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IN THE MATTER OF THE GENERIC ELECTRIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING ISSUES	E-00000A-02-0051 E-01345A-01-0822 E-00000A-01-0630 E-01933A-02-0069 E-01933A-98-0471
IN THE MATTER OF THE ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR VARIANCE OF CERTAIN REQUIREMENTS OF A.A.C. R14-2-1606(B)	DOCKET NO. E-01345A-01-0822
ELECTRIC COMPETITION RULES	DOCKET NO. RE-00000C-00-0275
ARIZONA INDEPENDENT SCHEDULING ADMINISTRATOR	DOCKET NO. E-00000A-01-0630

Arizona Corporation Commission
DOCKETED

FEB 25 2002

DOCKETED BY

RELIANT RESOURCES, INC. RESPONSES TO ARIZONA CORPORATION COMMISSION QUESTIONS REGARDING ELECTRICITY RESTRUCTURING

EXECUTIVE SUMMARY

The electricity industry has been jolted by the events in California and at Enron Corporation. Understandably, these events have caused a crisis of confidence among some analysts and policy makers and even led to calls by a few for a return to outdated modes of cost-

plus regulation. Reliant believes the severe problems in California's electricity market were caused by flawed market rules and a fundamental imbalance between supply and demand, and that the sudden collapse of Enron Corporation appears to have been caused by poor investments in non-core businesses and improper accounting practices. As FERC Commissioner Massey opined in a recent speech, nothing in the California experience or the Enron situation gives him (or the other Commissioners) any pause in their commitment to the established policy of promoting industry restructuring and increased reliance on competitive market forces.

Nonetheless, in the wake of these events, the Arizona Commission has called for a review of the state's electricity restructuring policy and made clear its intention to make any necessary changes in its rules to ensure that Arizona consumers will not only avoid the risks of a California-style meltdown, but equally important will realize the promised benefits of electricity restructuring. Reliant supports this action and welcomes the opportunity to provide the Commission with these comments.

In summary, Reliant believes the Arizona competition rules and the settlement agreement provide a sound foundation for the transition to competitive electricity markets and the Commission should proceed with implementation of those rules as planned. In particular, Reliant recommends that the Commission reject the APS request for variance, as it would decimate the market for new generation development, entrench the existing fleet of utility generation assets for years to come, and deny consumers the benefits of access to new sources of competitively procured generation that is clean, reliable and efficient.

Reliant believes that the optimal market structure is one in which the competitive aspects of electric service – generation and retail services – are separated from the monopoly services of transmission and distribution. In such a market structure, the regulated utility functions purely as a wires company with responsibility for safe and reliable energy delivery. It does not retain ownership of generation assets nor provide retail services such as commodity procurement. Under this structure, the appropriate business incentives will exist for competitive retailers to hold the best mix of generation assets. More economic units will replace generating units that are inefficient or uneconomic.

While the above structure represents the optimal end-state, Reliant also believes a competitive wholesale market can exist with or without a competitive retail market. In fact, a well functioning wholesale market is a necessary first step before full retail services competition can occur. For this reason, Reliant believes the Commission should focus on ensuring that a competitive wholesale market is in place, so that consumers can realize the benefits of such competition as soon as possible. The three most effective actions the Commission can take toward this end are to promote the development of a functioning RTO, ensure that sufficient transmission capacity exists and issue specific requirements for the utilities' competitive acquisition process (i.e., RFPs and competitively negotiated bilateral contracts) envisioned under the Arizona competition rules. This process will ensure that consumers receive the benefits of reliable, efficient and competitively priced electricity when the current retail rate freeze expires in 2003.

If the Commission proceeds with its rules requiring the utilities to competitively procure generation resources, there are and will be a sufficient number of competitors in the wholesale generation market. However, given the fact that APS has not yet conducted the first auction, and sufficient new generation cannot be brought on-line between now and the July 2003 delivery date, the Commission should limit APS' purchases from affiliate-owned generation assets to only short-term (1-2 years) power for delivery in 2003, while simultaneously contracting for longer term (5-15 years) power for delivery beginning no earlier than 2005. These longer-term contracts will take advantage of new generation, including facilities that will be able to access the Phoenix load center once planned transmission upgrades are complete.

The bids for the long-term contracts should be structured to ensure that APS would not be able to sustain uneconomic plants by averaging the cost of those plants with facilities that have very low variable costs. To ensure this outcome, the auction process should segment the generation market into baseload, intermediate, and peaking resources. In addition, to the extent that transmission constraints prevent outside generation from reaching localized markets during some periods, it will be necessary to build additional transmission or mitigate the potential for localized market power through local Reliability Must-Run contracts. Reliant believes that if the Commission directs APS to conduct an auction as described above, there will be sufficient competitors in the wholesale market in Arizona so that wholesale competition can flourish providing near-term benefits to consumers and laying the foundation for a competitive retail market.

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RELIANT RESOURCES, INC.
RESPONSES TO
ARIZONA CORPORATION COMMISSION QUESTIONS
REGARDING ELECTRICITY RESTRUCTURING

I.
INTRODUCTION

Reliant Resources, Inc. ("RRI") welcomes the opportunity to respond to the questions posed by the Commission in these Dockets. RRI has an interest in the continued development of a competitive market for electricity in Arizona. RRI has a significant investment in the Arizona market and would welcome the opportunity to increase its investment if the regulatory environment is structured so as to encourage such investment and if business conditions justify such investment.

II.
RESPONSES TO QUESTIONS
POSED BY CHAIRMAN MUNDELL

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:

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

Competition in generation is possible for all the generation related services identified above. The Commission should focus on ensuring a competitive

wholesale market, so that consumers can realize the benefits of such competition. In addition, wholesale competition in generation is the essential foundation that provides the opportunity for consumers to enjoy the benefits of full retail competition.

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

Distribution services (including ownership, construction, maintenance and repair of physical lines and the process of planning for and negotiating with distributed generators) should continue as a regulated service. The regulation of these services should provide non-discriminatory open access including standard interconnection terms for generators and direct access tariffs for retail providers.

Metering services (including ownership, installation, reading, and data analysis) can be competitive given fully functional wholesale and retail competitive markets. An important component of a successful competitive electric market is ensuring that consumers have the ability to respond to price signals. Therefore, rules encouraging competitive metering and the installation of enhanced time-of-use meters support the development of the competitive market.

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.

All of the above mentioned services have, to varying degrees, been offered successfully in a competitive environment in other areas of the country. Competitive generation planning and power supply acquisition are fundamental elements of a competitive wholesale market. Electric Service Providers (ESP's) will provide these and other aggregation services in a mature retail market. However, a well functioning wholesale market is a necessary first step before this market will develop.

