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AZ CORP COMMISSION  
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February 25, 2002

Chairman William A. Mundell  
Commissioner James Irvin  
Commissioner Marc Spitzer  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, AZ 85007

E-00000A-02-0051  
E-01345A-01-0822  
E-00000A-01-0630  
E-01933A-02-0069  
E-01933A-98-0471

**Re: Electric Competition Rules, Docket No. RE-00000C-00-0275  
AISA, Docket No. E-00000A-01-0630  
APS Request For A Variance, Docket No. E-01345A-01-0822  
Generic Docket for Electric Restructuring, Docket No. E-00000A-02-0051**

Dear Chairman Mundell and Commissioners Irvin and Spitzer:

The Arizona Competitive Power Alliance appreciates this opportunity to address issues related to electric restructuring in Arizona. Time and scope constraints prevented us from answering every question posed by the Commissioners, however we look forward to the prospect of providing witnesses who can supply more complete responses to these very important issues as this docket unfolds.

Again, we wish to thank the Commissioners for their interest and work on these critical issues.

Sincerely,

ARIZONA COMPETITIVE POWER ALLIANCE

Greg Patterson  
Director

Arizona Corporation Commission  
**DOCKETED**

FEB 25 2002

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## OPENING COMMENTS

*The Arizona Competitive Power Alliance is comprised of 13 independent power producers that are dedicated to providing competitive wholesale power to consumers in Arizona. Our member companies are in the process of constructing over 14,000 new megawatts of electric generation in the state of Arizona. . In the near term, we believe that consumers benefit most from competition when a well-regulated distribution company is directed to bid for power from a competitive wholesale market and pass those costs through to the retail consumer. In the long-term, we believe that retail electric competition will bring consumers lower prices, greater reliability, and greater product innovations than would have been offered under a fully regulated market model.*

*There are clear examples of successful forays into retail competition. For example, more than 550,000 Pennsylvania residents are being served by alternative electricity suppliers. Among these, some 20% have selected to purchase renewable power, willingly paying a slightly higher premium for the choice of "green power." It is critical to have a competitive retail (end-use) electricity supply market develop if consumers are to enjoy all of the benefits of electric competition. In a competitive market without price regulation, market forces drive prices toward the producer's cost of providing the product or service. This is the environment in most product markets in the United States.*

*Arizonans can significantly benefit from existing wholesale competition where the economic and environmental benefits of new, clean, and highly efficient generation can be passed onto the end-use customers through the Standard Offer. For example, new generation has already been constructed in Arizona that could offer power at prices significantly below the rates offered by APS in their recent filings, and would most likely have less environmental impact. Further, new*

*generation could be constructed and sold to APS, with similar or increased levels of reliability, at prices less than that offered through the Pinnacle West contract.*

*We applaud the ACC for asking the critical questions surrounding electric competition Arizona. The Alliance commends the Commission for carefully considering the input of the diverse interests participating in this process. We appreciate this opportunity to respond to your questions and participate in this process which that, in our view, will establish a vibrant competitive electricity market that benefits all Arizonans.*

*As indicated above, the Arizona Competitive Power Alliance is a trade association representing competitive power suppliers, including independent power producers, merchant generators and power marketers. These suppliers, who account for a substantial amount of installed and planned generating capacity, provide reliable and competitively priced electricity from environmentally responsible facilities serving Arizona's power markets. The Alliance seeks to bring the benefits of competition to all power customers. The views contained in this filing represent the position of the Alliance, as an organization, but not necessarily the views of any particular member with respect to any issue.*

**I. Identification of Retail Electric Products and Services for Which Competition Could Bring Benefits**

- A. What are the possible goods and services traditionally provided by the electric utility for which retail competition is possible? You may address the following categories of goods and services:

*Competition is possible for non-utility suppliers of electrical energy commodity and metering. Billing for all electric service can also be provided by*

*non-utility suppliers. Another service provided by competitive suppliers is pricing programs tailored to fit individual consumer needs.*

1. generation, including baseload, intermediate and peaking power; green power; distributed generation; firm and nonfirm power; long- and short-term contracts; backup and coordination services:

*Larger consumers are best suited for taking advantage of interruptible supplies (non-firm power), installation of on-site generation, and backup and coordination services. Larger consumers are more sophisticated purchasers and therefore may choose, for themselves, contract lengths and supply options that best suit their operating characteristics.*

2. distribution services, including ownership, construction, maintenance and repair of the physical lines; metering ownership, installation, reading and data analysis; and the process of planning for and negotiating with distributed generators:

*At this time, the incumbent utilities have the "in-house" knowledge and experience in providing reliable distribution electricity supply service, including line repair & maintenance, data flows, and interconnection of small scale generation. Not only does the utility have this knowledge, they have the systems, information, and infrastructure in place to provide this necessary service. The Alliance believes that – at least at this stage in market unbundling – the utility should perform these services.*

*Meters can be owned by a party other than the utility. Meter ownership is not the key issue. Information flow from the meter is the key issue. As time progresses, competitive metering services will provide consumers and suppliers with the information needed to provide the right product to the consumer. Retail competition can be offered to consumers today without competitive metering in place. However, competitive metering service with proper distribution of meter information should be part of the plan to migrate to more competitive Arizona retail energy markets.*

3. aggregation services, such as load profiling; load planning; customer services; data analysis; billing; generation planning; power supply acquisition; demand side management, energy efficiency and other services relating to matching supply and demand.

*Mid size markets, those between 30kw and 500 – 1,000 kw will be attractive markets for electricity suppliers who aggregate classes of customers. Customers that may fall into this class might be grocery stores, motels, bakeries, convenience stores, and a wide variety of other businesses. Many of these commercial operations exhibit similar physical characteristics as large manufacturers, but on a smaller scale. Many of these accounts are procured by a central organization which lowers marketing costs. In some cases, these types of commercial businesses desire to purchase power through their trade associations in the same manner that they may have purchased insurance or other common business needs. These "Association"*

*aggregating strategies on the part of the buyer should result in a more efficient transaction for both the supplier and the consumer. Regarding energy efficiency services, the Alliance views many of these products as being competitively supplied already. Timed thermostats, more efficient HVAC units, and other products are all part of a working and competitive open market for consumers.*

*The Alliance believes that the processes contained in the current Electric Competition Rules are appropriate, and provide retail customers the best opportunity for obtaining the benefits of the competitive marketplace. As the provider of Standard Offer service, the load serving entities should meet their load be through a portfolio of long-term and mid-term contractual commitments, and some spot market purchases. Contractual commitments should be obtained through an open bidding process. The proposal that APS/PWCC have submitted to the ACC is essentially their "bid" to provide a long-term contract. It would be beneficial to retail customers to determine whether others could provide the power at a cheaper rate. The Alliance members are confident they could provide savings.*

B. For each good or service for which competition is possible, what are the possible benefits of competition for each good and service?

1. What are the potential price benefits?

*Transitioning a market as vast as electricity will take time. But experiences from others sectors show that the when markets are opened up to*

*competition, prices drop and consumers get more choices. For example, air travel has tripled since airlines were deregulated, while the average air fare has fallen by nearly half in real terms. Since the 1984 AT&T divestiture launched competition to long distance telecommunications, rates have dropped by about 65%.*

*In the long run, electric consumers will enjoy lower prices due to efficiency increases. Also, consumers do not take the risk of cost overruns, inefficient operating practices, or other cost increases that may be suffered by a particular generating resource. In a competitive market, the market price is indifferent to these sorts of cost increases experienced by individual generators.*

2. Do the potential price benefits differ in the short-term and long-term?

*The Alliance members can sell long-term energy at prices less than those contained in the APS/PWCC proposal.*

3. What are the potential non-price benefits?

*From a consumer viewpoint, non-price benefits can include customer convenience, products designed to meet customer needs and desires, and other aspects of servicing consumers that distinguish one competitor from another. These items can range from payment plans to internet based account information to real-time consumption & price information.*

*From a resource viewpoint, the non-price benefits of more efficient power generation are clear. Perhaps the most important non-price advantage is that competition leads to more efficiency and more efficient power generation results in less environmental impact. Further, more competition provides more market choices, including choices that encourage power generation that is more environmentally sensitive.*

4. Are there any other potential benefits (e.g., environmental, energy security, etc.)?

*As mentioned above, newer plants are more efficient and environmentally friendly. If and when consumers demand renewable energy as part of their energy supply, then more generation driven by those energy resources will be constructed resulting in even less environmental impact. Additionally, if demand for renewable generation increases, the price associated with that resources base will be paid for by the consumers demanding renewable generation. Competition allows the marketplace to provide this choice for consumers, should Arizona citizens want that option.*

