BEFORE THE ARIZONA CORPORATION COMMISSION

CARL J. KUNASEK,
Chairman
JIM IRVIN,
Commissioner
WILLIAM A. MUNDELL,
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF ITS PLAN FOR STRANDED COST RECOVERY	Docket No. E-01345A-98-0473
IN THE MATTER OF THE FILING OF ARIZONA PUBLIC SERVICE COMPANY OF UNBUNDLED TARIFFS PURSUANT TO A.C.C R14-1-1601 *ET SEQ*.	Docket No. E-01345A-97-0773
IN THE MATTER OF COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA	Docket No. RE-00000C-94-0165

POST-HEARING BRIEF OF ENRON CORP.

August 5, 1999

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Pursuant to the Hearing Examiner's order in the above-captioned proceeding, Enron Corp. and its affiliates Enron Energy Services Inc. and Enron Capital & Trade Resources Inc., (jointly, "Enron") hereby file this Post-Hearing Brief on the Settlement filed by APS and others in this proceeding on May 14, 1999. The Settlement, *inter alia*, phases in retail competition for APS customers, sets both Standard Offer and Direct Access tariffs, and permits APS to recover $350 million in stranded costs. The overarching issue in this case is whether the Arizona Corporation Commission ("Commission") should approve the Settlement.

Enron submits that the Settlement should not be approved as filed. The record reveals that the Settlement will not create a viable marketplace in which Energy Service Providers ("ESPs") will be able to offer competitively priced products and services. By allowing APS to transfer all of its competitive assets to affiliated companies the Settlement raises serious market power concerns. Finally, the Settlement is either silent or vague on a number of extremely significant issues, which makes Commission approval premature at best and at worst a shot in the dark. Modifications to the Settlement must:

1. Increase both the shopping credit and the credits for the competitive metering and billing services, to levels which allow ESPs to compete.

2. Unbundle rates and services for both Standard Offer and Direct Access customers so that those rates and services are clearly comparable.

3. Eliminate provisions in the Settlement which allow APS to defer and then recover losses related to Standard Offer service.

4. Address market power and cross-subsidization issues that arise from the transfer of all APS generation assets to an affiliate.

5. Specify all assets to be transferred by APS, and include measures such as a strong Code of Conduct, recourse tariffs and divestiture/sales of generation to third parties.

I. Standard of Review

The APS Settlement is "global" in nature, attempting to resolve the gamut of restructuring issues: the phase in of competitive retail service, standard offer service, calculation and recovery of stranded costs, transfer of generation assets to an APS affiliate, unbundling rates for direct access service, code of conduct and future rate decreases and adjustments.

Staff Witness Smith set forth seven criteria against which to evaluate a settlement of this scope, and Enron believes these aptly form the proper basis for review. Under the criteria the settlement must (1) assure that all potential suppliers have fair access to customers; (2) assure that all potential suppliers have fair access to the wires: (3) identify and address market power in generation; (4) provide customers the opportunity to purchase electric services from a supplier of their choice; (5) inform customers of what they pay the utility for each service so they can compare different providers; (6) avoid subsidization of unregulated services by regulated services; and (7) resolve disputes over stranded costs. The record demonstrates that the Settlement fails to meet these criteria. APS and the parties supporting the Settlement have failed to meet their burden to show that the Settlement is in the public interest, and the Settlement, as filed, must not be approved.

II. The Settlement Neither Assures All Potential Suppliers Fair Access to Customers nor Provides Customers With an Opportunity to Purchase Electricity from the Supplier of their Choice.

A. The Implied Shopping Credit Does Not Reflect Market Prices of Energy or the Costs of Providing Retail Service.

Much discussion on the record focused on the "shopping credit" set forth in the Settlement. The shopping credit is the difference between the bundled Standard Offer rate available as a default service to APS's retail customers, and the Direct Access Rate available to customers who take service from ESPs. This difference effectively creates a cap on what the ESP can collect for the services it brings and costs it incurs over and above the Direct Access rates. If APS had performed a functional cost-of-service study and designed rates for standard offer and direct access service by function, then the difference between the standard offer and direct access rates would be a cost-justified, "natural" shopping credit. Since APS did not do such a study, the Settlement's shopping credit is an artificial division of costs. It does not reflect the true costs to either APS or the ESP in providing retail service. Nonetheless, since APS has not unbundled its rates based on costs, the Commission must look at the shopping credit to see if it is adequate for competitive retail service.

