition is in the form of a pilot, how can the term of the pilot be set so as to avoid discouraging long term contracts signed under the pilot?**

A simulated pilot program would allow interested parties to evaluate the impacts of retail wheeling without the need for new contracts.

**A4. Services Available on a Competitive Basis. Which services should be available in a competitive market?**

- Distributed energy services at market based rates (serving multiple consumers located in proximity, and not requiring transmission service from others); this is distinct from on-site self generation for just one consumer.**

See below.

- Central station generation services at market based rates (generation serving one or more consumers located at a distance from consumers and requiring transmission service).**

See below.

- Other services described in Sections A5, A6, A7, and A8.**

See below.

- Other services (please describe).**

Historically the legislative and regulatory framework has treated the U.S. electric industry as one industry - - integrated through the generation, transmission and distribution sub-markets - - with the belief that a natural monopoly existed in each of these sub-markets. Technological and philosophical changes have led policymakers to conclude that a natural monopoly no longer exists in the generation market. In addition, a new market is forming in energy services which includes the procurement of electricity supply.

Consequently, changes to each sub-market will be different. The generation or power development and production business of the future will be fully competitive. All customers, eventually, when appropriate, will have a choice of generation provider.

The transmission business is moving toward a federally-regulated tariff-based "open access" system under the Federal Energy Regulatory Commission (FERC). Many of these changes currently taking place were initiated by passage of the Energy Policy Act of 1992 and regulatory guidelines put in place by FERC. FERC Order 888 has made open access to the transmission system the industry standard. SRP is developing open access tariffs and will file them the Southwest Regional Transmission Association (SWRTA).

The distribution business essentially is a natural monopoly and therefore should stay a regulated, service-territory business under existing regulatory frameworks and laws.

A fully-competitive market is developing for energy services. Customers will choose who would procure generation for them, as well as energy-related services beyond normal distribution services.

Within this new overall structure of competitive generation and energy services, open access transmission, and locally-regulated, monopoly distribution there would be two types of electricity service suppliers with different purposes, roles and responsibilities - "traditional" and "non-traditional" suppliers.

*Traditional Suppliers:* These entities would continue to provide the full range of services to customers in existing service territories under existing laws, regulatory structures, tax obligations and public responsibilities. Existing territorial agreements and Commission-granted certificates of convenience and necessity would remain in effect.

Traditional suppliers would have an obligation to serve that, minimally, would cover delivery of power. For customers other than those who, either individually or by aggregation, have a peak load of 1 MW or greater for three consecutive months, the obligation would also extend to generation or reserves therefor, for which the traditional supplier would be due just compensation.

SRP believes a level of 1 MW would provide an adequate measure of which customers could potentially obtain favorable deals from traditional suppliers to the detriment of the traditional supplier's other customers. However, as market conditions change, this level may change, and SRP believes that periodic assessments should be undertaken to determine an appropriate threshold.

Traditional suppliers would ensure reliable operation of the electrical system.

Direct access to generation and energy services would be phased in, eventually, when appropriate, for all customers. Customers within a traditional supplier's service territory would have choice of providers for generation and energy services. Other entities could sell generation and energy services to these customers.

As some customers choose alternate suppliers, traditional suppliers would need a mechanism to market assets stranded by these customers, thus putting

resources to effective use to the benefit of customers and investors. Traditional suppliers could, if deemed appropriate, form non-traditional affiliates to compete with all players in the competitive market. Alternatively, traditional suppliers could choose to compete directly without the formation of an affiliate, subject to rules and regulations applicable to non-traditional suppliers. System economics would be protected and improved for the benefit of customers and investors. Existing resources would be put to beneficial use to the extent that entities have the competitive capability to do so.

Non-Traditional Suppliers: These entities would compete for retail customers with traditional suppliers and other non-traditional suppliers in the traditional supplier's service territory. Non-traditional suppliers would compete in the market under equivalent rules and comparable structures. They would have the ability to compete and provide generation and energy services to all customers and would acquire new resources to do so. Non-traditional suppliers would have no obligation to serve.

**A5. Necessary Services. Utilities and perhaps other parties will have to address the services listed below. Please indicate how these services should be offered, measured (metered), and priced on an unbundled basis.**

The services listed below are necessary for the reliable provision of electricity to retail customers. Retail customers now pay traditional electric suppliers for these services on a bundled basis through the traditional supplier's retail rates. Under competition, the arrangement for these services may change for some customers, but not necessarily for others.

