



0000065592

ARIZONA CORPORATION COMMISSION

RECEIVED
AZ CORP COMMISSION

SEP 12 12 50 PM '96

DOCUMENT CONTROL

Proposed Rule -- Retail Electric
Competition

Docket No. U-0000-94-165

Arizona Corporation Commission

DOCKETED

SEP 12 1996

DOCKETED BY

RT

COMMENTS OF

ENRON CAPITAL AND TRADE RESOURCES

Richard S. Shapiro, Senior Director
Enron Capital & Trade Resources
1400 Smith Street, Suite 2405
Houston, Texas 77002
(713) 853-3407

Dated: September 12, 1996

TABLE OF CONTENTS

INTRODUCTION.....	1
I. TIMEFRAME FOR RETAIL ACCESS (R14-2-XXX4.).....	2
II. ELECTRIC SERVICE FOR CUSTOMERS WHO CHOOSE NOT TO CHOOSE (R14-2-XXX6.).....	6
A. Fairly Allocating Basic Service among Licensed Providers.....	7
B. Provider Identification and Billing.....	8
III. UNBUNDLING OF SERVICES (R14-2-XXX6.).....	9
IV. RECOVERY OF STRANDED INVESTMENT (R14-2-XXX7.).....	10
A. Developing Strong Incentives to Divest.....	11
B. Contract Divestiture.....	12
V. ACCESS TO INFORMATION.....	13
VI. CONSUMER PROTECTION ISSUES/CERTIFICATES OF CONVENIENCE AND NECESSITY (R14-2-XXX3., R14-2-XXX12., and R142-XXX13.).....	14
VII. SYSTEM BENEFITS CHARGES (R14-2-XXX8.).....	16
VIII. MINIMUM SOLAR PORTFOLIO REQUIREMENTS (R14-2-XXX9.).....	16
IX. POOLING OF GENERATION AND CENTRALIZED DISPATCH OF GENERATION OR TRANSMISSION (R14-2-XXX10.).....	16
A. Unbundled Electricity Available from Competing Suppliers Will Propagate Aggregating Pools and Spot Market Without Regulatory Action.....	17
B. Electric Services Competition Will Require Flexibility, Not New Regulatory Creations.....	21
C. The PE Proposal Threatens to Deprive the Electric Services Industry of a Viable Forward Market.....	22
D. Achieving Regional Consensus for a PE is Unlikely and Could Forestall Timely Introduction of Retail Competition.....	24
CONCLUSION.....	25

electricity market to all Arizona consumers. The following comments outline specific suggestions for better implementing the Commission's goals.

I. TIMEFRAME FOR RETAIL ACCESS (R14-2-XXX4.)

The Commission should allow all customers to choose their electricity supplier beginning in 1998 rather than phasing in competition between January 1, 1999 and January 1, 2003. Delay only prevents Arizona consumers from enjoying the benefits of a competitive electricity market.

Getting from here to competition is easier than this Commission apparently believes. It has, in fact, been made much easier by the Federal Energy Regulatory Commission (FERC) which has already opened up the wholesale power market to competition. In the process of providing choice to utilities and opening up the transmission grid, the FERC has solved many of the difficult problems:

- They have written the tariffs which provide open and equal transmission access.
- They have established the information system infrastructure to ensure that participants in the market have access to the information they need in order to make effective use of the grid.
- They have established the standards of conduct governing the relationship between the utility's marketing function and transmission service function (which is necessary to ensure that control over the monopoly assets of transmission and distribution does not permit the utility to exclude competitors).

- They have established the rules for resale of transmission rights so that buyers and sellers of power can turn to someone other than the utility to gain access to the grid.

These were difficult issues, but they have been addressed in detail and Arizona utilities are now in compliance. The point is that the mechanics of access to the grid have been put in place and are already operating in most places in the country. Arizona can extend these same choices and this same structure (which, as we have mentioned, Arizona utilities will have to abide by anyway in their wholesale businesses) to retail customers. Significantly, Arizona can achieve that goal without surrendering sovereignty over important policies like universal access, low income ratepayer assistance, the resolution of stranded cost issues, or authority over the distribution rates themselves. The transition to customer choice should take months, not years. The grid is already in place and everyone is connected to it. ECT and others can and will provide service over the same set of wires the utilities use today -- if this Commission will let us.