## **II. Determination of the Feasibility of Competition**

- A. Are the product and geographic markets for the good or service conducive to

effective competition or manipulation by a single entity? For example--

1. Are there economies of scale which make it most efficient for the service to be provided by a single company?

*The transmission and distribution can achieve economies by spanning over large areas. The transmission system is currently being reformed to act as a single large system over expansive regional areas. Regional Transmission Organizations (RTO's) are being formulated to combine many smaller transmission systems into one, centrally operated, regional transmission system. The expected result will be a more efficient, more reliable transmission grid over the long term. At this time, distribution systems are not being combined in the same fashion as transmission systems. The Alliance believes that transmission and distribution services are areas where economies of scale exist. Consequently, effective regulation of these entities is critical if society is to enjoy both the benefits of competition and the economies of scale. Transmission and distribution entities need to be carefully regulated to insure that fair and equitable access to these systems is afforded competitive energy suppliers, meter suppliers, or other competitively provided services.*

*There are no economic reasons why power needs to be generated by a single entity. Utilities have been purchasing power from third party generators at competitive rates for more than 10 years. The new equipment used in these facilities is not only cheaper, but is cleaner and more reliable.*

2. Are there economies of scope which make it most efficient for the service to be provided in a bundle with certain other services?

*On the retail (end-use) level, there may be some natural bundling of services that result. For example, it is likely that the energy supplier will also provide certain ancillary services, such as operating reserves, as part of its commodity supply to customers. Likewise, a meter service provider may also package certain information services to customers and the customer's energy supplier. As competition progresses economies of scope will develop to better serve consumers and to provide competitive suppliers with additional business opportunities.*

- B. Are or will there be a sufficient number of competitors in each potentially competitive market?

*General Response:*

*It is difficult to assess if a sufficient number of competitors will exist in each market that is allowed to move toward competition. What number competitors constitutes viable competition? Some competitive markets are comprised of only 3 to 5 substantial competitors. Regulation of the distribution and transmission providers will be a large factor in removing barriers to entry into competitive energy markets. If the ACC allows the incumbent utilities to restrict access by competitive suppliers, then competition will not develop in AZ. All market participants must be governed under the same rules and have the equal access to information.*

*One of the largest market impediments in retail electricity markets to date has been the imposition of rate freezes or rate moratoriums. The public desire to protect consumers has often worked against the public desire to deregulate the electric industry. This clashing of policies has resulted in a wholesale market that, at times, provides higher prices than the retail market. This is a dysfunctional economic model and cannot be sustained. When these transitional market circumstances pass, then competitive retail markets can begin to evolve in a normal economic environment. In a normal environment, competition for customers will develop.*

1. Is the product or service one which viable competitors will actually be interested in providing?

*The Alliance members are very interested in providing power under intermediate and long-term contracts to Arizona customers. Many of its members have already made significant business and financial commitments to Arizona in responses to the state's opening its markets to competition.*

2. Is the cost of aggregating customers sufficiently small, relative to likely revenues, which new suppliers will find it profitable to enter?
3. Are there technical, legal, or other barriers to entry in the markets? For example:
  - a. Are there legal or technical barriers to the construction of the

different types of generation plants by non-utilities?

*There are interconnection and control area barriers to entry that are imposed on non-utility generators. "Green" power is generally above market with respect to price. Development of green power in any marketplace is usually dependent on statute (How much is required?) and investment recovery methods (incentives, rate recovery, etc.)*

- b. Is the cost of obtaining licenses, resources, knowledge and employees sufficiently small, relative to the expected revenues, such that new entrants will find the market attractive?

*While not small in costs or efforts, these resources are available to support market entrance.*

- C. Is it necessary for the product or service to be provided by a single regulated company to assure reliability and safety, or can multiple companies that provide the service subject to reliability and safety rules?

*It is necessary for the load serving entity (LSE) to assure the reliable delivery of energy over its wires. However, the LSE can assure reliable generation of power for its customers by entering into contractual arrangements with suppliers that ensures the availability of the power. Reliability and safety can be provided by multiple companies. In fact, the western electric grid is both reliable and safe today and is operated by scores of companies. The key is to have clear rules whereby each*

*market participant knows their respective responsibilities. Reasonable and effective regulatory oversight is appropriate to insure adequate reliability and safety. Multiple companies, subject to explicit rules and operating practices, can be part of a reliable and safe competitive electric system, both retail and wholesale segments.*

- D. For customers, is the cost associated with learning how to shop and actually shopping sufficiently small, relative to the expected benefit, that customers will want to shop?

*One of the underlying implications of electric deregulation is to allow the consumer to choose in a competitive environment because that system, in other markets, has provided the most efficient service available. In recent years consumers have become very skilled at purchasing high tech computer equipment, cellular phones, and other products. Information to the consumer is the key in educating the consumer about the products being competitively offered. Part of the product to be offered by competitive suppliers of energy is education about the product(s) they are offering for sale.*

### **III. Relationship of the Current Regulatory Regime to Competition**

- A. For each potentially competitive product or service, how does current state and federal regulation foster or inhibit (a) retail competition and (b) wholesale competition?

