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BEFORE THE ARIZONA CORPORATION COMMISSION

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3 WILLIAM A. MUNDELL
Chairman
4 JIM IRVIN
Commissioner
5 MARC SPITZER
Commissioner

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8 IN THE MATTER OF THE GENERIC
PROCEEDINGS CONCERNING ELECTRIC
9 RESTRUCTURING ISSUES

Docket No. E-00000A-02-0051

10 IN THE MATTER OF ARIZONA PUBLIC
SERVICE COMPANY'S REQUEST FOR A
11 VARIANCE OF CERTAIN REQUIREMENTS OF
A.A.C. R14-2-1606

Docket No. E-01345A-01-0822

12 IN THE MATTER OF THE GENERIC
13 PROCEEDING CONCERNING THE ARIZONA
INDEPENDENT SCHEDULING
14 ADMINISTRATOR

Docket No. E-00000A-01-0630

15 IN THE MATTER OF TUCSON ELECTRIC
POWER COMPANY'S APPLICATION FOR A
16 VARIANCE OF CERTAIN ELECTRIC
COMPETITION RULES COMPLIANCE DATES

Docket No. E-01933A-02-0069

17 IN THE MATTER OF THE APPLICATION OF
18 TUCSON ELECTRIC POWER COMPANY FOR
APPROVAL OF ITS STRANDED COST
19 RECOVERY

Docket No. E-01933A-98-0471

**STAFF'S RESPONSE TO ARIZONA
PUBLIC SERVICE COMPANY'S
MOTION FOR DETERMINATION
OF THRESHOLD ISSUE**

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22 Staff has reviewed the Motion for Determination of Threshold Issue ("APS Motion")
23 submitted on April 19, 2002 by Arizona Public Service Company ("APS"). While Staff disagrees
24 with many of the assertions contained in the APS Motion, we agree that the transition to electric
25 competition in Arizona will benefit from the Commission's immediate consideration of certain
26 threshold issues, most of which are raised more directly in the Commission's Generic Proceedings,
27 Docket No. E-00000A-02-0051. For that reason, Staff requests that the Commission grant the APS
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1 Motion, in part, stay proceedings in both the APS Variance Request, Docket No. E-01345A-01-0822,
2 and the Tucson Electric Power Company ("TEP") Variance Request, Docket No. E-01933A-98-0471,
3 and proceed to the immediate consideration of certain threshold issues in connection with the Generic
4 Proceeding. The remainder of this Response will describe Staff's view of the threshold issues to be
5 addressed, and explain some of Staff's disagreements with APS over the nature of the consequences
6 and the recommended approach for the Commission.

7 **I. COMPETITION/REGULATION IS NOT THE THRESHOLD ISSUE**

8 The APS Motion casts the threshold issue to be decided as whether the Commission still
9 believes it is appropriate to continue a transition to competition, or, alternatively, the Commission
10 believes that current conditions necessitate a return to a traditionally regulated electric utility industry
11 in Arizona. Then, having set forth this false issue, APS proceeds to paint a dire picture as its view of
12 the consequences of making the "wrong" choice.

13 Staff does not buy into the notion that the threshold issue to be decided in this matter is
14 whether to transition to a competitive electric utility industry in Arizona. Consistent with the position
15 stated in our Staff Report in the Generic Proceedings, Staff believes that decision has already been
16 made in favor of proceeding towards competition. Staff sees the consolidated proceedings as
17 attempting to address how best to accomplish the transition. Staff has not filed testimony supporting
18 a return to regulation. Staff is, however, greatly concerned that the visions leading up to the approval
19 of the Electric Competition Rules and Settlements in 1999 have not materialized. Accordingly, Staff
20 believes that it is necessary to revisit the timing and potential effects of certain irrevocable changes to
21 the structure of the industry, in light of the lack of development of an anticipated competitive market.
22 In particular, Staff has concerns about the market power impacts of transfer of generating assets from
23 a utility to an affiliate where there is inadequate competition to protect standard offer customers from
24 market power abuse.