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

To the Customer: The primary benefit of competition will be lower prices on average, and/or improved service and increased innovation. Retail customers will have the incentive to switch suppliers if an alternate supplier offers new, improved competitive services that are not currently part of the regulatory structure.

To Society: A secondary benefit is that competition will encourage more efficient use of resources. Suppliers will be encouraged to sell at the lowest possible cost in order to deliver a product the market will buy. The replacement of older, less efficient generation facilities by newer plants with lower heat rates will be encouraged. This will reduce the cost of generation and decrease emissions.

1. **What are the potential price benefits?**

The most obvious benefit is appropriate pricing for the consumer. For customers who value only price, suppliers offering the lowest possible price will be chosen. For those willing to pay more for options such as green energy, an appropriate pricing structure will be available. In addition, consumers will, to some extent, dictate the type of products offered by retail electric providers. Competition will force firms to be more responsive to the desires of consumers, with flexible billing, pricing or other options. These options will include fixed priced products that provide price stability.

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

Price benefits will likely be greater in the long-term as competitive markets become more mature. In the short-term, a well functioning wholesale market provides the greatest benefits for consumers and lays the foundation for the competitive retail market to develop.

3. **What are the potential non-price benefits?**

The non-price benefits of competition include increased innovation in products and services, improved customer service and customer choice. In addition, fixed price products that provide price stability are beneficial for consumers.

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

Yes. A competitive market will produce a more efficient use of resources. For example, environmental benefits will be created by improving consumer response to pricing signals and by replacing older, less efficient generators with new generation technologies. In addition, competition will allow customers to choose environmentally friendly generation resources.

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?

With respect to generation and aggregation services, it is most efficient to rely on a competitive market with multiple suppliers. Economies of scale in the provision of distribution services make it conducive to being a regulated service.

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

There may be economies of scope associated with bundling certain services and a competitive market with customer choice provides the best means for making that determination.

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

If the Commission proceeds with its rules requiring the utilities to competitively procure generation resources, there are and will be a sufficient number of competitors in the wholesale generation market. However, given the fact that APS has not yet conducted the first auction, and sufficient new generation cannot be brought on-line between now and the July 2003 delivery date, the Commission should require APS to purchase only short-term (1-2 years) power for delivery in 2003 from affiliate-owned generation assets, while simultaneously contracting for longer term (5-15 years) power for delivery beginning no earlier than 2005. These longer-term contracts will take advantage of new generation, including facilities that will be able to access the Phoenix load center once planned transmission upgrades are complete.

The bids for the long-term contracts should be structured to ensure that APS would not be able to sustain uneconomic plants by averaging the cost of those plants with facilities that have very low variable costs. To ensure this outcome, the auction process should segment the generation market into base-load, intermediate, and peaking resources. In addition, to the extent that transmission constraints prevent outside generation from reaching localized markets during some periods, it will be necessary to build additional transmission or mitigate the potential for localized market power through local Reliability Must-Run

contracts. Reliant believes that if the Commission directs APS to conduct an auction as described above, there will be sufficient competitors in the wholesale market in Arizona so that wholesale competition can flourish providing near-term benefits to consumers and laying the foundation for a competitive retail market.

The foundation of a well functioning wholesale market, combined with appropriate retail market rules, will result in a sufficient number of competitors for retail services. Essential elements of competitive wholesale and retail markets include:

- The lowest possible barriers of entry into the market
- A stable market structure
- A stable regulatory environment
- A well functioning RTO
- Sufficient transmission capability

Given the current state of the Arizona market, a competitive retail market is unlikely to develop for several years while the Commission and market participants ensure the development of a wholesale market. At that point, Arizona consumers will be in a position to reap the full benefits from retail competition.

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

Viable competitors exist in generation today and will exist in retail services in the future provided the conditions described above are met.

2. **Is the cost of aggregating customers sufficiently small, relative to likely revenues, which new suppliers will find it profitable to enter?**

Yes, the cost of aggregating customers is sufficiently small to make it profitable for suppliers to enter the market provided the appropriate market rules are in place.

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?**

   Construction of generation plants by non-utilities will occur provided that the Commission proceeds with implementation of the competitive wholesale acquisition process as provided for under the current market rules. No technical barriers exist to the construction of generation plants by non-utilities, although the availability of adequate transmission and standard interconnection practices may impact construction of certain plants.

   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?**

   Generally speaking, yes.

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?**

With respect to generation and retail services, multiple competitive companies

can provide such services reliably and safely.

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?

Yes, the cost associated with customer education and shopping is sufficiently small to make it worthwhile for customers to shop provided the appropriate market rules are in place and assuming a well functioning wholesale market exists.

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?

a. Retail competition?

With respect to retail services, current state regulations inhibit competition by creating market rules that favor the incumbent provider and provide inadequate incentives for entry by competitive service providers.

b. Wholesale competition?

With respect to generation, stated federal policy is to foster competitive wholesale markets. However, recent FERC actions imposing price caps and other administrative controls are undermining the functioning of those markets. Despite the existence of FERC administrative controls in the West, implementation of the Arizona competition rules will foster competitive wholesale markets.

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

With respect to generation, the Commission can protect consumers by ensuring the existence of a well functioning wholesale market and proceeding with implementation of the competitive resource procurement process envisioned in the Arizona competition rules. With respect to retail services, the Commission can protect consumers by establishing effective retail competition rules including customer protection rules and ESP certification procedures.

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?

A competitive wholesale market can exist with or without a competitive retail market. RRI supports a market structure wherein generation and retail service functions are provided competitively. However, if retail services are provided by the utility, RRI supports a system that requires the utility to acquire its generation through competitive processes (e.g., RFPs or competitively negotiated bilateral contracts).

As to retail competition, if the utility provides service at a Commission approved price, headroom is necessary for ESPs to enter the market. Interim rate reductions would reduce that headroom, making it more difficult for ESPs to enter the market and compete against the incumbent.

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?

With respect to past utility investments in generation, a policy that ensures recovery of such investment from ratepayers does not necessary impact the prospects for wholesale competition. However, depending on the design of the CTC mechanism, recovery of past utility generation investments can impede the functioning of the competitive retail market.

With respect to future investments in generation, Commission policies should be designed to foster reliance on competitive wholesale markets so that investment risks are borne by shareholders and not ratepayers.

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

Yes, the ability of competing suppliers would be negatively impacted if generation assets remain in the regulated utility. If generation remains under the control of the utility it is more difficult to create incentives for the utility to hold the optimal mix of generation resources. The utility should be required to obtain generation services through competitive processes (e.g., RFPs or competitively negotiated bilateral contracts).

