



0000100081

ORIGINAL

STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

30

RECEIVED

2001 NOV 13 P 4: 52

AZ CORP COMMISSION
DOCUMENT CONTROL

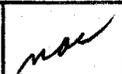
GENERIC PROCEEDING CONCERNING THE ARIZONA INDEPENDENT SCHEDULING
ADMINISTRATOR

DOCKET NO. E-00000A-01-0630

Arizona Corporation Commission

DOCKETED

NOV 13 2001

DOCKETED BY	
-------------	---

NOVEMBER 2001

Copies mailed to the Electric Competition Service List-RE-00000A-01-0630 and the foregoing:

Mr. Pat Sanderson
Post Office Box 6277
Phoenix, Arizona 85005-06277

Mr. Christopher Kempsey, Chief Counsel
Arizona Corporation Commission
Legal Division
1200 West Washington
Phoenix, Arizona 85007

Mr. Ernest G. Johnson, Director
Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Ms. Lyn Farmer, Director
Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTION.....	1
SUMMARY OF INDIVIDUAL COMMENTS.....	6
<u>I. Parties for the continuation of the AISA</u>	6
1. State and discuss the purpose of the AISA.	6
2. State and discuss the necessity of the AISA and whether it contributes (or not) to the development of retail competition.	7
3. State and discuss the functions of the AISA.	7
4. State and discuss the costs of the AISA. (how many employees, what they do on a daily basis, ect.).....	8
5. State and discuss the need to continue the AISA. (if the AISA is terminated, how will independent transmission oversight be managed?).....	8
6. State and discuss the timing and procedures for terminating the AISA. (discuss the legal ramifications of withdrawing funding.)	9
7. State and discuss AISA relationship to and with Desert STAR.	10
8. State and discuss the AISA relationship to and with any regional (multi-state) ISO or RTO that will serve Arizona.	11
9. Address the legal ramifications to the APS and TEP settlement agreements if those utilities are no longer required to support the AISA.	11
10. State and discuss any other relevant/pertinent items/information that you believe the Commission should consider regarding the AISA.....	12
<u>II. Parties indicating that the AISA may not be necessary at this time</u>	12
1. State and discuss the purpose of the AISA.	12
2. State and discuss the necessity of the AISA and whether it contributes (or not) to the development of retail competition.	13
3. State and discuss the functions of the AISA.	14
4. State and discuss the costs of the AISA. (how many employees, what they do on a daily basis, ect.).....	15
5. State and discuss the need to continue the AISA. (if the AISA is terminated, how will independent transmission oversight be managed?).....	17
6. State and discuss the timing and procedures for terminating the AISA. (discuss the legal ramifications of withdrawing funding.)	18
7. State and discuss AISA relationship to and with Desert STAR.	18
8. State and discuss the AISA relationship to and with any regional (multi-state) ISO or RTO that will serve Arizona.	19
9. Address the legal ramifications to the APS and TEP settlement agreements if those utilities are no longer required to support the AISA.	19
10. State and discuss any other relevant/pertinent items/information that you believe the Commission should consider regarding the AISA.....	20
STAFF LEGAL ANALYSIS	22
<u>Introduction</u>	22
<u>Electric Competition Rule 1609</u>	22
<u>Rule 1609 is summarized as follows</u>	22

<u>Stay or Modification of Rule 1609</u>	23
<u>APS Settlement Agreement as Approved by Decision Nos. 61973, 62035</u>	23
<u>TEP Settlement Agreement as Approved in Decision No. 62103</u>	25
<u>FERC Proceedings</u>	26
STAFF ANALYSIS	28
<u>Independence of the AISA</u>	28
<u>Necessity of the AISA</u>	28
<u>Wholesale Market Issues</u>	29
<u>Retail Access</u>	30
STAFF RECOMMENDATIONS	31

**STAFF ANALYSIS AND RECOMMENDATIONS - IN THE MATTER OF THE
GENERIC PROCEEDING CONCERNING THE ARIZONA INDEPENDENT
SCHEDULING ADMINISTRATOR.
DOCKET NO. E-00000A-01-0630**

INTRODUCTION

At the Arizona Corporation Commission's ("Commission") Open Meeting on July 24, 2001, the Commissioners directed the Hearing Division to open a docket concerning the Arizona Independent Scheduling Administrator ("AISA"). On August 3, 2001, a procedural order was issued directing interested parties to file comments on the following issues and questions:

1. State and discuss the purpose of the AISA.
2. State and discuss the necessity of the AISA and whether it contributes (or not) to the development of retail competition.
3. State and discuss the functions of the AISA.
4. State and discuss the cost of the AISA. (How many employees, what do they do on a daily basis, etc.)
5. State and discuss the need to continue the AISA. (If the AISA is terminated, how will independent transmission oversight be managed?)
6. State and discuss the timing and procedures for terminating the AISA. (Discuss the legal ramifications of withdrawing funding)
7. State and discuss the AISA relationship to and with Desert STAR.
8. State and discuss the AISA relationship to and with any regional (multi-state) ISO or RTO that will serve Arizona.
9. Address the legal ramifications to the APS and TEP settlement agreements if those utilities are no longer required to support the AISA.
10. State and discuss any relevant/pertinent items/information that you believe the Commission should consider regarding the AISA.

On September 27, 2001, Staff filed a request for a two-week extension of time to file its comments and recommendations, which was granted.

On September 5, 2001, Arizona Electric Power Cooperative ("AEPSCO"), Citizens Communications Company ("Citizens"), Tucson Electric Power Company ("TEP"), Arizona

Consumer Owned Electric Systems ("ACES")¹, Residential Utility Consumer Office ("RUCO"), APS Energy Services ("APSES"), Arizona Public Service Company ("APS"), Arizona Independent Scheduling Administrator Association ("AISA"), and Arizona Competitive Power Alliance ("AZCPA")² filed comments responding to a procedural order in the above referenced matter. Also on September 5, 2001, Arizonans for Electric Choice in Competition, Phelps Dodge Corporation and ASARCO, Inc., collectively referred to as ("ACEE")³, jointly filed comments responding to a procedural order in the above-referenced matter.

This report provides an executive summary of parties' comments, summary of comments by individual question and a staff analysis and recommendations section. The executive summary and comments by individual question, divide the parties based on the parties' positions on whether the AISA should continue.

¹ ACES is comprised of consumer-owned electric systems that are engaged in wholesale electric utility operations that serve end-use loads in the state of Arizona. ACES members are not subject to the Commission's jurisdiction. Member of the ACES include the following: Aguila Irrigation District; Ak-Chin Indian Community Utility Authority; Arizona Power Authority; Buckeye Conservation & Drainage District; Central Arizona Water Conservation District; Electrical District No. 1, Pinal County; Electrical District 2, Pinal County; Electrical District 3, Pinal County; Electrical District No. 6, Pinal County; Electrical District No. 7, Maricopa County; Electrical District No. 8, Maricopa County; Harquahala Valley Power District, Maricopa County Municipal Water Conservation, District No. 1; McMullen Valley Water Conservation & Drainage District, City of Mesa; Roosevelt Irrigation District, Town of Thatcher and Tonopah Irrigation District.

² AZCPA is a coalition in favor of electric competition. Members include the following: Allegheny Energy Supply, Duke Energy North America, LLC, Gila Partners, Mirant Americas, Inc., Panda Energy International, Inc., Teco Power Services Corporation, PG&E National Energy Group, PPL Montana, LLC, Reliant Energy, Semptra Energy Resources and Southwestern Power Group II, LLC.

³ ACEE is a coalition of energy consumers in favor of electric competition. Members include Amigos, Arizona Association of Industries, Arizona Retailers Association, Arizona Rock Products Association, Arizona School Boards Association, ASARCO, Boeing, Chemical Lime Company, Hickman's Egg Ranch, Homebuilders Association of Central Arizona, Honeywell, Intel Corporation, Leisure World Community Association, Lockheed Martin, Motorola, On Semiconductor and Phelps Dodge.

EXECUTIVE SUMMARY OF PARTIES' COMMENTS

APSES, AISA, AZCPA, AECC and RUCO support the continuation of the AISA. ACES, Citizens, TEP, APS and AEPCO indicate that it is not necessary to continue the AISA at this time.