*The Alliance believes the current Electric Competition Rules will produce the intended result of reliable electric service for Standard Offer customers. Already,*

*Arizona has seen several independent power providers bring new capacity on line in expectation of the implementation of the Electric Competition Rules. The APS proposal will frustrate this result as it will rely only on one supplier, their affiliate, to "bid" to meet the Standard Offer needs.*

- B. How can the Commission protect Arizona customers from the risks of competition while promoting competition?

*We believe that consumers benefit most from competition when a load serving utility is compelled to bid for the lowest-cost power from a liquid wholesale market and pass those prices through to the retail consumer.*

*Current rules, require regulators to determine whether a power plant should be built , but the underlying assumptions have changed since the rules were written. Under a traditional, rate regulated, cost-based system, consumers had to pay for excess capacity that was brought on-line. A regulator was forced to balance the need for reliability with the cost of excess capacity. Consumers bore the risk on both ends and the regulator had to walk the tight rope of building enough plants to ensure adequate supply and not forcing consumers to pay for idle plants. Now, merchant generators—not consumers-- bear the risk of excess capacity. If a merchant generator builds a plant that sits idle, the merchant generator and its shareholders bear that risk— not Arizona ratepayers . The market will determine when there is adequate capacity. When that level is reached merchant generators will no longer build capacity because of economics. On the other hand, when there is not adequate capacity the market will dictate that merchants build plants to meet the new load growth. The market has recently shown the former example, prices have been*

*reduced and several new plants are being reevaluated by the companies. The excess capacity surcharges approved by the ACC in the last few decades demonstrates the cost of the risk assumed Arizona consumers in a fully regulated environment. By design, a competitive market protects consumers from some risks that they have traditionally been forced to accept. In addition to eliminating the excess capacity risk for consumers, the current rules further tip the balance toward building plants by exposing consumers to price risk if too few plants are built. If the ACC defines "need" as current load plus a small reserve margin and prevents power plants from being built even though merchant generators are willing to build them, then there is a risk that Arizona will not have adequate capacity to meet growing demand. The ACC should develop policies that encourage wholesale market development and wholesale market competition in order to reduce the above mentioned risks to the consumers of Arizona.*

- C. How have the interim rate reductions for customers receiving standard service affected the ability or desire of generation suppliers to compete in Arizona retail markets?
- D. Do Commission policies or legal requirements ensuring that utilities recover investments from ratepayers affect the prospects for competition in any market for which competition otherwise would be possible?

*It depends on the structure of the recovery of the investments. For example, if the stranded costs recovery were charged to all customers as a flat fee, then there would be little impact on the market.*

- E. Does continuing utility control of depreciated generation assets affect the ability of competing suppliers to enter retail markets?

*Yes, it does. Allowing utilities to recover investments from ratepayers through a ratebase mechanism will adversely skew the market in favor of the utility generation and will not result in the lowest costs to customers. In the competitive market, the lowest cost providers are going to operate their facilities, and be the most successful. If these low cost providers are the utilities, then this is the most economic result for customers. However, if third party generation, combined with utility generation, is the lowest cost to customers, then this is the most efficient outcome.*

*However, if utilities are able to ratebase the capital costs of their facilities, and only have to recover operating costs in the market, they could be artificially lowering prices to the detriment of customers. This is because third party generation must recover all its costs in the marketplace and, when utilities have the advantage of recovery of capital costs through ratebase, cannot compete with the ratebased assets who must only recover operating costs in the marketplace. This would result in a situation where the utility generation was operating, even though the total costs (ratebase charges plus variable costs) of that generation were greater than the total costs of the third party generation.*

- F. How does current Commission regulation promote or deter the ability of (1) renewables, (2) distributed generation, and (3) energy efficiency and demand side management to compete with traditional generation resources?

G. What are the risks of moving to a regime of retail competition for each product or service and what are the methods for managing those risks?

H. If the current regime is not conducive to retail competition for a particular product or service, what actions should the Commission take to promote its success in the future? Specifically

1. Should the Commission require existing utilities to procure particular products or services from unaffiliated competitors?

*Yes. The single most important first step to ensuring Arizona consumers benefit from competition is requiring incumbent utilities to procure power from lowest cost merchant generators, affiliated or unaffiliated. The ACC recognized the importance of this critical backstop to competition when it promulgated the Electric Competition Rules in 1999.*

2. Are utilities taking steps that will make competition more difficult down the road (e.g., retail marketing, internal restructuring, entering into agreement to avoid customer self generation)? If so, identify those steps and how the Commission should respond.

