

OPEN MEETING ITEM



0000071314

Arizona Corporation Commission
BEFORE THE ARIZONA CORPORATION COMMISSION
DOCKETED

DEC 20 1996

Dec 20 3 32 PM

DOCUMENT CONTROL

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

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

DOCKETED BY

IN THE MATTER OF COMPETITION
IN THE PROVISION OF ELECTRIC
SERVICES THROUGHOUT THE
STATE OF ARIZONA.

DOCKET NO. U-0000-94-165

RUCO'S EXCEPTIONS TO STAFF'S
PROPOSED OPINION AND ORDER

The Residential Utility Consumer Office ("RUCO") hereby submits its Exceptions to the Arizona Corporation Commission Staff's ("Staff") Proposed Opinion and Order and Draft Rules ("Proposed Rules") on Electric Industry Restructuring.

RUCO believes that the Staff's Proposed Rules are premature. RUCO believes that issue resolution should precede rule adoption. The pace of change in the electric industry in the Southwest is likely to accelerate as California moves toward retail competition in 1998, while under the Proposed Rule only 20% of the Arizona market would be opened up by 1999, with complete retail access only by 2000.

RUCO believes that the contradiction between the undue haste of the rule-making and the overly drawn-out schedule for introducing retail competition should be resolved as follows. First, the rule-making should take place only after due deliberation and decision on the issues. This could take be achieved by April 1, 1997. Second, if the Commission truly wishes to move the restructuring process forward, RUCO's proposed implementation schedule should be adopted, commencing with a relatively small initial phase that would help to iron out the potential problems of retail access. There are no compelling reasons why an initial "pilot program" phase of retail access should not be introduced in 1997. Nor should half of Arizona's electricity consumers have to wait for over six more years for retail access. The phasing proposed by RUCO is as follows:

- 1 July 1, 1997: Phase One (Pilot Program) -- 2-4% of load.
2 January 1, 1999: Phase Two -- a total of 25% of load (additional 21-23%).
3 January 1, 2000: Complete retail access -- 100% of load (additional 75%).

4 RUCO believes that a clear danger in the Proposed Rule is that a select group of
5 customers, predominantly large industrials, will enjoy access to the competitive market long
6 before most other customers do. The Proposed Rule's provisions regarding the proportions
7 of eligible load in different customer classes are unduly complex. Anything short of
8 proportional access by all customer classes and on the same time schedule is a recipe for
9 favoring some customer classes over others and for shifting of stranded cost recovery to still-
10 captive customer classes. RUCO believes that as a general matter, the Rule should
11 explicitly provide that there shall be no shifting of responsibility for stranded costs between
12 customer classes.

13 RUCO believes that the same percentage of each class's load should be eligible for
14 retail access in each phase. For example, when 50% of load is eligible, it should be 50%
15 of each customer class's load. Equivalently, if residential customers account for 30% of a
16 distribution utility's demand, in each phase residential customers should account for 30%
17 of eligible demand.

18 RUCO believes that a further requirement that is necessary to make it practical (in
19 terms of transaction costs) for all customers to participate in the competitive market is that
20 no special customer metering should be required. Time of use meters should only be
21 required for those customers who wish to benefit from time of day prices. For other
22 customers or groups of customers supplied by competitive suppliers, the distribution utility
23 can estimate their hourly load responsibility using load research data.

24 RUCO believes that the distinction between distribution utilities and competitive
25 electricity suppliers should be clarified. As the debate about retail electric competition
26 continues, it is becoming increasingly clear that a number of services now being provided
27

1 by electric utilities can be provided competitively. What is not so clear, however, is exactly
2 *which* services can be provided competitively at any given time. RUCO believes that it is
3 not necessary to attempt to decide prematurely which services belong in each category --
4 competitive and non-competitive service.

5 RUCO believes that utilities and other electric service providers should be defined
6 with the distinction between these two categories of services in mind. Utilities should be
7 called "Distribution Utilities," it being clear that for the indefinite future the service of
8 providing the wires through which electricity is delivered to retail customers in a service area
9 will be a regulated monopoly.