Indeed, if the shopping credit is set too low, ESPs cannot supply energy to consumers. ESPs will not be able to recover the Direct Access portion of the rate, the generation component and the additive costs of providing retail service, because the resulting bundled ESP rate would then exceed the Standard Offer Rate. There are retailing costs which ESPs will incur and must be able to recover, over and above the unbundled services the Commission listed in its April 23 proposed Electric Competition Rules ("ECR").[1] These are commodity acquisition and supply portfolio management, energy imbalance costs, planning reserves and certain functions related to metering, billing and customer handling. As Mr. Kingerski explained,[2] prices for non-competitive services should be competitively neutral and should not affect a customer's decision to purchase competitive services. The success of competitors should depend on their success at providing competitive services and not on the pricing of non-competitive services.

Enron Witness Kingerski and others testified that the shopping credit was too low for competition to occur. Mr. Kingerski presented a calculation which showed, as an example, that for a 500 kW customer with a 50% load factor, the shopping credit was insufficient to cover the ESP's wholesale energy cost, much less the additional retail activities an ESP must perform.[3] While APS apparently understands this, APS does not believe that it presents a problem. Instead, APS claimed that the shopping credit was sufficient for at least certain customers in the 40 kW to 200 kW class. Mr. Kingerski

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[1] Order No. 61634.

[2] Enron Exhibit 6, Direct Testimony of H. Kingersky, pp. 16-17. *See also* Exhibit HJK-1 in Enron Exh. 6.

explained that the shopping credit even for this group was insufficient, once APS's numbers are adjusted for current wholesale energy costs and the cost of hourly interval metering, which APS will require for the direct access customer.[4] But even if APS were correct, a shopping credit that works only for some customers in certain classes with particular load profiles is not a shopping credit that fairly opens all of the market to choice. Nor has APS explained why the shopping credit so greatly differs for different sized customers, in most cases falling below wholesale energy prices.

B. <u>The Credits for Metering, Meter Reading and Billing Are Improperly Based on Avoided Costs.</u>

APS has used its short-run marginal costs to establish credits for the competitive metering, meter reading and billing services in the Direct Access Rate Schedule.[5] These credits are deducted from the Direct Access bill if the ESP performs the services itself. The record is clear that these credits are woefully inadequate. The credit given to an ESP for billing its own customer, $.30/month in most cases, is not even enough to pay for the postage to mail the bill. Setting credits based only on avoided costs creates the perverse result of encouraging ESPs to use APS metering and billing, even if the ESP has more efficient or value-enhancing metering or billing. If the credits are not set at levels which reflect APS's embedded costs, then the ESPs will not have enough pricing margin to build the systems and make the investments they need to provide these competitive services. Allowing APS to continue to collect embedded costs for competitive services from direct access customers is not just and reasonable; if these customers are not taking these services, they should not pay for them. If APS has stranded metering and billing

[3] Tr. at pp. 845-6, *see also* APS Witness Davis at Tr. p. 223, lines 15-18.
[4] Oral Surrebuttal of H. Kingerski, Tr. at pp. 845, line 20 – 847, line 11.
[5] APS Exhibit 2, Direct Testimony of Propper, p. 15, lines 9-10.

costs as a result of customers switching to direct access service, then they should be recognized and treated as such. Setting credits for competitive services on avoided costs merely kills the competitive marketplace for those services.

The ESP's ability to offer competitive metering services is further compromised by the Settlement. ESPs may be required to have hourly interval meter-reading capability for certain customers under the proposed ECR, which will require the ESP to install a new meter for those customers. APS, however, will not be required to change out the meter for the same customer if that customer stays on Standard Offer Service. The cost of the new meter presents a substantial economic barrier to the ESPs and gives APS's Standard Offer yet another undue competitive advantage.

APS noted that in California the billing and metering credits are set on the avoided or short-run marginal cost methodology.[6] APS conceded that California is revisitng this method.[7] The California Public Utility Commission ordered the utilities to include in their applications for post-transition period rates a more complete revenue cycle services unbundling at rates which approximate those likely to prevail in a sustainable competitive market, i.e., long-run marginal costs.[8]

C. To Assure that All Suppliers Have Fair Access to the Wires, The Direct Access Rate and The Standard Offer Rate Must Both Be Unbundled to Provide a Measure for Comparability of Service and to Allow Consumers to Compare Providers.