Not only are the grid and the mechanics of access to it in place; there are numerous market participants ready and willing to offer customers choices. There are hundreds of utilities across the country, hundreds of independent power producers, and hundreds of power marketing companies. In the New Hampshire pilot program, for example, thirty suppliers showed up to offer customer choice. This Commission has already set the correct policy course. It must now set deadlines for compliance and move ahead of the pack in the race to deliver savings to consumers.

Several reasons have been cited by the proponents of delay for delaying the advent of competition until the year 2000, including resolution of the stranded cost issue. First, this Commission should not lose sight of the fact that stranded costs are already in rates. They are not new costs created by competition; they are existing costs which would likely not be collected if the market were competitive. Because they are already in rates, rates will not go down by waiting for these costs to be amortized. By waiting for the collection of these costs or determining what they are before proceeding to competition, this Commission only delays the delivery of the net benefits to consumers which would be produced in a competitive market. Stranded costs can also be viewed as a rough indicator of how much there is to be saved in a competitive market. When utilities around the country claim, as they have, stranded costs amounting to \$200 billion dollars, what they are telling this and other Commissions is that in a competitive environment those investments would not have been undertaken or, at the very least, that consumers would not have been forced to bear them when they proved uneconomic¹. This is perhaps one of the biggest cost savings opportunities. With investors bearing the risks (and rewards) of

¹ Nevertheless, in ECT's view a regulated entity who incurred costs and undertook investments in direct reliance on the regulatory obligations contained in the so called "regulatory compact" and who now finds those costs and investments "stranded" as a direct result of the move to a more competitive market structure, should be allowed to recover those costs. However, it must be adequately demonstrated that the costs were in fact incurred on the strength of the compact, that the investments were rendered uneconomic as a direct result of the transition to a competitive market, that the utility has adequately mitigated its costs, and that the risks involved in making the investments were not already compensated in previous rate cases. Further, there is a very difficult problem in calculating the amount of stranded investment. One way of addressing this difficulty is to first require the utility to incur the shortfall before recovery is permitted. Another way, and one which avoids the inevitable wrangling and litigation implied by these difficult issues, would be to give utilities an opportunity to recover their investment by divesting generating assets and their sales business and letting an objective market process determine the shortfall between their embedded costs and the market price. The bottom line is that this Commission won't know what the level of stranded costs are until the market begins to emerge and produce prices against which the utility's investment can be measured. Stranded costs are a reason to move quickly to competition, not a reason to delay its benefits.

their own investments capital will be invested more wisely, existing facilities will be better utilized, and construction cost control decisions will be made more judiciously. We urge the Commission to begin realizing these significant long-term savings opportunities sooner rather than later.

Some have also argued that we should build in guarantees that all customers will benefit before moving to a competitive structure. This, frankly, is a red herring. Today, only large customers have choices, and even those choices are inferior to what they would see in a competitive market. Small customers are being left behind in today's system. The answer for all customers is choice and access to the competitive market, choice and access which utilities have today as a result of the FERC's recent actions in the wholesale market. All customer classes will benefit; some more than others, but no customer class benefits from the perpetuation of the current system.

The level of public desire for competition has also been raised as a reason to go slowly. The Pilot programs in certain states around the country have demonstrated that, given the opportunity, customers want to choose their electricity supplier. A recent poll², in fact, indicated that 75% of American consumers thought competition in electricity supply would be a good idea, with only 5% indicating it would be a bad idea. This same survey indicates that approximately 70% of those polled indicate that the current system should be changed, with only 27% indicating that the current system works well. The overwhelming majority of respondents also said that the current system should be changed

² These results are based on telephone interviews with a random sample of 1,007 adults age 18 and older. ICR Survey Research Group conducted this national survey July 12-16, 1996. At a 95% confidence level, the margin of sampling error is plus or minus 3% for data derived from the total sample.

so that all homeowners can buy electricity at the same price from competing companies. Customers who prefer the incumbent utility will likely be able to choose that utility or its affiliate. Customers who want other options should have that opportunity as soon as possible.

In summary, this debate is all about time. The arguments of those who would urge this Commission to delay retail choice so that they can continue to collect high rates are nearly endless. This Commission's highest and best action is early action. This Commission has made the right policy choice and merely needs to set more aggressive deadlines for compliance. Every year of delay means millions in foregone savings - savings Arizona consumers will never recover.