10 RUCO believes that the Distribution Utilities should not only be listed, as in the
11 Proposed Rule, but should be *defined* as those public service corporations franchised by the
12 Commission to provide, within their specified service areas, such services as are found by
13 the Commission to be non-competitive for the time being. In other words, Distribution
14 Utilities should continue to have the sole franchise to provide these non-competitive utility
15 services in their service areas.

16 RUCO believes that the Commission should periodically determine which services
17 are competitive and which are not. It follows from RUCO's previous point that the
18 Commission must make critical decisions from time to time regarding the general
19 competitiveness of different electric services, particularly the generation of electricity and
20 its supply to retail customers. RUCO believes that the Commission should make the
21 determination that a service is competitive if it can *generally* be competitively provided in
22 Arizona -- not necessarily to *all* customers -- a point that will become clear presently.

23 RUCO believes that the Commission should have the authority to make such
24 determination; to conduct such investigations and undertake such studies as it deems
25 necessary for this purposes *before* making such determination, *and* subsequently from time
26
27
28

1 to time as market conditions change (e.g., mergers could make a previously competitive
2 market no longer competitive).

3 The Commission should make an initial determination of those services that are
4 competitive at the present time, or rather, will in its opinion be competitive if (a) they are
5 deregulated and (b) appropriate restrictions are imposed on market participants to ensure
6 that there will be no undue exercise of vertical or horizontal market power. These services
7 could include electric energy generation, electricity supply (the putting together of supply
8 packages for retail customers , possibly including energy efficiency, special pricing features,
9 etc.). Competitive markets will likely also be established for certain ancillary services. This
10 category includes elements of system control and reliability such as voltage control and
11 reactive power. Metering, meter reading and billing may also become competitive services.
12 RUCO believes that after these services are deregulated, *i.e.*, freed from price regulation,
13 the Commission would need to make periodic assessments regarding any barriers to effective
14 competition, by establishing a complaints procedure and by having the authority to
15 investigate market power abuses on its own motion. The Commission should have the
16 power to rectify the situation or, in extreme cases, reintroduce price regulation.

17 RUCO believes that the Proposed Rule does not comprehensively address the
18 problem of market power. RUCO has serious concerns regarding the danger of market
19 power resulting from vertical integration between distribution, transmission and power
20 supply functions; affiliate transactions; and horizontal market combinations. The Draft Rule
21 needs to be strengthened in a number of respects to deal with the market power problem.

22 Although the Proposed Rule already provides that utilities must make customer-
23 specific information available to other electricity suppliers if requested to do so by the
24 customer concerned. The Rule should be strengthened, by requiring that Distribution
25 Utilities should make load research and other *customer class* data available to all
26 competitive Electricity Suppliers, even in the absence of a request by the customers. This
27
28

1 Four, the Commission should have the authority to investigate, review, and establish
2 rules for, *transactions between distribution utilities and affiliated electric service providers*.
3 More generally, it is becoming common to develop a "code of conduct" for utilities who wish
4 to participate in the competitive supply market.

5 The Proposed Rule does not deal adequately with the issue of Market Structure. In
6 the previous section, we began to consider market structure in the context of the problem
7 of continued vertical integration of generation and distribution functions. Here, we raise
8 another critical issue -- the relationship between bilateral contracting and the spot electric
9 energy market.

10 In the restructuring plans already being finalized in California and New England, the
11 creation of a *spot energy market* is being given a central role. In RUCO's Initial Comments
12 on retail electric competition, a dual market structure was proposed -- with both bilateral
13 contracts and an active spot electric energy market. As we said, we find ourselves in the
14 middle ground in this debate. By contrast, the Draft Rule focuses on bilateral contracts and
15 includes a reference to a spot market almost as an afterthought. In the Draft, the
16 development of spot markets is an option that is left to the market participants. RUCO
17 believes that a spot market should have a more central role in a restructured competitive
18 electricity industry. This matter must be resolved before Arizona embarks on electric
19 industry restructuring.

20 While primary responsibility for regulating a spot market will likely reside with the
21 FERC, even if an Arizona spot market is created as opposed to a regional one, the
22 Commission should be given the authority to determine whether the spot market(s) relied
23 upon by utilities are effectively competitive. Since regional utility power pooling is not as
24 fully developed as it is in New England, for example, Arizona must address this matter on
25 a state basis. In this respect the situation in Arizona is more like that in California, where
26 the state is taking strong initiatives with respect to pooling and spot market issues.

