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AZ CORP COMMISSION

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

DOCKETED BY *[Signature]*

Re: Docket No. U-0000-94-165 re Restructuring of the Electric Utility Industry; Request for Comments on Electric Utility Industry Restructuring

Ladies and Gentlemen:

Pursuant to your Request for Comments on Electric Industry Restructuring dated February 22, 1996 and your extension of time to comment dated April 23, 1996, I am submitting the following comments for your consideration.

I act as counsel for the Irrigation and Electrical Districts Association of Arizona, a non-profit Arizona association founded in 1962 to represent the interests of small districts and others engaged in the delivery of electric power and water resources, primarily in rural areas. I also represent a number of the members of the Association individually, while a number of them retain separate, individual counsel. The following comments have not been officially approved by the Association or its members and do not represent the official position of the Association or any of its members. The comments are, however, gleaned from my twenty plus years representing the Association and individual members and reflect what I believe would be the position of the Association and its members in any official presentation to the Commission. It is my understanding that this docket is an informal proceeding initiated by staff which may at some time in the future become a formal Commission docket. If and when that happens, the Association and its members will provide official positions to the Commission for its consideration. Time has not allowed the Association to formally consider these comments, even with the extension of time to comment, because of the extensive action by the Federal Regulatory Energy Commission in its recent

rulemaking and the changes to the industry that such rulemaking portends.

My comments will be divided into three groups: comments on the options listed by Commission staff in the original Request for Comment, comments on the objectives also listed, and comments and responses to the questions listed in Attachment A to the original Request.

#### OPTIONS

Staff listed four options: a pilot program, full competition as quickly as possible, phased-in competition, and retention of regulated monopoly service.

I do not believe the Commission has the option of retaining regulated monopoly service throughout its jurisdictional retail sector. The Federal Energy Regulatory Commission (FERC) in its Open Access order (Rule 888) makes it abundantly clear that FERC is ready to follow transactions down to the retail level to ensure increased competition in the bulk power market and open access to transmission and distribution facilities. Coupling that intent with the increased activity of marketers and independent power producers, as well as activities of non-jurisdictional utilities, creates a future climate antithetical to monopoly service by jurisdictional entities. Indeed, the jurisdictional entities would be disadvantaged by any such attempt to continue monopoly service. Retail competition would begin in service territories of non-jurisdictional entities and among large customers seeking reductions in power costs. Various arrangements would be made to get around any attempt to continue monopoly service and the jurisdictional utilities would be put at a serious disadvantage, unable to keep a true monopoly and simultaneously unable to compete.

A pilot program would be difficult to implement and even more difficult to assess. Should the pilot be on a geographic basis? Should it be on a customer class basis? Should it be inter- or intra-utility? Answers to each of these questions would give you different kinds of programs with different kinds of benefits and burdens and different problems of analysis. None of them would give you a clear picture of how true retail competition will ultimately work in Arizona. Actually, a pilot program already exists in Arizona. It is the arrangements of the small municipal utilities with their larger counterparts that allows transmission of third-party resources as well as control area resources both

for the benefit of these entities and for resale to their consumers. That is not to imply that these arrangements meet all the tests of Rule 888. They do not. But they provide a clear example about how contracting, administration and other activities related to acquisition of third-party resources can work and does work.

Full competition forced quickly will cause market confusion and probably drive retail costs up. The Commission should not rush to examine divestiture until it has the benefit of the reaction of utilities nationally to the requirement to separate transmission and sales functions and staff and to implement the information system required by FERC (OASIS). These milestones occur later this year and will provide considerable education about how vertically-integrated utilities are able to react to these requirements.

What remains is phased-in competition, which should start with existing arrangements being improved and other customer classes being added as quickly as possible. Phased-in competition is also necessary because of the institutional paranoia among jurisdictional utilities concerning the impacts of this massive shift to competition in the sale of electricity.

#### OBJECTIVES

In your Request, Commission staff lists nine objectives. It then asks the question: "How can the objectives listed above be measured?" The question assumes that the respondent agrees with the objectives. Because I do not totally agree, I will comment on each of the objectives separately.

1. *Encourage the benefits of retail electric competition.*  
Comment: This statement assumes that competition will be open, fair and thus beneficial to consumers. The benefits of retail electric competition will only be realized if the regulatory scheme for getting there ensures that the program indeed has these beneficial aspects. Retail competition should be focused on the sale of electricity and services related to generation. Transmission and distribution service and related ancillary services should remain monopolistic for the time being. Measurement of success here will initially be the number of complaints filed at FERC and at the Commission followed by observation of whether electric utility rates go up or down.