Large manufacturing or industrial customers may want to arrange for these services in the same manner that wholesale customers arrange for service. These customers would likely make separate arrangements for each service from their traditional electric supplier or from a non-traditional supplier where applicable in order to access or shop competitive markets on their own.

Residential and small commercial customers may want their non-traditional suppliers of electricity to arrange for some or all of these services with the customer's traditional electric provider. These customers may still pay for these services on a bundled basis through the non-traditional supplier's rates. The non-traditional supplier would have to arrange for these services with the customer's traditional electric supplier.

The prices for services that cannot be competitively supplied, typically distribution and transmission related services, should be based upon the costs associated with providing those services plus a reasonable rate of return. The prices for the sale of such services to the traditional electric utility's retail customers would be subject to the current regulatory framework. Existing

federal law and Federal Energy Regulatory Commission (FERC) policy governs how transmission service and associated ancillary services should be priced for purchase by a non-traditional supplier. Again, the prices for distribution related services would be regulated under the existing regulatory framework.

For those services that may be competitively supplied, such as supplemental generation services, market prices should prevail.

The services identified may be measured and priced through several mechanisms. Cost causation principles should apply in all cases. The cost of some services are essentially fixed; these would be attributable to the customer irrespective of use, or attributable to the capacity made available for the customer to use, which is measurable through the maximum kilowatts a customer has used in the past. Some of these costs are more dynamic, and are measurable through a customer's monthly, daily, or hourly kilowatt and kilowatt-hours of use.

○ **distribution service**

The distribution system is defined generally as the system from the meter to the high voltage (transmission) network. Distribution services cover activities required to install and maintain a metered connection to the transmission network.

The costs to provide this service are relatively fixed in nature and could be recovered through a combination of a flat charge and a charge based on the maximum capacity (kilowatts) used by a customer.

○ **transmission service**

The transmission system is generally defined as the high voltage facilities providing a connection between generating resources and the distribution system. Transmission services cover activities required to install and maintain metered connections between generating facilities and the distribution system.

The cost of this service has been guided by FERC's pricing policies; the charge should be related to the amount of capacity reserved by a customer or reserved by a non-traditional supplier.

○ **supplemental generation service**

Supplemental generating services can be defined as generation maintained in standby or backup to replace primary generating services. Without special metering the distribution company would have to provide, or contract for, regulation services. Facilities required to constantly match generating resources and demand must be included as a supplemental service.

These services have elements of both fixed and variable costs. The costs associated with reserving supplemental or back-up generation for a customer would likely be recovered through a capacity reservation charge based on kilowatts. Energy (kilowatt-hour) charges would also apply when energy is actually utilized by the customer. These services may be able to be supplied by a customer's traditional electric supplier, the customer's non-traditional supplier, or by other players in the market.

○ **imbalance service (including accounting for losses)**

Imbalance service is defined as the process of banking energy with the local control area. The difference between monthly kWh metering of demand and the delivery of energy supply each month, to the control area, would be maintained in an account for each retail customer.

Imbalance service might also include the difference between instantaneous customer demand, which is monitored real-time by specific metering, and the instantaneous delivery of energy for that customer's account.

System losses can be covered a number of ways but calculating actual losses for a customer might be applied to energy deliveries or a monetary payment might be considered.

FERC has addressed pricing for this service. FERC guidelines should be applicable.

○ **back-up (standby) service**

Generation back-up service could be tied to supplemental generation service. Generation back-up service requires generating resources.

Transmission backup services could be purchased if a primary path is established between the generation supplier and customer.

For distribution backup service, no change in the current planning criteria is required. The distribution company for a particular geographic area would continue to build redundant services as it does today.

○ **voltage control**

Along with frequency control, voltage control would be provided by the distribution or traditional supplier. Generation and transmission system elements work hand in hand to provide system VAR requirements and thus coordination by system operators is essential.

FERC has addressed pricing for this service. FERC guidelines should be applicable.

○ **other ancillary services necessary for maintaining system reliability**

Dispatchers must watch the system 24 hours each day. Generators, transmission and distribution elements must be scheduled for maintenance and construction. All outages must be coordinated by a central facility.