1 RUCO believes that a fully competitive spot market requires that no one utility
2 controls a sufficient share of generation in any energy price range. With control of
3 generating units that would be close to one another in the dispatching merit order, a utility
4 can increase its profits by submitting bids to the spot market that exceed the operating costs
5 of the lower-cost units. The Commission should ensure that this cannot happen. If it can
6 happen, steps must be taken by the Commission to rectify the situation.

7 *An Independent System Operator* will also likely have a central role in a new market
8 structure. Among the functions of an ISO could be the acquisition of *ancillary services*
9 needed to make the bulk power system function reliably. Even if the ISO takes
10 responsibility for these services, some of them could be competitively supplied, if there are
11 enough suppliers, etc. These services include reactive power/voltage control, load following
12 and spinning reserves, and energy imbalance service. The provision of generating *capacity*
13 as opposed to electric energy is now sometimes being included in the list. System dispatch
14 and control would be provided, or at least coordinated, by the ISO itself.

15 The relationship between the spot market and the ISO needs to be carefully
16 structured. In some proposals, they are related functions performed by the same entity, in
17 other models they are separately organized. RUCO has proposed that a Power Mart
18 function as a spot market, submitting its proposed generation unit dispatching schedules to
19 the ISO, which would implement them subject to reliability constraints.

20 RUCO believes that the Commission should not itself be primarily responsible *for*
21 *assuring system reliability*; it should be authorized to review the ISO's primarily role in this
22 regard, and take any steps necessary to satisfy itself that reliability is assured. In an extreme
23 case, it should be entitled to authorize or require the ISO to acquire additional generation
24 or transmission resources.

25 RUCO believes that the standard offer service must be permanently available,
26 RUCO noted above that a service could be determined to be competitive if it is *generally*
27

1 competitively provided, i.e., there is effective competition between a number of suppliers to
2 provide service to most customers, but not necessarily *all* customers. This is where Standard
3 Offer Service is essential. It includes not only the same regulated utility services that are
4 provided to *all* customers in a service area, but also all other electric services, i.e., those that
5 can be provided competitively to most other customers.

6 The underlying reality is that there are two sides to competition. First, there must
7 be a number of suppliers who compete effectively against each other. Second, however, any
8 given group of customers must effectively be able to exercise choices between the alternative
9 suppliers, taking into account informational barriers and transaction costs. The reality is
10 that a number of customers -- probably including many low-income customers, customers
11 with low electric consumption, and students and other temporary or seasonal residents --
12 may *never* be able to exercise market choices effectively. Standard Offer Service should be
13 available to these customers on a permanent basis. It should be available to all customers
14 in a service area who select it, or, by default, do not select a competitive Electric Services
15 Supplier.

16 RUCO believes that the franchise to provide standard offer service should be
17 competitively bid. During the phase-in period, RUCO believes it is acceptable for Standard
18 Offer Service to be provided by the incumbent distribution utilities. However, there is no
19 reason why this continued utility role should continue indefinitely. Commencing January
20 1, 2000, when retail access has been fully phased-in, the Standard Offer franchise for
21 specified areas should be put out to bid by the Commission for successive periods of time
22 such as five years.

23 The Commission should have the authority to determine the Standard Offer franchise
24 areas. The areas could be those currently corresponding with distribution utility service
25 areas, or they could be smaller sub-areas. The winning bidder should be given the franchise
26
27
28

1 under conditions specified by the Commission in the bidding process and on the price and
2 other competitive terms bid by the winning bidder.

3 Within each area, the Standard Offer supplier would provide all the competitive
4 services in free competition with competitive suppliers. The Standard Offer supplier would,
5 however, purchase the distribution utility's distribution and other monopoly services, and
6 would flow through the cost of such services to its customers in each rate class at the same
7 regulated rates at which those services are provided to all other customers of the same class.
8 The FERC-determined transmission component of regulated rates would be flowed through
9 in the same manner as the ACC-determined distribution tariff would be.

10 RUCO's intention is to leave all regulated distribution utility services with the
11 utilities. Only the other elements of Standard Offer Service would be put out to bid --
12 particularly generation, etc.