The proposed ECR require that APS unbundle its Standard Offer tariff and separately price a minimum of ten components.[9] By separating the rates into its unbundled

[6] APS Exhibit 11, Rebuttal Testimony of APS Propper, pp. 4-5.
[7] Oral Rejoinder of APS Witness Propper, Tr. p. 1137, lines 15-20.
[8] Oral Surrebuttal of Enron Witness Kingerski, Tr. at pp. 850-51.
[9] The elements are: Electricity: Generation, Competitive Transition Charge, Must-Run Generating Units; Delivery: Distribution Services; Transmission Services; Ancillary Service; Other: Metering Service, Meter Reading Service and Billing and Collection; System Benefits. R14-2-1606C.

components which reflect the cost of pricing the service,[10] parties can compare Standard Offer and Direct Access rates. The rate for each unbundled service, be it transmission, distribution, ancillary services, etc., should be the same for both a Standard Offer or Direct Access customer, as the service provided is identical, regardless of who is selling that customer power. Having rates for both services unbundled into their separate components ensures that ESPs enjoy "comparability of service." For example, the distribution charge for a standard offer customer should be the same charge if that customer takes direct access service, because the distribution service is no different. If the rate for distribution is more under the direct access rate schedule, then ESPs face an economic barrier which thwarts competition.

In *Tejas Power Corp., et al. v. FERC*,[11] the U. S. Court of Appeals for the District of Columbia Circuit reviewed FERC approval of a pipeline settlement which proposed open access transportation tariffs and a funding mechanism, the so-called "GIC," for the costs of maintaining supply. The GIC funded take-or-pay costs in gas supply contracts, which were the gas industry's version of stranded costs. The "GIC" in the *Tejas* case departed in a number of ways from earlier FERC decisions. FERC approved the "GIC," reasoning that under the Settlement, the pipeline's customers had sufficient flexibility to obtain alternative supplies. But FERC put off its review of the Settlement's open access tariffs and whether they established transportation and storage service for third parties that was comparable to the transportation and storage service that was provided by the pipeline in connection with its sales service. The Court of Appeals held that "without having first assessed the comparability of [the pipeline's] unbundled transportation and storage

[10] Order No. 61634, App. A, R14-2-1606C(4) and 1606H.
[11] 285 U.S. App. D.C. 239, 908 F.2d 998, 1990 U.S. App. Lexis 12206 (1990).

services, . . . the Commission could not rationally conclude that the LDC's could take advantage of any alternative sources of gas."[12] We must come to the same conclusion here: we cannot ascertain whether there is comparability of service under the Settlement because APS did not unbundled its Standard Offer rate.

We do, however, have an example of non-comparability of service between the Standard Offer and Direct Access Rate Schedules, that was examined at the hearing. The monthly residential customer charge under Standard Offer is $7.50. If a customer under that Rate Schedule opts for direct access service, the charge goes up to $10.00.[13] This means that the ESP must find $2.50 of monthly savings before it can even offer a lower price for generation, to be able to entice customers and show a profit. Furthermore, the Settlement sets a CTC demand charge for every kW of demand for Direct Access customers while Standard Offer customers have no such charge for the first 5 kW of demand. These examples illustrate that APS has not given the market comparability of service. It has created discriminatory service.

Mr. Kingerski addressed APS Witness Propper's argument that unbundling Standard Offer rates would result in extreme dislocations in class revenues and major rate dislocations. In Enron Exhibit 9, Mr. Kingerski provided an illustrative example of how standard offer rates can be unbundled with no effect on the customers' total rate.[14] He further explained that this can be done even where the total rate for a given class is different from the actual cost of service for that class. The value of this unbundling is that it provides for non-discriminatory, comparable prices for non-competitive services, as demonstrated in Enron Exhibit 9. Since APS has not conducted the cost of service

[12] 908 F2d at 1004.
[13] See Cross Examination of APS Witness Propper Tr. pp. 1166-1167.

study, the only viable option for immediately unbundling both direct access and standard offer rates is to use the top down approach. This approach necessitates making adjustments to each of the non-competitive, unbundled rate components if there are situations where the total rate for a given class is less than the actual cost of service for that class.[15]

D. The Settlement Protects APS From Market Risk, Even as It Allows APS to Offer Products into a Competitive Marketplace.

The Commission's proposed ECR require that after Jan. 1, 2001, power purchased by an investor-owned utility for Standard Offer Service shall be acquired through the open market, and that that source of power should be the lowest-cost generation available.[16] The conditions surrounding recovery of the costs APS thus incurs in obtaining power for the Standard Offer service is also of vital interest to ESPs, as provision for deferred recovery of costs for generation will make the Standard Offer more attractive to consumers. These customers are not getting real price signals if the Standard Offer rate can be adjusted in later periods to recoup losses for under-recovery.