○ **scheduling of supplies and demands**

Supplies must be scheduled through control areas and must be instantaneously matched with demands. Transmission must be available to move supply to demand. Metered instantaneous demand must be telemetered to the generation supplier and the entity responsible for matching supply and demand. Without special metering, the customer's demand would automatically be included in the local control area's load profile.

The cost of scheduling transmission services is embedded in the price of transmission paid by customers. Where no competition is present, the scheduling of generation services should be priced based on cost-based pricing principles

○ **repairs/consumer complaints**

Customer complaints should be handled by those parties responsible for providing specific services. If a customer has arranged for service through a traditional provider, repairs/consumer complaints should be handled by that provider and those costs should be a part of the cost of providing service.

○ **other necessary services -- please describe**

**A6. Market Center Services. The market may benefit from the services listed below. Please indicate how these services should be offered and priced.**

SRP believes that the regional market benefits from the availability of market center services. In response to market demand, effective April 1, 1996, SRP has opened the SRP Market Center to offer these types of services. Customers requiring market center services for their energy needs can purchase them from the SRP Market Center.

○ **title transfer**

To satisfy Western System Coordinating Council (WSCC) operating reliability criteria, each entity in a transaction string must designate the entity and control area generating the energy, all contracting intermediaries, and the entity and

control area recovering the energy. If an entity wishes to identify only the parties immediately before or after it in a given transaction, SRP offers bus transfer services for a fixed price per schedule day to research and identify all the other parties in the transaction string.

- **transaction confirmation**

All parties to transactions must be known and must confirm transactions before, during and after-the-fact. To comply with this requirement, a 24-hour dispatch capability is needed. Billing personnel must be connected to transaction checkout. SRP offers scheduling and dispatch services to customers seeking those services. Customer needs vary widely, and therefore SRP provides prices on a case-by-case basis.

- **establishing credit standards**

Membership in the Western Systems Power Pool (WSPP) currently includes a credit worthiness check.

- **invoicing**

SRP is currently developing a variety of billing services including aggregation at multiple transmission path segments, final checkout and invoice preparation and limited dispute resolution services. Since the needs of individual customers vary, prices will be quoted on a case-by-case basis, although SRP expects a market for standardized products, and hence prices, to develop.

- **dispatching of transmission/generation**

Dispatching services should be a required service for electricity purchasers, although SRP offers integration and dispatch if operational conditions permit.

- **exchanges/swaps**

- **interruption notification**

Customers located in SRP's service area may choose not to purchase backup supply from SRP if they purchase their electricity from an alternate supplier. Upon loss of their alternate supplier, SRP will interrupt service. SRP will provide notification of reasons for interruption to customers in this situation.

- imbalance trades**

SRP can provide a mechanism for different customers or groups of customers with equal and off-setting energy balances to zero out those account balances. SRP is developing terms and conditions and a fee for this service.

**A7. Spot Market Services. The market may benefit from the services listed below. Please indicate how these services should be offered and priced.**

- electronic bulletin boards for spot transactions/prices**

See below.

- power pooling services**

See below.

- coordination with futures/options markets**

Electronic bulletin board service will be offered on the region-wide Transmission Information Services Network (TSIN) being developed by SRP and other utilities in the region. SRP has offered to any of the transmission providers in the region an opportunity to participate in and use the TSIN to post their transmission and ancillary services that FERC's Order 888 might require.

While developed to post transmission availability and pricing information, the TSIN will have the flexibility to post other information. This information can be data for marketing products or services. Such information could be spot transaction/prices and power pooling services.

**A8. Transmission Service. For a competitive market to work, utilities owning transmission facilities must provide transmission service. Please indicate how the following objectives would be met:**

- services must be provided consistent with FERC tariffs.**

See below.

- **utilities must accept power delivered to their transmission systems by other suppliers and offer wheeling services comparable to services they provide to themselves.**

See below.

- **all sellers supplying consumers must have interconnection agreements with owners of necessary transmission facilities.**

As discussed in section A7, the development of the TSIN will provide all the transmission provider's transmission availability and pricing information plus additional back up information. Historical transactional information will also be posted primarily for audit purposes.

