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AZ CORP COMMISSION
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January 30, 2009

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Docket Control
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

**Re: AIC's Comments in Docket Numbers: E-00000A-02- 0051
& E-00000A-01-0630**

Dear Sir or Madam:

Enclosed are the original and 15 copies of the Comments of the Arizona Investment Council regarding retail electric competition.

Very truly yours,

Gary M. Yaquinto

Arizona Corporation Commission
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BUILDING ECONOMIC FOUNDATIONS
THROUGH ENERGY, WATER AND
COMMUNICATIONS INFRASTRUCTURE

ARIZONA INVESTMENT

Retail Electric Competition in Arizona

Docket No. E-00000A-02-0051 & E-00000A-01-0630

Comments of Arizona Investment Council

The Arizona Investment Council ("AIC") provides these comments in response to Staff's request for comments regarding retail electric competition in Arizona.

The promise of substantial benefits to consumers of retail electric competition has been greatly exaggerated. In most states where retail electric competition has been attempted, substantial increases in prices for electricity have occurred and service quality has degraded. Moreover, the rate increases have outpaced rate changes in states that continued to impose traditional forms of cost-based regulation.

Many states implementing retail competition chose to freeze rates for consumers during the transition to competition. Once the rate freezes ended, however, providers were able to raise rates to market levels. In states like Pennsylvania, Illinois, Maryland and Texas consumers saw hefty double digit price increases for electricity.

While the transition to competitive telecommunications markets over the past decade was helped by a proliferation of new telecommunications technologies, which lowered costs and provided customer choice, the introduction of competition in electricity markets presented a host of complex economic, safety and service delivery hurdles. Competitive electricity markets require careful and constant government monitoring and intervention.

California's power meltdown in 2001 was a dramatic, cautionary tale of what can go awry.

Based on the poor track record of retail competition to deliver any measurable benefits to almost all consumers, coupled with the myriad complexities which are related to its implementation, the AIC has grave doubts as to whether the public will be well served under the competitive model.

The remainder of AIC's comments are organized according to the topical areas identified by Staff in its e-mail to parties dated January 9, 2009.

1. What are the Potential Risks and Benefits of Retail Electric Competition?

As currently proposed with competitive providers intending only to offer service to select commercial and industrial customers, the chief risks relate to increased financial pressures that face incumbent providers from loss of such higher-load, low service cost customers; the additional costs required to structure and implement another transition to retail competition in Arizona; and whether investors will provide adequate investment in infrastructure if competition is reintroduced under these circumstances. Each risk poses serious consequences for consumers.

For example, generally electric service providers seeking to serve retail loads in Arizona have expressed a desire to serve only large, higher-load factor customers. Obviously, these markets are the cheapest to serve and offer the potential for the largest profits to

new entrants to the retail market. Once these larger customers leave an incumbent provider's system, the utility is left with smaller customers, which are more expensive to serve. As a result, customers remaining on the incumbent's system will face upward price pressures. Moreover, the ability of new entrants to "cherry-pick" the best customers will leave the incumbent providers in a weakened financial state; making it more expensive and difficult for them to access capital markets to make necessary investments in generation, transmission and distribution facilities.

Also, as the Commission is aware, the costs associated with implementing retail competition are substantial. These costs will have to be borne by customers, as well.

A very serious risk of retail competition is that it likely will lead to underinvestment in adequate generation, transmission and distribution facilities and thereby erode grid safety and reliability. Absent the traditional regulatory compact combined with a competitive model effectively aimed at gleaning quality customers from the incumbent, investors will understandably be wary of providing funds to the utility. At the very least, retail competition would have the effect of delaying or distracting companies from investing in renewable generation assets, because they are currently more costly than traditional generation sources. A competitive retail market would place a premium on least-cost generation sources.

2. Is Retail Electric Competition in the Public Interest?

Based upon experience to date, AIC does not believe that retail electric competition is in the broad public interest. Any benefits resulting from retail electric competition should inure to all customers and AIC sees no likelihood of that occurring for the reasons discussed.

3. What About Provider of Last Resort?

As mentioned previously, competitive electric service providers intend to serve the best customers – those that are least costly to serve and provide the best profit potential. These are typically large customers with higher load factors. Obviously, a provider of last resort will be required under these circumstances and, for many customers, will actually be the provider of only resort. Just as assuredly, the costs and planning challenges facing the provider of last resort in this model will be daunting.

4. Are the Commission's Current Rules Adequate?

The Commission's current Rules have to be completely rethought. They are premised on two major assumptions which are no longer operative: (1) the market, not the Commission, will set rates and (2) there will be a vigorous wholesale power market to compete for retail consumers.

5. What About Costs of Competition?

AIC has not prepared an analysis of costs related to implementing retail electric competition. However, based on past experience, such costs are significant. The

Commission should ensure these costs are timely recovered through rates. As discussed, there are other costs of competition as well, including higher rates for most customers, higher risks for and, therefore, higher premiums charged by potential investors and planning and operational costs.

6. Other Issues Related to Competition

AIC again cautions the Commission to proceed very carefully with any reconsideration of retail electric competition. Benefits to date have been illusory for customers in many states that have implemented competition. The Commission should also ask whether a competitive retail market best meets its goals for investment in renewable generating sources, energy efficiency and resource planning or whether these goals are better met under the current regulatory system.