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ARIZONA

Re: Electric Competition:		
Generic Docket for Electric Restructuring)	E-00000A-02-0051
Electric Competition Rules)	E-01345A-01-0822
AISA)	E-00000A-01-0630
APS Request for A Variance)	E-01933A-02-0069
		E-01933A-98-0471

COMMENTS OF THE ELECTRIC POWER SUPPLY ASSOCIATION

INTRODUCTION

The Electric Power Supply Association (EPSA)¹ appreciates the opportunity to respond to the Arizona Corporation Commission's (ACC or Commission) request for comments on issues related to the Commission's discussion of the state's electric competition rules. EPSA is the national trade association representing competitive power suppliers, including independent power producers, merchant generators and power marketers. These suppliers, who account for more than a third of the nation's installed generating capacity, provide reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. EPSA seeks to bring the benefits of competition to all power customers.

Arizona Corporation Commission
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¹ The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the view of any particular member with respect to any specific issue.

EPSA believes that all consumers should have a choice of electricity suppliers. Competition is the most effective tool to enhance reliability, bolster economic development and provide new services to consumers. While acknowledging that every state is unique, EPSA believes that every consumer nationwide can and will benefit from having a choice of electricity suppliers.

In November 2000, EPSA published a revised version of its white paper, *Retail Competition: Getting It Right!* This document includes detailed recommendations regarding the issues encountered by states that have already implemented retail electricity competition. Among its conclusions, EPSA recommends that states ensure and sustain a "date certain" when competition will begin; create effective customer choice through the unbundling of utility services; guarantee the full recovery of all legitimate, verifiable, immitigable, prudently-incurred, net (eligible) stranded costs; provide open and fair access to the transmission and distribution system for all suppliers; establish regional transmission organizations (RTOs); and eliminate barriers to participation in a competitive market. A copy of the white paper is enclosed for the Commission's consideration.

For ease of reading, EPSA's comments track the identification of issues in the Commission's notice. Given that EPSA represents competitive power suppliers nationwide, we will not respond to every question in the Commission's notice, but will instead discuss several issues on a broader basis. Some EPSA member companies will submit comments in greater detail in their filings with the Commission.

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

Generation

Competition in the wholesale electric generation business is quickly becoming the principal way to meet the incremental demand for electricity across the country. The competitive supplier share of installed capacity has increased almost four-fold in less than five years, rising from 70.3 Gigawatts (GW) in 1997 to 319.5 GW in 2001. During 1997-2001, the amount of competitive generation has grown from 8.5 percent of total U.S. capacity in 1997, to 35.6 percent of the total in 2001. Merchant power plants have become the dominant source of new power generation throughout the U.S. Competitive power suppliers are responsible for more than 90 percent of the capacity additions that have been made to the grid since 1997. Several EPSA members, including Allegheny Energy Supply, Calpine Corp., Duke Energy North America, PG&E National Energy Group, PPL Global, Reliant Energy and TECO Energy have power projects either in operation, under construction or in development in Arizona totaling approximately 9,000 MW. (Source: U.S. Energy Information Administration, Edison Electric Institute and EPSA data)

Merchant plants are designed to compete in the wholesale and retail markets, as well as to help maintain and enhance the reliability of regional electricity systems. Regulators and legislators must develop rules that: (1) encourage consistent, fair, non-discriminatory and workable interconnection policies; (2) ensure fair and open access to

transmission and distribution systems for all market participants on an equivalent basis; and, (3) control and mitigate market power problems. Adopting rules and policies that promote the development of merchant power plants provides numerous benefits, ranging from lower costs, environmental improvements, as newer facilities replace older generation assets, minimizing incumbent utilities' vertical and horizontal market power, and providing the liquidity needed to support robust wholesale trading. Furthermore, market signals are much faster than regulatory processes, so market incentives are a more efficient means of ensuring that sufficient capacity exists to meet demand on the system.