*The APS Variance request is an obvious attempt to make competition more difficult. APS' attempt to rush the Commission into approving a long-term, cost-based, above market, related-party contract violates the basic principles of competition. All competitors should be on a level playing field. If the affiliated generator can provide the lowest cost power then they should*

*provide the service. If a non-affiliated merchant generator provides the lowest cost power then they should provide the service. In either case the winner is the Arizona consumer.*

3. Are utilities entering into long-term contracts with existing customers? If so, how do they affect prospects for future retail competition? Should the Commission allow them?

*The Alliance is concerned that other competitive retail suppliers of electricity do not have the same access to these consumers as does the utility. If access to these consumers is fair and equitable for all competitive retail suppliers of electricity, then we have no issue with utilities signing such contracts. If not, then this activity on the part of the utilities should be halted.*

*In procuring electricity for the SO load, the load serving entity should be allowed to construct a portfolio of power (e.g., short, medium and long term contracts) in order to provide price stability to SO consumers. The portfolio design should conform to the retail rules promulgated by the ACC regarding the retail competition and the SO. California's experience has taught us that reliance on anything other than a well designed portfolio of contracts places undue risks on the consumer as well as the service provider.*

4. Should the Commission consider instituting competition for billing and metering services even if retail generation competition is premature?

*The Commission should begin to gather comments and information regarding competition in these areas. Metering is an area where competition may be appropriate regardless of the state of competition in other facets of electricity service.*

#### **IV. Retail Generation Competition**

##### **A. Regarding each identifiable generation product --**

1. Identify with particularity any defects in the wholesale market structure affecting Arizona.

*The primary problem facing the wholesale market today is that an operating RTO still does not exist.*

2. Are there an adequate number of competitors to sell in Arizona to make the product sufficiently competitive? How many sellers are there?

*Yes. It is possible that resources outside of Arizona will bid on the SO to retail customers. During the vast majority of the year, generation produced anywhere in the Western grid can be used to meet the needs of customers in Arizona. In fact, Arizona utilities have already been purchasing energy from California and the Pacific Northwest for decades, and have also been making sales into those areas. It is difficult to assess how many sellers will bid, however, similar solicitations in other states resulted in many offers*

*being received.*

3. How have mergers and consolidations in the industry affected the competitiveness of the product in the region at the wholesale and retail levels?

4. Are competitors building new generation able to price their generation at rates competitive with existing generation?

*Yes. We believe that new generation is able to compete with existing generation. If it were not then merchant generators would not be building plants, as they deploy capital where it will have the greatest economic benefit. The ACC needs to dictate that APS accept competitive bids and to choose the package that is best for the consumers of Arizona. If the bids provided by the third party suppliers do not meet the price or reliability needs of the state, then the state can further pursue APS' proposal.*

5. How has the Independent System Administrator affected the success of (a) retail competition and (b) wholesale competition?

*It will be the state's regulatory policy such as the Electric Competition Rules that will most greatly impact the success of these efforts. Retail access will not reach its full potential for benefits without non-discriminatory open access to transmission and that access cannot exist without an independent agency.*

B. Regarding the transmission and distribution infrastructure necessary to support competition for each identifiable generation product --

1. Are there transmission constraints inside or outside Arizona that currently impede the ability of competitors to reach Arizona customers during any seasons of the year or times of the day?

*Every marketplace has constraints. Constraints, or congestion, are locational in nature. Price signals developed by an RTO will point towards the areas requiring improvement. Improvements may be made in transmission or generation to relieve congestion. Transmission congestion exists in the Palo Verde hub area as well as within Phoenix.*

2. What plans are in place to relieve transmission constraints?

*APS and SRP have announced their plans to construct a transmission line from Palo Verde to Phoenix. Locally, CATS has identified needed infrastructure improvements. These improvements are being prioritized. Some of these projects are becoming reality – SWV and SEV lines. New lines are proposed in 10 year plans filed by utilities and merchants. Pricing signals need to be developed in order for the proper investments to be made. The RTO discussions also include transmission enhancements on a regional basis that may relieve congestion within Arizona and/or the western grid.*

3. How long will it take to relieve any existing transmission constraints and what factors are affecting and will affect prospects for relief?

*Due to AZ's growth, some level of constraints will always exist, because we cannot control where people will locate. Generation projects will have great ability to solve local constraints, but as seen in the Santan case, location of generation near load centers is difficult and costly. The Commission needs to offer some method to make these sitings easier.*

4. Are the owners of constrained transmission facilities, or holders of transmission rights, able to use their control to affect market prices?