13 RUCO believes that the buy-through should be eliminated. The concept of "buy-
14 through" is a potentially fatal flaw -- a kind of "Trojan horse" -- in the market structure
15 proposed in the Draft Rule. The key problem with buy-through is that it opens up the
16 danger that part of the utility's power supply will be ear-marked for favored customers. It
17 is inevitable that the creation of a separate power supply portfolio for select customers will
18 be at the expense of small customers, who will end up being held responsible for the
19 stranded costs associated with the remaining high-cost portfolio. The Commission should
20 preferably eliminate the buy-through provision from the Draft Regulations.

21 RUCO is concerned about the manner in which the Draft Rule singles out solar
22 energy for special treatment. RUCO is concerned that these provisions could prove costly
23 to ratepayers. It would be preferable in a competitive generation market for the
24 Commission to leave issues regarding types of resources in the hands of power producers
25 subject to regulation by environmental agencies. For example, it is quite likely that wind
26 power will prove to have far greater economic potential than solar power in the near future.

1 is no guarantee of recovery of stranded costs by utilities. The Commission should be
2 authorized to make a determination regarding the amount of stranded costs that should be
3 recoverable by each utility.

4 Second, greater emphasis should be placed on mitigation of stranded costs by utilities.

5 Third, to the list of considerations to be taken into account in determining the
6 amount of stranded costs that is recoverable by any utility, the Draft Rule should include
7 the utility's restructuring proposals. Utilities should not be given the opportunity to drag
8 their heels with regard to restructuring, while continuing to recovery high levels of
9 potentially stranded costs, either in existing rates or in special stranded cost charges that
10 apply to retail access customers.

11 As with stranded cost charges, system benefits charges could be separated out and
12 directly charged to *all* customers, whether or not identified separately in the bill. It should
13 not be controversial to explicitly identify these charges.

14 System Benefits charges should be limited in extent. The main item should be
15 continued provision of low-income support and limits on service terminations during winter
16 months.

17 RUCO believes that the in-state reciprocity provisions should be simplified. The
18 conditions contained in R14-2-1611(D) are unrealistic. Applicable to Salt River Project
19 (SRP), there is a requirement that all other Affected Utilities must consent to SRP's
20 voluntary participation in the competitive market.

21 It would be preferable to require that the Commission be authorized to decide upon
22 an application by an Arizona electric utility, not subject to its jurisdiction, to participate in
23 the competitive market. It should make its determination in terms of the public interest,
24 including taking into account the impact on other utilities.

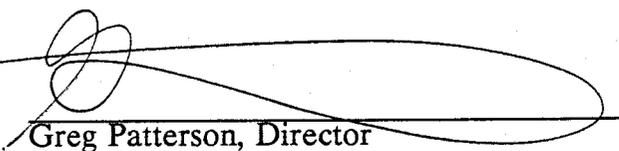
1 RUCO believes that the Proposed Rule raises serious legal problems. The situation
2 of Salt River Project discussed in the previous section raises legal issues with regard to the
3 Commission's jurisdiction, as well as the charter of SRP.

4 More fundamentally, the franchise rights of existing utilities are entrenched in
5 Arizona law to a far greater extent than the rights of utilities in many other states. It is
6 questionable whether radical changes in these rights, of the kinds necessary to introduce
7 retail competition, can be made without the Commission first obtaining legislative
8 authorization.

9
10 **Conclusion: RUCO's Procedural Recommendation**

11 In conclusion, in light of RUCO's many fundamental concerns regarding the
12 Proposed Rule, RUCO recommends that the Commission return in the New Year to the
13 policy-making phase of electric industry restructuring. Coordination with the executive
14 branch and/or key legislative committees would ease the process. The policy-making phase
15 should culminate with the submission of draft legislation, followed by rule-making.

16
17 RESPECTFULLY SUBMITTED this 20th day of December, 1996.