II. ELECTRIC SERVICE FOR CUSTOMERS WHO CHOOSE NOT TO CHOOSE (R14-2-XXX6.)

ECT supports the concept of Basic Service or, as this Commission refers to it, a Standard Offer for customers who choose not to choose. Power consumers have never before had a choice of supplier. The local utility incumbent or "Affected Utility" has always been there and been there alone. Early in the process of introducing retail competition to the State of Arizona, simple inertia will likely cause a large percentage of retail load to default to a Standard Offer. If the affected utility alone has access to this potentially large segment of the market, consumers will be seriously disadvantaged and new entrant suppliers will be denied significant scale economies. For these reasons, ECT supports a Standard Offer, but strongly objects to rules that would fence this important market off from retail competition. Rather, ECT recommends the fair allocation of Standard Offer customers among licensed Standard Offer suppliers.

A. Fairly Allocating Basic Service among Licensed Providers

The Standard Offer market is defined largely by customer inertia brought on by the fact that Arizona consumers have no experience with selecting retail power service providers. The same inertia that made it necessary to allocate default service customers among long-distance carriers in order to prevent continued monopolization by AT&T will likewise require, at least initially, some allocation procedure to allocate Standard Offer customers among licensed providers other than the incumbent Affected Utility.

ECT suggests that the Commission undertake a sequential process to match Standard Offer providers with customers. Initially, potential vendors will apply and, if qualified, be licensed to be Standard Offer providers. Thereafter, within the incumbent Affected Utilities' billing envelope (and perhaps other media) all Arizona consumers should be provided iterative notices, approved by the Commission, that (1) describe the licensed provider, (2) certify that the provider offers the minimum Standard Offer requirements, (3) detail any additional, value-added services offered, and most importantly, (4) inform customers that they can either choose a provider by a certain date or be randomly assigned on a proportional basis to one of the licensed providers.

The legitimate administrative process of shifting monopoly customers to a competitive environment is not, in itself, untoward or unlawful and, in fact, represents the optimal policy choice. To those who would question such a process, ECT would note that Arizona retail customers are not taking service from their incumbent Distribution Company today as a result of informed consent or choice. In addition, to those who complain that a neutral and informed allocation process will impose certain administrative

costs, ECT acknowledges that introducing competition into the largest and oldest regulated monopoly in the U.S. economy will necessarily impose certain administrative costs. These costs, however, are required to ensure the proper transition and surely can be imposed proportionally on the incumbent and the new entrants providing the Standard Offer service.

B. Provider Identification and Billing

In order to become effective competitors within the Standard Offer market, licensed new entrants will need to be able to communicate with and obtain access to Standard Offer customers on an equal basis with the incumbent Distribution Company. The importance of this access cannot be over emphasized. At all times until now, the incumbent has controlled all of the information that most Arizona electricity customers -- and almost certainly all likely Standard Offer customers -- have ever received about the availability and price of electric energy. The incumbent has name recognition and dominates the information market as a direct consequence of its historical monopoly status.

In connection with the proposed rules, the Commission should develop fair and efficient rules for allowing licensed new entrants to obtain name recognition as providers of Standard Offer Service. At a minimum, two options should be opened to competitive Standard Offer providers. In the first option, a licensed new entrant would be guaranteed access to Distribution Company services, including metering and billing envelope services, on the same basis as the Distribution Company provides those services to its own power supply operations. With respect to the billing envelope, the Commission should clarify

that the Distribution Company must clearly and prominently identify the third-party supplier of Standard Offer energy. That supplier should be given the option of providing its own billing insert. In the alternative, the new entrant should be given the opportunity to purchase distribution capacity and undertake to bill Standard Offer Service customers directly for both energy and distribution services, on an unbundled basis. Having the ability to choose between either of these options is likely to be essential to providing Standard Offer customers the benefit of competition.

III. UNBUNDLING OF SERVICES (R14-2-XXX6.)

ECT would urge the Commission to move more aggressively in its unbundling of services that can be competitively provided. Unbundling the cost of providing competitive services and transferring responsibility for their delivery, from the monopoly to a competitive supplier, is crucial to the success of retail restructuring. Companies such as ECT, at a minimum, are fully prepared to offer what can be characterized as revenue cycle services, (i.e., metering, billing, customer and collection services) at the time that retail access is initiated. Most significantly, these services represent a large proportion of the small customer's bill and, without unbundling, competitive suppliers will likely be unable to effectively market to these smaller customers.

The criteria for unbundling services which this Commission should utilize, which are met by each of the above referenced services, are as follows:

- 1.) The services can be provided competitively.
- 2.) The services do not impair system reliability.