The preferable market structure is one where the competitive aspects of electric

service, generation and retail services, are separated from the monopoly services of transmission and distribution. In such a market structure, the utility does not retain control of generation assets and the appropriate business incentives will exist for market participants to hold the best mix of generation assets. More economic units will replace generating units that are inefficient or uneconomic. However, at this time in Arizona, a way to transition to the structure described above would be to proceed with the competitive acquisition process as described in Reliant's answer to Question B.

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?

1. Renewables

The ACC's Environment Portfolio Standards promote investment in renewables. Each of the IOUs is required to purchase a minimum portion of its load requirement from renewable sources. Each of the IOUs is required to establish a monthly surcharge, based on the customer class and subject to ACC approval, which is included in its base rates. This commitment to renewables provides a basis for guaranteed revenue for companies in a position to develop renewables.

2. Distributed generation

The Commission Staff opened a docket in 1999 to solicit input from all stakeholders regarding the deployment of distributed generation. A Final Report was generated and posted on the Commission's website. Reliant is not aware of any further action taken to implement the suggestions provided in the Final Report.

3. Demand Side Management

The Commission should promote competitive wholesale and retail markets so that demand side management can 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?

The competition rules adopted by the Arizona Commission form a sound basis for the transition to fully competitive electric markets, and therefore the risks of a California-style meltdown have been effectively managed. Specifically, with respect to generation services, the Commission should ensure the existence of a well functioning wholesale market and proceed with implementation of the competitive resource procurement process envisioned in the Arizona competition rules. With respect to retail services, the main risk is customer confusion and too little competition. The commission should ensure that the shopping credit is sufficient, require the utilities to provide better information related to retail

competition and require utilities to unbundled their standard offer tariffs. At this time, however, the most important action the Commission can take is to ensure access to the competitive wholesale market as described in Reliant's answer to Question B above.

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?

See answer to Question B above. If an affiliate provider participates in the bidding process, an independent third-party should evaluate the bids to determine the selected provider(s).

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?

Yes, the APS Variance request would undermine competition at both the wholesale and retail levels. The Commission should deny the Variance Request and proceed with the implementation of the current competition rules.

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?

Any attempts by the utilities to enter into long-term contracts with existing customers will negatively impact the prospects for future retail competition.

If such contracts are permitted, the Commission should ensure that remaining customers are not adversely impacted by any discounts provided to the customer receiving the long-term contract.

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

Billing and metering services (including ownership, installation, reading, and data analysis) can be competitive given fully functional wholesale and retail competitive markets. An important component of a successful competitive electric market is providing consumers with the ability to respond to price signals. Therefore, rules encouraging competitive metering, including the installation of enhanced real-time meters supports the development of the market.

IV. Retail Generation Competition

A. Regarding each identifiable generation product:

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

A number of deficiencies exist in the wholesale market structure affecting Arizona, including:

- *RTO* – Lack of an RTO is detrimental to the development of a competitive wholesale market.

- *FERC price caps* – since prices are artificially held below the equilibrium price by price caps imposed by FERC, another method must be found to provide generators with an incentive to enter the market and recover fixed cost (e.g., creation of a capacity market). In a well-designed market without price caps, a separate capacity market is not necessary.
- *Ancillary services* - there is no competitive market allowing for third-party provision of ancillary services.
- *Regulatory uncertainty* – the APS variance request has created regulatory uncertainty with respect to the implementation of the competitive resource acquisition process required under the competition rules.

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

Yes, there are enough generators willing to sell power into the Arizona wholesale market provided the Commission proceeds with its rules requiring the utilities to competitively procure generation resources. More than a dozen companies have announced plans for building new generation capacity in Arizona. These projects if completed will add more than 12,000 MW's of new capacity to the Arizona's wholesale market by 2006. This is more than double APS' current generating capacity. In addition, Arizona is part of an interconnected regional market that can provide supply to Arizona.

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

Mergers and consolidations are an inevitable part of the industry's transformation and have not had a negative impact on competitiveness at the wholesale or retail levels.

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

The best way to determine whether rates are competitive is to conduct the RFP required by the competition rule. The Commission should require APS to accept competitive bids and to choose the lowest economic cost resources for the consumers of Arizona. See also answer to Question B.

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

One of the important duties of the AISA is to independently administer the transmission rights that were made available to competitive retail providers by the utilities into the major load centers. While the low Competitive Credit has led to few ESPs taking advantage of these transmission rights so far, the ability to obtain such transmission rights through an independent administrator is imperative to any future retail competition. Once an appropriately structured RTO is in operation, these duties of the AISA can pass to that RTO. The AISA was not intended to have an impact on wholesale competition. RRI supports the formation of an RTO to ensure open access and enhance the development of competitive wholesale and retail markets.

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?

Arizona's Revised Biennial Transmission Assessment contains a discussion that suggests that there may be physical constraints into certain, so-called "load pocket" areas that would limit the ability of any competitor of the local utilities to serve a portion of the load in those areas for a few hours. However, for most hours, and for much of the load even in the remaining hours, competitors would be able to serve Arizona customers if transmission rights were available to those competitors. The Commission could alleviate any issues caused by transmission constraints by designating appropriate units as RMR units.

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

The Palo Verde - SE Valley project, associated with the Central Arizona Transmission Study, would increase the transfer capability from Palo Verde into Phoenix. Other projects that may be developed out of the Central Arizona Transmission Study would relieve current congestion as well.

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

Issues regarding the siting of new transmission lines and "who pays" are generally the factors that limit projects that could alleviate congestion.

The development of an RTO that would more economically and fairly allocate transmission rights would also serve to relieve congestion. If these factors are addressed new transmission could be built within 2 – 4 years.

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

Any action (or inaction) that a holder of transmission rights takes that results in an uneconomic allocation of transmission rights (such as delaying the development of an RTO, limiting construction of transmission into a load pocket, etc.) will affect market prices. The FERC ANOPR on Interconnection Procedures should result in a great improvement in the interconnection process.

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.

Through the filing of the WestConnect proposal, the transmission owners have sought to preserve preferential access to the transmission system, rather than creating a system that efficiently allocates transmission rights to the valued uses.

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?

In the latest Biennial Transmission Assessment Report, the ACC Staff concludes that existing and planned transmission is deficient in certain areas. Implementation of an RTO will help facilitate construction of new

transmission.

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

Arizona currently has access to approximately 4.4 Bcfd of natural gas pipeline capacity, primarily via Transwestern and El Paso. Several companies have recently announced new interstate pipeline projects that would increase available pipeline capacity. Additionally, two natural gas storage projects have been announced that could have a positive impact to natural gas users in Arizona. The proposed pipeline additions, if all were built, would add about 1.5 Bcfd in capacity. The storage projects are estimated to total 1.7 Bcfd in capacity. If one assumes that each 500 MW combined cycle plant consumes on average 90,000 mcfd, then the proposed pipeline projects could support an additional sixteen, 500 MW power plants.

