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COMMENTS OF THE ARIZONA RETAILERS ASSOCIATION (ARA)
REGARDING THE PROPOSED SETTLEMENT AGREEMENT
BETWEEN THE ARIZONA CORPORATIONS COMMISSION (ACC)
AND ARIZONA PUBLIC SERVICE (APS) Nov 30 4 40 PM '98

Opening Statement

Arizona Retailers Association members own and operate retail facilities throughout Arizona, including Department Stores, Food and Drug chain stores, as well as small independently owned and operated businesses. ARA members (including Robinsons-May, et. al.), employ thousands of people throughout the state. The ARA has been an active participant in the re-structuring of the Electric Utility industry in Arizona, actively supporting the positions of residential as well as small and large commercial customers. We welcome the opportunity to provide you with our written comments on the proposed agreement between the ACC Staff and APS.

The Arizona Retailers Association finds little to support in this proposal. In the last several months, the Commission's position had been to push for divestiture of Generation assets for both APS and TEP, or hold the APS and TEP accountable for each and every dollar in stranded cost recovery. Those positions now appear to have been abandoned, and in the process, customers in all rate classes are left with little hope for meaningful savings. The Commission Staff appears willing to give up everything of value for nothing of value in return.

The impact of the proposed settlement on the marketplace is as damaging as 100% of stranded cost recovery. The ARA believes the proposed settlement does nothing to stimulate a competitive marketplace, and in fact, would create significant risks that will discourage both Electric Service Providers and Direct Access customers from participating.

We had believed that the Commission had learned from the experiences that customers have endured so painfully in California. We urge the Commission to take appropriate measures to avoid repeating many of those same mistakes in Arizona.

1.0 The Market Generation Credit (MGC)

The use of the proposed NYMEX monthly futures prices for the full calendar year establishes a forecast of the Market Generation Credit (MGC) that maximizes the opportunity for forecast error. This is followed-up by a true-up based on actual prices for all Direct Access customers, creating tremendous risks that will serve to discourage ESP's from entering the Arizona market, and effectively prevent the birth of a competitive marketplace.

We had hoped that all parties in Arizona had learned from California that Market Generation Credits based on Exchange Market Clearing Prices to calculate stranded cost recovery serve primarily to inhibit a market, not to stimulate it. We urge the Commission to follow SRP's lead in allocating fixed CTC's for each customer class, and avoid error-prone forecasts and true-ups.

2.0 Horizontal Market Power

- 2.1 The ARA believes that the proposed settlement fails to relieve the significant existing levels of Horizontal Market Power, and in fact, increases APS's market power. Too much reliance is placed on the promise of regional cooperation without specific guarantees. APS currently controls almost 4,700 MW or about 31% of the state-wide total of 15,146 MW. The transfer of an additional 300 MW in generation capacity as proposed would serve to increase APS's market share to 33%. While APS's share falls short of the statewide 40% cut-off established by Order 69077, its control over generating capacity greatly exceeds 40% in the combined APS/TEP market that is created initially through this proposal. This arrangement may be in place longer than anticipated if regional cooperation fails to materialize.
- 2.2 The Commission Staff appears to rely on the threat of rescinding APS's CTC recovery if "it finds that APS or its competitive affiliate has significant market power and has manipulated the market price for power in the region." In fact, any eventual downstream litigation could easily cost all customers and ESP's millions of dollars, and APS would be given the opportunity to exploit this market structure for years while waiting for a legal remedy. The interests of all customer classes would be better served by creating a stronger market structure and diluting APS's market share from the beginning, while the Commission still holds the assured recovery of stranded costs as an incentive for APS to cooperate.

3.0 Vertical Market Power and Transmission Access and Pricing

Equal and open access to transmission is a key element to the existence of a functional, robust market. While it is apparent that the Commission has made transmission control a central issue, the structure of the proposed agreement undermines the plan for addressing it.

- 3.1 The proposed settlement attempts to dispose of concerns regarding vertical market power by removing all transmission facilities at or above 345 kV from APS's control. A preliminary review of the WSCC transmission map for the area indicates there is considerable networking of 230 kV lines within the state. This does not support the notion that 230 kV is "used for distribution purposes only." The transfer of transmission facilities should include 230 kV lines.
- 3.2 The Commission cannot rely on FERC regulated open access transmission tariffs to provide open and equal access to transmission, since FERC's regulations focus on open access at the wholesale, rather than the retail level. Unless the Commission takes specific actions, it is still possible that preferential transmission access for native loads may prevent Direct Access customers from receiving equal transmission access, delivering a fatal blow to any chances for meaningful competition.