2. *Limit the potential harm to utilities and utility investors.*  
Comment: A properly managed stranded investment program at the retail level will ameliorate some of the financial risk monopoly utilities have made in developing systems and generation. Not all this risk should be borne by consumers. After all, utility investors assume a risk by investing and should not be totally held harmless because the industry is changing.
3. *Enable a wide range of consumers to participate in a competitive market.*  
Comment: Ultimately, all consumers should be able to participate if it is to their economic advantage to do so.
4. *Limit the potential for decreases in electric system reliability.*  
Comment: System reliability should be the policy veto over any suggested program or proposal to reach retail electric competition. In this, the regional reliability councils must have a significant role in consultation with the Commission and its sister regulatory agencies in other states within the reliability region in order to continue reliability assurance.
5. *Limit the potential for market impediments such as: (a) exertion of market power by utilities which blunts competitive forces, and (b) high transaction costs for market participants.*  
Comment: Market power must first be and is being addressed at the wholesale level. A truly open communication system (OASIS) should blunt the ability of generating utilities to exert market power. However, both exertion of market power and exaction of high transaction costs can be prevented by a true unbundling of services necessary to accompany generation and transmission and assurance that rates set for these ancillary services are comparable as FERC defines that concept.
6. *Encourage a variety of market developments.*  
Comment: I agree with the laissez faire concept articulated by the staff accompanying this objective. If markets are truly competitive, then competitors will be compelled to be innovative to survive. The role of the Commission should be to ensure that these innovations are not anti-competitive at the retail level when applied.

7. *Promote renewable resources.*  
Comment: The basic purpose of moving to retail competition is to lower the cost of electricity to consumers. Encouraging the use of renewable resources can only meet that objective if these resources are economically competitive. It is obvious to everyone in the industry that most renewable resources other than hydropower are not competitive at this time and will not be in the near future. Rather than forcing the purchase of these uneconomic resources and the blending of a subsidy into retail rates, the Commission should explore how utilities can be given incentives to continue the research and development necessary to bring the cost of renewable resources into line with other energy sources.
  
8. *Protect important public programs.*  
Comment: This concept deserves serious debate. It basically assumes that electric utility rates should subsidize a wide variety of activities not related to the generation and delivery of electricity as well as those that are related. It is one thing to give low income customer assistance (such as the LIHEAP program) or plan for nuclear power plant decommissioning. It is quite another thing to force electric consumers to subsidize environmental protection, renewable resources development, increased energy efficiency, etc. Those activities seem better suited to being shouldered by investors or by the general public through taxes. Electricity cannot become the economic deep-pocket to fund increasing wish lists of activities and still meet the goal of reducing prices to retail consumers through competition.
  
9. *Shield consumers who do not or cannot participate in the competitive market from rate increases attributable to competition.*  
Comment: This objective assumes that captive customers or "native load" customers who do not have the economic incentive to participate in a retail competitive market will see their rates go up. This is the ultimate measurement of whether the program is successful. If these captive customers' rates do go up, the program isn't working. Costs are supposed to be driven down across the board by competition, making the end product less expensive to all. Truly comparable rates should do this. If for some reason they cannot, then retail competition in that sector or geographic area may not be wise.

ATTACHMENT A QUESTIONS

In the Request and in the Preamble of Attachment A, Commission staff asks for comments and responses related to a variety of issues as to implementation of a pilot program. Since I do not believe a pilot program as these questions imply is the proper course of action, and since the questions themselves are more broadly stated, I will assume that I can respond to the questions generally for whatever benefit that may be to the Commission staff.

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

All jurisdictional utilities should open their markets to competition. Non-jurisdictional utilities will have to follow if not parallel that opening because of consumer demand.

**A2. Scope of Restructuring.**

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

All retail markets should be opened and all ancillary services related to generation should likewise be opened. Transmission and distribution services and ancillary services legitimately associated with them should remain monopolistic at this time.

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

All consumers should be allowed to access a competitive market for capacity and energy. Geography and consumer class should not play any role in this unless it can be clearly demonstrated that retail competition for a particular geographic area or consumer class will not provide the assumed benefits.

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

Existing customers should be able to seek reformation of their contracts which contain anti-competitive terms. To the extent that such reformation would allow some entry into the competitive market that the contract blocks, that benefit should be available,

especially where the utility is seeking to prevent transmission of third-party resources across its transmission and/or distribution system.

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

Forced divestiture should be considered only as a last resort. It should only be considered if the functional separation requirements of Rule 888 prove ineffective. Additionally, the development of independent system operators (ISO's) may accomplish the same objectives that the Commission staff assumes that divestiture would accomplish without the intense regulatory interference that forced divestiture implies.

**A3. Term of Restructuring.**

- a. When should competition start?

It already has. Commission staff should explore those areas of competition that are already at work in Arizona and seek to expand the principles and methodologies associated with them to other consumer classes by assessing which consumer classes are best suited for entry into retail competition at this time. In developing a time table, the Commission staff must realize that we cannot progress toward retail competition in a vacuum. We must be sensitive to developments in sister states with which we compete economically and not put Arizona utilities at a disadvantage because we lag behind.