Generating facilities that competitive power suppliers construct are built at their stockholder's risk. This shifting of risk from the incumbent utilities' ratepayers to merchant power investors indicates that, with respect to development projects financed by new entrants, certificates of need are obsolete. Experience with the emerging markets has demonstrated that the competitive pressures of supply and demand are an effective substitute for a regulatory certification process, particularly where private investors, not ratepayers, are at-risk. In light of the availability and willingness of competitive power suppliers to meet the nation's growing electricity needs, there is no reason to require utility ratepayers to continue to bear the risks associated with utility investment in power generation when other market participants can insulate consumers from those risks. Enclosed is a copy of EPISA's recent publication entitled "*Merchant Power for 21st Century America.*"

Role of Power Marketers

Power marketers play a valuable role in competitive wholesale power markets by providing both products and services that improve reliability and performance while reducing risk in competitive markets. Marketers are keenly interested in the costs and value of supply for customers and constantly strive to increase options, provide better alternatives and decrease costs. Marketers' products are transaction-based and often guarantee product quality; their services establish performance standards and price stability. These products and services are essential in a fully competitive market, since they furnish customers with an intermediary that can supply the appropriate products and services that fit with each customer's needs and risk tolerances. The contribution of these products and services to the market is the cornerstone of market liquidity, a necessity in a fully competitive market. Power marketers are pivotal in enabling the movement of power across the West, resulting in a more efficient operation of the Western Systems Coordinating Council system and providing load-serving entities and end use customers access to lower cost energy that otherwise would not be available.

Interconnection

To obtain the benefits of competitive generation, merchant power plant developers must be able to reach consumers with their service. Thus, it is essential to promote policies that provide for consistent, fair and workable interconnection rules and

procedures. The Federal Energy Regulatory Commission (FERC) is currently engaged in a Notice of Proposed Rulemaking process designed to ensure standardized and fair generation interconnection procedures. However, EPSA encourages state regulatory commissions to require their state's jurisdictional utilities to develop clear and consistent interconnection policies, with definitive timelines for action, confidentiality guidelines and standardized interconnection agreements to meet their regional needs. Clear and efficient interconnection procedures are critical to developing, maintaining and enhancing competitive electric power markets. Uniform business practices allow generation developers, many of whom are national companies, to develop more efficient, streamlined procedures for their project development efforts. There is no reason for these requirements to vary from transmission provider to transmission provider in an arbitrary, inequitable manner.

Competitive Bidding for Generation Capacity

Absent a competitive bidding process, there is no reason to believe that consumers will receive optimal benefits from a utility's construction of additional rate-based facilities. A competitive marketplace routinely leads to an efficient allocation of resources and the highest possible level of economic well-being for society as a whole. Open, transparent competitive bidding overseen by an independent entity ensures customers, regulators and market participants that electricity is being provided at the most affordable, prudent price, and that new technologies and environmental improvements are appropriately considered in the process. A January 1991 study by the National Regulatory Research Institute, *"Implementing A Competitive Bidding*

Program for Electric Power Supply,” noted that as early as March 1990, competitive bidding programs were being operated by utilities and/or public utility commissions in 26 states.

One of the most important aspects of independent power development is that competitive power developers, not utility ratepayers, bear the risks of providing the electricity. Given the availability and willingness of competitive power suppliers to meet the electricity needs of the ultimate consumers in Arizona, there is simply no rational reason to require utility ratepayers to bear the risks associated with a utility or its affiliate’s investment in power generation facilities, when other market participants can insulate consumers from just such concerns. The history of cost-plus regulation has shown a tendency for utilities to overpay for generation facilities. A lack of market discipline has led to inefficiency and poor performance on the part of many electric utilities. The Commission has a responsibility to Arizona standard offer customers to not allow utilities or their affiliates to force consumers to pay for questionable economics and poor public policy decisions, especially during a time of robust investment by independent developers in the state and region.

Market power is a significant concern in a competitive market. The dominant incumbent companies may be able to control prices and exclude market entrants, thereby severely limiting new entry and reducing the likelihood that there will ever be the sufficient number of both buyers and sellers necessary for workably competitive markets. New market entrants, such as EPSA’s members, will also be placed at a

serious disadvantage if they must compete against these “super-competitors” whose capital costs are recovered from captive ratepayers and who also can sell some of the power in competitive off-system markets.

EPSA is also concerned about the utilities’ ability to use their generation market dominance in conjunction with their ownership and control of regional transmission assets in the wholesale market to the detriment of new power suppliers and other market participants. Despite the Federal Energy Regulatory Commission’s open access rules, competitive power suppliers are still finding that some transmission facilities’ owners have the motive, opportunity and incentive to use their pre-existing control of transmission to favor their own or affiliates’ generation assets. Increasing their generation portfolio only increases the potential for utilities and their affiliates to use their control over their transmission system to favor their own assets at the expense of other market participants and, ultimately, the consumers of Arizona.