Comments regarding the necessity of the AISA vary. Parties supporting the continuation of the AISA comment that retail access cannot exist without nondiscriminatory access to the transmission system. Without the AISA, retail markets in Arizona are unlikely to progress. As wholesale prices decline, customers will look to alternative suppliers. AISA further comments that it is unlikely that the FERC would allow the functions of the AISA under the Protocols Manual to be transferred to the FERC jurisdictional transmission providers. Although the Protocols are complete and have been approved by FERC, changes to the Protocols are inevitable as markets change. For example, a temporary retail transmission allocation mechanism is set to expire on December 15, 2001. AZCPA further comments that even if a RTO were to be established, the AISA may still be needed to address retail access issues. In addition, the Capitol Electric Competition Rules and several utility settlements embrace a competitive bidding process for the generation portion of standard offer service that is scheduled to commence before January 2003. Dissolving the AISA sends the wrong message when thousands of megawatts are being constructed in the state. It could be perceived as a step backward for electric competition and nondiscriminatory access to the transmission system. RUCO commented that under-developed markets will not fully utilize the AISA's services.

Parties indicating that it is not necessary to continue the AISA comment that the AISA has performed one of its preliminary functions in implementing a set of operating Protocols. The Protocols have been made a part of the Affected Utilities Federal Energy Regulatory Commission ("FERC")-approved Open Access Transmission Tariffs ("OATTs"), which will ensure that the Protocols will be used whether the AISA remains in existence or not. The AISA's role in dispute resolution is unnecessary until retail competition becomes active in Arizona. ACES further comments that the current crisis facing the western region and the shopping credits embodied in the stranded cost settlements have eliminated the possibility of viable retail competition. AEPCO further comments that competition will not occur until well into the future due to the current market cost of energy and the Competition Transition Charges ("CTC") for APS and TEP.

All parties generally agree that the purpose of the AISA is to provide nondiscriminatory transmission access on an interim basis until an RTO becomes functional. Parties indicated that Commission rule A.A.C. R14-2-1609, describes the intended functions of the AISA. These functions are: calculating Available Transmission Capacity ("ATC"), developing an over reaching statewide Open Access Same-Time Information System ("OASIS"), implementing and overseeing the nondiscriminatory application of operating protocol to ensure statewide consistency for transmission access, providing a dispute resolution process, standardizing scheduling procedures, and implementing a transmission planning process. Generally, all parties

indicate that the current focus of the AISA is the Protocols Manual and dispute resolution procedures.

AEPCO and ACES further comment that Commission's Electric Competition Rules expanded the original purpose of the AISA. AEPCO comments that some utilities felt it would be helpful to include stakeholders in the discussions and negotiations between parties, which led to modifications in the AISA's governing documents. The Commission's Reliability and Safety Workgroup became part of the process and ultimately displaced the original organization in drafting the Protocols. AEPCO further comments that interest groups lobbied Commission Staff, which resulted in Commission rule 1609 (D), which requires certain utilities to form the AISA. ACES further comments that, the Commission's Electric Competition Rules expanded the purpose of the AISA, even though the Commission lacked jurisdiction over the majority of the AISA members. In addition, ACES comments that other stakeholders, including the Commission Staff, attempted to fundamentally alter the existing norms of transmission service. This action caused Salt River Project and the Western Area Power Administration to withdraw from the AISA.

The comments regarding the function of the AISA varied among parties. Parties indicating that it is not necessary to continue the AISA comment that the function of the AISA are limited to the billing and collection of funds from AISA participants and participating in board meetings. The AISA is not calculating ATC, providing dispute resolution, or receiving requests for scheduling and use of transmission facilities. In addition, the implementation of the transmission planning process is being under taken by the Affected Utilities and others through a joint planning process of various transmission planning studies.

The comments regarding the cost of the AISA also varied among parties. Calculations of the impact of the AISA's cost to ratepayers varied from 1.08 cents per month in June 2001, to 1.1 cents per month in July 2001. The parties indicating that it is not necessary to continue the AISA, comment that the AISA continues to incur large legal expenses. APS further comments than the existence of the AISA is less of an issue than its continued level of cost.

In addition, the comments regarding the termination of the AISA varied. Parties for the continuation of the AISA, comment that the AISA Bylaws indicate that the AISA will continue until a RTO becomes operational. The AISA further comments that the termination of the AISA would require a demonstration that it is in the public interest to do so. In addition, it would have to be demonstrated that termination is consistent with the terms of the service agreements on file with FERC.

The parties indicating that it is not necessary to continue the AISA, comment that the provisions for winding up the AISA were included in the FERC Section 205 filings made by the Affected Utilities. In addition, there are no material legal or financial impediments to the AISA winding up its affairs within a three-month period.

Generally, all parties agree that the AISA's relationship to Desert Southwest Transmission and Reliability Operator ("Desert STAR") is limited in that the AISA acts as an interim organization until Desert STAR becomes operational. AZCPA comments that Desert STAR is focusing on wholesale access only; therefore, the AISA should provide retail functions even after Desert STAR is in place. The AISA comments that the AISA's implementation plans call for a review of the formation of an RTO in a determination whether to transition into the second stage of AISA implementation.

Comments regarding no longer requiring APS and TEP to support the AISA and the legal ramifications to their settlements also vary. Parties for the continuation of the AISA, comment that the support of the AISA and subsequent RTO is an integral part of the APS and TEP agreements. AECC further comments that that the settlement agreements contain provisions that any future Commission action shall be administered in a manner that does not conflict with provisions of the settlement agreements. In addition, if the settlement agreements are inconsistent with provisions of future ratemaking, the parties are obligated to seek a waiver from those provisions. TEP and APS indicate that they have complied with the provisions of the settlement agreements by providing funding to the AISA and incorporating the AISA Protocols Manual into their OATTs. ACES further comments that it is concerned that the APS and TEP settlements have jeopardized the independence of the AISA. ACES further comments that any legal ramifications should not be the responsibility of the retail or wholesale consumers who were not part of the settlement.

Comments regarding any other relevant information that the Commission should consider also vary. The AISA comments that the AISA is valuable because the time frame for the implementation of an RTO is uncertain. In addition, when market conditions become more favorable to competitive suppliers, market participants need the continued independence of the AISA and the support of the Commission's retail competition program when deciding whether to commit resources to Arizona's market. AECC comments that it is concerned that there are several problems associated with terminating the AISA and allowing the transmission owners to administer the transmission Protocols. Self-administration is flawed due to conflicts of interest among utilities. FERC has sent a clear message that transmission Protocols must be overseen by an independent organization.

The parties indicating that it is not necessary to continue the AISA, comment that without a significant number of direct access customers the existence of the AISA does not make economic sense and the AISA should be terminated. AEPCO expresses concern that the ratepayers are currently paying for a organization that does not add any value to the services they receive. AEPCO also comments that, early on, SRP experienced a few retail transactions on its system and successfully managed and made available the required competitive transactions without AISA participation. Citizens and TEP comment that further expenditures to fund the AISA could be better spent on efforts to relieve transmission constraints and to identify locations for generation that would mitigate the need for new transmission lines.

SUMMARY OF INDIVIDUAL COMMENTS

I. Parties for the continuation of the AISA

APS Energy Services ("APSES")

APSES comments that it will not address all of the questions raised by the Commission. APSES supports the AISA, but wants a full RTO to be formed in order to sustain meaningful choice for customers. APSES further comments that it would like to discuss a critical feature of the Protocols Manual that must be retained to ensure the potential for direct access. APSES believes that the "common path" allocation of transmission path capacity is critical to an ESP being able to provide direct access. The common path allocation allows an ESP to purchase wholesale generation and, using a single transmission path, transmit the power directly to the competitively served load. This common path allocation replaced the prior interim proposal of a pro rata allocation of transmission path capacity. Pro rata allocation requires an ESP to use several paths to serve its customers and places unreasonable limitations on the ESP who would then have to purchase "pancaked" transmission services. This puts the ESP at a disadvantage because the incumbent providers are not subject to this condition.

1. State and discuss the purpose of the AISA.

Arizona Independent Scheduling Administrator ("AISA")

AISA Comments that the purpose of the AISA is to facilitate the development of competitive retail electric markets by providing independent oversight for the statewide Protocols Manual and provide an open forum for evolving toward greater retail access and eventually a RTO. The Commission adopted A.A.C R14-2-1609, which supports the formation of the AISA.