3.) The services are of interest to and willing to be provided by competitive suppliers.

ECT urges this Commission to more extensively unbundle distribution services as this effort is essential to customer choice and supplier viability. In order to achieve a market where competitive suppliers offer a wide range of competitive distribution services and to meet this Commission's objectives for achieving a competitive electric services industry, aggressive unbundling of services is a prerequisite.

IV. RECOVERY OF STRANDED INVESTMENT (R14-2-XXX7.)

To the extent that the Commission allows Affected Utilities to recover some or all of their uneconomic or "stranded" investments, the measure of stranded investment should be based on a market valuation of the stranded-cost claimant's *net* uneconomic investments. This will require that the allegedly stranded investments be put on the market as a prerequisite to stranded-cost valuation and recovery. Without highly speculative administrative prognostication or trackers, the resulting sale will establish the market value attached to the sunk costs carried on the claimant's books. Further, the sale will ensure that the claimant utility is not paid for an uneconomic resource it is allowed to keep and make sales from it at the same time. Equally important is that divestiture can bring closure to the transition from vertically integrated bastions of market power to a competitive electric power industry. For these reasons, ECT urges the Commission to pursue aggressively the approach that voluntary divestiture be made the price of stranded cost recovery.

A. Developing Strong Incentives to Divest.

Recognizing that most utilities have a mix of power supply resources, including multiple generating stations and purchase power agreements, it would be inequitable to permit a utility to seek stranded-cost recovery for selected uneconomic investments without netting the cost of those stranded investments against other resources in which sunk accounting costs are at or below replacement cost. Indeed, an approach that fails to net "economic" investments against the uneconomic resources, if pursued in tandem with deregulation of the price of power from existing rate-based generating units, would thrust utility customers into the worst of all possible worlds. In that world, charges for low-cost resources would increase from cost-based levels to market prices while rates for stranded assets would be set at embedded costs levels in excess of market prices. As a result, ratepayers would be required to pay the *higher* of cost or market. The Commission should take steps to ensure that this does not occur.

To ensure that departing utility customers are not denied credit for the utility's economic investments, but saddled with only uneconomic investment costs, a divestiture incentive must attach itself equally to uneconomic and economic assets. For example, once a utility determines that it has uneconomic investments for which it will seek recovery through a stranded-investment charge, then the Commission should require the utility to file evidence of its total system sunk accounting costs together with a plan to sell all of its resources. All or some portion of the difference between the sunk accounting costs and the sales proceeds would represent a market valuation of stranded investment.

B. Contract Divestiture

An intermediate form of divestiture that is available to the Commission is the sale of contract rights to the output of allegedly stranded utility generation facilities. These rights could entitle the purchaser to the output of specific units or a "slice" of the utility's system capability. This treatment of stranded assets finds an analog in the FERC's proposal for the recovery of uneconomic utility investments in the wholesale power market. Under FERC's proposal, departing customers targeted with stranded cost charges by their incumbent wholesale power provider may assert control over the use of the underlying stranded assets to ensure that they are operated in a manner that mitigates the customer's stranded cost exposure.

The terms of these generation output contracts could vary, but would be designed to avoid the risk of "fire sale" devaluation of utility assets that many appear to fear divestiture will produce -- i.e., the possibility that the outright sale of all utility generation assets could flood the market with assets of uncertain value, leading to underbidding and increasing stranded costs. Whether or not there is an actual risk of a "fire sale" (which ECT doubts when considered in light of the successful outcome of massive privatizations elsewhere in the world), requiring the sale of contract rights to generation would not only prevent asset devaluation, but would also (a) reduce the utility incentive to discriminate in favor of its own generation, (b) provide a fixed measure of stranded costs (at least for the term of the contract), and (c) avoid transaction costs associated with asset transfers. Regardless of whether the Commission chooses to incentivize the outright sale of assets

for the sale of contract rights, stranded investment recovery must be predicated on divestiture to protect consumers from inflated estimates of stranded investments

V. ACCESS TO INFORMATION

A significant issue not specifically addressed by the Commission in its proposed rules is whether all competitive suppliers will be able to access certain customer information in order to effectively compete. To assure fair competition, this information playing field must be level. This means that all customer history and usage information as well as mailing list data must be available to competitors on a timely basis and in a format that is readily useable by standard computer systems. Distribution of such information should be carried out on both an aggregated and on an individualized basis. Competitors should have access to all customer information on terms equal to the terms of access enjoyed by any electric utility or utility affiliate. Also, certificated competitive suppliers in Arizona should have equal access to utility bill inserts for distribution of their own promotional material. The bottom line with respect to all of this information is that the incumbent utilities now possess it because they are monopolies, not because they were particularly creative. This information, which is as essential to competitive suppliers as is access to the wires, must be provided on a non-discriminatory basis.