Aggregation Services

There is every indication that residential customers can benefit significantly from competition. Residential customers can benefit directly from all the cost efficiencies and service gains competition will deliver. The aggregation of residential and small business customers’ needs could result in additional savings. Aggregation provides opportunities for small customers, who may not otherwise be the target of marketing efforts by retail energy suppliers, to participate in and benefit from the competitive market. Through aggregation, small customers are able to pool their purchasing power

and wield the same influence, as much larger customers. As the competitive retail market evolves, aggregators may also be able to secure valuable services, such as consolidated billing, energy management services, and energy use analysis for smaller-use customers. Aggregation is an increasingly effective tool for maximizing savings and mitigating risk in the competitive power market. For instance, Green Mountain Energy was selected in February 2001 to serve more than 400,000 electricity customers in Ohio in the nation's largest-ever energy aggregation contract to-date. The Northeast Ohio Public Energy Council formed the electricity-buying group to serve nearly 100 communities in the state.

Price Benefits

A study commissioned by EPSA and conducted by Craig Roach, Ph.D., principal of Boston Pacific Co., "*Assessing the 'Good Old Days' of Cost-Plus Regulation*," analyzed sales data for 60 of the nation's investor-owned utilities during 1985-1999, when traditional cost-plus rate regulation began evolving toward a more competitive environment. During the 1985-1999 period, according to the analysis, inflation-adjusted electricity prices decreased an average 30 percent for residential customers and 36 percent for industrial/commercial customers. This reduction in real electricity prices can be attributed to the onset of competition combined with lower fuel prices, slowing inflation, and the depreciation of high-cost plants. As the nation moved toward wholesale competition, consumer prices for electricity steadily declined. This stands in stark contrast to 1984 when Arizona Public Service Co. filed a request at the Commission for a 55% retail rate increase in order to rate-base Palo Verde units 1, 2

and 3. The resulting rate shock produced a massive, expensive and multi-year regulatory prudence audit and eventual disallowance.

Additional proof of success on pricing can be seen in states such as Pennsylvania, where the statewide "customer choice" program has saved employers and families nearly \$4 billion; up to 1 million people have cumulatively shopped for power; and nearly 600,000 are currently shopping. Furthermore, Pennsylvanians are currently paying electric rates that are 1 percent below the national average. Before competition, they were paying rates 15 percent above the national average.

III. Relationship of the Current Regulatory Regime to Competition

Price Caps

Price controls prevent demand-side response to rising prices. For competitive markets to flourish, supply and demand must interact freely to determine the price, thereby allowing market participants to make intelligent resource allocation decisions. At just the time when we need to attract capital for new generation and to expand and improve the electrical system's infrastructure, price controls create uncertainty that will discourage and delay this much-needed investment. This narrow speculation regarding demand-side responsiveness amounts to a high stakes gamble that consumers are harmed more by short-lived, infrequent price spikes than by long-term delays in generation investment needed for reliability purposes. Rather than speculative short-

term outcomes, the wiser approach to both price spikes and reliability concerns is to utilize free market forces and the investment capital they attract to opportunities.

Finally, price controls divert policymakers from making the structural changes necessary to assure a fully competitive market that offers competitive prices, low risk, high reliability and superior environmental performance. Policymakers should concentrate on developing market-oriented solutions to any remaining market flaws.

Customer Switching Rules

There are several aspects of switching rules that are critical to the successful development of retail markets. Uniform business rules for switching customer accounts are necessary for a properly functioning competitive marketplace. High exit fees are a significant barrier to competitive suppliers in developing markets, since high customer acquisition costs discourage participation in retail markets. Lengthy notice periods, and cumbersome authorization requirements, before consumers can switch to a new electricity supplier also pose a threat to the competitiveness of new market entrants. When a customer initiates contact with its distribution company to authorize the switch, and provides identifying information, additional barriers to finalize this transaction should not be imposed. The distribution company's only obligation should be to record the change for billing purposes. Customers who are solicited by a supplier to switch should not be switched until the new supplier obtains authorization in one of three methods: oral verification by an independent third-party, electronic verification or written authorization.