25 Thus, Staff's formulation of the threshold issues to be addressed is somewhat different than
26 APS's. Staff would state the threshold issue as follows: What changes are necessary to the Electric
27 Competition Rules and/or Settlements, to ensure a smooth transition to competition, unimpeded by
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1 market power abuses during the transition. Integral to this threshold issue is the Commission's
2 consideration of the timing and extent of the utilities' transfer of generation assets to an affiliate.

3 While Staff does not agree with APS that the issue of whether to proceed to competition
4 remains undecided, we do feel compelled to explain our vigorous disagreement with APS as to what
5 the consequences might be from a decision to return to regulation. The first point to be made
6 involves APS's characterization of possible Commission action as constituting breach of a contract.
7 Staff has never considered that the 1999 Settlement Agreement created contractual rights in APS.
8 This is an issue on which Staff and the Commission have disagreed with APS, and it continues to be
9 a point of disagreement. The Commission's Order approving the 1999 Settlement Agreement,
10 Decision No. 61973, is a regulatory decision. It isn't necessary to rehash the arguments over the
11 extent to which the Commission can amend its Decision pursuant to A.R.S. § 40-252, and, most
12 particularly, the extent of the requested amendment embodied in the APS Variance Request.

13 Suffice it to say that, should the Commission opt for a return to regulation, that change would
14 require consideration of a number of items, although Staff disagrees with APS as to the extent of the
15 likely impact. For example, at page 6 of the APS Motion, APS indicates that it has "written off \$234
16 million of prudently incurred costs". Staff absolutely agrees that the Commission would have to give
17 cognizance to this occurrence. However, we must point out that the majority of that "write off" was
18 the result of "stranded cost" issues. It is relatively certain that APS has not incurred any significant
19 stranded costs to date. In the event of a return to regulation, it would seem unlikely that APS would,
20 in fact, ever incur any stranded costs. Thus, the results of an inquiry into the write off amount might
21 not result in APS being entitled to recovery of any amount. Similarly, APS points out the ongoing
22 rate reductions that have been undertaken, at least in part as an outgrowth of the Settlement. While
23 the exact nature of a proceeding is unclear, it may be necessary to reevaluate what rate levels are
24 appropriate for APS in light of a return to regulation. Whether those rate levels would be higher or
25 lower than current rates could be the subject of inquiry. Costs incurred by APS in conjunction with a
26 transition to competition that did not occur could also be considered and treated at such a rate
27 proceeding.

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1 In sum, while Staff does not believe that the Commission has actively considered a return to
2 regulation, there do not appear to be any overriding issues that would prevent consideration of that
3 course of action. Staff offers no opinion on whether customer rates would be higher or lower than
4 current rates following a rate case to implement such a decision. Staff does not advocate this action,
5 but neither do we find the prospect fearful, at least by comparison with the potential issues that might
6 face customers, utilities and the Commission if a fatally flawed competitive model is allowed to
7 proceed, such as occurred in California.

8 **II. THE APS VARIANCE MATTER SHOULD BE STAYED WHILE THE**
9 **COMMISSION CONSIDERS THRESHOLD ISSUES, INCLUDING THE TRANSFER**
10 **AND SEPARATION OF ASSETS**

11 The APS Motion indicates APS's intention to submit the 30-day letter regarding transfer of
12 assets on approximately August 1, 2002. As the discussion above indicates, the transfer of assets is
13 among the threshold issues, in Staff's view. While it is important to address all of the issues raised in
14 the Staff Report, it is not essential that each be addressed before additional steps are taken towards
15 the transition to competition. In Staff's view, a Competitive bidding process can be developed in a
16 relatively short time frame, once the subsidiary decisions are made. Conversely, Transmission
17 Constraints and Reliability are likely to remain concerns and require ongoing consideration over an
18 extended period of time. Adjuster Mechanisms and the specifics of Retail direct Access and
19 Shopping Credits are ultimately essential to a functioning competitive market, but need not be
20 addressed with finality at the outset.

21 As a result, it is Staff's view that the very first issues that must be considered are the Transfer
22 and Separation of Assets, along with consideration of the initial Market Power and Monitoring
23 considerations arising from the removal of all or some generation currently used to supply standard
24 offer customers from this Commission's jurisdiction. An orderly transition to competition necessitates
25 that a competitive market be enabled, yet demands protection for customers who continue to be
26 captive. Only by considering these two issues in tandem can the Commission make a rational
27 decision about the timing and extent to permit transfer of APS's generation assets.