Arizona Competitive Power Alliance ("AZCPA")

AZCPA comments that the AISA's purpose is to ensure non-discriminatory retail transmission access in a competitive environment on an interim basis until the Desert STAR becomes operational. The nondiscriminatory access is obtained by having a board of stakeholders. The AZCPA indicates that it is committed to ensuring that the board operates effectively in the future.

Arizonans for Electric Choice and Competition, Phelps Dodge Corporation and ASARCO, Inc. ("AECC")

AECC comments that the purpose of the AISA is to facilitate open, nondiscriminatory transmission access until a RTO, such as Desert STAR becomes operational. Absent the AISA, there are no rules or Protocols in place to address transmission access needs associated with the implementation of retail electric competition.

Residential Utility Consumers Office ("RUCO")

RUCO comments that the purpose of the AISA is to facilitate open, non-discriminatory transmission access to support retail competition.

2. State and discuss the necessity of the AISA and whether it contributes (or not) to the development of retail competition.

AISA

The AISA comments that there is a need for uniformity of rules and regulations to operate and provide oversight of transmission access. The AISA is a necessary component of the competitive market. If wholesale prices continue to trend downward, customers will look to alternative suppliers. Without the AISA, the retail markets in Arizona are unlikely to make any progress.

AZCPA

AZCPA comments that retail access cannot exist without non-discriminatory transmission access, which is to be provided by the AISA as reflected in A.A.C. R14-2-1609. Even if an RTO is established to run the transmission system, the AISA may still be needed to address retail access issues.

AECC

AECC comments that the AISA is necessary as long as Arizona customers have a right to retail access and an RTO is not yet operational. Fair and efficient access to transmission, a robust wholesale market and a rational unbundled pricing scheme are necessary in order to have competition. The AISA is concerned with the fair and efficient access to transmission. State regulators can offer incentives to improve the performance of wholesale markets through incentives for construction of new generation, efficient consideration of transmission siting requests and by allowing utilities that provide standard offer service greater flexibility in procuring resources. The unbundled pricing structure was established in the APS and TEP settlements. As wholesale prices decline, the interest in direct access will return. The APS unbundled pricing structure will become more rational as wholesale prices drop because the CTC will better align with previous forecasts and become less of an impediment to competition.

RUCO

RUCO comments that competitive markets drive the demand for the AISA. Underdeveloped markets will not fully utilize the AISA's services.

3. State and discuss the functions of the AISA.

AISA

AISA comments that the Commission's competition rules describe five functions that the AISA would be required to perform. They are: calculating Available Transmission Capacity, developing an over arching statewide OASIS, implementing and overseeing the nondiscriminatory application of operating protocols to ensure statewide consistency for transmission access, providing a dispute resolution process, standardizing scheduling procedures, and implementing a transmission planning process. The AISA is currently focusing on the implementation of the Protocols Manual and dispute resolution.

AZCPA

AZCPA comments on the same functions of the AISA as stated above. During the transition to competition, many of these functions are dormant. The AISA is currently focusing on the implementation of the Protocol Manual and dispute resolution procedures.

AECC

The electric competition rules denote a number of specific functions of the AISA. At the current time the AISA has limited its functions to those that are central to its role in facilitating nondiscriminatory transmission access for retail access. These functions include the implementation of the Protocols Manual and provision of dispute resolution.

RUCO

RUCO comments that the AISA must perform the functions set forth in A.A.C. R14-2-1609.

4. State and discuss the costs of the AISA. (how many employees, what they do on a daily basis, ect.)

AISA

AISA comments that the annual operating costs are \$408,000 for the partial implementation of Phase I of its implementation plan, which include the provision of dispute resolution services and the limited oversight of the Protocols Manual. Actual operating costs for June 2001, were \$36,376.12. A household using 1000 kWh per month for the month of June would see an increase of 1.08 cents in its electric bill. Full implementation of Phase I would require additional staff members and minor infrastructure additions such as office equipment. The estimated cost for full implementation of Phase I is \$259,000. The cost to a household using 1000 kWh would be 1.71 cents per 1000 kWh.

AZCPA

AZCPA comments that, at its current level, the AISA costs approximately \$500,000 annually. The cost is reasonable and necessary to bring about open access to the transmission system.

AECC

The AISA costs \$400,000 per year, or a little more than one penny per megawatt hour.

RUCO

RUCO comments that the costs are on record with the AISA.

5. State and discuss the need to continue the AISA. (if the AISA is terminated, how will independent transmission oversight be managed?)

AISA

The AISA comments that independent oversight of the Protocol Manual and alternative dispute resolution functions of the AISA were considered necessary by the stakeholder groups. It is unlikely that the FERC would allow the functions of the AISA under the Protocols Manual to be transferred to the FERC jurisdictional transmission providers. Although the Protocols are complete and have been approved by FERC, changes to the Protocols are inevitable as markets change. For example, a temporary retail transmission allocation mechanism is set to expire on December 15, 2001. This issue will have to be revisited. Without the AISA, those kinds of required updates may not occur.

AZCPA

The AZCPA discusses six reasons why it is necessary to continue the AISA. First, the AISA is the appropriate entity to solve disputes or questions of interpretation because it is an independent entity, specifically trained for that purpose. AZCPA indicates that a possible dispute could occur due to the competition for limited transmission at Palo Verde, which will require a non-partial independent board to resolve the dispute. Second, the AISA provides a forum for stakeholder members to discuss issues that would reduce the opportunity for misunderstandings. Third, FERC may not accept existing AISA Protocols if the AISA does not continue to exist. Fourth, it is best for the AISA to continue until DSTAR or some other RTO serving the southwest provides the required functionality and becomes operational. Discontinuing and then recreating the AISA would be difficult. Fifth, dissolving the AISA sends the wrong message when thousands of megawatts are being constructed in the state. It could be perceived as a step backward for electric competition and nondiscriminatory access to the transmission system. Sixth, retail electric competition can rebound quickly as generators are constructing thousands of megawatts and are in discussion with retailers, utilities and others. The upcoming completion of stranded cost recovery in some portions of the state will help revive the market. In addition, the rules and several utility settlements embrace a competitive bidding process for the generation portion of standard offer service that is scheduled to commence before January 2003.

AECC

AECC comments that if the AISA is terminated there will be a lack of oversight until an RTO is operational in 2003 or later. The AISA is necessary if Arizona customers have the right to retail access and an RTO is not yet operational. AECC argues that the work of the AISA is not yet completed and the Protocols Manual, which has been approved by FERC, will need to be adjusted. For instance the interim allocation of retail transmission will expire in December 2001 and it is important that this interim allocation be extended.

RUCO

RUCO comments that the development of the competitive market is uncertain. In the meantime regulatory oversight might be manageable under the incumbent utilities OATTs.

6. State and discuss the timing and procedures for terminating the AISA. (discuss the legal ramifications of withdrawing funding.)

AISA

AISA comments that a demonstration that it is in the public interest to terminate the AISA must take place prior to its termination. In addition, it would have to be demonstrated that termination is consistent with the terms of the service agreements on file with FERC. Each agreement contains specific provisions governing termination.

AZCPA

AZCPA comments that the AISA bylaws state that the AISA will exist until a regional independent system operator, currently known as Desert STAR, becomes operational. Desert STAR, as currently envisioned, is primarily responsible for facilitating wholesale access to transmission and is not currently focusing on retail access. Therefore, the Commission may want to evaluate whether Desert STAR is capable of providing retail functions. The AISA should provide retail access functions even after Desert STAR is in place.

AECC

AECC comments that the AISA should be terminated when an RTO becomes operational. The AISA should monitor the development of an RTO and plan to transfer its responsibilities when an RTO becomes operational.

RUCO

RUCO defers to the comments of the AISA.

7. State and discuss AISA relationship to and with Desert STAR.

AISA.

AISA comments on question Nos. 7 and 8 together. AISA comments that Commission rule 1609 requires the Affected Utilities to develop a regional multi-state independent ISO to which the AISA should transfer its relevant assets and functions when it becomes operational. The AISA implementation plan calls for the review of any plans by Desert STAR for the formation of an RTO. The AISA would make a determination whether to undertake the transition to second stage implementation depending upon Desert STAR's schedule for implementation. Currently, the AISA's functions are limited to oversight of the compliance to the Protocols Manual.

AZCPA

AZCPA comments that the AISA is a precursor to Desert STAR, but Desert STAR is not focusing on the retail issues handled by the AISA. Even with Desert STAR in place, AISA may be necessary to help the retail market develop.

ACEE

ACEE references its response to question No. 8 below.

RUCO

RUCO comments that Desert STAR's function as an RTO would supercede all functions of the AISA.

8. State and discuss the AISA relationship to and with any regional (multi-state) ISO or RTO that will serve Arizona.

AZCPA

AZCPA references its answers to question No. 6 and 7 above.

AECC

AECC comments on question Nos. 8 and 9 together. According to the AISA's bylaws, the only relationship between the AISA and Desert STAR is that the AISA will cease operations when Desert STAR becomes operational. The AISA is the only entity with approval from FERC to perform independent oversight of the transmission system until such a time that an RTO becomes operational. AECC further comments that the parties involved in the AISA are also involved with Desert STAR.

RUCO

RUCO refers to its answer to question No. 7.

9. Address the legal ramifications to the APS and TEP settlement agreements if those utilities are no longer required to support the AISA.

AISA

AISA comments that it wishes to defer this issue to the parties that participated in the settlements.

AZCPA

AZCPA comments that support of the AISA and subsequent RTO is an integral component of the APS and TEP settlement agreements. If the Commission selectively approves a change to the AISA, it may open the door for additional requests from utilities or other parties. The agreements were intended to balance the interests of many parties and are intended to remain in place despite developments that are not preferable to any one party.

AECC

AECC comments that the settlements and A.A.C. R14-2-1609 require APS and TEP to support the formation of the AISA. AECC further comments that the settlement agreements contain provisions that any future Commission action, shall be administered in a manner that does not conflict with provisions of the settlement agreements. In addition, if the settlement agreements are inconsistent with provisions of future ratemaking, the parties are obligated to seek a waiver from that provision (TEP settlement section, 14.3 and APS settlement 7.1)

RUCO

RUCO comments that the APS and TEP settlements would be unaffected.

10. State and discuss any other relevant/pertinent items/information that you believe the Commission should consider regarding the AISA.

AISA

AISA comments that the AISA is valuable because there is uncertainty surrounding the start-up of Desert STAR. The most recent date for the start-up of Desert STAR is late 2003. This date had previously been pushed back on several occasions. In addition, FERC has mentioned a potential platform for a Western RTO, which makes estimating the timeframe for the implementation of an RTO difficult. In addition, Phase I functions are more limited than many non-transmission provider market participants wanted. However, the Commission and those market participants acknowledge that a phased implementation would satisfy current market needs. When market conditions become more favorable to competitive suppliers, market participants need the continued independence of the AISA and the support of the Commission's retail competition program when deciding whether to commit resources to Arizona's market.

AZCPA

AZCPA comments that Arizona is benefiting from electric restructuring through lower electric rates and investments in generation. The organizational structure that exists in the form of the AISA, will be needed to ensure that Arizonans can take advantage of those benefits.

AECC

AECC comments that there are several problems associated with terminating the AISA and allowing the transmission owners to administer the transmission Protocols. Self-administration is flawed due to conflicts of interest among utilities. FERC has sent a clear message that transmission Protocols must be overseen by an independent organization. The AISA is the only vehicle for making necessary adjustments on a going-forward basis.

RUCO

RUCO comments that the mechanisms for establishing a competitive electricity market can be found in several publications. They include the following publications: Western Governor's Association, WGA Policy Resolution No. 01-01, *Western States Energy Policy Roadmap* (August 14, 2001); Western Governor's Association, *Conceptual Plans for Electricity Transmission in the West, Report to the Western Governors Association* (August 2001). These documents are available at www.westgov.org.

II. Parties indicating that the AISA may not be necessary at this time

1. State and discuss the purpose of the AISA.

Arizona Consumer-Owned Electric Systems, ("ACES")

ACES comments that according to the AISA By-Laws, the purpose of the AISA was to provide independent oversight of the transmission system in Arizona. The Commission's

electric competition rules expanded the purpose of the AISA, even though the Commission lacked jurisdiction over the majority of the AISA members. The Affected Utilities and other stakeholders, including Commission Staff, attempted to fundamentally alter the existing norms of transmission service. This action caused Salt River Project and the Western Area Power Administration to withdraw from the AISA. The AISA lacks widespread acceptance and is not in a position to accomplish the goals set in the AISA bylaws and the electric competition rules.

Citizens Communications Company ("Citizens")

Citizens comments that the purpose of the AISA is to promote non-discriminatory access to transmission and distribution facilities. Specifically the AISA was directed to perform the following functions in the electric competition rules: calculate Available Transmission Capacity, implement and oversee nondiscriminatory application of operating Protocols, provide dispute resolution to market participants, process all reservation and scheduling and implement a transmission planning process.

Tucson Electric Power ("TEP")

TEP comments on the purpose of the AISA, as stated above. TEP further comments, that the AISA's role is contingent upon a vibrant competitive retail market.

Arizona Public Service ("APS")

APS comments that the AISA was to facilitate the development and approval of direct access Protocols to allow the scheduling coordinators fair and comparable treatment, which has been accomplished. The AISA would also provide transmission related dispute resolution to transmission owning utilities and ESPs.

Arizona Electric Power Cooperative ("AEPCO")

AEPCO comments that the original purpose was to facilitate retail electric competition by assisting in the delivery of non-discriminatory transmission access. The AISA was to act as an auditor to monitor the retail transactions on the OASIS with Protocols developed by transmission utilities with 24-hour dispute resolution. AEPCO further comments that some utilities felt it would be helpful to include stakeholders in the discussions and negotiations between parties, which led to modifications in the AISA's governing documents. The Commission's Reliability and Safety Workgroup became part of the process and ultimately displaced the original organization in drafting the Protocols. Interest groups lobbied Commission Staff, which resulted in Commission rule 1609 (D), which requires certain utilities to form the AISA.

2. State and discuss the necessity of the AISA and whether it contributes (or not) to the development of retail competition.

ACES

ACES comments that the AISA has not enhanced the competitive electric industry. The current energy crisis facing the western region together with the shopping credits embodied within the stranded cost settlements have eliminated the possibility of viable retail competition.

The AISA will only add additional costs and scheduling complexities to Arizona's electric supply industry.

Citizens

Citizens comments that the AISA has served a valuable function in facilitating the development of operating Protocols. The Protocols are the basic rules for nondiscriminatory access to transmission facilities. They were approved by the FERC and certain utilities have incorporated them into their OATT or intend to in the future. Incorporating the operating Protocols into the utilities OATT ensures that the Protocols will be used whether the AISA exists or not.

TEP

TEP comments that the AISA has implemented a set of operating Protocols that are conducive to the development of retail electric competition. The Protocols were adopted by the Affected Utilities and incorporated into their FERC OATT's, which will ensure that the Affected Utilities will follow the Protocols independent of the AISA. TEP further comments that the Commission's determination of the necessity of the AISA will be influenced by the evaluation of the viability of retail electric competition.

APS

APS comments that the AISA has already performed one of its preliminary roles in implementing direct access Protocols in the development of retail electric competition. If the AISA ceased to exist, the Affected Utilities should commit to keeping or including the AISA Protocols in their OATTs until the formation of an RTO. The AISA's role in dispute resolution is unnecessary until retail competition becomes active within the Affected Utilities service areas.

AEPCO

AEPCO comments that the AISA is not required to operate a transmission system that accommodates retail competition and that it does not contribute to retail competition. AEPCO further comments that FERC already requires transmission utilities to provide open access on a wholesale level. FERC has already set up a dispute resolution process that can be consulted through a telephone hotline or a full evidentiary hearing process. Viable retail competition in Arizona has not occurred and it will be well into the future before this changes due to the current market cost of energy and the CTC charges for APS and TEP. The CTC charge for APS and TEP will last until 2004 and 2008 respectively.

3. State and discuss the functions of the AISA.

ACES

ACES comments that the functions of the AISA are set forth in the Protocol Manual, which has been approved by FERC. The AISA has delegated those functions back to the transmission providers for implementation. The scheduling coordinators for APS and TEP are the only entities currently taking service. Currently, the transmission owners instead of an independent body are providing the oversight. A lack of independent oversight threatens

competition. The calculation of energy imbalance services is one area that lacks independent regulation and there is no incentive to ensure that a transmission provider and its affiliates will not deal with one another in a self-serving manner. At some point, the Commission will need to confront attempts by the transmission provider to recover these energy imbalance charges from the end use customers.