18
19 
20 Greg Patterson, Director
Residential Utility Consumer Office

21
22 AN ORIGINAL AND TEN COPIES of the
23 foregoing filed this 20th day of
December, 1996 with:

24 Docket Control
25 Arizona Corporation Commission
1200 W. Washington
26 Phoenix, Arizona 85007
27
28

1 COPIES of the foregoing hand delivered
2 this 20th day of December, 1996 to the
3 following:

3 Jerry Rudibaugh, Chief Hearing Officer
4 Hearing Division
5 Arizona Corporation Commission
6 1200 W. Washington
7 Phoenix, Arizona 85007

6 Paul Bullis, Chief Counsel
7 Legal Division
8 Arizona Corporation Commission
9 1200 W. Washington
10 Phoenix, Arizona 85007

9 Gary Yaquinto, Director
10 Utilities Division
11 Arizona Corporation Commission
12 1200 W. Washington
13 Phoenix, Arizona 85007

12 COPIES of the foregoing mailed
13 this 20th day of December, 1996
14 to the following:

14 Barbara Klemstine
15 Arizona Public Service Co.
16 Law Department, Station 9909
17 P.O. Box 53999
18 Phoenix, Arizona 85072-3999

17 Thomas L. Mumaw, Esq.
18 Steven M. Wheeler, Esq.
19 Snell & Wilmer
20 One Arizona Center
21 400 East Van Buren
22 Phoenix, Arizona 85004-0001

21 C. Webb Crockett, Esq.
22 Fennemore Craig
23 Two North Central Avenue, Suite 2200
24 Phoenix, Arizona 85004-2390

23 Michael A. Curtis
24 Martinez & Curtis, P.C.
25 2712 North 7th Street
26 Phoenix, Arizona 85006
27 Attorneys for Arizona Municipal Power
28 Users' Association

- 1 Walter W. Meek, President
Arizona Utility Investors Association
2 3030 North Central Avenue, Suite 506
Phoenix, Arizona 85012
3
- 4 Rick Gilliam
Land and Water Fund of the Rockies
2260 Baseline Road
5 Boulder, Colorado 80302
- 6 Charles R. Huggins
Arizona State AFL-CIO
7 110 North 5th Avenue
P.O. Box 13488
8 Phoenix, Arizona 85002
- 9 David C. Kennedy
Law Offices of David C. Kennedy
10 100 West Clarendon Avenue, Suite 200
Phoenix, Arizona 85012-3525
11
- 12 Norman J. Furuta
Department of the Navy
900 Commodore Drive, Building 107
13 P.O. Box 272 (Attn: Code 90C)
San Bruno, California 94066-0720
14
- 15 Thomas C. Horne
Michael S. Dulberg
Horne, Kaplan & Bistrow, P.C.
16 40 North Central Avenue, Suite 2800
Phoenix, Arizona 85004
17
- 18 Barbara S. Bush
Coalition for Responsible Energy Education
315 West Riviera Drive
19 Tempe, Arizona 85252
- 20 Sam Defraw
Department of Navy
21 Naval Facilities Engineering Command
Navy Rate Intervention
22 901 M Street SE, Building 212
Washington, D.C. 20374
23
- 24 Rick Lavis
Arizona Cotton Growers Association
4139 East Broadway Road
25 Phoenix, Arizona 85040
26
27
28

- 1 Steve Brittle
Don't Waste Arizona, Inc.
2 6205 South 12th Street
Phoenix, Arizona 85040
3
- 4 Ajo Improvement Company
P.O. Drawer 9
Ajo, Arizona 85321
5
- 6 Columbus Electric Cooperative, Inc.
P.O. Box 631
Deming, New Mexico 88031
7
- 8 Continental Divide Electric Cooperative
P.O. Box 1087
Grants, New Mexico 87020
9
- 10 Dixie Escalante Rural Electric Association
CR Box 95
Beryl, Utah 84714
11
- 12 Garkane Power Association, Inc.
P.O. Box 790
Richfield, Utah 84701
13
- 14 Mohave Electric Cooperative, Inc.
P.O. Box 1045
Bullhead City, Arizona 86430
15
- 16 Morenci Water and Electric Company
P.O. Box 68
Morenci, Arizona 85540
17
- 18 Louis A. Stahl, Esq.
Lisa D. Duran, Esq.
Streich Lang
19 Renaissance One
Two North Central Avenue
20 Phoenix, Arizona 85004-2391
- 21 Beth Ann Burns
Citizens Utilities Co.
22 2901 N. Central Avenue, Suite 1660
Phoenix, Arizona 85012
23
- 24 Bradley S. Carroll
Tucson Electric Power Co.
P.O. Box 711
25 Tucson, Arizona 85702