*VI. CONSUMER PROTECTION ISSUES/CERTIFICATES OF
CONVENIENCE AND NECESSITY (R14-2-XXX3., R14-2-XXX12, and
R142-XXX13.)*

A necessary corollary to the advent of the competitive supply of electricity is the methodology for ensuring the accountability of competitive suppliers. ECT agrees that this Commission should certify all competitive suppliers based on financial and technical capability, but does not agree with the very cumbersome and overly intrusive requirements articulated in the proposed rules (e.g., filing of tariff, filing of price lists). This Commission instead should rely on certification processes for new competitive entrants in Arizona to ensure technical and financial ability without unnecessarily choking off market innovation by imposing rigid tariff and price posting requirements. To avoid unnecessary delays or the creation of unreasonable market entry barriers, the certification process should utilize a verified application and rest on a presumption of qualification in the absence of the Commission's objection to certification. The verified certification form should be submitted by an officer of the supplier, under the penalties of perjury, and contain basic company information, including customer and regulatory contacts, a financial statement, a performance bond or acceptable surrogate (e.g., corporate guarantee), and other documentation as the Commission might direct. If the Commission does not act within ten days of receipt of the information, the supplier would be deemed to be certified. The Commission, however, would retain the jurisdiction to review the financial and operational capability of each supplier as circumstances dictate. The Commission should

also have the authority to impose progressive sanctions, including corrective orders, penalties and suspension, to address deficiencies in the conduct of competitive suppliers.

Although a supplier certified under this procedure would be entitled to contract independently with any retail customer for the sale of electricity, Stranded Offer service should be provided only by suppliers formally approved by the Commission for that express purpose. The Commission's formal evaluation and prior approval of the supplier's qualifications is necessary in light of the significance of those services.

Additional consumer protections will be provided by existing state and federal consumer protection laws which will provide safeguards from deceptive trade practices. The development of a competitive market does not require additional or more specific regulatory controls, with the exception of appropriate slamming prohibitions and billing and termination procedures which this Commission has already articulated. As noted earlier, the Commission must refrain from the regulation or prior approval of the terms, conditions, and price of supplier contracts, in order to allow the proliferation of products, services and lower prices which the competitive market will produce. Considerable flexibility in packaging services and products will be required to meet the ever changing needs of customers and to achieve the desired cost reductions. The requisite level of innovation may be lost in a regime that demands the prior approval of contracts or pricing disclosures. The Commission's authority to review the certification of any supplier, along with the existing consumer protection statutes, ensures that inappropriate supplier behavior will be addressed without the need for greater regulatory controls.

VII. SYSTEM BENEFITS CHARGES (R14-2-XXX8.)

ECT supports the Commission's plan to create a system benefits charge to fund low income and environmental-related programs as well as nuclear decommissioning costs that are deemed desirable by this Commission. ECT recommends that such charges be broadly spread among all customers through an access charge to ensure that the mechanism for collecting the funds do not impact upon a customer's choice of supplier(s).

VIII. MINIMUM SOLAR PORTFOLIO REQUIREMENTS (R14-2-XXX9.)

While ECT would comply with any minimum solar portfolio requirements, the decision to purchase renewable power should be left to the marketplace.³ If consumers want renewable power or "green" options, as we certainly expect they will, competitive suppliers will offer renewable and "green" service options. The market can make this decision more efficiently than any arbitrary government standard. The Commission should also take into consideration that restrictive supply requirements may deter certain competitive suppliers from entering the Arizona electric services market, thereby limiting the effectiveness of competition in Arizona.

IX. POOLING OF GENERATION AND CENTRALIZED DISPATCH OF GENERATION OR TRANSMISSION (R14-2-XXX10.)

ECT believes that the Commission's objectives can best be met without the establishment of a government mandated pool and that the existence of such an institution will actually inhibit the development of many desirable characteristics of the commercial market.

³ If the market does not produce the desired renewable resource usage level, the Arizona Legislature could choose to subsidize renewable resources through general revenue taxes or a broad-based access charge.

A. Unbundled Electricity Available from Competing Suppliers Will Propagate Aggregating Pools and Spot Market Without Regulatory Action

Market created pools into which generators and other power suppliers can sell at wholesale will provide valuable services and opportunities to both sellers and buyers in the electric power industry. Likewise, a spot market will add valuable market-clearing capabilities to a competitive retail electricity market. For these reasons, competing pools which result in individual spot prices that will then clear in the regional spot market will emerge when electric energy is allowed to become a freely tradeable commodity in Arizona. It will become such a commodity when it is unbundled from the monopoly functions of the vertically integrated power supply industry -- transmission and distribution -- and when access to those functions, on a nondiscriminatory basis, is ensured.

It is incorrect to assume this Commission must prescribe and place its imprimatur on a single, centralized pooling institution -- for purposes of these comments, we shall refer to it as the Power Exchange or "PE" -- in order for an aggregating pool or a spot market to develop. There is simply no service provided by a PE that could not better be provided by bilateral contracts for power, accompanied by a liquid market in risk management tools.⁴ Indeed, such a liquid market based on bilateral transactions is much more likely to establish a competitive spot price than is the market-clearing price determined by a Commission-mandated, day-ahead PE.

⁴ The New York Mercantile Exchange has been authorized to trade and is currently trading an electricity futures contract at two locations in the western states.

1. *Commercial pooling and aggregation services will outperform a Commission-mandated exchange* -- Power marketers are currently providing a growing volume of both supply and demand of aggregation services. These aggregation services add real value by improving load factors of supply resources and loads. Of equal or greater value, competitive aggregators generate diversified product offerings. Marketers can and do provide multi-fuel/power products for customers -- e.g., factories, schools, hospitals, etc. -- that are capable of switching between power sources. They also offer power supplies that can vary qualitatively in response to either a customer's preferences or the price elasticity of the customer's demand. The spectrum of potential products is wide, ranging from firm constant voltage and constant harmonics to the lowest quality of available service. Further, as noted earlier, competitive aggregators that are capable of meeting appropriate licensing requirements should be allowed to supply one or more levels of Standard Offer service, in addition to other product offerings.

While there will be no paucity of aggregators in Arizona offering pooling-type services in a competitive retail power market, the introduction into this market of a Commission-mandated PE may have the unintended effect of limiting the availability of such services. As ECT understands the concept as advanced elsewhere, the PE would provide a market for generation that is either required to sell into the PE or chooses to sell through the PE over other commercial marketers. In this capacity, the Power Exchange confines its aggregation service to a single product, hourly (or semi-hourly) day-ahead electricity at a spot price. Market created pools would, however, compete to supply the best combination of products and services. Ironically, for power sellers required to sell

into the PE and for customers required to buy through the PE or who default to the PE through inaction, a Commission-mandated PE will actually limit pooling and aggregation services as well as product offerings.

2. Once electricity becomes a commodity, market participants will develop a spot market -- The proposed PE is not an essential or even an important ingredient of a spot market. A spot market acts as the residual market for transactions that are not consummated pursuant to contracts for physical delivery or cleared in a forward market. In this way, spot markets provide a balancing mechanism that allows commodity markets to match supply and demand at the time of delivery.⁵ To fulfill this function, spot markets develop naturally in response to demand.

By contrast, a PE mandated by regulation will inhibit competition in the spot market by displacing commercial marketers who would otherwise be transacting in the spot market. The practical effect of mandating a PE in most, if not all, markets would be to bundle all of the wholesale market's generation and transmission resources in a manner that permits incumbent utilities to manipulate -- or, if you will, "fix" -- the price at which bid power supplies clear the spot market. This result is likely (at least in the near-term) since, in most markets, incumbent utilities continue to control the majority of the generating capacity. Under these circumstances, those in control of a large proportion of generating capacity will be able to manipulate the market clearing price available to all

⁵ As explained further below in Part VIII.D, a Commission-mandated PE for trading day-ahead power is likely to reduce liquidity in the forward market. To the extent this occurs, there will be less need for a spot market, i.e., traders needing to purchase from the spot market to cover short positions or to sell into the spot market their long positions.

others.⁶ Any lower-cost competitor has no reason to compete; instead, it simply bids in at a very low price or zero, knowing that, under the rules of the proposed PE, it will invariably be paid the higher market clearing price bid by the local utility or utilities.