As Enron Witness Kingerski explained, the provisions of the Settlement seem to indicate that costs APS incurs in providing Standard Offer Service are completely recoverable from all Standard Offer customers, with no risk to APS.[17] Section 2.5 allows APS to defer costs, including costs incurred in providing Standard Offer Service, for later full recovery through an adjustment mechanism. Section 2.8 authorizes APS to seek increases in its Standard Offer Rate, even during the rate freeze period prior to July 1,

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[14] Enron Exhibit 9, and Oral Surrebuttal of Enron Witness Kingerski at Tr. pp. 848-850.
[15] See Cross Examination of Enron Witness Kingerski at pp. 881-886.
[16] R14-2-1606.
[17] See Direct Testimony of Witness Kingerski, p. 9, lines 19-21, discussing Settlement sections 2.6 and 2.8. Section 2.6 allows APS to defer costs, including Standard Offer costs, for later full recovery through an

2004, under certain conditions, which APS was unable to describe with any certainty at the hearing.[18] This allows APS to sell Standard Offer below market or even below cost, making it impossible for ESPs to compete. APS is then able to recover any revenue shortfalls through the adjustment mechanism in Section 2.6 or the safety valve provision in Section 2.8. This is carte blanche for APS to engage in predatory pricing. The Commission should at the very least modify the Settlement to prevent rate increases in the Standard Offer rate due to upward movement in market prices.

III. The Transfer of Generation Assets to An APS Affiliate Raises Market Power and Related Regulatory Concerns Which the Commission Must Address.

There is no question that APS, as a regulated monopoly, enjoys market power in its service territory today. The Settlement permits APS to carry this market power forward into the competitive arena, through, *inter alia*, its treatment of the generation assets. Referring back to the *Tejas* case, the Court of Appeals there stated:

> If the pipeline has significant market power with which to extract an agreement unfavorable to its LDC customers, then it would not require much imagination for the pipeline to also require that they support the agreement fully before the Commission. In any event, quite apart from whether the settlement is unfavorable to the LDC's, the Commission may not be complacent about the possibility that the GIC is so structured as to enable the pipeline, through the exercise of significant market power, to impose unreasonable terms that will likely be paid for by end users that were not parties to the settlement.[19]

This Commission must ensure that APS's market power does not live on, either through its Standard Offer service or through the transfer of assets to an affiliate.

A. APS's Monopoly Market Power Will Be Transferred to GENCO

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adjustment clause. Section 2.8 authorizes APS to seek increases in its unbundled or Standard Offer Rate even during the rate freeze period prior to July 1, 2004.

[18] Cross Examination of APS Witness Davis, Tr. at p. 264, line 17 through p. 271, line 15..

[19] 908 F.2d at 1004.

Referring again to the criteria that should guide the Commission in this proceeding, it is incumbent upon the Commission to identify and address market power in generation or other areas that will result if the Settlement is approved. Enron Witness Frankena made several significant findings regarding generation market power in Arizona. He found that load pockets exist in the Phoenix and Yuma areas (Phoenix is a relevant geographic market during high load periods), APS and SRP own 35% and 65% of the generating capacity in the Phoenix load pocket and market power is a serious problem in this area. Dr. Frankena testified that further investigation may show that there exist additional relevant geographic markets for electric capacity and energy larger than the identified load pockets, which would give APS substantial market share. Next he concluded that the Settlement leaves ownership of the generating capacity in Arizona unchanged but for the fact that APS's share would be owned by an APS affiliate, which would have the same ability and incentive to exercise market power as the incumbent. Lastly, Dr. Frankena concluded that the Settlement did not mitigate APS's market power or reduce the likelihood of the exercise of this power through coordinated behavior by two or more parties. The leverage this Commission has to reduce market power derives from its treatment of APS's stranded costs. Once that decision is reached, as it would be through approval of this settlement, then the Commission loses its power to address market power concerns.

APS Witness Hieronymous attempted to rebut Dr. Frankena's conclusions. Mr. Hieronymous used the FERC Appendix A methodology to address market power. Dr. Frankena challenged the use of the Appendix A methodology in great detail,[20] and even

[20] Oral Surrebuttal of Enron Witness Frankena, Tr. at pp. 175, line 5 to p. 178, line 7.

Mr. Hicronymous has been critical of Appendix A.[21] Mr. Hieronymous criticizes Mr. Frankena's point that there may be relevant markets larger than the load pockets identified, stating that this analysis is not required by the the DOJ Guidelines.[22] Witness Hieronymous simply concludes that if he had looked at larger markets, APS's share would have been less.[23] However, this is an opinion without any substantiation. The sum and substance of Dr. Frankena's testimony, which remains unrefuted by APS, is simply this. The public interest requires a more detailed analysis of market power than the last minute analysis Witness Hieronymous provided based on the controversial Appendix A methodology. Absent such a study the Commission cannot ascertain the competitive impact of the wholesale transfer of APS's competitive assets to an affiliate.