Competitive Bidding for Standard Offer Service

The importance of standard offer service issues to the development of competitive markets cannot be overstated. In the transition to a fully competitive market, legislators, regulators and consumer advocates have been understandably concerned about ensuring small customers receive continued generation service at a reasonable price. Customers should be assured a continuous source of electricity, even if they do not choose a new supplier. In addition to those customers who choose not to choose, other customers who must also be assured access to electricity include: (1) customers who need standard offer service because they are unable or unqualified to obtain service from a competitive power supplier, and (2) customers whose service has, for whatever reason, been terminated by their supplier and who need "backstop" service. State regulators must decide who will provide the electricity service to these customers. It is important that policymakers design standard offer service programs to maximize customers' choice, and minimize the number of customers who take standard offer service.

Allowing new market entrants (including competitive utility affiliates) to bid to provide standard offer service is essential. If customers can, by not choosing, remain with the incumbent utility, then the incumbent utility has gained a significant competitive advantage. Competitive suppliers will have a tremendous struggle to enter this market, which may discourage them from doing so.

IV. Retail Generation Competition

Transmission Infrastructure

The development of a seamless regional transmission systems where all transmission usage is accorded fully-comparable treatment is vitally important to the growth of a competitive electric power industry. The establishment and enhancement of RTOs represents an important step towards that end. Properly structured, and with an efficient standard market design, RTOs can ensure non-discriminatory access to and efficient usage of the transmission system. As FERC notes in Order No. 2000, transmission-owning utilities have an inherent conflict of interest that often leads to preferential treatment for their own or their affiliates' customers, to the detriment of third-party transmission customers. Policing these abuses is difficult and expensive. The prospect of real wholesale and retail competition continues to be threatened by, among other things, the manifest lack of comparability between certain wholesale and retail transmission pricing and access policies -- resulting from the discriminatory exemption of all native load from open access rules.

Today, the wholesale markets and the transmission system have evolved to form regional electricity markets. Electrons moving along the transmission grid do not recognize state boundaries, nor can they be differentiated between those designated for wholesale and retail service. Thus, rules designed to protect native load in a particular state often have the effect of adversely impacting retail customers in an adjacent system. Further, such rules often favor incumbent utilities, denying wholesale customers, including municipals and cooperatives that also buy power for *their* native

load customers, the benefits of being able to choose an alternative suppliers who might otherwise better serve their needs. Clearly, consistent and nondiscriminatory rules are needed to protect *all* electricity customers.

Ultimately, the elimination of residual discrimination will occur only when all uses of the transmission grid are placed under the same rate schedules, terms and conditions. With actual comparability, the transmission owner's interest would be to operate the grid as a stand-alone business and maximize throughput, rather than to use transmission position to increase the return on its investment in power generation, marketing and sales. Thus, comparability is critical if competitive power markets are to achieve their full potential.

In order to reflect true comparability, all transmission service must be reserved and provided pursuant to the same, system-wide tariff. RTO open access tariffs should be revised to incorporate this requirement. The "single tariff model" outlined in the FERC Staff's December 19, 2001, White Paper, designed to develop consistent regional rules for the use of the transmission system, is critical to the efficient operation of the electricity market.

Only when all uses of the transmission service occur under the same tariff will continuing incentives for discrimination be eliminated. Only full comparability will assure that retail customers of all states, whether traditional utilities or new market entrants serve them, receive the same service. Without full comparability, individual states will retain the opportunity, incentive and motive to disadvantage each other, while individual utilities will retain the opportunity, incentive and motive to disadvantage other

market participants. A single, system-wide transmission tariff will allow all load-serving entities, whether they are the current incumbents or new market entrants, access to the lowest cost supplies to meet their customers' needs.

V. Industry Events External to Arizona

The California Experience

During the summer of 2000, the California energy market fell victim to a confluence of circumstances: inadequate generation, lack of demand-side programs, lethargic siting approvals, low hydroelectricity due to severe drought conditions, significant load growth throughout the West, the inability of load-serving entities to hedge risks, masked price signals to retail customers and poorly-functioning retail markets that resulted in blackouts and price volatility. To avoid a similar experience, we urge the Commission here to learn from California's mistakes and: (1) encourage new generation, (2) develop effective demand-response programs; (3) expand transmission infrastructure and improve interconnection procedures; (4) provide credit assurances; (5) increase natural gas pipeline capacity; (6) avoid price caps and other price controls; and, (7) stimulate retail services by allowing more customer choices. A copy of EPSA's "*California: After the Storm*" is enclosed.