Under FERC Orders 888 and 889, all transmission users, including the host utility and affiliates, will have to request and purchase the transmission service they need through the TSIN. Through the Regional Transmission Groups, transmission service will also be made part of a transmission provider's tariff. The transmission providers must offer transmission service not being used to anyone on a nondiscriminatory basis. The RTG's define what transmission capability they can reserve for themselves through the TSIN. The remaining capacity on an hourly, weekly, monthly and yearly basis through a 10 year period must be made available (Available Transfer Capability or ATC) to anyone by the transmission provider. SWRTA bylaws make it clear that transmission providers include both transmission owners and those holding contract rights.

While one is not sure what ancillary services will be have to be offered through the FERC tariff, whatever ancillary services that are offered must be posted on the TSIN.

As noted above, requests for transmission service will be made through the TSIN. Before a request can or will be granted, both parties must execute an agreement to define the transmission providers obligations and limitations for service. The agreement will also identify the users' obligations such as paying for the service.

**A9. Recovery of Stranded Investment. Please indicate how the recovery (if any) of stranded investment should be accomplished. Address each of the following issues:**

- a. **The definition of stranded investment.**

See below.

- b. **The fraction of stranded investment which should be recovered.**

See below.

- c. **How the Commission will determine the amount of stranded investment, taking into account: revenues under traditional tariffed rates (or existing special contracts); actual utility revenues from customers who obtain discounted rates or obtain service from others; increases in net revenues from wholesale sales and additional retail sales, including the effects of price elasticity of demand; increases in the value of assets due to new pricing or competition; mitigation of stranded investment; and other relevant factors.**

See below.

- d. **Preliminary estimates of the magnitude of stranded investment (please provide supporting analyses).**

See below.

- e. **The proper ratemaking treatment of negative stranded investment.**

See below.

- f. **From whom stranded investment should be recovered.**

See below.

- g. **The mechanism for recovery of stranded investment.**

See below.

- h. **The time period over which stranded investment is to be recovered.**

See below.

- i. **How utilities can mitigate stranded investment?**

See below.

All industries which have undergone the transformation from a regulated to a market system have had to deal with transition issues. As the electric utility industry evolves towards an environment characterized by customer choice for generation suppliers, one of the critical transition issues to be addressed is

stranded cost recovery. Given the critical implications as to the length of the transition period and key assumptions as to the computation of stranded costs, SRP will address this question generically, recognizing that specific responses to the sub-questions set forth in the Commission's docket item can change based on the assumptions that are used.

Because the implications of retail stranded investment depend on the timetable for the introduction of retail wheeling, SRP advocates a reasonable transition period in which utilities should work through any variety of approaches to mitigate any potential stranded cost exposure. The objective should be to eliminate all such costs within a reasonable transition period of eight to ten years. However, an overriding proviso should operate to avoid negative consequences for all customer classes and for investors. In this regard, the stranded investment equation should not be looked at as a "zero sum game," wherein some customer classes or investors benefit at a cost to others.

"Stranded investment" consists of those legitimate, prudently incurred costs that may be avoided by a departing customer who switches energy suppliers. Costs stranded by self-generation or relocation are not considered stranded investment. Similarly, under SRP's assumption that the transmission system will be a federally regulated, tariff-based system, and that distribution service monopolies will continue, some transmission costs and most distribution costs should not be considered stranded investment. Rather, stranded costs principally include generation, the cost of which may exceed anticipated future market prices; decommissioning and environmental costs which are not reflected in rates; demand-side management obligations and uneconomic federal, state or local mandates; and regulatory assets consisting of various cost deferrals arising from resource contract buydowns, debt refinancings and in the case of investor owned utilities, deferred taxes and generation investment which are excluded from current rate base calculations. Consistent with the foregoing, Power Marketing Administration (PMA) output should be considered as a stranded benefit of the customers who have purchased it. Those customers have relied on the legislative and regulatory system that provided them with this output, and as the system changes, those customers should have the opportunity to purchase those assets at book value.

As electric industry participants in California and in other states have learned, agreement on the recovery of stranded costs is essential in the transition to a restructured industry. FERC recognized this in its Order 888 which provides for full recovery of stranded costs associated with wholesale requirements contracts signed before July 11, 1994, and contractual recovery of such costs after that date. This Order permits recovery of wholesale stranded costs from departing customers.