Arizona's natural gas needs are currently served via deliveries on El Paso Natural Gas Co. (EPNG) and Transwestern Pipelines (TW). Both pipeline mainlines pass through Arizona and can be accessed directly by proposed power generation facilities. EPNG has capacity of 3.3 Bcf/d (north and south mainlines combined) and TW has capacity of over 1.1 Bcf/d. In addition, there are proposed expansions on both TW and El Paso.

TW

- **Red Rock Project**, mainline expansion of 150,000 Mcf/d, targeted completion date of June 2002.

- **Sun Devil Pipeline Project,** additional pipeline from SJ (Blanco) to

Phoenix with capacity of up to 450,000 Mcf/d, target completion of Q2 2004.

EPNG

- **Line 2000** (All American Pipeline), expansion of 320,000 Mcf/d (with potential expansion capability to 500,000 Mcf/d, targeted completion date of mid-2003.

- **Bi-Directional Lateral, Line 1903,** new service from Daggett, Ca to Blythe, Ca. and Ehrenberg, Arizona, "Project will facilitate the movement of natural gas within California and provide service to power plants in California and Arizona, 500,000 Mcf/d capacity from Daggett (Mojave, Kern River, PG&E, SoCal Gas) to Ehrenberg (North Baja Pipeline, SoCalGas, and transport upstream of California)," Targeted completion Along with EPNG's intention to file with FERC for East-to-West transportation on it's system can provide Arizona generators with access to supplies from Kern River, Mojave, PG&E & SoCalGas.

In addition to the existing lines and the proposed expansions of those lines, the following new pipeline project has been proposed:

- ***Questar - Southern Trails Pipeline***, former oil pipeline converted to natural gas pipeline, runs from New Mexico San Juan to California, capacity is 120,000 Mcf/d, target completion date was initially Q2 of 2002.

Thus, total current and proposed capacity leading to and through Arizona is approximately 5.9 Bcf/d

Additional pipeline expansions, which will indirectly provide additional supplies to Arizona include:

- ***Kern River*** pipeline currently has 825,000 Mcf/d of transportation capacity to California and So. Nevada. The plan is to expand this pipeline up to a total capacity of 1,710,000 Mcf/d (or 1.71 Bcfd) by May 2003. Although this does not directly supply gas to Arizona, it will increase deliverability to California with inexpensive Rocky mountain supplies thereby displacing gas on TW and EPNG sourced from more expensive Permian and San Juan basin gas destined to California markets. This displacement will create more available gas supply for those markets/generators in Arizona. The same can be said for any expansions from Canada to California.

8. Does the transmission and distribution system facilitate or deter --

a. development of renewable energy technologies?

b. development of distributed generation?

c. development of demand-side management and energy efficiency?

The T&D systems are necessary for the development of any of these items. The processes through which these systems are planned and operated may deter the development of these alternative technologies, if not structured to support their development. For example, Commission policies should encourage installation of real-time meters and provide for streamlined procedures for interconnection of distributed generation resources.

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 a substantial variance would remove the only currently viable means for developing wholesale electric competition in Arizona. It would entrench the existing fleet of generation assets for years to come, and deny consumers the benefits of access to new sources of competitively procured generation that is clean, reliable and efficient.

a. How would retail customers be affected?

If the Variance were to be approved, retail customers-and regulators--would be forced back into a cost-based system. Instead of generators

bearing market risks, customers would continue to bear the risks of fuel price increases, stranded costs, and inefficient plant operations. 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 again bear the risks plants that were over budget or had excess capacity. Customers in Tucson are still paying excess-capacity surcharges that were placed in rates in the 1990's.

b. How would retail generation competition be affected?

See answer to a. above.

c. How would wholesale generation competition be affected?

If competitive bidding for a significant portion of the electric supply for standard offer customers is eliminated, it will severely reduce wholesale competition in the state from what would occur under the current rules. If generators that are building facilities in order to supply a portion of the Arizona load are denied access to that load, either via the wholesale market or the retail market, due to a change in regulation, these competitive providers are unlikely to invest in future generation projects in Arizona and may not complete projects that have already been announced and that are currently under

development.

Consumers will be forced to continue to subsidize generation resources that are older, less efficient, more expensive, consume more gas, and emit more pollution. In addition, much of the incentive for independent power producers to add more capacity would be removed and the Arizona wholesale market would become dependent on the incumbent utility generation assets for years to come.

2. Are sufficient competitors available for an effective bidding process for 50% of standard offer service? A higher or lower percentage?

There are enough competitors in the market to allow for 50% or more of the standard offer service to be competitively bid. See Reliant's response to Question B above.

In its variance request, APS assumes that the only plants able to bid into this market are the existing Arizona plants. They ignore that over a period of several years, new more efficient generation can be added and they also ignore that Arizona is part of an interconnected regional market.

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?

The settlement agreement as currently structured has such a low generation shopping credit that retail customers are effectively precluded from seeking alternative suppliers. In APS' bundled tariff, generation costs are under-

weighted relative to the true cost of generation. If APS' generation is forced to stand on its own, there would be far more room for other generators to compete. Since there is no retail competition, it is clear that wholesale competition will be severely restricted if a utility is allowed to procure all its generation from an affiliate. Robust competition can not develop in an environment where the only choice is generation from an affiliated company.

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.**

See answer to Question 5, below.

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?**

Markets will function best in an environment where the rules are clear. The market has developed in accordance with the rules of the current settlement agreement. To substantially change those rules hinders further development of the market because of the regulatory uncertainty that is introduced. The Commission should therefore direct the utilities to proceed with the competitive bidding process.

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 severely impact 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 pricing of power supply contract rates should be based on a competitive bidding process.

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

Contracts that result from of a competitive bidding process will provide reliable supplies and stable prices for consumers.

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.

FERC's new approach, the "Supply Margin Assessment" ("SMA") test, attempts to measure potential market power by assessing the market as a whole, including generation and transmission, to determine whether market power exists. In simple terms, if a generator controls more generation than the "reserve margin" available in the area, the generator is deemed to have market power. In such instances, market based rate ("MBR") authority may be denied. If FERC adopts the SMA test, companies selling into Arizona would be subject to the SMA test and could be denied MBR authority if they had market power. Because of significant concerns raised by participants from various sectors of the market, the implementation of the SMA test will

be delayed until a technical conference is held to explore, and hopefully resolve, these concerns.

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, provided the long term contract results from a competitive bidding process.

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.