Citizens

Citizens comments that currently there are no customers taking competitive service in an Affected Utilities service area. Therefore, there is no need for competitive capacity reservations to be scheduled, no disputes to be resolved and no need for a statewide OASIS. The necessity of the AISA to implement a transmission planning process is reduced by current efforts of coordinated transmission planning. Coordinated planning of transmission facilities is occurring through the Southeastern Arizona Transmission Study, the Central Arizona Transmission Study, the Commission's Biennial Transmission Assessment and future 10-year plans.

TEP

TEP comments that at the current time the AISA's functions are limited to sending out invoices, receiving payments and repaying loans to the Affected Utilities. The AISA is not calculating ATC, providing dispute resolution, or receiving requests for scheduling and use of transmission facilities. In addition, the implementation of the transmission planning process is being under taken by the Affected Utilities and others through a joint planning process of various transmission planning studies.

APS

APS comments that the AISA currently bills and collects assessments from AISA participants to fund its operations. The AISA also participates in various FERC matters. Its role in developing direct access Protocols has been accomplished and its role in dispute resolution procedures is currently unnecessary.

AEPCO

AEPCO comments that the AISA performs no function because there is no retail competition, retail transmission usage or transmission disputes. Currently, the only function of the AISA is to conduct board meetings and send out bills to recover its expenses.

4. State and discuss the costs of the AISA. (how many employees, what they do on a daily basis, ect.)

ACES

ACES comments that the current cost of the AISA does not reflect the true cost to that which will eventually be incurred if the AISA is ever to staff up to administer the Protocols. The events in California demonstrate that effective monitoring of the implementation of retail competition requires extensive staffing and procedures to ensure the protection of retail consumers from the exercise of market power. This is a great concern in Arizona where divestiture of generation and other utility functions by transmission providers involve transfers to

their affiliates and not independent third parties. The AISA is currently faced with large legal expenses associated with its FERC filings, compliance filings and appeals that are in part due to a disagreement between the Commission and FERC over who will regulate transmission at retail. The Commission should ask itself if retail competition would be served by incurring costs arising from such jurisdictional disputes.

Citizens

Citizens comments that APS, AEPCO, SRP and TEP provided funding in the amount of \$1.2 million to establish the organization, conduct hiring and obtain office space. The funds were provided in the form of loans to be paid back after the AISA began to receive revenue from customers taking service under its tariff. Currently money to pay back those loans is coming from retail Standard Offer customers of Affected Utilities who are not receiving any useful services from the AISA. Additional reimbursable funding is being provided by TEP and APS. According to the June 2001 budget report, the AISA has \$174,000 in assets, \$1,353,000 in liabilities, and \$50,000 in operating expenses. For 2001, the AISA expects to spend \$638,000 with an income of \$562,000. In the past, an insufficient number of board members have attended the meetings, which has prevented business from being conducted. The AISA continues to incur additional expenses associated with FERC despite the fact that its tariff has already been accepted at FERC.

TEP

TEP comments that as of September 2001, the AISA was indebted to SRP, AEPCO, Citizens, and TEP in the amount of \$1.7 million for operational and organizational costs to establish and operate the AISA. Additional funding for operations was provided by APS and TEP that was not part of the loan arrangement. The AISA's June 2001 balance sheet reflects \$174,000 assets, \$1,253,000 liabilities and \$42,000 in operating expenses. It is estimated that for 2001, the AISA will spend \$647,00 and generate an income of \$571,000. The AISA's average cost per MWh in July was 1.1 cents.

APS

APS comments that there are two employees, an Acting Executive Director and an Administrative Assistant. They have combined salaries including benefits of \$200,000. Legal fees account for \$200,000, D&O insurance accounts for \$47,000, office expenses account for \$36,000 and travel and entertainment expenses are \$12,000. APS has no knowledge of what the AISA's employees do on a daily basis or why it is incurring such legal fees.

AEPCO

AEPCO comments that to date the AISA has a cost of \$857,878. It projects revenues of \$201,258 for August 2001. Monthly expenses for July 2001 were \$64,461. The AISA has two employees, the Acting Executive Director and an Office Manager. The AISA must pay for the following monthly expenses: rent, legal costs of FERC and local counsel, accounting and bookkeeping services, office expenses, E&O insurance, and other expenses such as lunches at board meetings and the cost of conference calls. Some AISA directors are concerned about the legal costs of the AISA, which they believe to be exceptionally high in light of the lack of AISA

business activity. AEPCO further comments that the AISA staff determines the AISA monthly operating costs, processes bills to be sent out to APS and TEP, and calculates the AISA monthly payments to APS and TEP for payment of start-up loans advanced by them.

5. State and discuss the need to continue the AISA. (if the AISA is terminated, how will independent transmission oversight be managed?)

ACES

ACES comments that the AISA is not expected to provide any independent transmission oversight. It is highly unlikely that the AISA will be called upon to be the regulator of independent transmission service. The FERC OATT is a federally supervised mechanism to implement the transmission function of establishing a restructured competitive electric industry. There is no need to continue with the AISA. The Commission should require transmission providers to restore their OATTs and rely on the existing procedures with whatever adjustments may be necessary to extend the OATTs to retail service.

Citizens

Citizens comments that there is no need for the AISA to continue. Retail transmission access and dispute resolution procedures are provided for under the utilities OATTs in schedule, Retail Network Integration Service.

TEP

TEP comments that the AISA has served a useful purpose in setting Protocols that provide for nondiscriminatory access and dispute resolution procedures that have been incorporated into the Affected Utilities OATTs. However, until a more competitive market develops the functions of the AISA can be accomplished by the Affected Utilities.

APS

If the AISA was terminated prior to an RTO being formed, and the utilities retained the AISA Protocols in their OATTs, then FERC would have the responsibility of oversight of the Protocols and transmission related disputes.

AEPCO

AEPCO comments that there is no need for the AISA. Unstable energy markets and CTC costs strongly indicate that it will be a number of months and possibly years before Arizona sees substantive competitive retail activity. AEPCO further comments that once a competitive marketplace materializes and transmission access is needed, the Protocols approved by the AISA and FERC in APS' and TEP's OATTs, will continue regardless of the status of the AISA. Federal and state rules are in place to govern retail transmission without the AISA. FERC Rule 888 requires transmission utilities to provide open access. In addition, A.A.C. R14-2-1609 (A), also requires open access to transmission facilities

6. State and discuss the timing and procedures for terminating the AISA. (discuss the legal ramifications of withdrawing funding.)

ACES

ACES comments that the drafters of the agreements that the AISA has entered into with transmission providers intended to ensure that either party would not be encumbered with arrangements that they could not escape from. There are no material or legal or financial impediment to the AISA winding up its affairs within a three-month period.

Citizens

Citizens comments that the provisions for winding up the AISA were included in its 205 compliance filing at FERC. Two of the Affected Utilities, APS and TEP have signed the AISA-TP Agreement. If the Commission were to allow the Affected Utilities to cease funding the AISA, the winding up process could begin. Funds provided to the AISA by the utilities could be recovered through a future rate case with the exception of SRP.

TEP

TEP comments that the provisions for winding up the AISA were included in FERC Section 205 filing made by the Affected Utilities who signed the AISA-Transmission Provider Agreement ("TP Agreement"). TEP believes that the AISA-TP agreement can provide guidance on how the AISA could be terminated.

AEPCO

AEPCO comments that the AISA should be terminated. The AISA was designed to be short lived with a limited purpose. From a corporate standpoint, the procedures set forth in Title 10 of the Arizona Revised Statutes would apply. From a regulatory standpoint, the AISA should be terminated. The AISA is not necessary to develop retail competition and its functions are covered in the Affected Utilities OATTs. AEPCO further comments that the Commission could issue an order in this docket that concludes that the utilities have complied with their responsibilities. All requirements regarding the AISA in Commission Rule 14-2-1609 (D)(E)(I)(J) have been met. The Commission also could issue a waiver in this docket, which would waive any further requirements on Affected Utilities concerning the AISA. In addition, the Commission could commence a rulemaking proceeding to amend R14-2-1609 by repealing (D) and (E) and deleting the reference to the AISA in R14-2-1609 (C), (F), (G), (H), (I) and (J).

7. State and discuss AISA relationship to and with Desert STAR.

ACES

ACES comments that the AISA has no formal relationship with Desert STAR. It was envisioned to be an interim organization until an RTO was formed.

Citizens

Citizens comments on same relationship as stated above. Citizens further comments that Desert STAR has not identified processes that addresses deliveries to retail customers. When

deliveries of competitive energy occur, these transactions will be covered by the Affected Utilities unbundled tariffs filed at the Commission and their OATT rates filed at FERC.

TEP

TEP comments that the only connection between Desert STAR is that they have some of the same attendees at their meetings. Once Desert STAR becomes operational, the AISA will wind up its operations.

APS

APS also comments on a lack of a direct relationship. APS further comments that the AISA has been intended to be a statewide interim organization. The purpose of the organization and functions of the AISA are significantly different from those being considered by Desert STAR.

AEPCO

AEPCO also comments that there is no formal relationship between the AISA and Desert STAR. APS further comments that the AISA was intended to facilitate retail competition until an RTO was formed. Operationally, AISA and Desert STAR are in the same place. The AISA has a FERC tariff and no retail transactions. Desert STAR is close to filing for FERC approval of its tariff and Desert STAR participants have numerous wholesale transactions.

8. State and discuss the AISA relationship to and with any regional (multi-state) ISO or RTO that will serve Arizona.

ACES

ACES comments that the AISA has no relationship with any regional ISO or RTO. AISA lacks the expertise and credibility to develop such relationships.

Citizens

Citizens and TEP comment that the AISA has no current or prospective relationship with any multi-state RTO/ISO. It appears that FERC is advocating a single RTO for the Western Interconnection. Citizens further comments that a single RTO would take up a larger geographic area and exacerbate the problems with a multi-state organization.

AEPCO

AEPCO comments that the SW Transco is unaware of any AISA involvement with any regional or state ISO other than Desert STAR.

9. Address the legal ramifications to the APS and TEP settlement agreements if those utilities are no longer required to support the AISA.

ACES

ACES comments that it is concerned that the APS and TEP settlements have jeopardized the independence of the AISA. Any legal ramifications should not be the responsibility of the retail or wholesale consumers who were not part of the settlement.

Citizens

Citizens has no comment.

TEP

TEP comments that it has complied with the provisions of its settlement agreement. TEP has actively supported and aided in the formation of the AISA. In addition, TEP has partially funded the AISA. TEP was a leader in incorporating all of the changes resulting from the AISA Protocols Manual into its OATT. If the Commission determines that it is in the public interest to modify or terminate the AISA, TEP will comply with the Commission's orders.

APS

APS comments that there would be no legal ramifications for APS. If the Affected Utilities were no longer required to participate in the AISA, APS would still be required to support the AISA in its settlement agreement. If A.A.C. R14-2-1609, were amended to prohibit participation in the AISA, APS would still seek a waiver from the rule. APS has already rendered support to the AISA as was necessary and appropriate. It provided much of the AISA's initial funding and participated in the development of the AISA Protocols. These Protocols have been incorporated into APS' FERC-approved OATT. No additional direct funding is required and the Protocols have been developed, therefore, it is unclear what additional support APS would be in a position to provide.

AEPCO

AEPCO comments that it was not a party to that proceeding and would defer its comments to others more familiar with the issue.

10. State and discuss any other relevant/pertinent items/information that you believe the Commission should consider regarding the AISA.

ACES

ACES comments that there is no FERC precedent that would preclude the AISA from terminating its tariff and withdrawing from all other FERC proceedings and 9th Circuit Court of Appeals litigation.

Citizens

Citizens comments that it recommends that the AISA be terminated. There is little justification for the AISA to exist until sellers are willing to provide competitive energy to retail customers at lower costs than the incumbent utilities. Resources and funding would be better spent to promote the construction of economical energy supply resources in places where

transmission is limited. In addition, resources could be used to eliminate barriers that prohibit construction of new transmission.

TEP

TEP comments that without a significant number of direct access customers, the existence of the AISA does not make economic sense. The functions of the AISA can be accomplished through Commission order, Commission rule and the Affected Utilities OATTs. Further expenditures to fund the AISA could be better spent on efforts to relieve transmission constraints and to identify locations for generation that would mitigate the need for new transmission lines.

APS

The cost of the AISA is more of an issue than the existence of the AISA. APS will continue to urge AISA's board to reduce expenditures to the bare minimum. APS will also press on with RTO formation, which will obviate the issue of the AISA.

AEPCO

AEPCO comments, that given the status of competition in Arizona, people should not be expected to pay for the AISA. Currently, a number of ratepayers are paying for an organization that does not add any value to the services they receive. It is reasonable to expect that some form of regional RTO will be operational within the next 24 months or prior to competition materializing in Arizona. Many proponents of the AISA reside outside of the state. Therefore, they do not share in the costs that Arizona ratepayers are paying. AEPCO further comments that SRP is not a member of the AISA. Early on a few retail transactions occurred on SRP's system. While they have since been discontinued, SRP successfully managed and made available the required competitive transactions without AISA participation.

STAFF LEGAL ANALYSIS

Introduction

In its August 3, 2001, Procedural Order, the Commission directed the parties and Staff to address several legal issues related to continuation of the AISA. One such issue identified by the Commission was: "the legal ramifications to the APS and TEP settlement agreements, if those utilities are no longer required to support the AISA." August 3, 2001, Order at 2. The following discussion reflects Staff's review of the parties' comments as well as Staff's analysis of these issues.

The parties' comments implicate three components as starting points for legal analysis of the potential consequences of either retention or discontinuation of the AISA on the APS and TEP settlements. These components are the Electric Competition Rules (most specifically Rule 1609), the APS Settlement Agreement as approved by Commission Decision Nos. 61973 and 62035, and the TEP Settlement Agreement as approved by Commission Decision No. 62103.

Electric Competition Rule 1609

The Commission adopted the original Electric Competition Rules in December 1996, to provide a framework for the transition from a non-competitive to a competitive retail generation market. Commission Decision No.59943 at 2. The Commission modified the original rules to include, among other amendments, the provisions of Rule 1609 to require nondiscriminatory open access to transmission for all Arizona retail customers. Commission Decision No. 61272, entered in December 1998. Under Rule 1609, nondiscriminatory open access was hoped to be achieved by mandating that the utilities under Commission jurisdiction establish and support an interim AISA until a FERC-approved RTO or ISO was functional.

Rule 1609 is summarized as follows

Rule 1609.A mandates that the Affected Utilities provide non-preferential and nondiscriminatory open access to transmission and distribution facilities. Rule 1609.B requires Utility Distribution Companies to ensure that there is adequate transmission import capabilities as well as distribution capacity to serve all Arizona distribution customers.

Rule 1609.C provides that the Commission supports the development of a FERC-approved RTO or ISO, and in the absence of either, an AISA. The Commission states in the rule that it "believes that such organizations are necessary in order to provide nondiscriminatory retail access and to facilitate a robust and efficient electricity market."

Rule 1609.D directs Affected Utilities that own or operate Arizona transmission facilities to form an AISA with oversight/operational control of a statewide transmission system with certain characteristics. These characteristics or functions under the oversight/operational control

of the AISA are identified in the rule as: calculation of Available Transmission Capacity ("ATC"), consistent and nondiscriminatory operating protocols, expeditious dispute resolution, reservation of and scheduling transmission, and implementation of planning processes for meeting future transmission needs.

Rule 1609.E requires the Affected Utilities to establish and implement the AISA and its critical functions under specified times frames. Rule 1609.F provides that the Affected Utilities use good faith efforts to develop an RTO or ISO. When an RTO or ISO is developed and able to carry out these functions, the AISA is to transfer its assets and its critical functions and characteristics to the RTO or ISO.

Rule 1609.G provides for recovery of establishment and operational AISA costs by the Affected Utilities from all transmission customers under FERC tariffs, or if none, Commission approved surcharges.

Rule 1609.H states that the Commission supports Scheduling Coordinators to provide aggregation of customers' schedules to the AISA. The rule then describes the duties of the Scheduling Coordinators. Rule 1609.I prescribes certain actions by the Affected Utilities under the auspices of the AISA related to the availability and scheduling of must-run generation. Rule 1609.J also requires the Affected Utilities under the auspices of the AISA to develop a fair settlement pricing mechanism.