3.3 The proposed settlement appears to accept promises that an APS/TEP market will be constructed, even though that market will initially exist only at the wholesale level. References to open access principles in Section V appear to create a regional marketplace, but customers are left without specific assurances that out-of-state power can be brought in to compete with regional resources. Power delivered to an interconnection point must be treated as equal to generation created within the region. If out-of-region power is charged an entrance fee, customers will in effect, be required to artificially prop up the price of local generation.

3.4 Promises are made by APS to join a regional ISO, but APS will not be prevented from realizing 100% stranded cost recovery if it fails to join the ISO. The proposed agreement relies heavily on the fact that APS is offering a portion of its transmission in exchange for 100% recovery of CTC's, increased Horizontal Market Power, and a significant competitive advantage against ESP's. Assuming APS does join the regional ISO, it will, as will other transmission owners, be required to assign control of its transmission operations to that ISO. With respect to Vertical Market Power, the Commission Staff appears to have traded everything of value for something APS will give up in the near-term anyway.

4.0 Transition Costs Allowances to APS

The proposed settlement provides for 100% recovery of APS's stranded costs, requires a final irrevocable order from the Commission guaranteeing rate recovery for these costs, and appears to trade hundreds of millions of dollars in transition cost assurances for changes to the ownership of transmission assets and unsecured promises of an open access structure.

4.1 Although Order 60977 provides for the full recovery of regulatory assets that APS claims amounts to \$995 million, approximately 50% is associated with deferred accumulated tax liabilities. The ARA urges the Commission to review these costs again and not give them the same preferential rate treatment as Palo Verde deferrals or sale/leaseback levelization.

4.2 Order 60977 discusses rate recovery for transition costs (absent full divestiture of generation assets) in terms of the utility receiving:

“sufficient revenues necessary to maintain financial integrity, such as avoiding default

under currently existing financial instruments for a period of ten years... or for the

Commission to otherwise provide an allocation of stranded cost responsibilities and risks

between ratepayers and shareholders as is determined to be in the public interest...”.

Clearly what was contemplated by this Order is significantly less than 100% recovery of five hundred and thirty-three million dollars. We urge the Commission to reject any proposal to allow 100% of generation-related stranded cost recovery that does not include significant divestiture of generation assets, as well as divestiture of 230 kV transmission.

4.3 Cost Shifting

The proposed settlement openly promotes cost-shifting between customer classes in at least two ways:

- 4.3.1 The creation of the load-based adder to the Market Generation Credit that is intended to encourage small customers to participate actually shifts cost to larger users. The adder is higher for low load factor customers and lower for high load factor customers.

The ARA has consistently supported efforts to find ways to encourage small customers to participate in Direct Access. We have also consistently supported efforts to prevent cost-shifting between customer classes, despite the fact the Commercial Meter class has paid, and will continue to pay more than its fair share.

We urge the Commission to find ways to promote Direct Access participation for all classes, without shifting costs between customer classes.

- 4.3.2 APS is provided with an explicit opportunity to file a revenue neutral rate case designed to do nothing more than change the existing allocation of costs for rates beginning in January 2000. Under the proposed settlement, APS will be able to propose a change in cost allocations while CTC collection is going on. As a result, APS will be able to target CTC collection among customer classes. This allows APS to design rates that would reduce prices to the most competitively sensitive classes in an attempt to thwart competition from other sources.

While ARA believes that all parties have had sufficient time to prepare for the opening of a Direct Access market 1/1/99, we hold little hope that a meaningful market will have been created through this settlement, or that enough market participants will believe a meaningful market exists to risk participation by that date.

We believe that it is more important to have a well-designed, open marketplace than to meet the 1/1/99 deadline, but we do not believe a significant delay is required. We will continue to work with all parties to achieve a more satisfactory settlement to meet the 1/1/99 deadline or a date not later than 3/1/99.

The ARA urges that this proposed settlement be rejected outright, and that customer groups be included in helping to develop a proposal that better serves all the utility customers of Arizona.

Please direct any comments or questions you may have regarding this material to:

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