*If the AISA protocols are enforced, this should not be a problem. These protocols prevent the owners of constrained transmission facilities from effecting market prices by manipulating their transmission rights. AISA, and eventually WestConnect (RTO), is in place to avoid such circumstances. The ultimate formation and operation of WestConnect is critical to the development of regional wholesale competition that is conducted in a fair and impartial manner.*

5. Are these transmission owners currently doing things that will allow them to exert more or less control in the future? If so, please detail.
6. Will the transmission system be adequate prospectively (e.g., in the next, 5, 10, 15, 20 years) to deliver power from new generation plants?

*Consumer demand for power is spurring the development of new generation plants. Therefore, the market will also demand that transmission*

*be built or enhanced to deliver that power. If competitive market forces are allowed to work, then transmission infrastructure will be adequate to deliver that power to the consumer for the periods mentioned. In some case, optimal siting of generation may alleviate the need for transmission or those generators may enjoy competitive advantages in accessing some consumers. Upgrades and expansions to the transmission system, have been and will continue to be, an ongoing activity. Market signals from an RTO are the best tools for the commissioners to evaluate the effectiveness of generation delivery.*

7. Is the natural gas pipeline infrastructure adequate to support all proposed new gas-fired generation plants? How many plants can it support?

*The answer is yes and no. The existing facilities cannot support all the proposed plants running at full load all the time. However, this situation will not happen. Market forces will keep some plants out of the market, which reduces gas demand.*

*The increase in gas demand has prompted market response. EPNG was not offering competitive solutions, so competitors have. The Desert Crossing Pipeline is a line that provides access to a new natural gas supply basin and provides storage, which AZ desperately needs, as AZ has no gas supply basins to rely upon. Natural gas supply in AZ is a multi-state issue. There are users upstream of AZ which remove a certain amount of gas from the line and there are states downstream of AZ that have contracts for the*

*gas. Other storage facilities and pipelines are being proposed in response to need. Merchants will have the ability to strategically develop gas supply infrastructure to accommodate their needs.*

8. Does the transmission and distribution system facilitate or deter --
    - a. the development of renewable energy technologies?
    - b. the development of distributed generation?
    - c. the development of demand-side management and energy efficiency?
- C. Regarding competitive bidding --
1. Identify with particularity any adverse consequences that would result from Commission approval of a substantial variance to the electric competition rules that require competitive bidding for 50% of the electric supply for standard offer customers, starting in 2003. Specifically:

*Granting the Variance would cut the heart out of electric competition. Since the retail market has been slow to develop, consumers have yet to benefit directly from the lower rates that competition brings. Acceptance of the APS Variance by the ACC would deny the Arizona consumers access to a competitive electric market. In order to allow all consumers some access to the competitive electric market, the Alliance strongly supports the Commission's requirement that the monopoly electricity distributor be*

*required to bid for competitive power for a portion of the supply portfolio to consumers. Nothing has changed to compel the Commission to relax this requirement of monopoly electricity distributors.*

a. How would retail customers be affected?

*If the Variance were to be approved, retail customers, as mentioned in C.1 above, would not get to experience the cost saving associated with the lowest bid. A competitive bid process results in the lowest price the market will bring without regard to whether the winner is the affiliated or a non-affiliated generator. Consumers should be able to experience the price benefits that competition brings. The Variance, if approved, will prevent retail customers from experiencing this benefit. Furthermore, approving the Variance will result in retail consumers—and regulators-- being forced back into a cost-based system which has inherent risks to the consumer. Regulators would attempt to determine if costs were reasonable and prudent, known and measurable and ascertain if plants were used and useful. Their findings would be litigated in yearlong rate cases before the Corporation Commission. Consumers would bear the risks that plants were over budget or had excess capacity.*

b. How would retail generation competition be affected?

See (a) above

c. How would wholesale generation competition be affected? See a above

2. Are sufficient competitors available for an effective bidding process for 50%

of standard offer service? A higher or lower percentage?

*Yes. Some of our members have operational projects or are constructing new projects in Arizona. Further, as mentioned earlier, generation from all around the entire West can be transmitted to consumers in Arizona. Finally, it seems PWCC will have the ability to meet virtually all of APS' needs itself, so if it were a competitor in the bidding process, more than enough generation would be available for the SO service.*

*In its variance request, APS assumes that the only plants able to bid into this market are currently being built in Arizona. As we have seen in other state competitive bidding processes, bidders from out of state and those with generation under construction also participate in the process. It is short sighted to merely add up the capacity of the Arizona merchant plants and compare the capacity to APS' load and conclude that there is inadequate capacity.*

3. Can retail competition develop if current rules are modified to allow a utility to procure all its generation for standard service from an affiliated company?