Unlike investor-owned utilities, locally-owned utilities such as SRP have no equity owners to help absorb the costs of assets built in a prior environment

which may be rendered uncompetitive in a deregulated environment. Additionally, to the extent they recover stranded investment, the tax-exempt status of bonds used to finance those assets may be jeopardized under complex IRS private use regulations that have yet to be finalized. The consequences of running afoul of these regulations, even in their proposed form, are serious and can result in the interest on said bonds becoming taxable to the investor, absent costly early redemption of the debt by the issuer. Irrespective of the problems posed by these regulations, an exit fee or "wires charge" may ultimately prove to be bad public policy and damaging to customer relationships which are so essential in a truly competitive marketplace.

The only other recourse would be to raise customer rates to recover stranded investment.

Instead, SRP advocates affording market participants flexibility in recovering stranded costs by allowing an adequate period of time in which to deal with this critical transition issue equitably, and without negative consequences to customers and investors. Moreover, in the case of locally-owned utilities such as SRP, it is essential that investments which may become stranded as a result of departing customers can be remarketed, as necessary, to supply new customers outside historic territorial boundaries, subject to the laws, rules and structures set forth for the competitive sector. This solution will result in the fair and economic use of resources and work to the benefit of all customers.

**A10. Recovery of Costs of Commission-Mandated Utility Low Income, DSM, Environmental, Renewables, and Nuclear Power Plant Decommissioning Programs ("Mandated Programs").**

- a. **How shall costs of mandated programs be recovered from participants in the competitive market?**

See below.

- b. **How shall the magnitude of the costs of mandated programs be determined?**

With the opening the electric industry to competition, market mechanisms will drive both the demand and supply of generation, resulting in the optimal allocation, mix and use of scarce energy. Any government policies regarding resource mix and energy efficiency should be implemented through mechanisms outside of the competitive marketplace. For example, a fee tied to distribution service is one way to recover such costs.

**A11. Encouragement of Renewables.**

- a. **How shall renewables be encouraged in a competitive environment? Please discuss such mechanisms as a requirement that x percent of energy sold in the competitive market must come from solar resources.**
- b. **How could progress in encouraging renewables be measured?**
- c. **How could a renewables program be enforced by the Commission?**

See response to A10.

**A12. Pooling of Generation and Centralized Dispatch of Generation or Transmission.**

- a. **Should pooling of generation or centralized dispatch of generation or transmission be mandatory or voluntary?**

Formation of transmission and generation pooling arrangements, or centralized dispatch should be approached on a voluntary basis. Where it makes sense to establish such pools, they will be formed by those interested in doing so under terms that best apply to the specific situation.

On the wholesale level in Arizona, and in the west in general, utilities have demonstrated a willingness to foster open competition, have established an active wholesale market, and have embraced the concept of Regional Transmission Groups, such as SWRTA. It took several years to establish SWRTA but now interested parties have a forum to bring transmission issues forward for resolution.

Looking at SWRTA and the wholesale market as an example, it takes a significant amount of effort to establish arrangements that address the positions of the many participants in the utility market. The development of a centralized operation for generation and transmission would also likely be a long complex process. Furthermore, at this time it is difficult to show that the benefits provided by this type of operation over that those from the voluntary development would exceed the costs of its development and operation.

Today there are others who are working to develop centralized dispatch arrangements and centralized transmission operation (Independent System Operators), such as the PJM Power Pool, and the recent activities in California. SRP believes that it is prudent to watch the development of these pools and learn

from their experiences before consideration is given to mandating similar arrangements for utilities in Arizona.

- b. **What technical requirements will be necessary to ensure reliable and efficient use of generation and transmission resources? Please propose specific requirements, if possible.**

Given that centralized operation should not be mandated, it is unnecessary to establish additional technical requirements at this time.

**A13. Non-Public Service Corporations. How shall non-public service corporations such as municipal utilities be involved in a competitive market? For example, the service territories of Arizona utilities not regulated by the Commission may not be open to competition and Arizona utilities not regulated by the Commission may not be able to compete for sales in the service territories of the utilities identified in Section A1. Alternatively, an Arizona utility not regulated by the Commission may voluntarily participate in a competitive program if it makes its service territory available to competing sellers and if it agrees to all of the requirements of the Commission's competitive program.**

The purpose of a competitive electric industry is to increase efficiency and lower costs. In this environment, well-managed, efficient and innovative companies, whether existing entities or new entrants, will survive and prosper, regardless of what organizational form they take. Competition will not discriminate: the market will dictate which providers survive. Industry transformation should not introduce new rules to limit, eliminate, or restrict the number or types of providers in the marketplace. To do so would reduce competition in the electricity market.