Enron Bankruptcy

Although Enron was closely associated with the move to open U.S. energy markets to competition, the company's collapse is unrelated to the industry restructuring

now underway. Financial analysts, economists and regulators agree that Enron's fall was the result of investors and financiers pulling back after they lost confidence in the company's financial disclosures and debt levels, not because of problems in competitive energy markets. U.S. Secretary of Energy Spencer Abraham is among those making this point. "In the face of Enron's collapse, the largest bankruptcy in U.S. history, there were no price spikes, no trading panics, no electricity outages and no gas shortages," Abraham said. "... there is no indication that the energy side of Enron's business was the cause of its collapse."

Energy marketing and trading continued without interruption in Enron's wake. Ironically, the competition that Enron helped establish ensured that the company's departure did not become a crisis in terms of energy supply – as trades were picked up by other companies, energy supplies were undisturbed, power flowed from generators to utilities to consumers, and prices remained stable.

Supplemental Questions

Divestiture or Corporate Separation

Many states are now working to create opportunities for wholesale markets and for merchant generators to build new power plants and sell wholesale electricity to their states' and regions' utilities. As part of this progression toward a more competitive electric marketplace, some states, such as Pennsylvania, Massachusetts and Illinois, have encouraged utilities to auction their generation assets to the highest bidder. Other

states, such as Maryland and Texas, have allowed the transfer of utility assets to unregulated affiliates at book value. If the latter is joined with the functional separation of competitive and non-competitive services, and a strong code of conduct, EPSCA believes both of these actions, coupled with the removal of any barriers to entry for merchant generation, are positive first steps toward an ultimate goal of a fully-restructured market.

Merchant Power Plants and the Environment

Merchant power plants are inherently friendly to the environment. Most run on clean natural gas and are highly-efficient, meaning they use less fuel to produce the same amount of electricity. Most new merchant power plants use cleaner-burning natural gas. This allows them to be built quicker and to operate with reduced emissions of carbon and nitrogen in comparison to existing, older, less-efficient facilities. An increasing number of merchant power plants are being planned and built using clean, alternative energy sources, including wind power and geothermal heat under the competitive market model.

Because they are competitively-driven, merchant power plants employ the newest and most productive technologies. These systems pollute much less than older technologies because they burn natural gas and need less fuel to operate. As private businesses backed by considerable investments, merchant power plants have both the incentive and the wherewithal to invest in the best technology, a distinct improvement over power plants tied to the traditional vertically-integrated utility model.

Because profitability requires a careful and accurate assessment of the market, merchant power plants are invariably sited efficiently. This minimizes the need for additional plants or the sort of duplication that could burden the environment. The very flexibility of merchant power plants means that they can be small and sited within existing industrial complexes, minimizing the magnitude of land disruption. And because they are profit-driven and well-financed, merchant power plants can and do invest in newer, cleaner, more efficient technologies.

CONCLUSION

As a result of federal and state initiatives, the power industry is being transformed from a landscape of inefficient monopolies to more responsive and competitive businesses. Over time, this will result in a far more efficient supply than was possible under the vertically-integrated utility model. Now is the time for the Commission to stay the course and continue moving forward to bring the benefits of increased wholesale and retail competition to Arizona.

EPSA commends the Commission for its initiative and thanks the Commission for this opportunity to express its views on some of the issues that have been presented. EPSA hopes that its Comments will assist the Commission in its determinations about how to proceed on these important issues. If you have any additional questions regarding these issues, please don't hesitate to contact us. We

are happy to be an ongoing information resource for you and your staff, and to serve as a liaison with our membership.

Enclosures

February 25, 2002

Respectfully submitted,

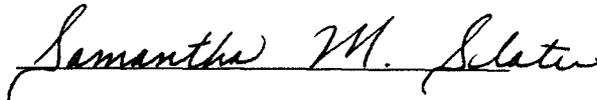
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CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the foregoing document upon each person designated on the official service list compiled by the Clerk in this proceeding.

Dated at Washington, D.C. this 25th day of February, 2002.

A handwritten signature in cursive script that reads "Samantha M. Slater". The signature is written in black ink and is positioned above the printed name.

Samantha M. Slater