*No*

4. How would retail competition be affected by other deviations to the competitive bid rules? Be specific about the changes in the rules and their consequences.

5. Instead of entertaining individual requests for substantial variances to the

competitive bid requirements, should the Commission proceed on a generic basis to modify the rules for competitive bidding?

*The request from APS should be denied in the first instance. However, if the Commission were inclined to pursue these issues further, a formalized proceeding is necessary to ensure the issues associated with any new alternative are adequately identified and addressed. The Alliance supports the ALJ's inclusion of the Substantial Variance Request in the 40-252 hearing.*

6. If the Commission would change the 50% bidding requirement for standard offer service, are there other specific measures the Commission can take to promote retail competition?

*No, approving the Variance would eliminate both retail and wholesale competition.*

D. Regarding the pricing of power supply contract rates --

1. Identify any advantages that would result if the Commission approved a long-term supply contract for standard offer customers that was based solely on cost-based rates. (Your answer should define "long term" as compared with "short term" contract.)

*The assumed advantage that results from commission approval of a long-term (i.e. multi-year) cost-based contract is price stability. The competitive marketplace provides multi-year contracts. Therefore, if the Commission determines that price stability is a desirable goal, then that goal*

*can be achieved through the competitive market and the bidding rules in place today. Cost based contracts, in general, do not provide the price stability as one would think. Since the contract is based on the costs of the producer, the contract only stabilizes the returns to the producer's shareholders. Consumers will pay all of the costs plus a reasonable return to shareholders. When a cost based contract is entered into between two parties, the consumer is speculating that costs will not rise substantially and the producer is speculating that economic returns demanded by shareholders will not rise substantially. Both parties are comfortable with the variabilities (contingencies) of the cost based contract. The longer the term of the contract the greater the chance that one party is somehow disadvantaged; either by cost or by economic return. Normally, the problem with cost based contracts is that the producer has little incentive to control costs. Almost always, the producer has no incentive to cut costs.*

*The competitive wholesale electricity market can provide consumers with true price stability using fixed price, multi-year contracts. The consumer would not be subject rising costs. Alternatively, if the producer cut its costs, then the shareholder will accrue the benefits from cost savings and efficiency gains. This model provides both consumers and investors with the product that they want. A cost based model does not.*

*The ACC could enter into a long-term, cost-based contract and in the long run arrive at the same position that led consumers to lodge the same complaints that initiated electric restructuring; industrial consumers would*

*have access to lower rates and competitive power markets while residential consumers would be stuck with monopoly service, relatively high prices, and continuing escalation in rates.*

2. What if the contracts are based solely on market-based rates?

*It is important to make a distinction here about "market based rates."*

*In the short-term, market prices are going to be driven purely by the laws of supply and demand, with little relation to generation costs. Conversely, the "market price" of a long-term contract is an offer to sell based on the fixed and variable costs associated with a third party generation bidder. In this case, the lowest price offer wins, and becomes the "market price." Some of the key benefits of this approach are an ability to acquire the least-cost generation, and to be able to push the risk of cost overruns away from ratepayers.*

*Market-based contracts, of course, are called for in the current rules and are supported by the Alliance. These contracts can be for a varying type of product (baseload, intermediate, peaking) and for various lengths of time (short, intermediate, long). The market offers provided by third party generators in the long-term contract RFP process will be based on this diversified portfolio approach and will provide the best value to the consumer that the market has to offer. Market-based contracts eliminate the need for the commission to engage in the extensive auditing and speculation to determine if a cost-based contract is prudent. Prudent construction is not necessarily optimal or efficient construction. Competitive bidding allows*

*consumers and the Commission to benefit from the MOST efficiently constructed and operated plants.*

*Consumers should benefit from lower prices in a competitive environment. If price signals are unimpeded, and if adequate supply is allowed to develop, market-based prices provided by a competitive market will provide reliable power at reasonable prices. Additionally, any risk of excess capacity or cost overruns will be borne by shareholders instead of customers.*

*Consumers are looking for reasonably priced energy. Consumers are not looking to become speculators in electric power generation investments. Consumers are best served by purchasing power from a competitive marketplace and transfer any investment risk to the individuals who choose to invest in power generation.*

3. Describe how FERC's new approach for analyzing the ability of sellers with market rate authority to exercise market power affects generation companies selling into Arizona.
  
4. Does the Commission have the ability to assure that approval of a long-term contract would protect ratepayers receiving standard offer service as well as foster competition?