Although some parties' comments claim that the AISA is not an effective functioning body, there are no pending filed requests for waiver or modification of Rule 1609 to make the AISA a more effective functioning body. Waiver of Rule 1609 is discussed below in the context of potential impact on the Commission-approved settlement agreements for APS and TEP.

Stay or Modification of Rule 1609

If the Commission determines that the Rule 1609-mandated interim AISA is no longer essential for transition to a competitive retail market, some action would be necessary to stay or modify the rule. This could be accomplished by the Commission's own initiation of a noticed proceeding for this purpose, or upon a request by one or more of the parties dissatisfied with the AISA. Because the APS and TEP settlements specifically require those utilities' continued support of the AISA, a decision by the Commission to stay or modify the Rule 1609-mandated interim AISA also implicates the Settlement Agreements as well.

APS Settlement Agreement as Approved by Decision Nos. 61973, 62035

In Decision No. 61973, the Commission approved the APS Settlement as modified because the Settlement struck the proper balance between competing objectives of the Company and its customers. Decision No. 61973 at 14. One of the APS-identified benefits of the Settlement that resulted from "hard negotiations" with its customers was APS' continued support for a regional ISO and the AISA. Decision No. 61973 at 4.

Section 7.6 of the Settlement Agreement expressly mandates APS' active support of the AISA:

APS shall actively support the Arizona Independent Scheduling Administrator ("ASIA") and the formation of the Desert Star Independent System Operator. APS agrees to modify its OATT to be consistent with any FERC approved AISA protocols. The Parties reserve their rights with respect to any AISA protocols, including the right to challenge or seek modifications to, or waivers from, such protocols. APS shall file changes to its existing OATT consistent with this section within the (1) days of Commission approval of this Agreement pursuant to Section 6.1.

Certain parties' comments indicate that any modification or stay of the Rule 1609 mandates for a functional interim AISA, cannot be reconciled with their bargained-for-settlement contract as approved by the Commission.

Analysis of the Settlement also includes the subsequent modification to Section 7.1 approved by Decision No. 62035. Decision No. 62035 at 2 approved the following revised Section 7.1:

Approval of the Agreement by the Commission shall constitute a waiver of any existing Commission order, rule or regulation to the extent necessary to permit performance of the Agreement, as approved by the Commission. Any future Commission order, rule or regulation shall be construed and administered, insofar as possible, in a manner so as not to conflict with the specific provisions of this Agreement, as approved by the Commission. In the event any of the Parties deems a future Commission order, rule or regulation to be inconsistent with the specific provisions of this Agreement, a waiver of the new Commission order, rule or regulation shall be sought.

Nothing in this Agreement is intended to otherwise interfere with the Commission's ability to exercise its regulatory authority by the issuance of orders, rules or regulations. The requirements of this Agreement shall be performed in accordance with the Commission's Electric Competition Rules (including any specific waivers granted by the Commission's order approving this Agreement), except where a specific provision of this Agreement would be excuse compliance. (emphasis added).

Under revised Section 7.1 of the Settlement, if any Settlement signatory party deems a Commission action on Rule 1609 as inconsistent with specific provisions of the Settlement, APS would be required to seek a waiver of that Commission action.

The legal consequences of APS seeking such a waiver, and the Commission's actions under such circumstances, are speculative. If any Commission action included amendment of the Settlement, Decision No. 61973 approving the Settlement would need to be modified pursuant to A.R.S. §40-252. This statute specifically requires that final Commission orders may be modified only by providing notice and opportunity to be heard. However, any amendment to the Commission order approving the APS Settlement could result in breach of contract claims either among the Signatories or even against the Commission itself. This could occur irrespective of any proceeding pursuant to 7.1 of the Settlement.

Some parties' comments indicate that a stay or modification to Rule 1609 (no matter how it occurs) results in cherry-picked changes to the Commission-approved Settlement to the detriment of their settlement contract rights. (Staff notes that Applications for Intervention in APS' October 18, 2001, request for a Variance of Rule 1606.B raise similar legal issues concerning the APS Settlement). The ramifications of legal challenges making such claims against the Commission or APS are made more speculative in light of pending appellate litigation on the Electric Competition Rules and APS Settlement. The validity of the Electric Competition Rules (including Rule 1609) is set for oral argument before the Arizona Court of Appeals in Cause No. 1 CA-CC 01-0068, on November 19, 2001. Whether the Commission's order approving the APS Settlement could and did bind the Commission as a party to a contract is before the Arizona Supreme Court in Cause No. CV-01-0162-PR.

A final comment on the APS Settlement relates to Section 7.8. Section 7.8 states:

In the event of any disagreement over the interpretation of this Agreement or the implementation of any of the provisions of this Agreement, the Parties shall promptly convene a conference and in good faith shall attempt to resolve such disagreement.

The Parties' comments do not explicitly refer to the Section 7.8 conference required by the Settlement. If there is disagreement among the Settlement signatories concerning the Rule 1609 AISA, it appears by terms of their own agreement, a good faith attempt to resolve the disagreement is required.

TEP Settlement Agreement as Approved in Decision No. 62103

In Decision No. 62103, the Commission approved the TEP Settlement as modified because, like the APS Settlement, the TEP Settlement struck a balance between competing objectives of the Company and its customers. Decision No. 62103 at 17. Also like the APS Settlement, one of the TEP-identified benefits of the Settlement that resulted from "hard

negotiations" with its customers was TEP's continued support for a regional ISO and the AISA. Decision No. 62103 at 4.

Section 9.1 of the Settlement Agreement expressly mandates TEP's active support of the AISA:

TEP shall fully support the development of the Arizona Independent Scheduling Administrator ("AISA") and Desert STAR. TEP shall modify its FERC Open Access Transmission Tariff ("OATT") to be fully compatible with the AISA/ISO Bylaws and Protocols Manual. The Parties reserve their rights with respect to any AISA protocols, including the right to challenge or seek modifications to, or waivers from, such protocols. TEP shall file changes to its existing OATT consistent with this Section within ten (10) days of Commission approval of this Settlement Agreement pursuant to Section 13.3

The parties comments filed in this docket indicate that any modification or stay of the Rule 1609 mandates for a functional interim AISA, cannot be reconciled with their TEP bargained-for-settlement contract as approved by the Commission. Like the APS situation, language in both the decision and TEP Settlement reflects that such issues exist for some signatories to the TEP Settlement Agreement.

Analysis of the TEP Settlement as approved by Decision No. 62103, includes the subsequent modification to Section 14.3. TEP was required to modify Section 14.3 of its settlement to incorporate the same language that modified Section 7.1 of the APS Settlement, cited above.

Under modified Section 14.3 of the TEP Settlement, if any Settlement signatory party **deems** a Commission action on Rule 1609 as inconsistent with specific provisions of the Settlement, TEP would be required to seek a waiver of that Commission action. The legal consequences of such a waiver would be substantially similar to the legal consequences addressed in the APS Settlement discussion. However, there does not appear to be a directly comparable provision in the TEP Settlement to APS Settlement Section 7.8. Also, Section 13.5 of the TEP Settlement expressly provides that each provision in the TEP Settlement is made in consideration and support of all other provisions.

FERC Proceedings

The Commission's August 3, 2001, Procedural Order also requested comments concerning (1) FERC proceedings necessary to terminate the AISA; and, (2) the status of the Affected Utilities' OATTs if the AISA was terminated. With the exception of the AISA filing, the parties' comments do not provide an extensive legal analysis on these FERC-related matters. (Staff has requested additional legal analysis on FERC issues from certain parties to support

assertions made in their September 5, 2001, filings. Such additional legal analysis may be reviewed in a Staff supplemental filing, if necessary).

Staff's review of these FERC issues indicates that a FERC proceeding would be necessary to terminate the AISA. The AISA made filings at FERC for certain approvals, and some unraveling of FERC actions on the AISA would be necessary. Further, Staff has found no express legal support for comments by some parties that protocols related to the AISA included in the Affected Utilities' OATTs remain effective in the absence of an AISA. Likewise, Staff has found no express legal support that there is an automatic default to a pro forma OATT for the Affected Utilities, if the AISA is terminated.