B. <u>The Asset Transfer Raises Other Regulatory Concerns, Including Subsidization of Unregulated Services by Regulated Services.</u>

The asset transfer proposal in the Settlement must be viewed not only in terms of generation market power, but also in the fairness of the resulting stranded cost recovery, and cross-subsidization concerns. Enron Witness Rosenberg addressed these issues, testifying that the Settlement provides insufficient evidence that the transfer of generation assets to an unnamed APS affiliate ("GENCO") will sufficiently safeguard customers and promote competition.

The Commission must deal with cost-shifting between GENCO and APS. There is no indication in the Settlement as to how APS will deal with GENCO once the generation assets have been transferred. In fact, APS does not even plan to transfer the competitive assets to GENCO or any other affiliates until the end of 2002. This means that, for at

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[21] Cross Examination of APS Witness Hieronymous, Tr. at pp. 1251-1253.
[22] Oral Surrebuttal of APS Witness Hieronymous, Tr. at p. 1242, lines 15-16. DOJ Guidelines are the Department of Justice/Federal Trade Commission merger guidelines.

least the first three years of competition, there will not even be the protection against cross-subsidization and other intra-corporate favoritism that corporate separation between the provider of Standard Offer Service and the owner of the assets gives. Absent functionally unbundled rates, we can be assured that some measure of the generation service is being recovered in the Direct Access rates, a clear situation where competitive services provided by third parties are subsidizing the regulated Standard Offer against which they compete. Additionally, APS rates will recover certain costs associated with the generation facilities it will transfer to GENCO, giving GENCO yet another advantage in the wholesale electric market.[24]

Dr. Rosenberg further identified a concern that APS might retain favorable purchase power contracts in the wires company, which would otherwise be a stranded benefit to ratepayers, and certainly embues Standard Offer service with competitive advantage.[25] Mr. Davis testified for APS that in fact, the "only purchase power contract we have in terms of magnitude" is the Salt River Project power purchase contract. He testified that if APS has less Standard Offer service than the magnitude of that contract, they would transfer it to an affiliate, if not, then the contract would stay in the wires company, to supply its Standard Offer service.[26] This is precisely the kind of cherry-picking that Dr. Rosenberg warned against.

Dr. Rosenberg also testified that the asset transfer proposed in the Settlement raises concerns over capitalization and capital structure. The issue here is that the transfer of

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[23] Oral Surrebuttal of APS Witness Hieronymous, Tr. at p. 1242, lines 16-18 and p. 1244 at lines 11-13.
[24] Cross Examination of APS Witness Davis, Tr. at p. 263, decommissioning and fuel disposal costs will be recovered in systems benefit charge.
[25] Enron Exhibit 1, Direct Testimony of A. Rosenberg, at p. 3.
[26] Tr. at pp. 1118-1119.

assets from APS to GENCO requires a new division of debt and equity.[27] This division has implications for all customers. Debt financing is cheaper than equity financing and is tax deductible to the corporation. A more highly leveraged structure benefits customers, but if the transfer shifts the higher cost of capital (equity) to the regulated company, the GENCO gets the unearned competitive advantage derived from a low capital cost. APS indicated that it had not determined the future funding method for its competitive affiliates.[28] Accordingly, the Commission cannot evaluate the impact of this aspect of the transfer based on the record before it.

C. Voluntary Divestiture is an Option that Should be Explored.

Witness Rosenberg explained the numerous advantages that an auction has over the intra-corporation transfer of generation assets. (Direct Testimony at p. 4.) An auction elicits the highest possible price for the assets, providing the most mitigation of stranded costs. Auctions would likely lead to multiple owners of generation assets, reducing generation market power concerns. An auction eliminates the problems of the capital structure of the GENCO and the wires company discussed in the preceding section.

While APS asserts that Enron is attempting to re-argue lost arguments from the ECT proceeding over mandatory divestiture, in fact the opposite is true. Enron's objective is to point out the advantages in the auction method, which APS is free to choose under the ECR and Stranded Cost Rules. Voluntary divestiture through auction, even of only a part of the generation assets, will alleviate many of the concerns Enron and other ESPs have expressed with the Settlement.

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[27] Dr. Rosenberg illustrates this on pp. 6-9 of his Direct Testimony, Enron Exhibit 1.
[28] