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Chairman Renz Jennings
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Re: Docket No. U-0000-94-165

Dear Mr. Chairman:

I am writing to seek your intervention in obtaining a delay in process which has been put forth by Staff. Specifically, Staff has proposed a new rule which will have far reaching legal and technical ramifications and which could jeopardize the very integrity of the product we provide; *that being safe, reliable and affordable electric service.*

The comment date of September 12 does not provide adequate time to fully assess the Proposed Rule. While it is apparent that Staff has expended considerable time and effort in drafting the Rule, it is equally apparent that the effects on purchasing companies, such as Citizens, have not been considered.

Further, the complexity of the issues warrant sufficient time so that we can approach this matter in the appropriate way. To facilitate your review of the issues, I have attached Citizens' proposal for restructuring. I am sure you will agree that Citizens' concept, provides for a mechanism by which all customers in the state are guaranteed fair and equitable treatment and such programs as DSM, low income and renewables can be advanced without having to rely on conflicting interests.

I stand ready to meet with you, or anyone you believe can adequately address this issue, so that we can collaborately move forward.

Sincerely,

James P. Avery
Vice President, Energy

cc: Marcia Weeks
Carl Kunasek
Docket Control

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BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
CHAIRMAN
MARCIA WEEKS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.	DOCKET NO. U-0000-95-165 **COMMENTS BY CITIZENS UTILITIES COMPANY**

Citizens Utilities Company ("Citizens" or "Company") hereby submits its written comments in response to the February 22, 1996 and April 23, 1996 letters of the Arizona Corporation Commission ("Commission") that invited comments on two sets of issues. One set of issues involves the measuring of the objectives that competition should meet. The second set of issues involves whether or not a pilot program should be implemented and if so, how. Citizens herein addresses those issues and the related questions posed by the Commission.

I. INTRODUCTION

In early 1994, the Commission established Docket No. U-0000-95-165 to begin its investigation of electric industry restructuring including the introduction of retail competition in electricity markets. The investigation has proceeded to the point that the Commission's Staff ("Staff") is now considering whether and how to develop a proposal for introducing retail competition in the electric industry. Citizens is pleased to submit its proposal for restructuring the industry to meet the general objectives of the introduction of competition as outlined in Staff's February 22, 1996 letter. The proposed structure will not require the implementation of a pilot program and will accomplish a truly competitive market for all customers at the time of implementation.

Citizens is in a unique position relative to the restructuring of the electric industry. As an integrated supplier of public utility services to customers across the country, the Company

has been an active and successful participant in the restructuring of the telecommunications industry and the natural gas industry and has recently submitted a proposal for restructuring the electric industry in Vermont.

Citizens has approached the restructuring of the electric industry from the perspective of broad social redesign of the industry. This is in contrast to some of the suggestions for restructuring put forth by other electric utilities across the country that have been developed with the objectives of protecting existing interests. The Company realizes that its proposal will have a material impact on how Citizens does business in Arizona. As stated in Citizens' Vermont filing, the Company believes that by taking a global perspective all parties will share in both the benefits and the risks of a restructured industry.

Citizens' restructuring proposal represents a comprehensive approach to bringing competition to the electric industry in Arizona and choice to its residents, while protecting low income customers and the environment, in alliance with the other objectives and principles governing the move toward competition in the industry. Following the presentation of this comprehensive proposal, these comments discuss the measuring progress in meeting the objectives. Finally, Citizens responds to the specific questions raised in the Staff's letter, either pointing to specific locations in the proposal where the questions are addressed, or providing clarifications where appropriate.

II. PROPOSAL

1.0 INTRODUCTION AND PHILOSOPHY

In its Request for Comments on Electric Industry Restructuring, the Commission has identified certain general objectives that should be met through the introduction of competition into the electric industry. These objectives are to:

1. Encourage the benefits of retail electric competition
2. Limit the potential harm to utilities and utility investors
3. Enable a wide range of consumers to participate in a competitive market
4. Limit the potential for decreases in electric system reliability

5. Limit the potential for market impediments such as exertion of market power by utilities which blunts competitive forces and high transaction costs for market participants
6. Encourage a variety of market development
7. Promote renewable resources
8. Protect important public programs (protection of the environment, renewable resource development, low income customers' assistance, increased energy efficiency, and safe nuclear power plant decommissioning)
9. Shield consumers who do not or cannot participate in the competitive market from rate increases attributable to competition.

Citizens has attempted to lay out a framework for the future of the electric industry that addresses all of these principles.

Some of the suggestions for industry restructuring that have been put forth by electric utilities around the country have been developed with the objective of protecting existing interests. In contrast, Citizens has approached restructuring from the perspective of broad social redesign of the industry. By taking this global perspective, Citizens believes that all parties will share in both the benefits and the risks of a restructured industry. The Company believes its proposal steps away from existing interests to incorporate broader social benefits. In particular, the Citizens' proposal will:

- Achieve true open access for all customers
- Retain important societal programs
- Remove artificial barriers that exist between traditional utility territories
- Provide a mechanism for mitigating the burden of stranded costs
- Treat all parties fairly
- Minimize opportunities for collusion

The proposal being filed in Arizona is virtually identical in concept and structure to the proposal filed on March 12, 1996 with the Vermont Public Service Board by Citizens' Vermont Electric Division, with additional elaborations filed on June 19, 1996. The Company has

made certain modifications to the proposal to account for certain differences in the electric industry in Arizona. However, Citizens believes its proposal is fully applicable throughout the country, and encourages review in that context.

Electric utilities in Arizona do not operate in isolation. We are closely tied in to, and heavily reliant upon, the Western Area Power Administration's and other utilities' transmission and generation assets, as well as being interconnected to the electric markets in California and elsewhere in the West. Accordingly, Arizona can ill afford to reorganize in seclusion. Actions taken in neighboring states and by the federal power administrations will affect the ability of Arizona's electric utilities to control their own destiny and protect principles important to the state and its citizens. All players in the electric industry restructuring process in Arizona -- the Commission, the Residential Utility Consumer Office ("RUCO"), the utilities, electric users, citizen groups, and environmental parties -- must work together to ensure that Arizona is not disadvantaged regionally or nationally by restructuring activities going on around us.

Citizens has put forth this proposal for restructuring the electric utility industry from the perspective of what it believes is the in the best interest of society as a whole. Citizens has not, however, attempted to answer whether or not the deregulated industry will be better (lower prices, better service, enhanced reliability, etc.) than the present industry. Deregulation of the electric utility industry offers a unique opportunity to garner the benefits of free market enterprises in an industry whose origin required a monopolistic framework to become established.

The question remains whether the costs associated with the higher rates of return (increased cost of capital/higher discount rates) associated with free market companies will be less than the cost associated with inefficiencies inherent with the present regulated industry. In addition, future benefits will not be realized unless the present degree of regulation is decreased or the regulatory process is streamlined. If the overall regulatory and compliance burden placed on the future portions of the industry -- both regulated and unregulated -- equals or exceeds the present level, then many of the benefits of restructuring

will be lost. The proposal developed by Citizens attempts to free the industry to garner the benefits of competition and market forces, while providing for the continuation of societal benefits associated with the existing industry.

Finally, society must not be lulled into the belief that future capacity needs can be met by capacity developed by new technology that would not have been developed by the present industry. Theoretically, the potential for greater profits may allow entrepreneurs to take higher risks -- but with higher risks come higher cost of capital and higher expected rates of return. Short term, immediate benefits associated with the present abundance of capacity will likely be lost in the long run.

Citizens welcomes the opportunity to discuss its proposal with interested parties in Arizona and elsewhere in the coming weeks. The Company is enthusiastic about the potential opportunities for society as a result of restructuring in the industry, and is ready to move forward immediately to implement that restructuring. However, it must be remembered that this is an unknown future into which we are moving, and the benefits of that future cannot be guaranteed in advance.

2.0 PROPOSED INDUSTRY STRUCTURE

2.1 Overview of the Structure

Citizens believes that the electric utility industry should be restructured into four separate components:

- Regional or statewide transmission companies ("TRANSCOs"), evolving from existing transmission coordination groups where those exist, and regulated by the Federal Energy Regulatory Commission ("FERC").
- Multiple state-regulated distribution companies ("DISTCOs"), with franchised service areas and an obligation to connect all customers within those areas.
- A broad category of mostly unregulated companies that would own generation and sell packages of power services in the wholesale and retail markets. Asset ownership and power sales activities could exist in any combination within a single company. These comments will use the term GENCOs to refer to

entities owning generation assets and selling power at the wholesale level and RETAILCOs to refer to entities packaging power services for sale to ultimate consumers, recognizing that some companies will be both a GENCO and a RETAILCO.

- Regional independent system operators ("ISOs") and power exchanges, possibly evolving from existing power pools where those exist (e.g., Western Systems Coordinating Council, Western Systems Power Pool, Southwest Regional Transmission Association) with responsibility for coordination of the region-wide transmission of electricity, reliability of the transmission grid, matching buyers and sellers in the spot market, and other related functions.[1]

Citizens believes that these regulated and unregulated components of the industry must be functionally and administratively separate from each other. In particular, a company that is acting as a DISTCO or a TRANSCO ***and*** as a GENCO or a RETAILCO must provide for separate facilities, staffing, management, and direct support (e.g., customer service, marketing, billing) for the regulated and unregulated portions of the business. This separation is necessary to preclude information flowing preferentially between affiliated regulated and unregulated businesses to the detriment of non-affiliated competitors in either the regulated or unregulated operations. Citizens recognizes that there are certain administrative support functions (for example, human resources) that are efficiently provided by centralized systems. There is little, if any, chance of inappropriate information flow through normal human resource operations, so sharing of these functions at a corporate level should not be a problem.

Administrative separation, as defined here, together with regulatory requirements and oversight should effectively preclude discriminatory information flow and self dealing. In

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[1] Citizens believes the ISOs and power exchanges will evolve separately from the vertically integrated utilities and, therefore, the Company has not included their structure in its plan. The ownership of ISOs must be completely separate from the ownership of TRANSCOs.

particular, the following projections would be in place in the restructured environment:

- ***Rate case review of cost allocations:*** the regulated entities, both TRANSCOs and DISTCOs, will continue to be subject to review by state and federal commissions, so that any inappropriate cost allocations to the regulated entities could be rejected and rates adjusted accordingly.
- ***Formal complaint processes:*** the public or any GENCO or RETAILCO could file complaints of preferential or discriminatory treatment by a DISTCO or a TRANSCO with the appropriate regulatory agency, with appropriate action being taken by the regulatory body.
- ***Provision of customer lists:*** DISTCOs would be required to provide lists of connected customers to all registered RETAILCOs and GENCOs in the state on a regular or on-request basis, so that all entities engaged in marketing power in the state would have equal access to customer information.
- ***Public posting of prices:*** For small and medium usage customers, RETAILCOS will be required to post prices publicly, thereby making electricity available on a non-discriminatory basis irrespective of proximity to an affiliated entity's franchise area.

Citizens believes that these protections will be sufficient to provide a level playing field between RETAILCOs and GENCOs affiliated with regulated entities, and those that are independent of DISTCOs and TRANSCOs. Should they not be sufficient, and self-dealing and complaints arise, regulators at the state or federal level could take appropriate action at some future time.

2.2 Structure and Evolution of the TRANSCOs

The TRANSCOs would be in the business to transmit electricity between GENCOs, DISTCOs, and other TRANSCOs. Citizens believes that operational efficiency and administrative clarity suggest that many states or regions would best be serviced by one transmission company. A single statewide or regional TRANSCO would simplify the monitoring and operation of the transmission grid within the state or region and eliminate

intrastate pancaking of transmission rates. A single TRANSCO could also result in efficiencies in development of and participation in the Real-time Information Networks that are being required by the Federal Energy Regulatory Commission ("FERC").

In Arizona the transmission system is complicated by a number of factors that will affect the ability to implement a statewide TRANSCO approach. In particular:

- The transmission system is highly integrated over several states (Arizona, Nevada, Utah, California) so that state borders have little meaning for the transfer of electricity. An Arizona-only approach is not feasible due to the interconnected nature of the system and the multi-state ownership of the assets. A regional approach to the transmission system would require the cooperation of regulators in multiple states.
- The present system is owned by numerous entities, including large and small investor owned utilities, municipals, and federal government agencies. In addition, non-utility, currently non-regulated, entities are actively pursuing transmission ownership. Each entity will have its own agenda and objectives, complicating any plan to create a single TRANSCO with overall transmission asset ownership. On the other hand, having each entity charge a separate fee for transmission will vastly increase the hard and soft costs (e.g., dollars per kilowatt hour, administrative and contracting costs) associated with retail transfers of power over the system. A broader postage stamp rate with centralized administration would improve the efficiency of the open system, providing benefits to all consumers.
- Contract capacity on the transmission system is constrained, with access to the system already a key issue in many areas. A statewide or region-wide approach to open access to the transmission grid could facilitate optimizing the utilization of the current system by allowing capacity not needed by the owners to be used by other parties to benefit consumers. Certainly a broader approach would simplify planning for future capacity investments.

- Unintended power flows resulting from the natural preference of electricity to follow the path of least resistance are a larger issue in the West than other areas of the country, due at least in part to the existence of extra-high voltage transmission lines connecting heavy load areas with remote generation many miles away. A broader approach to the transmission system (either single ownership or voluntary statewide postage stamp rates) could remove some of the concern over compensation for inadvertent power flows, since compensation would be independent of physical path.

Because of these complicating factors, the optimum approach in Arizona (and neighboring states) for the transmission portion of the electric industry will need to be a compromise among the numerous parties, balancing efficiency in operation, pricing, and planning with political and logistical considerations. Citizens would like to see as much consolidation and simplification in this portion of the industry as is possible within the constraints.

TRANSCOs would be price- and service-regulated by FERC and, therefore, would be obligated to provide transmission service to all DISTCOs, out-of-state TRANSCOs, and GENCOs pursuant to current and future FERC orders. The need for and siting of new transmission assets within state borders would be done by the TRANSCOs, subject to then-current state regulations.

FERC orders will establish operating criteria, rate limitations, required ancillary services, and other TRANSCO requirements. Citizens believes the state should work with appropriate parties at FERC to have certain key points addressed in the FERC orders. In particular, Citizens believes that:

- TRANSCOs should have the obligation to plan, serve, and construct to serve DISTCO (and, therefore, end user) needs on a postage-stamp basis.
- Revenues received from point-to-point services should be credited against network services, so that network tariffs are reduced, providing benefits to those customers who will be served under those tariffs.

- TRANSCOs may own limited generation for voltage and area support, the cost of which would be part of the cost of service. However, they should not be able to serve load directly and any excess generation would be sold on the spot market.

System failure can occur in the distribution system, transmission system, or generation system due to acts of nature, equipment failure, etc. If a failure occurs in the distribution or transmission systems, the failure can be isolated and electricity routed around the problem until the situation is resolved. Appropriate responsibility and payment in the event of distribution or transmission failure would be handled through contracts between the various parties. If the problem occurs at the generation source, integrated utilities formerly relied on other sources of generation. Now that GENCOs would be independent, the possibility exists that the GENCO (or similarly an out-of-state TRANSCO) could fail to deliver its contracted supply of electricity to the TRANSCO. Provisions must, therefore, be made for acquiring and paying for backup power through contractual arrangements between some combination of the GENCOs, the TRANSCO, and the power exchange. Through these contractual vehicles, each segment of the industry will have obligations and incentives to ensure system reliability.

2.3 Structure and Evolution of the DISTCOs

DISTCOs would serve certificated areas and could not be bypassed. The DISTCOs would be fully regulated by the state and would have the obligation to connect all customers within the certificated areas under approved tariffs. New customers would sign up for connection of service through the DISTCO, and would select a RETAILCO to provide power services in a manner similar to the way long distance phone service is selected today. The DISTCO would be obligated to provide publicly posted prices and eligibility criteria from all registered RETAILCOs on a nondiscriminatory basis. Customers could switch RETAILCOs at any time, although DISTCOs may establish reasonable notification of waiting periods to allow for administration of RETAILCO changes.

Customers having no preference on RETAILCO would be assigned to a RETAILCO on a lottery basis. The assignment process would be managed by the state. RETAILCOs

that wish to be included in the lottery assignment list would register their interest with the managing entity. The managing entity would be required to publish information documenting the assignment process on a periodic basis. All RETAILCOs would have access to the assignment data and could file a complaint with the regulators if they believe they were not receiving equal treatment.

The DISTCOs would be responsible for meter reading, billing, collection, and payment of funds to the RETAILCOs and other fee accounts.[2] The RETAILCO would, in turn, be responsible for appropriate payments to TRANSCOs, GENCOs, and the ISO. The invoice to the customer would include the distribution system service charge, transmission service charge, the power sales charge from the RETAILCO serving that customer, and separate line items for additional charges, including the investment recovery fund surcharge for recovery of stranded costs (discussed in Section 3.0 below), above-market energy efficiency and other societal programs (discussed in Section 4.0 below), and taxes and franchise fees. As is the case currently when all the costs are provided in a bundled bill, customers may not elect to not pay specific portions of their bill without risking collection processes and ultimately disconnection of service.

Citizens proposes that the distribution system service charges be made up of a simple, flat, monthly charge for small users, and a flat charge plus a demand-based charge for larger users. Depending on cost causation with respect to system and customer characteristics, two or three categories of large customers may be appropriate. Certain customers (most likely large users) may elect to install real time meters to enable rapid procurement of electricity from the electricity commodity market. The DISTCO would connect to such a system at the expense of the individual customer and could develop a customer- or equipment-specific distribution charge cost adder to recover its connection costs. Additional charges could be developed and applied in specific instances to account for other justifiable

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[2] The DISTCOs could elect to contract out these customer services to private industry, but must assure the regulators that such actions are least cost and do not disadvantage customers or the market process.

cost differences.

The break points between small and large customers will need to be determined as the rates are established and will vary from state to state because of load and system differences. For simplicity, the Company suggest's the points should be similar for all utilities in a given state. The distribution system service charges could either be based on traditional cost-of-service methods of rate making or be performance based.

The DISTCO will continue to have the right to discontinue service under existing regulations, and may require a deposit or payment of past bills prior to re-initiating service for a delinquent or questionable account. Centralizing the billing, collection, and connection process at the DISTCO will minimize customers switching among RETAILCOs to avoid paying bills. As is the case currently, the DISTCO may refer customers to state energy assistance personnel as appropriate for assistance with bill payment.

The RETAILCOs would pay regulated fees to the DISTCO for the meter reading, billing, and collection services they receive. The service fees would be cost-based and set through the rate case process. T he DISTCO may also choose to offer additional services to RETAILCOs on an unbundled, nondiscriminatory, voluntary basis, although the charges for those services would still be regulated.

The DISTCOs would have the obligation to maintain and improve distribution system reliability and efficiency in accordance with current state regulations. As with the TRANSCO, DISTCOs may own generation to support system operations (e.g., voltage support, line loading, stability) and could only sell excess generation on the spot market.

2.4 Structure and Requirements of the GENCOs and RETAILCOs

Entities engaged in the generation and purchase of power and the bundling and sale of power and related services -- the GENCOs and RETAILCOs -- would be unregulated from the standpoint of prices and service offerings. Power service providers would earn profits based upon their marketing ability, their ability to purchase power through bilateral contracts or on the open market at prices below the posted or negotiated prices, their ability to generate cost-effective power, and their ability to hedge power supply costs.

GENCOs and RETAILCOs would be registered with the state and would have to meet certain requirements to be able to sell services in the state. Thus, these unregulated providers would be similar to insurance companies or long distance telephone companies. Citizens envisions slightly different licensing requirements for entities operating at the wholesale (GENCO) and retail (RETAILCO) levels. Table 2-1 provides a preliminary list of licensing requirements.

Table 2-1

Preliminary RETAILCO Licensing Requirements

- Post a performance bond to guarantee conformance with service obligations
- Maintain membership in good standing with the appropriate ISO or pool,
- Agree to comply with DISTCO, TRANSCO, ISO, Pool requirements
- 30-day notification of an increase in prices
- Full disclosure of market price-following service offerings for posted price services
- 60-day notice of discontinuation of service offer for posted price services
- During an initial period, provision of a Standard offer with no service conditions
- Service conditions on other offers conforming to technical conditions
- Nondiscriminatory provision of services
- Agree to complaint resolution through the licensing board (w/ specified appeal process)
- Payment of annual licensing fee (cover oversight, consumer education, complaint resolution activities of licensing board)
- Agreement to provide certain types of records in the event of complaint or periodic review by the licensing board
- Follow state/Commission service termination policies
- Establish fair service deposit requirements, based on likely bills and loss risks
- Establish credit policies based on standard credit ratings and apply those policies on a nondiscriminatory basis

Any entity desiring to solicit for and sell power services in the state, at either the wholesale or retail level, would be required to pay an annual power sales permit fee, made up of a registration fee and a load service fee. The registration fee would entitle a power services company to solicit for customers. The load service fee would be a charge per kW of actual load served.[3] Full credit would be given on the load service fee for capacity (either generation or purchase power contracts) purchased in the state's asset auction (discussed in Section 3.0). The power sales permit fee would be paid into the Investment Recovery Fund (discussed in Section 3.0), thereby reducing the level of stranded costs to be recovered from customers in the state. In developing the details of the power sales permit fee, mechanisms will need to be included to eliminate gaming with data on load served and instate capacity owned. Also, a process would need to be developed to avoid double payment of the fee in the case of purchases of wholesale power by RETAILCOs from separate GENCOs.

GENCOs would own generation or power supply contracts and would buy and sell generation in the market, either through the power exchange (i.e., the spot market) or through bilateral contracts with RETAILCOs or other GENCOs in or out of state. The sale and purchase of power by GENCOs would be at market-based or negotiated prices, and would be subject only to whatever restrictions are imposed by the ISO or the power exchange. In the case of direct purchases from the spot market, transmission contracting and coordination and procurement of necessary, ancillary services should be the responsibility of the purchasing entity. In the case of bilateral agreements, the selling GENCO may contract for transmission and ancillary services and coordinate with TRANSCOs to ensure delivery of the power as part of the contract, or those responsibilities may remain with the purchasing entity.

Each GENCO will need to have access to the ISO and the power exchange, either directly or through another GENCO, to provide for dispatch of its generation facilities and

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[3] For example, the power sales permit fee could be set at some percentage of the cost of a new generating facility.

delivery of purchased power.[4] Dispatch of generation facilities would be subject to ISO operations and restrictions. Depending on how the ISO is structured, this could be on a bid price basis or on a traditional economic dispatch basis. Units could be operated on a must-run basis (e.g., run of river hydro facilities and facilities required for system stability). Citizens anticipates that an active, efficient power market will develop to handle spinning reserve, next hour and next day power sales. The ISO or the power exchange would provide billing and other services in support of the power market.

A RETAILCO could purchase power from the power exchange (spot market) or through bilateral contracts with GENCOs or other RETAILCOs, or generate its own power if it were also a GENCO. RETAILCOs would then package the power with transmission and other ancillary services as appropriate, and sell the package to end users. A customer purchasing directly from a GENCO does not exempt the customer from paying transmission and distribution costs. Following restructuring of the industry, there would be two basic types of retail power sales:

- Posted prices, available on a nondiscriminatory basis to all small and medium customers meeting the posted technical eligibility requirements.
- Negotiated contracts for customers over a certain size level, with individualized, confidential contract terms and prices[5].

RETAILCOs would not be required to offer both posted price services and negotiated contracts. However, if a RETAILCO company wished to offer any posted-price services, those services, within the constraints of available capacity, must be open to all customers that meet the posted eligibility requirements. This provision will allow RETAILCOs to specialize in certain areas of the market (for example, residential or high load factor customers), but not to engage in arbitrary discrimination within those defined areas. Services that RETAILCOs may elect to provide could include:

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[4] This access would be similar to the current membership in the regional power pools.

[5] Alternative billing arrangements will be required for these contracts.

- Basic open service, priced at market level (this would probably be the service that would be offered to customers with no RETAILCO preference)
- Spot market pricing
- Futures-based service, tied to monthly or multi-month electric futures prices
- High load factor service, tied to specific bilateral contracts and available to customers with load factors above some pre-specified level
- Interruptible services
- High power quality that could include on-site power conditioning investments or stronger transmission guarantees
- Green power, tied to bilateral contracts with must-run renewable resources
- Peak/off-peak service, with high on-peak charges and low off-peak charges
- Traditional demand/energy pricing

Citizens believes that RETAILCOs will become available to serve all types of customers, and that if a RETAILCO extracts excess profits from a specific portion of the market, other players will enter that portion and undersell the profit taker. This is the basis of a free marketplace, and the Company believes it will work within the electric industry if artificial barriers do not prohibit entry and exit from the market, and transmittal of market pricing signals. However, Citizens also recognizes that initially there may be a need for a required standard offer that would be available to all consumers on a "no condition" basis. As the competitive electric market develops and consumers become more familiar with the operation of that market, the need for a required standard offer will decline. Because they will be the ultimate providers of competitive electric services, Citizens recommends that RETAILCOs be the providers of the required standard offers. In particular, the Company recommends that all RETAILCOs providing posted price services be required to provide a standard service offer, available to all consumers without condition for a period of three to five years. The standard service offer could be priced at spot market or perhaps on a 30-day firm basis. Citizens also suggests there be a market test that would allow the requirement to expire early if the market become sufficiently mature. If there was continued concern

regarding the need for a no condition service beyond the initial period, there would be sufficient time to develop alternative delivery mechanisms for this type of service.

Both the posted prices and negotiated contract prices would be unregulated and market based. RETAILCOs must notify customers taking service under an affected posted price offering 30 days in advance of price increases. Notification would not be required for price decreases. Customers would be allowed to switch RETAILCOs at any time, subject to their DISTCO's approved waiting period, as described in Section 2.3 above.

3.0 DISTRIBUTION OF EXISTING GENERATION ASSETS

Citizens has developed a unique approach to the handling of stranded costs associated with the investments made by electric utilities under the regulatory compact that has underlain the industry to this point[6]. Citizens' proposal recognizes that as an industry, the utilities and their regulators have made commitments that must be respected. Further, the Citizens' plan establishes a level playing field for all customers in the state, allowing all customers to realize the benefits of competition and open access without regard to their current electric provider.

In summary, Citizens' proposal includes the following:

- Use of an auction to establish the amount of stranded costs associated with generation and purchased power assets in the state
- Payment to existing utilities and all independent power producers (IPP) of 100% of original costs less depreciation for generation assets or the option to retain all generating assets for entry into the power market
- Assignment of all purchase power contracts to the state for auction
- Refinancing of the stranded costs through state-obligation bonds at eligible rates, thereby lowering the carrying cost on the stranded costs and mitigating the total level
- Crediting of all funds received from the power sales permit fees (see Section

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[6] Stranded cost are sometimes also referred to as stranded obligations or stranded investments.

2.4), thereby obtaining additional dollars to further mitigate stranded costs

- Providing full credit towards the power sales permit fees for assets purchased in the auction, thereby bringing more bidders into the auction and raising the minimum value on the assets
- Recovery of the stranded costs through a statewide Investment Recovery Fund ("IRF") Surcharge, providing a levelized playing field for all citizens in the state

The value of stranded costs would be established through a state-administered auction of generation assets and purchase power contracts. Citizens believes the auction approach to establishing stranded costs has a clear advantage over any forecasted market price alternative. An auction truly represents the market value for the assets and is not limited by, or subject to disagreements about, estimates of future market prices. An auction more rapidly moves toward a free market system of valuation and operations, and does not require any ongoing review or ex-post adjustments to the stranded valuation.

Participants in the auction will determine the prices they are willing to pay for each of the assets and contracts available, based on asset characteristics and individual expectations of market prices, strategies, and risk profile. The risks of paying more than actual future value, as well as the benefits of paying less than actual future value, are taken into account when participants develop their bidding strategies and submit bids.

Under the Citizens' plan, the auction would be facilitated by a state entity (the Investment Recovery Fund Department ("IRFD") under supervision of the state regulatory bodies). The IRFD would manage the auction and administer the refinancing of the stranded costs and the repayment of that financing. Utilities and other entities would assign their generation and purchase power agreements to the state for auction. Generation assets deemed necessary for system stability or voltage support could be retained by the owning utility and transferred to the affiliated TRANSCO or DISTCO at original cost less depreciation. Assets believed by the utilities as falling in this category would have to be reviewed and approved as such by the IRFD and the regulators.

A utility or independent power producer would not be required to place its generation

assets in the auction. However, nonparticipants would be required to retain all of their present generation assets -- that is, they could not pick and choose which assets to auction -- and non-participants would forfeit any preexisting right to receive future compensation above free market sales. Prior to the auction, the value of generation assets would be set and reported to the IRFD at original cost less depreciation. The owning entity can then know that it will receive that level of proceeds, and can develop its own bidding strategy for the auction accordingly. Note that there is no requirement that current asset owners participate in the auction, nor does the proposal provide a right of first refusal to existing asset owners. Citizens believes that such a right would depress the value placed by the market on the assets and would discourage out-of-state bidders from the auction. Some parties have expressed concern that an auction provides the potential for market dominance or control by a few GENCOs. Citizens believes this potential concern must be addressed on a regional or national level through FERC or the Securities and Exchange Commission.

As discussed in Section 2.4, full credit would be given on the power sales permit fee for capacity and contracts purchased through the state auction. This credit for purchased capacity will accomplish two significant objectives. It will increase the value to assets that might otherwise have little value in the auction, and it will bring more bidders to the auction. In particular, Citizens believe a floor value per kW of capacity will be established as the present value of the power sales permit fees. In situations where an asset is mostly depreciated, this floor value will be greater than the net book value, resulting in a reduction of the total stranded costs. Additionally, more parties should participate in the auction, since any entity that wishes to solicit power sales in the state must pay the power sales permit fee and, therefore, would realize a benefit from obtaining assets or contracts from the auction. Note that there is no obligation on the part of the purchasers of generating assets to operate those assets to serve instate customers, or indeed to operate the assets at all.[7]

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[7] FERC and the state regulators should create provisions to allow the "mothballing" of generation assets, and establish environmentally and economically reasonable decommissioning requirements.

The IRFD would establish the rules for the auction taking into account the processes used in similar-type auctions (e.g., the Environmental Protection Agency for sulfur emissions credits and the Federal Communications Commission for air waves). Detailed information on the assets and contracts to be auctioned would be made available to all interested parties. The actual auction may be conducted at one time, or at multiple times. The auctions could be open or sealed bid, or single or active bidding.

Auction rules could reasonably require pre-qualification of bidders to ascertain that bidders are qualified to operate facilities in accordance with standard procedures. Additionally, it would be reasonable to require security deposits prior to distributing information on the facilities to be auctioned, or as part of submitting bids. This would discourage frivolous bidders and could be used to offset the cost of the auction administration.

Certain facilities may require special handling in the auction. For example, it may be appropriate to allow entities to bid for portions of large facilities that currently have multiple owners, with appropriate adjustments for entities that are qualified to operate the facilities. Entities interested in acquiring nuclear assets will have to be either an existing operator in good standing of a nuclear facility or pre-approved by the Nuclear Regulatory Commission ("NRC") to take over operation of nuclear facilities.

Citizens believes that the decommissioning obligation associated with nuclear assets must remain with those assets through the auctioning process. Citizens recognizes that the value of nuclear assets will be depressed if the new owner must also take on the decommissioning liability. However, the Company believes there is no other reasonable mechanism for addressing the decommissioning liability, short of the federal government taking on the complete liability. Decommissioning escrow accounts must be fully funded by the current nuclear asset owner to the date of transfer. These accounts would be transferred along with the nuclear asset, and must remain in an account inaccessible by any future owners for any purpose other than decommissioning.

GENCOs operating nuclear facilities would be required to set aside a nuclear

decommissioning charge commensurate with current charges and requirements into an inaccessible interest-bearing escrow fund. The charge would be on a per kWh basis and would be set by the NRC. The NRC would be responsible for review and adjustment of decommissioning charges, taking into account the existing decommissioning funds collected for the particular nuclear facility. The fees and interest collected under the new system would be combined with the existing decommissioning fees upon final shut down of the facility, and decommissioning would be undertaken following NRC requirements existing at that time.

The difference between the proceeds from the auction and the total net book value paid out to the original owners plus the difference between original purchase power prices and prices garnered in the auction constitute the stranded costs.[8] The stranded costs would be placed in the Investment Recovery Fund and would be financed by tax-exempt state revenue bonds. Use of state revenue bonds will mitigate the level of stranded costs relative to their present funding mechanisms. Specifically, the cost of capital for utilities is approximately 11 to 14% and is much higher for independent power producers and other private funding sources. Financing stranded costs through either utilities (by leaving those costs within the DISTCOs) or the market would result in significant additional carrying costs.

Recovery of the fund plus interest would be guaranteed through a state-mandated, non-bypassable IRF Surcharge collected at a dollars per kWh basis on all DISTCO deliveries as a separate line item on the bill. Statewide recovery of the IRF Surcharge recognizes that the stranded costs are the result of the regulatory compact, and that all investments made by utilities in the past were approved by the state regulators as being the most appropriate option for the state at the time the decisions were made.

The recovery period for the IRF would be established based on the magnitude of unrecovered obligation, with the intent of balancing likely reductions in the cost of electricity with the level of the Surcharge. The Surcharge should be based on the initial balance in the

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[8] There are various other costs, for example DSM and other regulatory assets, that may be stranded as the industry restructures. These costs could be recovered through the IRF or the energy efficiency fee (see Section 4.2).

IRF, the term and interest rates for the revenue bonds, and historical usage. In practice, sales of power will increase from the base, and power sales permit fees will be credited to the IRF. As a result, the IRF should be eliminated in advance of the term on the bonds. Provision could be made to readjust the IRF surcharge periodically to stretch the recovery period for the full term; alternatively, the IRF could simply be left to expire early.

The auction process, the IRFD and the IRF funding and Surcharge recovery will need to be established by legislative action. The legislation should specifically tie the state revenue bonds to the IRF Surcharge, and provide that the IRF Surcharge expires on repayment of the revenue bonds. Without specific sunset language, it is possible that the IRF surcharge could become a recurring tax collected through the DISTCOs, thus, indefinitely delaying receipt of the full benefits of the electric industry restructuring.

4.0 SOCIETAL PROGRAMS

One goal of restructuring is to maintain a state's ability to compete in business regionally while enhancing societal benefits. Citizens supports this as an underlying principal of the restructuring process in Arizona. However, Citizens does not believe that utilities should be in the business of providing societal programs. Thus, Citizens recommends that social programs that the state wishes to continue in an unregulated electric industry (e.g., certain energy efficiency programs, renewable development, low income energy assistance) be carried out by appropriate arms of the state government. Citizens believes it would be preferable for these programs to be funded completely separately from the utility industry. However, the Company recognizes that the DISTCOs may be the most practical means to collect the funds. Accordingly, the DISTCOs in the state could serve as collectors of social programs fees, but only if those fees are included as separate line items on customers' bills.

4.1 Low Income Energy Assistance Program

Citizens believes that assistance programs for low income energy consumers would be best carried out by the Arizona Department of Economic Security ("DES"). Line-item funds collected by the DISTCOs would be transferred to the DES for distribution in accordance with established procedures and qualifications.

4.2 Energy Efficiency Programs

Citizens believes that the only state-funded and administered energy efficiency programs should be those that are subject to market barriers. In addition, Citizens expects the number of energy efficiency measures subject to market barriers to decline as open access develops and pricing of power becomes market based.

Should it be determined that sufficient market barriers to energy efficiency exist to justify intervention programs, Citizens believes that an existing or newly created department within state government would be the appropriate administrator for these programs, with an independent review board that would approve programs and funding levels. The review board would establish an energy efficiency surcharge, most likely on a dollars per kWh basis to be included on bills as a separate line item. It would also verify both the cost effectiveness of the proposed efficiency programs and the continued existence of barriers to market implementation of the proposed measures and would set the budget for administering and implementing the programs. There would be no requirement to apply expenditures uniformly across the state; instead, expenditures would be directed toward those programs and target markets where barriers exist and where the most cost-effective efficiency gains can be achieved.

The designated state department would provide public notification regarding its planned programs (e.g., measures, location, incentives, delivery mechanism) to permit proper coordination with and response by DISTCOs and RETAILCOs. This department would competitively bid for the implementation of its programs as appropriate. In general, programs that could be undertaken by unregulated private entities would be required to be bid. The utilities would continue their existing programs until the implementation date for open access when state-run programs would be initiated. The first year funding would be set by the oversight board convened the previous year, capped at 3 to 5 mils/kWh. During the last year of regulated operations, the designated state department would be organized/reorganized to prepare for its administration of these programs.

It is assumed that energy efficiency activities that are not subject to market barriers

will be undertaken by private enterprise. The state-run energy efficiency department may use standard market information gathering mechanisms to identify market-based energy efficiency activities (i.e., surveys) but would not require private energy-efficiency providers to file with the department.

4.3 Renewable Technologies

As with the energy efficiency programs, a similar framework could be established for implementation of renewable technologies. The same designated department and independent review board could oversee state-supported renewables activities. Citizens envisions an annual or biannual public review process by the administering department that would set forth an assessment of market-based renewable (or other low-emission technology, e.g. fuel cell) activity, a prioritization of research and/or commercialization needs, and a proposal for funding levels and allocations for the next period. The outcome of the public review process would be an approved plan and the establishment of a uniform statewide surcharge to be collected by the state's DISTCOs on a non-by-passable basis.

In order to stimulate market activity in renewable technology, new generation using renewable energy sources would be given full credit toward the power sales permit fee, whether instate or out-of-state.

4.4 Environment

Citizens supports environmental goals and compliance with federal and state environmental regulations for Arizona and elsewhere. Accordingly, the Company believes that all new construction related to the electric utility industry -- generation, transmission, distribution -- must remain subject to environmental siting regulations. Streamlining of the permitting process in light of the restructuring of the industry could reduce development costs without adversely impacting the end results.

Citizens believes that all existing generation resources -- fossil-fueled and renewable -- can provide benefits to Arizona residents. Accordingly, Citizens suggests that mechanisms be developed for old sources to be considered in conjunction with renewable resources, with the goal that the combined emissions result is movement toward attainment of new-source

standards for the cumulative electricity generated. This approach will promote continued operation of societally important renewable resources that alone would generate electricity at above-market prices and might be shut down. Such recognition for renewable resource capacity will enhance the auction prices of both the fossil-fuel and renewable generation above what they might gain if required to compete on their own without the pairing. Once the old sources reach the end of their present life cycle, the facilities could be decommissioned or be subject to life extension investments under then-current environmental regulations.

As an alternative, the electricity generated by renewable resources could be sold by GENCOs as certified green power, potentially garnering a higher market price. To help overcome the price barrier, renewable resources being marketed as green power in Arizona could be given extra credit toward the power sales permit fee.

III. MEASURING PROGRESS IN MEETING OBJECTIVES

In its Request for Comments on Industry Restructuring, the Staff seeks input from interested parties on specific methods for measuring progress in meeting the various objectives of the introduction of competition in Arizona electricity markets. Citizens recommendations are as follows:

Encourage the benefits of retail electric competition.

The benefits of reduced cost and increased customer choice can be measured by comparing post-restructuring power costs, service offerings, and the number of suppliers to a baseline of these values established just prior to opening up markets to competition.

Limit the potential harm to utilities and utility investors.

The biggest potential harm to utilities and investors surrounds the treatment of stranded investments and obligations in the transition to open markets. Utilities need to take all reasonable actions to mitigate the level of potentially stranded costs. The Arizona Commission will ultimately need to judge the performance of each utility in reducing its strandable costs and allow for full recovery of the net amounts. Measuring progress toward mitigation requires defining a period for transition and establishing baseline stranded costs

at the beginning of the transition.

Another area of potential harm to utilities is the increased cost of capital resulting from the increased risk of a competitive business. This may need to be monitored directly and possibly netted to reflect decreases in regulatory costs associated with industry restructuring.

Enable a wide range of consumers to participate in a competitive market.

Under Citizens' proposal, where all consumers will participate in the competitive market, measurement of progress on this issue reduces to monitoring the percent of customers who rely on default "Standard Service" offerings (e.g. spot market pricing) rather than taking advantage of other customer-focused offers from suppliers. This can be accomplished by surveys of consumers.

Limit the potential decreases in electric system reliability.

Service reliability is an issue primarily associated with those components of the industry that will remain regulated under Citizens' proposal, TRANSCOS and DISTCOS. Reliability measurements in place today for these aspects of the industry will continue to be valid after transition to open markets. On a generation level, reliability is mainly a function of reserve levels that are maintained. Under Citizens' proposal it is envisioned that minimum capacity and operating reserve requirements will be enforced by the ISO, which will monitor these levels on a continuing basis.

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.

Market power can be measured through the number and market share of suppliers operating in the Arizona marketplace. This information should be obtained through consumer surveys. Transaction costs can also be measured directly through surveys and compared to baseline costs prior to industry restructuring.

Encourage a variety of market developments.

Monitoring the expansion of services and innovation in the competitive marketplace requires a sound baseline of customer options available prior to industry restructuring. After

initiation of open competition, survey techniques can be used to determine the number and type of service options available.

Promote Renewable Resources.

Under Citizens' proposal, ongoing monitoring of renewable resources would be done by a state department designated to carry out above-market renewable resource activity.

Protect important public programs.

Citizens' proposal for restructuring the electric industry contains specific components for environmental protection, renewable resource development, low income customer assistance, increased energy efficiency, and nuclear decommissioning. The key to monitoring progress in these areas is establishing a sound baseline prior to open access.

Shield consumers who do not or cannot participate in the competitive market from rate increases attributable to competition.

Under Citizens' proposal this issue becomes moot in that all customers have access to open markets. Even those who choose not to participate in innovative service offerings will be able to access competitive markets through default spot market "Standard Service" offerings.