If there is no AISA, it appears that some filing at FERC would be necessary to modify the Affected Utilities' OATTs that refer to AISA protocols. However, whether FERC would approve modifications to the OATTs with similar protocols without an AISA is speculative. FERC may require the Affected Utilities to adopt a pro forma OATT in compliance with FERC Order 888 without any Arizona specific provisions. Furthermore, until our Commission has had an opportunity to review any prospective OATT filings by the Affected Utilities, it is premature to conclude that our Commission could support OATT filings incorporating AISA-like protocols without AISA independent oversight.

The length and complexity of FERC proceedings to unravel the AISA, and to put into place Affected Utilities' OATTs in compliance with Order 888 (whether or not modified by protocols) is unknown. The AISA's legal analysis indicates that the process would be lengthy and complex. No other party provided substantial supporting legal analysis on the length and complexity of FERC proceedings in their September 5, 2001, comments.

Staff's view at the present time is that we just do not know how long FERC would take to act (or how it will act) on an "unraveling" AISA filing or on the Affected Utilities' modified OATT filings. The parties' comments reflect a broad range of possible FERC action and inaction precisely because there is no certainty on these FERC related issues.

STAFF ANALYSIS

Staff has analyzed the comments received regarding the AISA and believes that the general pros and cons of retaining the AISA, and its defined functions, have been adequately addressed in the comments submitted by the various organizations. There are basically two factions:

- The organizations that will potentially benefit from retail competition argue for the necessity of keeping the AISA.
- The organizations that will potentially suffer from retail competition argue against the necessity of keeping the AISA.

However, the parties' discussions of the specific issues the August 3, 2001 Procedural Order requested comment on lacked any rigorous analysis or quantification, which makes them difficult for Staff to evaluate. Therefore, Staff is compelled to provide analysis and recommendations that are largely independent from the comments.

Independence of the AISA

It is Staff's opinion that for retail competition to become viable, *the functions* necessary to ensure retail access which were defined in R14-2-1609 (D) are critical. While the functions defined in R14-2-1609 (D) are critical, maintaining the AISA in its current form is not the only method for performing those functions. Staff believes that a critical component of performing these functions is that they be done by an independent entity. To date, Staff does not believe that the AISA is or has been truly independent of those parties that have an interest its operation, largely due to the ongoing controversy over funding.

Necessity of the AISA

With this being said, Staff agrees that presently there is not viable retail electric competition in Arizona. Therefore, most of the functions that the AISA was intended to perform have not been necessary due to the lack of competition during the AISA's six months of operational existence. However, the AISA has developed a Protocols Manual and has filed it with the FERC. These protocols have been approved by FERC.

The question that arises is the proverbial "chicken & egg". Will a viable wholesale market, and thus retail market, develop without a RTO or a local entity such as the AISA; or should such an entity not be created until such markets are developed and its duties are required?

The questions facing Staff in making a recommendation, regarding retaining the AISA are:

- When will there be a viable wholesale market that will allow retail competition to develop?
- Should the AISA be retained to ensure retail access, in order to facilitate development of the retail market?

Wholesale Market Issues

Arizona's Retail Electric Competition Rules were based on the premise that a viable wholesale market would exist for Arizona. In order for the wholesale market to facilitate retail competition there will have to be sufficient capacity in place to ensure price stability. Markets that lack sufficient supply are "ill-liquid" and can be subject to severe price swings. Because of the following, Staff believes that a viable competitive wholesale market could develop in the near future:

- The amount of generation that is presently being built exceeds the projected load growth, which should allow a competitive wholesale market to develop.
- The demand in the near term is likely to be down due to a downturn in the economy and conservation efforts spurred by the high prices for electricity.

Arizona's generating capacity is projected to increase by more than fifty percent through 2003. Staff believes that this is a conservative estimate because it only includes generating units that have received the necessary regulatory approval to begin construction. This additional capacity should provide the wholesale market with the additional liquidity necessary for its development. The following tables illustrate the new generation capacity that is expected to come on line by 2003.

Table 1. New Generation (with regulatory approval) expected to come on line in Megawatts by year

Current Plant Status	2001	2002	2003	Total
Commercial Operation	1,830			
Under Construction		2,370	3,365	
Regulatory Approval Received		450	1,040	
Total MWs	1,830	2820	4,405	9,055

Table 2. Proposed New Generation (not yet received regulatory approval)

Current Plant Status	2001	2002	2003	Total
Application Under Review		500	2,340	
Application Filed				
Announced			520	
Total MWs		500	2,860	3,360

TOTAL CURRENT CAPACITY IN AZ: 16609 MW

In a competitive environment there is always a concern that a market can be manipulated. This is especially the case if there are a few entities that control a majority of the market. Thus, in addition to new capacity, a viable wholesale market will require rules and institutions that will prevent market manipulation and that will ensure that demand and supply conditions are appropriately reflected in wholesale prices. Credible allegations have been made that the severe price swings in California's wholesale electricity markets are attributable (at least in part) to market manipulation rather than real supply constraints. The FERC has jurisdiction over operation of wholesale electricity markets. At this point in time, it is still unclear as to whether the FERC will take the steps necessary to put the rules and institutions in place that will ensure a viable wholesale market for Arizona.

Retail Access

In addition to wholesale competition, open access to transmission is required for retail competition to work. Arizona's Retail Electric Competition Rules set up the AISA as the entity that would ensure open access to transmission. There are three transmission providers that own over 90% of the transmission capacity to serve Arizona load. TEP and APS are under the jurisdiction of the ACC. The third, SRP that owns roughly 40% of the transmission capacity, is not under the jurisdiction of either the ACC or FERC. Staff believes that if these three companies are able to control the transmission market in Arizona without independent monitoring there may well be no open access to transmission and thus there will be no retail electric competition.

STAFF RECOMMENDATIONS

Staff believes that evaluating the merits of the AISA should not be done in a vacuum. The AISA is an integral part of the Retail Electric Competition rules. Other aspects of the rules were conditioned on the existence of the AISA. Thus, questions about the appropriateness of the AISA raise questions about the appropriateness of many other provisions of the Retail Electric Competition rules. Additionally, in its October 18, 2001 filing (Docket No. E-01345A-01-0822) Arizona Public Service Company has called into question the appropriateness of another key aspect of the rules, the wholesale purchasing requirements of R14-2-1606(B). Because of the extent to which the individual sections of the Retail Electric Competition rules are interrelated, Staff does not believe it is appropriate to address these very important questions about them in a piecemeal fashion. Rather, if there is to be an evaluation of the rules it should be done in a comprehensive manner so that the Commission can manage the transition to competition appropriately.

As a consequence, Staff has identified three options for Commission consideration:

Option A: Forego the transition to competition and return to the traditional regulated monopolist environment.

Option B: Retain the existing Retail Electric Competition Rules and associated timeline.

Option C: Perform a comprehensive reevaluation of the rules so that a different path can be established for the transition to competition.

Staff recommends that the Commission pursue Option C. Because of the many questions raised by the responding parties about the Retail Electric Competition Rules and because of the recent APS filing, Staff believes that a comprehensive assessment of the rules is appropriate. Such an assessment should evaluate the manner in which the existing rules require the Commission to manage the transition to competition by comprehensively reevaluating the existing rules and associated timelines. The goals of the assessment should be to develop a framework that fosters an environment where retail competition can flourish while preserving the current reliability of Arizona's electric system.

In light of the need for a reassessment of the rules and the current non-existence of retail competition, it would seem appropriate that the operation of the AISA be suspended. Subsequent to the completion of the assessment the Commission can determine the necessity and appropriateness of the AISA and/or its functions.

Staff does not support Option A (a return to Monopoly) because the growth in capacity discussed in the analysis above should result in conditions that are favorable to the development of a viable competitive wholesale market for competition. Considering the capacity coming on

line, a well functioning wholesale market should result in reasonable and stable wholesale prices. Should this be the case, Staff believes that retail customers would be in a better position to reap the benefits envisioned by the proponents of competition.

Staff does not support Option B (leaving the rules intact) because Staff does not believe that the rules in their current form will foster the development of retail competition. Since the rules were approved, circumstances have changed such that the assumptions supporting the appropriateness of the rules are no longer valid. One key assumption supporting the appropriateness of the rules is that there would be a viable and competitive wholesale market for electricity by the time that the rules were envisioned to be fully in effect. The reality is that this viable and vibrant wholesale market has yet to develop. Unfortunately, the sequence of events is such that the Arizona retail market has opened prior to the development of a vibrant wholesale market. This sequence of events virtually assures the demise of the retail market due to the absence of the supporting wholesale structure.