	12-36 months	48-60 months
US	• FERC will establish pro forma RTO standards • RTOs will begin improved regional coordination of transmission expansion • Consistent day ahead spot markets will develop • Wholesale price volatility will continue to occur, but will be mitigated through market-based risk instruments • Vibrant wholesale markets will ease fear about retail competition	• Western RTOs will coordinate activities • Enhanced federal regulatory role will result in more consistent market practices. • Retail competition will reemerge as consumer benefits are realized • Distributed generation and demand response markets will develop substantially
Arizona	• Utilities will continue to press for re-integration • Transmission expansion will emerge as necessary market enhancement • WestConnect will be reevaluated and restructured to be consistent with FERC pro forma standards	• Consumers will realize the benefits of wholesale competition and the transition toward full retail competition will be underway.

B. Is there anything the Commission should do to continue to avoid California's retail electric competition experience? Please be specific.

California's problems were related to supply/demand imbalance and poor market design. The ACC should continue to promote competitive wholesale markets. Competitive retail markets depend upon well functioning wholesale markets. The ACC should:

- Support continued development of merchant generation in Arizona.
- Expedite needed transmission expansion.
- Do not put up regulatory barriers to developing procurement portfolios (combination of long and short term purchases).
- Institute "plain vanilla" bundled default service and encourage the competitive market to develop alternatives.
- Make sure that consumers have ability to respond to price signals.
- Separate utility merchant generation interests (including affiliates) from utility portfolio management obligation.

In the summer of 2000 the California IOUs asked that the CPUC declare that the rate freeze was over. All three of the IOUs asked for a revenue requirement increase that equaled approximately 2 cents a kWh. The CPUC refused to accept such a proposal. The Governor stated that if he wanted to raise rates, he could have "solved the problem in 20 minutes". In January of 2001, the CPUC raised rates for each of the IOUs the equivalent of 1 cent a kWh. In March of 2001, the CPUC raised rates for each of the IOUs the equivalent of 3 cents a kWh. The rate increase approved by the CPUC is to repay the states general fund, for funds expended by CDWR as the states' authorized creditworthy buyer when they bought the IOUs net short power (the difference from what the IOUs could self generate and their total energy demand). The rate increases authorized by the CPUC are almost twice as much as the IOUs requested in the summer of 2000.

Although the competitive rules in California were flawed, they could have been easily fixed by removing the requirement that all power had to be sold to the PX and by granting authorization for the IOUs to enter into forward contracts,

without prudency review. If it is appropriate for DWR to enter into forward contracts without prudency review, it certainly makes sense that the IOUs are quite capable of entering into forward contracts with CPUC oversight.

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

Enron's problems were not related to its core energy business. The minimal impact of Enron bankruptcy on energy markets demonstrates that the markets work. There have been no supply disruptions and no unexpected price volatility. It is revealing to contrast this to the California situation where regulatory inaction and government intervention exacerbated price excursions, took response out of consumer's hands, and left consumers paying the cost of high priced long term contracts for the next decade.

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

While the AISA provides a "work-around" to allow ESPs to obtain transmission rights necessary top serve retail load, formation of effective RTOs, independent of market participants, will enhance wholesale competition, lowering costs and improving reliability. As noted previously, a vibrant wholesale market is a prerequisite for effective retail competition. A properly constituted RTO will result in an economic allocation of transmission rights, resulting in the most economic generation being used to serve the load. In addition, a properly constituted RTO will provide a truly independent interconnection process that should ease the ability of new generators to interconnect to the system.

The WestConnect RTO proposal, as currently filed at FERC, is not properly constituted, as the many intervenors in that FERC Docket have noted. However, through that Docket and FERC's Standard Market Design, Standard Interconnection Procedures and related rulemakings, a properly constituted RTO for the southwest should be developed.

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.

No, FERC policy clearly recognizes that retail competition issues are state-jurisdictional.

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.

There is already Federal oversight of security at both nuclear facilities and power facilities and gas transportation facilities in general. The NRC, the DOE, the FBI and the National Guard with the independent oversight of the facility owners already provide security oversight.

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

Security does not change simply because the generation facilities are removed from Commission ratemaking jurisdiction.

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

The transfer of ownership of such assets requires the approval from both the State of Arizona and the United States. Various federal agencies such as the SEC for publicly traded company and the Department of Justice must approve any such transfer. Acquisition of ownership by a European country would require E.U. approval. In sum, there is nothing inherent in foreign ownership that would suggest security concerns.

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

No. Again, there is nothing inherent to ownership by a non-Arizona entity that would give rise to security concerns.

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

Security issues and oversight does not change - continued compliance remains a requirement.

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 measure for determining at various stages how successful the process has been.

Reliant Resources supports the vision statement contained in FERC staff's recent concept

paper, and believes that Arizona's electricity markets are likely to (and should) develop in a manner consistent with that vision.

FERC staff vision statement:

By 2006-2011, electricity will be purchased and sold in both wholesale and eligible retail markets by any willing creditworthy participant. Markets will clear with competitive prices. Competitive prices will function so as to ration existing supplies efficiently in the short run and to elicit adequate technology and infrastructure in the long run, so that there will be no involuntary curtailment of service at market prices. Electricity markets will be both transparent and liquid, and market participants will have opportunities to hedge risks. Although regulation of monopoly service providers will continue, even these monopolies will feel some pressure of competitive market forces.

Wholesale electricity markets will have the following characteristics:

- Wholesale energy-related products, such as transmission and power, will be fully unbundled to the extent that there is no monopoly advantage left due to vertical integration. In other words, anyone will be able to purchase the products and services necessary to buy or sell "delivered" electric energy for themselves, or as a service provider for others.
- There will be relatively few barriers to entry and exit, and those that do exist will be as low as is reasonably possible to obtain. There will be no significant barriers to innovation.
- Market participants will not be able to exercise market power in generation or transmission markets. Ownership or control of physical assets will not convey (will not be allowed to convey) significant market power.
- Market institutions will exist that maintains market transparency and keep transactions costs low, while affording liquidity for both the short-term and long-term

markets.

- Good market-driven price signals will exist to support well-planned investment in new generation and new transmission when and where they are needed, and in a timely manner (before shortages occur).
- Buyers will receive accurate and timely price signals and will have the ability to react to them, so that they can make rational and efficient choices in the amount of energy they consume at any given point in time. As a result, demand will be responsive to market price changes.
- Non-investor owned entities (e.g., public power and electric power cooperatives that are financed by the Rural Utilities service) will be allowed (even encouraged) to join regional organizations (including RTOs), and will be treated comparably with investor-owned entities. They will not face disincentives to join RTOs, but neither will they be given special treatment.
- Where states don't provide for retail choice, there will be competition in wholesale markets to allow local utilities to acquire electricity at reasonable prices.
- Where states have approved retail choice (and thus, where retail products are fully unbundled to the extent that there is no monopoly advantage left due to vertical integration), the wholesale market structure will not prevent anyone from purchasing the products and services necessary to buy or sell "delivered" electricity for themselves, or as a service provider for others.