28 In this regard, we should note that Staff does not perceive the issue of transfer of assets as an
"all or nothing" matter in the way APS does. The APS Motion indicates APS's view that, if the

1 Commission in any way adjusts the transfer of assets from that envisioned by the 1999 Settlement,
2 that such a decision amounts to a reversion to regulation. Staff respectfully disagrees. In Staff's
3 view, a staggered transfer of assets might be necessary to both protect customers and facilitate
4 competition, which would be a means of adapting the transition to competition. It is true that there
5 may be consequences of such a decision. It is even true that those consequences might include
6 adjusting the plan in such a way as to accommodate the corporate structure adopted by APS. The
7 point is that it is necessary to both protect customers and facilitate competition, knowing that a
8 competitive market has not developed as yet.

9 Staff believes that the risks could be managed in such a way as to provide the best possible
10 result, protecting customers and facilitating competition. Of course, should that effort fail, there
11 would remain the option of a return to regulation. As we pointed out earlier in this pleading, that
12 alternative has not been considered by Staff, but is not necessarily unpalatable.

13 The APS Motion contains the seed of the solution. APS, as mentioned earlier, has indicated
14 an intention to submit the 30-day letter on approximately August 1, 2002. That letter would
15 anticipate a transfer to be effective on approximately September 1, 2002. It is Staff's view that the
16 prudent course of action for the Commission is to structure a process to yield a decision on the
17 transfer of assets and associated Market Power issues no later than August 1, 2002. All parties would
18 know the terms upon which APS was to be allowed to transfer its generation assets, including any
19 measures necessary to protect against the potential for market power abuses. If necessary to protect
20 customers, a return to regulation could be commenced before the transfer of assets had occurred.

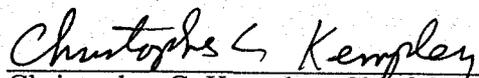
21 Unfortunately, as currently constituted, the proceedings on the APS Request for Variance will
22 not yield an answer to this threshold issue. The proceedings on the APS Variance Request will yield
23 information that may prove very useful in establishing the parameters for a competitive bidding
24 program at a later time. It will also provide information that is useful in establishing more detail as to
25 an appropriate pace for the phasing in of competition. But it is of little use on the very fundamental
26 questions of the appropriate timing and extent of asset transfer, or means to address the potential for
27 market power abuse occasioned by the transfer.

1 Staff can reach only one conclusion. APS has dictated the urgency of addressing the issue of
2 transfer of assets. Staff concurs in that urgency. Staff does not see the Variance Request proceedings
3 as yielding consideration or decision on that issue. Accordingly, Staff's conclusion is that the
4 Variance Request proceedings should be stayed, and a schedule established to address the specific
5 issues of transfer of assets and attendant market power issues. While APS has explicitly indicated in
6 its Motion that it does not wish to impede the hearings, the nature of the Motion belies that statement.
7 Commission Staff, and other parties, will be taxed to complete consideration of the transfer of assets
8 and market power issues by August 1, 2002. Conducting the hearings on the Variance Request as
9 scheduled may make it impossible.

10 **III. CONCLUSION**

11 Based on the recent events, including the APS Motion, as well as the Panda Gila Request for
12 an Order to Show Cause on competitive bidding, it does not appear that the Commission's resources
13 are best devoted to conducting the hearings on APS's and TEP's Variance Requests. Instead, Staff
14 suggests that the proceedings be stayed until further order of the Commission. Instead, Staff would
15 propose that a Procedural Order be issued in the Generic Docket, providing a schedule for
16 consideration by the Commission of the issue of transfer of assets and attendant market power
17 considerations. The procedural schedule adopted should allow the Commission to decide these
18 threshold issues no later than August 1, 2002.

19 RESPECTFULLY SUBMITTED this 23rd day of April, 2002.

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1 Original and ten copies of the foregoing
2 filed this 23rd day of April, 2002,
with:

3 Docket Control
4 Arizona Corporation Commission
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7 Copy of the foregoing mailed this 23rd
8 day of April, 2002, to:

9 All parties of record

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