- 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.

The phase-in time table can be no longer than that of the sister state moving most quickly toward that end, likely California. The phase-in can begin immediately but it must be completed on whatever time table works to prevent utilities outside Arizona from gaining unfair advantage or access to Arizona markets. Utilities will be self-motivated to take care of their larger customers and retain such loads just as they

will be self-motivated to attract other large customers.

- 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?

If a pilot program as these questions envisage goes forward, it could be conducted on a one-year renewable basis, thus avoiding any opportunity for long-term contracts whatsoever.

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

In addition to the provision of electricity, ancillary services related to generation should be available in a competitive market. The battle will come as utilities seek to gain advantage by moving services and capital equipment to or from generation or transmission as local tactics dictate. The general strategy of integrated utilities would seem to necessarily be moving assets to transmission and distribution and away from generation costs in order to be more competitive with marketers and independent power producers. At the retail level, the Commission must not allow this practice. It would constitute overpricing the delivery system to others to prevent competition.

This question and the following four questions contain suggestions of service listing and grouping that are far beyond that specified in Rule 888. It remains to be seen whether these services can in any reasonable way be separately described, costed and put in rates at the retail level for native load as well as under comparability rates reviewable at FERC. To judge what ultimately should be included in ancillary services, the Commission as to each potential service should answer the following questions:

Are the services truly ancillary?

Are separable costs incurred?

Can such services be truly offered by others in a competitive market?

If the ancillary service in question is truly a separable service for which separable costs are incurred and which can be offered by a competitor, then such service related to generation should have a separate tariff. If any of the answers to the above questions are no, it should not. If any of the services are legitimately related to transmission or distribution of electricity, rather than generation, this analysis should also apply. However, this is not a place to bury general company overhead.

- 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.

Before any of these services are offered, measured and priced, they must be subjected to the above analysis. They should then be offered and priced on a comparable basis to all customers.

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

The question assumes that the above analysis would give each of these activities credibility as to a separate service with a separate tariff. That is not necessarily true and should be the subject of a separate analysis.

- 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 will develop as the large utilities comply with Rule 888 and Rule 889 (OASIS). Being a requirement of the federal rule, no revenue should result. Pooling services, if they can be separately described, are a function of trading among the utilities and not a proper retail function. Pooling among retail loads is best left to those customers. Coordination with the stock market is a business venture, not a rate tariff subject.

- 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:

FERC tariffs will be enforced by FERC through 206 or 211 filings. Equal access provisions will likewise be

enforced in the same fashion. Providing equal access in wheeling agreements is initially a federal matter. The Commission may wish to explore uniform comparable retail wheeling and ancillary service charges if the comparability rates required by FERC are not sufficient. Sellers should be protected by the requirements of FERC Order 888.

**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.

Stranded investment should be defined as generation investment rendered unusable by competition and not necessary for reasonably-projected load growth. Temporary reductions in the use of generation sources should not be considered stranded investment.

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

This cannot be predetermined, nor can it be a uniform standard. It will require utility-by-utility analysis.

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.

The Commission should require jurisdictional utilities to file reports containing this information in order to make stranded investment determinations. The Commission can obligate jurisdictional utilities to make these statistics available or bar them from recovering stranded investment in their rates or charges.

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

In a rapidly growing state and region, all estimates of the magnitude of stranded investment are speculative.

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

This should be handled in the same fashion as positive stranded investment, that is, the same sort of revenue recovery should be applied to both. If exit fees are allowed for positive stranded investment, then the equivalent short-term revenue deduction should also occur for negative stranded investment, i.e., existing customers should not be penalized for utility load growth requiring acquisition of additional resources.

- f. From whom stranded investment should be recovered.

Stranded investment should be recovered from exiting native load customers only.

- g. The mechanism for recovery of stranded investment.

Stranded investment will probably have to be covered by an exit fee subject to refund. The charging utility should be required to file reports of collection of these fees and the exiting customer should have an opportunity to challenge the payment of them if the investment is not truly stranded.

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

There may not be a single time period fairly applicable to all classes of customers and to all utilities, regardless of the age or nature of the investment. Prudent utility practices would indicate however that the stranded investment adjustment period should be no more than five years.

- i. How utilities can mitigate stranded investment.

They are already doing so. Both Arizona Public Service Company and Salt River Project, for example, are aggressively writing down investment in the Palo Verde Nuclear Generating Station. Both utilities are aggressively seeking new customers and promoting business growth within their existing service territories. Both are aggressively looking at ways to retain retail customers as competition approaches. Both are looking at new wholesale arrangements. The Commission can assist in this process by making it clear that it intends to be stingy in its allowing of stranded investment recovery.

**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?

Arizona utilities cannot be loaded up with mandated programs and made non-competitive with utilities in sister states. Additionally, some of these programs are not justified for rate recovery and need to be assigned to the stockholders or the taxpayers if justified as a matter of public policy.

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

Some of these costs are already accounted for by Commission-mandated accounting. To the extent the traditional accounting practices cannot account for other costs, those costs should not be included in rates.

**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.

This blatant subsidization of uneconomic resources is totally antithetical to the basic purpose of increased competition, i.e., a reduction in power rates. If there is to be any encouragement at all, it should be in the form of incentives to the utilities to continue research and development activities so that non-competitive renewable resources in the future might become competitive.

- b. How could progress in encouraging renewables be measured?

Progress in encouraging renewables doesn't need to be measured. As fossil fuel and nuclear sources become more fully committed, the market will take care of whether renewable resources are to be developed.

- c. How could a renewables program be enforced by the Commission?

Aside from incentive treatment for research and development investment, the Commission should not force utilities to buy uneconomic power sources.

**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?

In a competitive marketplace, pooling arrangements will be made based on sound economic decisions and do not require regulation. That will also be true of centralized dispatch, especially once ISO's begin to be implemented.

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

There are no requirements necessary to ensure reliable and efficient use of generation. A utility that doesn't use its resources in a reliable and efficient manner will go out of business. Open access to transmission resources will be enforced at FERC and market forces will provide sufficient incentive for efficient use of transmission resources.

**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.

Non-jurisdictional utilities will enter the competitive market because of consumer demand. They already compete for sales in service territories of many of the jurisdictional utilities where those service territories overlap. Third-party resources are already available in some areas because of the contracts of the municipal

utilities and that availability will only increase as the marketplace makes a wider range of choices available. In the end, whoever survives will be that utility or group of utilities that best satisfy consumer demand. That consumer demand will not distinguish between jurisdictional and non-jurisdictional utilities in Arizona. Thus, market forces themselves will ensure that a competitive market develops in Arizona.

**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 to utility service after the conclusion of the pilot.

I don't see how you can ask somebody to enter a pilot program and then imply that it will cost them for having volunteered for the experiment. If the duration of the program is short and renewable, then no harm should be caused to the utility reacquiring the customer.

**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.

It would certainly be appropriate for a returning customer to be required to absorb marginal costs of the additional resources necessary to serve the additional customer or customers, if that is in fact the case. This would also be true of distribution and transmission costs if the customer has also gone off the delivery system. However, this is an area where "gaming the system" has a significant opportunity to exist. At least over the near term, it is hard to pinpoint an Arizona utility that would suffer marginal costs increases from the kinds of resource or delivery switching that is likely to take place in the initial years of this program. Compounding the problem is the old question of requiring utilities to provide a safety net for small customers to allow them to return. Since open competition is antithetical to the obligation to serve, some accommodation in these principles needs to be made in order to avoid economic injury to small customers. This is an area that will require some considerable further study.

**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.

Subjective considerations of what is "reasonable" need not be made. These requirements must be the same for all customers. Special conditions for a customer obtaining generation from a third party would destroy comparability and permit, even encourage, discrimination.

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

Since we are talking about open competition, notification should be best left to the utilities. They will be competing for market share and how they do that should be up to them.

- 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.

If comparable rates for comparable services are truly put in place, adverse impacts on rates or service quality should not occur. If such adverse impacts do occur, it is a sign that the system isn't working.

- 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.

Whatever reports the Commission desires to have from jurisdictional entities should be appropriate to the information necessary to ensure true open retail competition. Other sellers of electricity have other reports that are required of them in other forums. That information is available to the Commission. Duplicating reporting requirements is unnecessary.

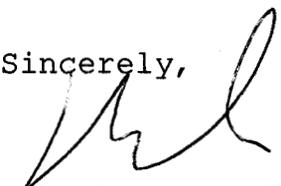
- A19. Certificates of Convenience and Necessity.** Please comment on whether competitive sellers who supply electricity to an

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.

The current concept of a CCN cannot be maintained. It is the essence of monopoly. It is also the flip side of the obligation to serve. The CCN concept should be adapted for use with regard to transmission and distribution facilities to avoid unnecessary duplication of such facilities and to address what will remain of the obligation to serve as retail competition grows in Arizona. Attempting to require non-jurisdictional utilities to obtain a CCN seems unnecessary under these circumstances. First, it would require a change in the Arizona Constitution. Second, it would require a continuation of monopolies in the generation market in order for such certificates to have value. The Commission should realize that its role will be shifting from that of a hands-on regulator to that of a competition watchdog more in line with the role played by FERC. Along with this continuing study of developing retail competition, the Commission will have to address significant changes in its mission as well.

Thank you for the opportunity to comment on this important inquiry.

Sincerely,



Robert S. Lynch

RSL:psr  
cc: IEDA Members