III.

RESPONSES TO

CHAIRMAN MUNDELL'S SUPPLEMENTAL QUESTIONS

For the purposes of the questions below --

1. an "affiliate company" means (a) any person or company that owns or has the power to control the outstanding securities of 5 % or more of the entity or (b) any officer or director of the entity;

2. a "retail supplier" may be a public utility, including a distribution company or a competitive provider of energy or other retail electric services such as Electric Service Providers (ESPs) under our rules;

3. a "subsidiary company" means any company in which the entity owns or controls five percent or more of the outstanding securities of such company.

Corporate Structure and Affiliate Relations

1. If the U.S. Congress repeals the Public Utility Holding Company Act of 1935 ("PUHCA" or "Act") PUHCA -

a. what regulatory protections would be lost for Arizona consumers?

b. what would be the risks for Arizona consumers?

c. for any identifiable risks, are the risks reduced or increased under a competitive retail regime?

Reliant takes no position on these issues at this time.

2. What is the extent of the Commission's authority to protect retail consumers from any potential adverse consequences resulting from multi-state companies operating in either wholesale or retail markets in the state?

Reliant does not believe there are potential adverse consequences resulting from multi-state companies operating in either wholesale or retail markets in the state. Whether or not retail customers are served by an in-state provider or a multi-state provider should

have no impact on the Commission's authority to protect retail consumers.

3. How would the existence of effective retail competition in Arizona affect your responses to Questions 1 and 2 above?

The answers would not change.

4. What is the extent of any impact on effective federal or state regulation to protect Arizona wholesale and retail consumers, if a holding company is (a) registered or (b) "exempt" under PUHCA?

Reliant takes no position on this issue at this time.

Questions Specifically for Retail Suppliers as Defined Above

5. Explain the retail supplier's corporate structure.

This question is not applicable to Reliant at this time.

6. Identify all subsidiary companies and the businesses in which they are engaged.

This question is not applicable to Reliant at this time.

7. Identify all affiliate companies and the businesses in which they are engaged.

This question is not applicable to Reliant at this time.

8. Identify each entity that owns or has control of 5 % or more of an affiliate of the retail supplier, and describe the businesses in which that entity is engaged.

This question is not applicable to Reliant at this time.

9. Describe the financial relationships among the various affiliates and subsidiaries, such as pledges of assets and encumbrances and contracts for services and goods.

This question is not applicable to Reliant at this time.

10. Explain whether the retail supplier, or any affiliate or subsidiary of the retail supplier, is regulated by the Securities and Exchange Commission (SEC) as either an "exempt" or "registered" public utility holding.

This question is not applicable to Reliant at this time.

11. Identify any waivers or "no-action" letters the retail supplier, its affiliates, its subsidiaries, or other associated companies has received in the last 15 years from the SEC under PUHCA or the Investment Act of 1940 or from FERC under the Federal Power Act.

This question is not applicable to Reliant at this time.

12. Provide copies of filings to the SEC and FERC made by the retail supplier and any affiliates or subsidiaries in the last five years pursuant to the agency's administration of PUHCA.

This question is not applicable to Reliant at this time.

13. If the retail supplier is a subsidiary of a registered holding company, identify any SEC-approved contracts with affiliates or subsidiaries in the last 5 years.

This question is not applicable to Reliant at this time.

Divestiture or Corporate Separation

14. How would the divestiture or transfer of assets of vertically integrated utilities now serving Arizona affect the Commission's regulatory authority over the divested entities? What controls or limitations might the Commission place on divestiture or transfer of assets to limit any loss of authority over the divested assets?

The Commission would continue to have authority over divested or transferred assets to the extent permitted under state law. In addition, the Commission will have complete control over the rules governing retail transactions occur. Since that is the point where the Supplier and the Consumer meet, the Commission's rules will impact the wholesale supply chain.

15. How would the divestiture or transfer of assets of vertically integrated utilities now serving Arizona affect federal jurisdiction under the FERC and the SEC over the divested entities?

Wholesale sales are subject to FERC authority. Any divestiture would subject the purchasing entity to the various market power reviews required by various federal

agencies, including FERC.

16. How would the potential effects of divestiture or transfer of assets on Commission authority differ under a competitive retail regime than under a monopoly regime?

See response to Question 15, above.

17. How would a requirement that competitive services, such as generation services, be offered only through a separate corporate affiliate affect the Commission 's regulatory authority and any risks identified in response to the questions above?

If full divestiture is not required, complete functional separation with strong a strong code of conduct should be required. The Commission's authority would be the same as described in the answer to question 14.

18. For any risks resulting from a divestiture requirement or a requirement that competitive services be offered through separate affiliate, how might those risks be eliminated or reduced? Specifically--

a. What actions might the Arizona Commission take?

In the case of functional separation, the imposition of a code of conduct should ensure that competitive affiliates of the incumbent utilities are not receiving undue preferences. A capacity auction process can reduce market concentration where necessary. In the case of required divestiture, the best way to mitigate risks is to have a functioning market with multiple suppliers competing with each other.

b. Are there actions that the Commission might encourage the FERC or the SEC to take to maintain adequate oversight for the protection of ratepayers?

The FERC and SEC currently have sufficient authority to provide adequate oversight related to any divestiture of generation assets.

IV.
RESPONSES TO QUESTIONS POSED BY COMMISSIONER SPITZER

If there was a competitive market, these are the types of incentives and benefits that would exist; Arizona has adopted but not implemented a competitive market.

1. In a vertically integrated utility model, what incentives (regulatory, financial and ratemaking) exist for the expanded use of renewable energies?

Regulatory incentives exist if a Renewable Portfolio Standard is in place with enforceable penalties. Financial incentives usually will take the form of a "renewable energy fund" that provides additional support to renewable energy development. Ratemaking incentives are limited to green pricing programs/tariffs that rely on voluntary demand. Standardization of distributed generation interconnects and net metering are also incentives for renewables.

2. In a competitive electric market model, what incentives exist for the expanded use of renewable energies?

In competitive markets, green tariffs have been replaced with specialized customer product offerings that often contain premiums for the portion of energy use that is derived from renewable sources. Competition affords retailers the motivation to offer a diverse portfolio of renewable products and related marketing to attract consumers.

3. In a vertically integrated utility model, what disincentives (regulatory, financial and ratemaking) exist for the expanded use of renewable energies?