While the marginal pool that results from this regulatory contrivance may be transparent, equal or greater transparency can be achieved through commercial alternates that do not constrain competition in the manner of the PE. In most commodity markets of any appreciable size -- and electricity has the potential to become one of the largest, if not the largest North American commodity market -- trade associations and publications compete aggressively to compile and sell accurate price indices based on information received confidentially from market participants.⁷ The locational spot prices reported by these services will reflect actual spot market prices as accurately or more accurately than a Commission-mandated PE.

⁶ For a description of how a proposed, centralized, day-ahead market in New York could be manipulated by those New York utilities that control a significant percentage of the state's generating capacity, see Randal J. Falkenberg, *PoolCo and Market Dominance*, 133 Pub. Util. Fort. 26(Dec. 1995). ECT shares the view expressed in the testimony of economist Thomas J. Prisco that the Department of Defense filed with FERC in connection with FERC's recent inquiry into pooling institutions:

Poolco is a method advocated by utilities and seems to me largely designed to keep control of the price of generation in the hands of the utilities who now control that price. Under that alternative all suppliers of energy are forced to sell power for what they can get from the "Poolco" and where all customers are left to buy from the "Poolco" at a price established by the "Poolco." This creates a middle man with both monopsony and monopoly powers and probably will leave control of the rates for electricity largely in the hands of those controlling "Poolco".

"Test. of Thomas J. Prisco at 12-13, FERC Docket No. RM 94-20"

Professor Robert Michaels of the University of California, Fullerton, expresses a similar view that proposals to mandate centralized day-ahead pools are not the competitive alternatives to retail competition, as portrayed by their proponents, but rather the last gasp efforts to retain utility control over access and price. Robert J. Michaels, *Wholesale Pooling: The Monopolist's New Clothes*, 7 The Elec. J. 64(Dec. 1994).

⁷ ECT would suggest that a much less intrusive solution is to have the Commission publish a spot index for a defined transitional period. The index could be derived from price reports required to be filed with the department on a confidential basis by all suppliers. While ECT does not believe the Commission's published index will be able to provide the best data available, because it will be less adaptable to market needs than privately published indices, it can serve the purpose of allaying any concerns about price transparency.

*B. Electric Services Competition Will Require Flexibility, Not New
Regulatory Creations*

ECT urges the Commission to proceed with competitive reforms even if the end product of those reforms is not yet known, simply because competitive markets are dynamic. Direct communication between buyers and sellers in competitive markets produces product diversification and services that are rarely foreseen by most market participants. Where the threat of market power and monopoly rents has been removed, flexibility is essential to competitive markets achieving their optimal performance without the constraints of additional regulatory structures that may create unanticipated and undesired consequences. Commenting generally on why electricity markets need fewer and not new or more centralized institutions, author and long-time power industry consultant Leonard Hyman recently commented that

‘[i]n a way, setting up a rigid, centralized pool designed by the government or by the [utility] incumbents bears the same risks as other centrally-imposed solutions in a rapidly changing world, such as pricing of deep gas, California water allocation, Standard Offer 4 contracts, lifeline rates to owners of ski lodges, nuclear power and syngas.⁸’

Many promising innovations in power markets are found in the concept of total energy service programs. In these programs, vendors package types of power with other products, such as energy efficient appliances or demand reduction programs to tailor customer-specific packages of least-cost energy. In other programs, environmentally benign power sources are aggregated and sold as a distinct product; this is particularly valuable for intermittent resources such as wind, solar and run-of-river hydro because they

⁸ Leonard Hyman, *A Modest Proposal: Follow the Internet, Not PoolCo.*, 134 Pub. Util. fort. 21, 25 (Jan./Feb. 1995).

can be packaged with resources possessing complementary availability, thereby increasing load factor and value. In marked contrast, the PE, by offering only one product at one energy price, will stymie the development of total energy services and other new power products.

Central to the PE concept is the assumption that loads are homogeneous -- all purchasers pay the same energy price irrespective of their load characteristics and the accuracy of their nominations to the pool. However, in a competitive market, consumers will be free to select the level of reliability and other qualitative aspect of service they need and for which they are willing to pay. Only then will power supplies go to those who need them most⁹ and savings will accrue to others who can tolerate interruptions that facilitate load balancing or system constraints. A centralized, day-ahead pool or PE does not make these important distinctions.