IV. RESPONSES TO STAFF QUESTIONS ON RESTRUCTURING

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

All electric utilities in the state of Arizona should open their markets to competition, including investor-owned, municipal, and public power.

A2 Scope of Restructuring.

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

b. Which consumers should be allowed to shop around for power & energy?

As indicated in Citizens' proposal, the entire electric industry should be opened to competition.

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

This issue should be explored further with interested parties. Large customers currently under contract could be allowed a buy-out or a renegotiation period, or perhaps an option for them to buy their contracts back from the utilities through the auction.

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

This is discussed in Section 2.0 of Citizens' proposal.

A3 Term of Restructuring.

a. When should competition start?

As soon as possible. The December 1999 date put forth in House Bill 2504 is probably achievable within the State of Arizona.

b. If competition is in the form of a pilot or phase-in, how long should the pilot or phases run?

Restructuring should occur as of a certain date, rather than through a phase-in or pilot program. While specific provisions can be made during a transition period to facilitate the move to open access (e.g. a "standard" service offering), Citizens believes that a phase-in or pilot period will simply delay the process and distort the conversion to a competitive market without any material benefits.

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?

This issue is one of many reasons for not doing a pilot.

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

All services other than distribution and transmission should be available in a competitive market. See Section 2.0 of these comments for more information.

A5 Necessary Services. *How should these services be offered, measured (metered), and priced on an unbundled basis?*

Distribution and transmission rates would continue to be regulated by the state and FERC, and the services would be provided by the DISTCOs and TRANSCOs. Reliability, imbalance, backup, and related ancillary services will be provided through contracts between

the RETAILCOs, GENCOs, TRANSCOs, and the independent system operator or power pool. These services will either be FERC-regulated or market-based. See Section 2.0 of these comments for more information.

A6 Market Center Services. *How should these services be offered and priced?*

Consumer services, such as billing, credit, invoicing, will be handled by the DISTCO. Dispatching, exchanges, swaps, imbalance trades would be handled by the ISO or the power exchange. Interruption notification would need to be addressed by the RETAILCO under contract with its GENCO. See Section 2.0 of the Proposal for more information.

A7 Spot Market Services. *How should these services be offered and priced?*

A functioning spot market is an important part of the competitive electric market. Already an electric spot market is developing with one futures delivery point in Arizona (at the Palo Verde Nuclear Power Plant). The Commission should not attempt to regulate spot market transactions under taken by the unregulated portions of the competitive industry. To do so would distort and delay the efficient operation of the market.

A8 Transmission Service. *How would the objectives be met?*

The objectives listed here would be handled by the TRANSCO, the ISO, and the power exchange. The TRANSCO will file tariffs with FERC that will be approved and will be operating as a common carrier, accepting and delivering power through the transmission system. The ISO, power exchange, and TRANSCO can handle the requirement that RETAILCOs and GENCOs must have contracted for the transmission. See Section 2.0 of these comments.

A9 Recovery of Stranded Investment. How would the objectives be met?

The objectives and proposed treatment of stranded cost are described in Section 3.0 of these comments.

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

These issues are addressed in Sections 4.0 and 3.0 (for Decommissioning) of these

Comments.

A11 Encouragement of Renewables.

These issues are addressed in Section 4.3 of Citizens' comments.

A12 Pooling of Generation and Centralized Dispatch of Generation or Transmission. *Should pooling of generation or centralized dispatch of generation or transmission be mandatory or voluntary? What technical requirements will be necessary to ensure reliable and efficient use of generation and transmission resources?*

The competitive electric industry is capable of determining technical requirements necessary to ensure reliable and efficient use of generation. Efforts in this regard are underway across the country, including the Western Area. Mandates in this area are not needed.

A13 Non-Public Service Corporations. *How shall non-public service corporations such as municipal utilities be involved in a competitive market?*

All generation and all utilities should be opened up for competition. If a municipal utility elects not to open itself up for competition, it would in essence become a combination RETAILCO and DISTCO and would have to purchase its power under bilateral contracts in the open market. Presumably their existing power purchase contracts would remain in effect and would need to be sold in the auction as an integral part of the generation assets that supported those contracts.

A14 Conditions for Returning to Utility Service After the Conclusion of a Pilot Program.

Citizens does not support a pilot program, favoring instead a direct move to a competitive industry, in which there would no longer be any "traditional" utility service.

A15 Conditions for Returning to Utility Service.

Under Citizens' proposal, there would be no "traditional" utility service in the competitive industry. All customers would be purchasing their power on a competitive basis from a RETAILCO.

A16 Administrative Requirements.

The issued raised here would be the responsibility of the RETAILCO, TRANSCO, and independent system operator and would be addressed through contractual arrangements in a manner similar to those of the natural gas pipeline industry. Since all utilities would be participating, there would be plenty of time to notify their customers. There would be an established open season when customers could choose suppliers.

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

Under Citizens' proposal, all customers will be participants. Service quality would be maintained through contractual arrangements between the industry players and through registration requirements for the RETAILCOs and GENCOs in the state.

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

Since RETAILCOs and GENCOs are unregulated, there should only be minimal reporting requirements for them (e.g., number of customers, by standard offer and other offers, unresolved complaints). DISTCOs and TRANSCOs would continue traditional reporting and rate filing requirements.

A19 Certificates of Convenience and Necessity. *Would competitive sellers who supply electricity to an end user need to obtain a Certificate of Convenience and Necessity from the Commission?*

Under Citizens' proposal, DISTCOs would retain their certificated service territories and the obligation to connect end users as discussed in Section 2 of the comments. Since supply of electricity would be an unregulated service, a Certificate of Convenience and Necessity ("CC&N") would generally not be required. However, a GENCO that wished to construct new capacity in the State of Arizona would need to meet state generation plant construction requirements. Whether that is a CC&N or some new filing requirement with a siting board

would be subject to discussion. The CC&N for existing generation would transfer with assets and be sold at auction. GENCOs and RETAILCOs would need to be registered with the state to sell electricity in the state. Citizens' proposal includes a preliminary identification of the requirement for obtaining such a registration, including payment of the power sales permit fee, bonding requirements, and agreement to go along with the requirements set up by the TRANSCO and the ISO relative to scheduling and reserve requirements.

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Respectfully submitted,

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