Green tariffs provide minimal incentive compared to that of competitive model. Unless instructed to do so, vertically integrated utilities do not have the incentive to execute long term power purchase agreements required to stimulate investment in developing a

particular state's renewable potential.

4. In a competitive electric market utility model, what disincentives exist for the expanded use of renewable energies?

In competitive markets, protocols on scheduling and settlement can create a disincentive for intermittent renewable energy such as wind power. Firm renewable energy, such as biomass and geothermal, does not suffer this disincentive.

5. During Arizona's period of reliance on the vertically integrated utility model, what renewable energy programs were enacted in Arizona?

SRP - Solar Choice/Earthwise Energy (10/98), Tucson Electric Power - Greenwatts (1/00), APS - Solar Partners (1997).

6. Since Arizona' s adoption of a competitive electric market model, what renewable energy programs have been enacted in Arizona?

Environmental Portfolio Standard

7. Under the vertically integrated utility model, what incentives exist to build newer plants that are less damaging to the environment to replace older, dirtier plants?

None, unless mandated to do so by the Commission.

8. Under the competitive electric market model, what incentives exist to build newer plants that are less damaging to the environment to replace older, dirtier plants?

In a competitive electric market model, the market rewards the lowest cost producers. New generation is more efficient, and therefore produces fewer emissions, than the existing stock of generation. The competitive marketplace provides incentives for newer, cleaner technology to enter the market and replace the generation that would otherwise come from higher emitting generation plants.

9. Under the vertically integrated utility model, what disincentives (regulatory, financial and ratemaking) exist to build newer plants that are less damaging to the environment to replace older, dirtier plants?

In the vertically integrated utility model, new generation was added only after a regulatory-based need was determined. Then the process of approval to include the plant in rates was performed. This resulted in longer lead times than would currently occur for a competitive generator that doesn't require such determinations. Additionally, older, dirtier plants were kept on the system if they were considered used and useful from an operating perspective rather than an economic perspective. This would not happen in a competitive environment where economics determines such decisions.

10. Under the competitive electric market model, what disincentives exist to build newer plants that are less damaging to the environment to replace older, dirtier plants?

Assuming a well functioning competitive electric market model, the lack of economic viability of the new plant would be the only impediment. If it is economical to build the newer plant and the competitive electric market model is functioning correctly, entry will occur.

11. During Arizona's period of reliance on the vertically integrated utility model what emphasis did the Commission place on pollution control measures in Certificates of Environmental Compatibility?

(a) What is the most stringent pollution control measure placed on a CEC during Arizona' s reliance on the vertically integrated utility model?

This question is not applicable to Reliant Resources.

12. Since Arizona's adoption of a competitive electric market model, what emphasis has the Commission placed on pollution control measures in Certificates of Environmental Compatibility?

This Commission has been quoted on several occasions to the effect that each CEC

Permit Application is reviewed on a case by case basis and as times goes on the "bar is raised" with subsequent requests. This was detailed recently by an article in the Arizona Republic where Griffith's CEC contained 5 conditions and most recently Duke's Arlington Valley II project contained 25 conditions. Several of the Duke conditions focused on environmental issues pertaining to water and limiting contributions to the air shed.

(a) What is the most stringent pollution control measure placed on a CEC since Arizona's adoption of a de-regulated utility model?

Duke Arlington Valley II was granted a CEC conditioned on the requirement that it install LAER control equipment. Likewise, Santan was granted a Permit with LAER, but with a 5 year rolling evaluation as LAER technology advances.

(b) What is the likelihood that that measure would have been placed on a similar CEC in a vertically integrated utility model?

In part, the Commission balances its decisions based on the impact new power plants have on all of Arizona's natural resources, whether the project is built by an incumbent utility under the old paradigm or by a merchant company under the new paradigm. However, if economics allow, merchants have been known to raise the bar voluntarily, for example, by proposing to install catalytic reduction when not required or by submitting air permit applications with reduced criteria pollutant amounts compared to current authorized amounts.

13. During Arizona' s period of reliance on the vertically integrated utility model, what amount of excess generating capacity existed in Arizona?

This question is not applicable to Reliant Resources.

14. Since Arizona's adoption of a competitive electric market model, what amount of excess generating capacity existed in Arizona?

Currently there is no excess capacity in Arizona. The amount of excess capacity in the

future will depend on the purchasing practices and the reserve margin obligations established for load serving entities in the state.

V.

RESPONSES TO QUESTIONS POSED BY COMMISSIONER IRVIN

I. Arizona Independent Scheduling Administrator

My position concerning the continued existence of the AISA is well documented (see letter dated November 19, 2001, Docket No. E-00000A-Ol-0630). Open Access Transmission Tariffs (OATT) currently on file with FERC should be changed to conform with lithe Protocol Manual developed by the AISA, and should be sufficient to facilitate Arizona's floundering retail market. Arizona cannot overlook FERC's determination that -once a state commission adopts a system where generation service is available as a separate product *-all transactions* (even standard offer) fall within the federal government's exclusive jurisdiction [see Denial of ACC request for rehearing, FERC Docket No. ERO2-348-000]. I am not willing to concede this point, nor am I willing to lightly concede state jurisdiction over such matters without clear Benefits for all classes of Arizona consumers.

Questions

Please address whether Arizona's Constitution prohibits the Commission from giving up *any authority* with respect to the pricing of services by public service corporations which occur solely within the state.

Reliant offers no response to this question at this time.

Should Arizona be willing to let the federal government take over pricing jurisdiction (market- based rates) for all retail transactions which occur in the state, or is this an inevitable (and proper) result of opening retail markets to competition?

FERC has sufficient authority over market based pricing to ensure market power does not exist and is committed to implementing such authority.

Can Arizona's UDCs modify their tariffs with the FERC to conform to AISA protocols so that retail transactions can still take place without the AISA? How many times has the AISA been used to resolve disputes over transmission issues to date?

Reliant believes the UDCs can and should modify their FERC tariffs to incorporate AISA protocols if the AISA is no longer in place.

II. Retail Electric Competition Rules ("Rules")

Anyone who suggests that revisiting the ACC's current Electric Competition Rules will have a dramatic negative impact on investment, generation supply or the development of market rates fails to recognize reality. In the legal arena, these rules have been challenged and held to be "unlawful and unconstitutional under Article 15, section 14 of the Arizona Constitution and Ariz. Rev. Stat. § 41-1001 et. seg." [Tuscon Electric Power Company, et al. vs. The Arizona Corporation Commission, Case No. CV 97-0348 -Consolidated]. After Judge Campbell's decision I wrote, "Certainly, an opportunity to rehabilitate our electric competition rules pursuant to Judge Campbell's decision brings with it an ability to create more consumer protection provisions for Arizona ratepayers." [press release dated November 29, 2000].