C. The PE Proposal Threatens to Deprive the Electric Services Industry of a Viable Forward Market.

Excess costs in the current electric services industry, and the greatest potential for generating future uneconomic or "stranded" investments, result from the industry's current lack of a liquid forward market for power. By allowing buyers and sellers to commit today to prices for future deliveries, a forward market shifts from the ratepayer to the market the risk of price volatility. At the same time, a forward market sends accurate

⁹ ECT fully appreciates that electricity service to meet the needs of the poor, elderly and disabled will require in some instances subsidization. Compensation for this Universal Service will come from a non-bypassable general access charge. While this funding is exogenous to the commercial market for retail electricity, ECT encourages the Commission to permit all qualified suppliers to compete to provide Universal Service.

signals about the need, or lack of need, for new investment.¹⁰ Further, risk management tools available in the forward market permit investors to lock in on future costs and revenue streams. For example, a futures market lowers the capital cost of new supply and demand-side investments. Indeed, the ability to manage the risk of future price volatility is one of the most valuable advantages that can be achieved through restructuring the electric power industry. The emergence of a liquid forward market in the natural gas industry has made it possible for all customer classes to benefit from competition and shift price risk to the market where it can be handled most efficiently.

By forcing transactions and price setting *ab initio* into a day-ahead, hourly spot market, the PE would concentrate all transactions and liquidity in the short-term spot market. Making the spot market the center of the PE in this manner is precisely the opposite of what occurs in competitive commodity markets. In competitive commodities' markets, liquidity concentrates where the market can most cheaply provide fungible, tradable products -- e.g., in exchanges or over-the-counter forward contracts between buyers and sellers. This is where price and value are determined today for purposes of future deliveries. In a competitive market, the short-term spot market (made preeminent under a PE) exists only for incremental trades. Arizona should reject the PE if for no other reason than it will deny Arizona power consumers the price stability, price transparency, and risk management available in a liquid forward market for competitive electric services.

¹⁰ A forward market projects a transparent, forward market price curve. As this price curve approaches the cost of production from a new facility, the market is informed that investment in new capacity is economically justified.

*D. Achieving Regional Consensus for a PE Is Unlikely and Could Forestall
Timely Introduction of Retail Competition*

Even if introduction of a PE were a sound policy choice for restructuring the Arizona electric power industry, it nevertheless will require introduction of an unwieldy, new market structure that is likely to require the concurrence of neighboring state utilities and regulators, and is certain to require application to the FERC for approval of PE sales under the Federal Power Act.¹¹ ECT is concerned that this required level of regional and state/federal cooperation and support for the PE is unlikely to be forthcoming. Consequently, insofar as the PE becomes a central component of Arizona's proposed reforms, those reforms are unlikely to be implemented in a timely manner and likely not within the schedule contemplated in the proposed rules.

Other jurisdictions that have implemented or propose to implement centralized day-ahead pools, such as the PE, typically have comprised large and relatively self-contained energy markets. Examples are the United Kingdom and Wales, New Zealand, Alberta, and California. In each of these examples, a centralized authority was able to prescribe the pool for the self-contained energy market. Arizona, by contrast, is an integrated part of the larger Western energy market. Whether a PE limited to Arizona could function independent of the rest of the Western market is subject to serious question. If for no other reason, the jurisdictional complexity of the PE should give this

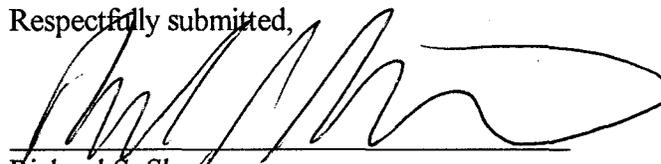
¹¹ As the California proponents of a similar power exchange institution recognized in recent filings with the FERC, a day-ahead pool for wholesale transactions is subject to FERC's exclusive jurisdiction under § 201(b)(1) of the Federal Power Act, 16 U.S.C. § 824(b)(1)(1994). See *Application of Pacific Gas and Elec., et al.*, FERC Docket No. ER96-1663 (filed April 29, 1996).

Commission pause. Even the least regional dissension over the creation of a proposed PE could appreciably prolong restructuring Arizona's power industry.

III. CONCLUSION

ECT anticipates being an active participant in the future of Arizona's competitive electric power industry and respectfully urges the Commission to move forward with the introduction of retail electric power competition and universal customer choice as proposed in the foregoing comments.

Respectfully submitted,



Richard S. Shapiro
Senior Director, Governmental Affairs
Enron Power Marketing, Inc.
1400 Smith Street
Houston, TX 77002
(713) 853-3407

Date: September 12, 1996