26
27
28

- 1 Terry Ross, Vice President
Center for Energy and Economic Development
2 7853 East Arapahoe Court, Suite 2600
Englewood, Colorado 80112
- 3
4 Peter Glaser
Doherty, Rumble & Butler, P.A.
1401 New York Avenue, N.W., Suite 1100
5 Washington, DC 20005
- 6 Richard S. Shapiro, Senior Director
Enron Capital & Trade Resources
7 1400 Smith Street, Suite 1405
Houston, Texas 77002
- 8
9 Albert Sterman, Vice President
Arizona Consumer Council
2849 E. 8th Street
10 Tucson, Arizona 85716
- 11 Calpine Power Services Company
50 West San Fernando
12 San Jose, California 95113
- 13 Jack Haenichen
Arizona Department of Commerce
14 3800 North Central Avenue, Suite 1500
Phoenix, Arizona 85012
- 15
16 K. R. Saline & Associates
P.O. Box 30279
Mesa, Arizona 85275
- 17
18 Robert S. Lynch
2001 North Third Street, Suite 204
Phoenix, Arizona 85004-1472
- 19
20 Dan Neidlinger
Neidlinger & Associates, Ltd.
3020 N. 17th Drive
21 Phoenix, Arizona 85015
- 22 Russell E. Jones
O'Connor Cavanagh Molloy Jones
23 One E. Camelback Road, Suite 1100
Phoenix, Arizona 85012-1656
24 Attorneys for Trico Electric Cooperative
- 25
26
27
28

1 John Jay List, General Counsel
National Rural Utilities Cooperative
2 Finance Corporation
2201 Cooperative Way
3 Herndon, Virginia 21071

4 Sue Arnold, Financial Analyst
Program Support and Regulatory Analysis
5 Utilities Service
United States Department of Agriculture
6 1400 Independence Avenue, S.W.
Mail Stop 1522
7 Washington, DC 20250-1522

8 Wallace F. Tillman, Chief Counsel
Susan N. Kelly, Regulatory Counsel
9 National Rural Electric Cooperative Association
4301 Wilson Boulevard
10 Arlington, Virginia 22203-1860
David X. Kolk, Ph.D.
11 Power Resource Managers, L.L.C.
2940 Inland Empire Boulevard, Suite 123
12 Ontario, California 91764

13 Debra S. Jacobson, Manager
State Regulatory Affairs
14 Southwest Gas Corporation
P.O. Box 98510
15 5241 Spring Mountain Road
Las Vegas, Nevada 89193-8510
16

17 Ellen Corkhill
American Association of Retired Persons
5606 N. 17th Street
18 Phoenix, Arizona 85016

19 William D. Baker, Assistant Secretary
Electric District No. 6
20 Pinal County, Arizona
P.O. Box 16450
21 Phoenix, Arizona 85011

22 Sheryl A. Taylor
Ryley, Carlock & Applewhite
23 101 North First Avenue, Suite 2700
Phoenix, Arizona 85003-1973
24

25 Douglas C. Nelson, P.C.
7000 North 16th Street
#120-307
26 Phoenix, Arizona 85020

27
28

1 Nancy Russell
Public Interest Coalition on Energy
2 2025 North 3rd Street, Suite 175
Phoenix, Arizona 85004

3
4 Jessica Youle
Jana D. Alfano
Salt River Project Agricultural
5 Improvement and Power District
P.O. Box 52025, PAB 300
6 Phoenix, Arizona 85072-2025

and
7 John Christian
Glenn Carter
8 Jennings, Strouss & Salmon
One Renaissance Square
9 Two North Central Avenue
Phoenix, Arizona 85004-2393

10
11 Barry N. P. Huddleston
Regional Manager, Regulatory Affairs
Destec Energy, Inc.
12 2500 City West Boulevard, Suite 150
Houston, Texas 77042

13
14 Karen Glennon
19037 North 44th Avenue
Glendale, Arizona 85308

15

16 By Cheryl Fraulob
17 Cheryl Fraulob
Legal Secretary

18

19

20

21

22

23

24

25

26

27

28