No one argues that California's experience with 'deregulation' (a loosely used term) was, and continues to be a disaster. It should be noted that California has already began to 're- regulate' its electric industry with a myriad of new state agencies. Rolling blackouts, alleged price fixing in natural gas, and a highly volatile spot market for electricity have chilled restructuring plans in the western region. Arizona stands alone as the **only** state, which has not suspended or postponed retail competition rules or laws.

Nevertheless, I have long since held the view that Arizona's move toward II competitive markets will necessitate revisiting the Rules on a periodic basis. Like an architect's building specifications which are modified during the construction process, so too must this Commission look at existing electric competition rules to see if modifications are necessary, or as Chairman

Mundell writes, "[consider]... whether circumstances have changed enough to compel a different pace or path."

Markets

Functional wholesale markets are paramount before creating robust retai1 markets in electricity generation. Retail customers -especially residential consumers -desire reliability and price stability in addition to appropriately priced power. Arizona has yet to determine what a retail market should look like, and whether 100% participation provides sufficient benefits for consumers to warrant wholesale change. Perhaps its because Salt River Project s customers enjoy traditionally low electric rates; perhaps its because APS and TEP standard of r customers are currently protected by rate caps. Nevertheless, since the ACC adopted the current Rules in mid-1999 (and the Legislature's adoption of HB 2663 in 1998), there has no, been ONE residential customer who has switched to a different provider in Arizona.

When in effect, R14-2-1606 (B) requires each UDC to acquire all of its power purchased for standard offer customers to come from the competitive market -with a least *50%* going to competitive bid. However, this rule fails to identify some unit of time which would characterize the power purchases of the UDC. Will independent power producers (IPP) bid the r generation output in a spot, short-term or long-term wholesale market? Will IPPs market directly to retail consumers through and electric service provider -even though the number of ESP, continue to decline?

Questions:

If the majority *of* market participants intend *to* market electricity *only to* industrial, large commercial and load serving ESPs entities, should retail markets be limited by load ~size to allow those entities with true bargaining power to negotiate Direct Access?

In an appropriately designed market, there is no reason to limit the benefits of competition to certain customer classes. If desired, incentives can be provided for retail providers to serve certain customer classes.

What will be a UDC's primary functions in a competitive market?

The UDC's primary function in a competitive market is to transport electricity form the transmission system to customers.

Is it important to first establish functional wholesale markets before creating robust retail markets in electric generation? If so, why? If not, why?

A functional wholesale market is required for a robust competitive retail market. It can be established either concurrently or prior to the development of a competitive retail market. If policymakers wish to transition into retail competition, a good plan is to provide wholesale competition for some period of time and then retail competition.

When price caps are lifted for the majority of Arizona consumers, what assurances1 do we have that volatility in the market (for both natural gas and electricity) will not result in unstable or inflated rates? Will the generation price of electricity fluctuate with the price of natural gas?

The question assumes that increased costs of electricity should never be borne by consumers. This is a recipe for disaster in electric markets whether regulated or unregulated. An efficient market will allow consumers to receive appropriate price signals, thus providing the guidance necessary for conservation and demand responsiveness to occur.

Should there be a provision added to RI4-2-1606 (B) which would allow/limit a UDC to contract for wholesale power in three or five year intervals? What would be a proper length term contracts?

The auction should be conducted as described in Reliant's response to Question B above in Chairman Mundell's first set of questions.

What are the real benefits to residential consumers and small businesses in retail competition, other than consumer choice? Will IPPs market their power directly to retail customers, or are their efforts mainly focused on selling power to wholesale customers?

All consumers will benefit from the efficient use of resources brought about by a competitive market. While IPP's may or may not market directly to retail customers, other market participants, many retail energy providers including Reliant Resources, The New Power Company, Green Mountain Energy, AES Energy Services are currently directly marketing power to retail customers in other states.

Currently, is residential choice a real option? If not now, when?

Given the current state of the Arizona market, a competitive retail market is unlikely to develop for several years while the Commission and market participants ensure the development of a wholesale market and the points in response to Question B in Chairman Mundell's first set of questions above. At that point, Arizona consumers will be in a position to reap the full benefits from retail competition.

What provisions, if any, are necessary to effectuate a gradual replacement of those existing plants in Arizona which are older, more polluting and less efficient than the newer combined cycle plants currently being built?

See Reliant's response to Chairman Mundell's Question II.B.

What are the long-term effects of divestiture for APS? How does the Commission guard against a PG&E situation, where the distribution company declares bankruptcy after profits have flowed to its parent holding company?

Reliant offers no response to this question at this time.

Pricing

The three major components of pricing, generation, transmission and distribution -all require prudent planning in order to achieve a level of stability acceptable to the average consumer. Since 1999, we have seen wholesale prices for electricity fluctuate between $20.00 per megawatt to $2000.00 per megawatt. Likewise, the price of natural gas has moved from an approximate low of $2.50 a term to a high of nearly $10.00 per thermo Volatility in these markets will only continue to hold both consumers and the economy at large hostage.

Since transmission is a major component of the price ultimately charged to the consumer, the establishment of a regional transmission organization for the southwest is vital, and should be accomplished as quickly as possible if competition -either wholesale or retail -is to take root in Arizona. To that end, I believe that this Commission should be working more closely with the FERC to make Arizona's concerns known in this matter.

Competition in Arizona

I am not prepared to announce the death of competitive energy markets in Arizona -but the fruits hanging from the vine of deregulation are in desperate need of nourishment. Restructuring the electric industry should be about consumer benefits and bettering the quality of life in the state, not appeasing Wall Street's earnings expectations for one company or the next. Left unchecked, corporate greed (i.e. Enron) can replace sound reasoning and result in highly volatile markets ultimately harming average consumers.

All of us should keep in mind that the vast majority of people (and businesses) are interested in the bottom line. We cannot accept a restructured system that benefits only a few without regards to the basic needs of the whole. If competition is to move forward in Arizona, sufficient consumer protections need to be in place to assure that a commodity as valuable as electricity is safe, reliable and affordable to all classes of customers.

VI.
CONCLUSION

Reliant believes the Arizona competition rules and the settlement agreement provide a sound foundation for the transition to competitive electricity markets and the Commission should proceed with implementation of those rules as planned. In particular, Reliant recommends that the Commission reject the APS request for variance, as it would decimate the market for new generation development, entrench the existing fleet of aged generation assets for years to come, and deny consumers the benefits of access to new sources of competitively procured generation that is clean, reliable and efficient.

RESPECTFULLY SUBMITTED this 25th day of February 2002

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