Territorial agreements may require modification to facilitate the introduction of competition in the electric industry. To the extent that such modification is necessary or appropriate, parties should proceed to develop and implement such modification.

The different structures of industry participants, investor-owned and public power utilities, result in certain tax and financial benefits and burdens that differ for each participant. Each structure carries with it its own set of advantages and disadvantages that result in roughly equal competitive positions for both structures.

To facilitate the implementation and acceptance of retail competition in Arizona, SRP will form an affiliate to do business outside its traditional service area. The affiliate would meet all applicable requirements of a competitive program and compete on the same footing and basis as other non-traditional suppliers. Other

locally-owned utilities may have different proposals to meet any requirements of a competitive program. SRP's proposal does not speak for other locally-owned utilities other than SRP.

**A14. Conditions for Returning to Utility Service After the Conclusion of a Pilot Program.** If a pilot were adopted, please indicate what conditions are appropriate for returning utility service after the conclusion of the pilot.

A simulated pilot program will allow interested parties to evaluate the impacts of retail wheeling without the need for customers to leave existing utility service.

**A15. Conditions for Returning to Utility Service.** Please indicate what conditions (if any) are appropriate for returning to utility service if a competitive market is on-going.

Traditional suppliers would have an obligation to serve that minimally covers delivery of power. For customers less than 1 MW, the obligation would also extend to generation or reserves therefor, for which the traditional supplier is due just compensation, including those who wish to return after purchasing generation or other energy services from other providers, although they could be subject to differential pricing.

Customers of 1 MW or more are those who by virtue of their size, individually or through aggregation are in a strong position to obtain electric service under terms and conditions that would be detrimental to other customer segments and individual customers.

**A16. Administrative Requirements.**

- a. **A utility may require consumers obtaining generation from another entity to adhere to reasonable scheduling notification requirements, accept reasonable delivery points, adhere to reasonable metering requirements, and accept reasonable remote control requirements for interruptions or other purposes. Please specify what you consider to be reasonable.**

All transactions scheduled from one control area to another must comply with NERC and WSCC guidelines for system reliability.

**b. How should the utilities identified in Section A1 notify their customers of the adoption of a competitive program by the Commission?**

Each electric utility should be responsible for designing and implementing its own procedures for notifying its customers of the available competitive program options. Each utility should have the flexibility to develop notification procedures, such as media advertising, direct mail and interviews, that it believes most appropriate for its particular customer base. Additionally, this will allow utilities to design procedures tailored to various classes of customers served.

Information on generation provider choices would be made available by those competing in the market.

**A17. Impacts on Other Utility Customers. Please indicate how adverse impacts on rates or service quality for utility customers not participating in the competitive market could be minimized.**

Under competition, all customers should benefit from lower costs and increased services, including those not participating in the competitive market. Service to those customers participating in the competitive market must not be subsidized by traditional utility customers who do not participate.

**A18. Reporting Requirements for All Sellers of Electricity to End Users. Please indicate what reporting requirements (to the Commission) are appropriate and who should file reports.**

SRP believes the current framework for reporting should be maintained for existing electric utilities.

"New entrants" into the Arizona electric market should be subject to some type of reporting requirements to adequately protect consumers and service reliability. However, SRP believes the appropriate regulatory mechanisms may depend on the structure and nature of such entities.

**A19. Certificates of Convenience and Necessity. Please comment on whether competitive sellers who supply electricity to an end user must obtain a Certificate of Convenience and Necessity from the Commission (unless the seller already has an applicable Certificate). Please describe whether any conditions on the certificate would be necessary.**

Traditional suppliers would provide service to customers in existing service territories under existing territorial allocation agreements, state law, regulatory

structures, tax obligations and public responsibilities. Existing territorial agreements and Commission-granted certificates of convenience and necessity would remain in effect for distribution services.

Non-traditional suppliers would be subject to the same requirements as all players in the competitive marketplace.