*Yes, the Commission could approve longer term, market based supply contracts from non-affiliated suppliers and protect ratepayers who receive the standard offer. At the same time, the competitive wholesale electricity*

*supply market in Arizona would remain vibrant. Approval of the APS variance would stop the development of a competitive market.*

**V. Industry Events External to Arizona**

- A. Describe in detail developments you believe will occur in both the wholesale and retail competitive electric generation markets nationally and in Arizona over the next 12 months, 24 months, 36 months, 48 months and 60 months.
- B. Is there anything the Commission should do to continue to avoid California's retail electric competition experience? Please be specific.

*Allow the load serving entities the ability to present a portfolio of competitively bid contracts to serve the SO load. Ensure that the portfolio supply is designed to accommodate the rules of retail competition in Arizona and does not place undue risk on the consumer or the load serving entity.*

*Also, require a solid margin of generating capacity. Don't let the desires of the minority, affect the benefit to the majority with respect to transmission sitings and generation sitings. Determine, through market pricing signals what generation or transmission is needed and facilitate its development.*

- C. Does the Enron bankruptcy have any lesson for retail electric competition in Arizona?

*The Enron bankruptcy situation provides little or no lesson for competition in Arizona or elsewhere. While the story is still unfolding, it appears that financial*

*obfuscation and potential SEC and GAAP violations were central to the collapse of Enron. That said, opening any market as vast as electricity is sure to come with transitional adjustments. But Enron's collapse has not resulted in a single business or household going without power, nor resulted in any regional or national price instability.*

- D. How will FERC's RTO initiative affect the realization of effective retail generation competition in Arizona?

*The premise of the RTO is to facilitate more wholesale electric competition within a wider region. Not surprisingly, the western regions have segmented into three (3) separate RTO's that represent what has been the traditional "trading area" for power. The establishment of a vibrant competitive wholesale market is critical to the formation of effective retail competition. FERC is focused on developing an RTO model that provides open access to the transmission system for generators to reach consumers. The ultimate goal of FERC is to provide consumers with the most efficient, lowest cost electricity supply available over the long term. The goals of FERC in the wholesale markets are consistent with the goals of the ACC in Arizona.*

- E. Do you anticipate changes in federal utility statutes to affect the jurisdiction of the Commission and its ability to foster retail competition in Arizona? Please detail.

## **VI. System Security**

- A. Are there compelling reasons to be concerned about security for electric generation facilities since the Sept 11, 2001 tragedy? Please include discussion of interconnection at a central location such as Palo Verde/Hassayampa.

*No. The security of the nation's generation fleet has an admirable record. The owners of these facilities are compelled to protect their assets and revenue stream. That said, since 9-11 we are all on a heightened sense of security. The "concern" raised by some about the number of generators interconnecting to Palo Verde/Hassayampa is generally misunderstood. While for convenience, parties refer to the Hassayampa yard as integral to the PV yard, the fact is that two distinct hubs are forming. Yes they are connected, as all hubs are, but the fact of the matter is that they are separated physically and electrically. Physical security at Hassayampa is an issue that the transmission operator will address effectively. Electrical security is further enhanced by terminating new lines at Hassayampa versus Palo Verde. AZ has relied for a long time on a significant portion of its power flowing from the PV Hub. While the demand will double, the second interconnection area (Hassayampa) effectively mitigates this issue.*

- B. Does transferring ownership of generation facilities out from traditional Commission jurisdiction have any potential negative security consequences?

*No. Electric system reliability and security issues will still be overseen by FERC and other organizations such as NERC. Security of generation facilities is as or more important to the owners of the assets as it is to the Commission.*

- C. What if ownership after transfer results in a foreign corporation eventually controlling Arizona's generation?

*Any corporation, foreign, domestic, or Arizona based must follow the same rules and regulations as an Arizona based company. Foreign or out-of-state ownership of generation is not a critical factor, it is the ability of the owner to meet the obligations of generating electricity in accordance with all state, tribal and federal rules and regulations. Electrical generation should be viewed no differently than any other competitive industry. American energy companies own assets abroad also.*

- D. Does such a transfer to a non-Arizona entity potentially impact security issues for Arizona?

*No. FERC and NERC as well as other statutes mandate the necessary security of generation facilities.*

- E. Are there any positive security aspects to transferring electric generation out from Commission traditional regulation to a foreign corporation?

See answers above.

- F. Provide specific examples to support your answers.

## **VII. Vision**

Please provide your vision for how viable competitive wholesale and retail electric markets will (or will not) develop in Arizona. Please be specific regarding dates, the development process, and measures for determining at various stages how successful the process has been.

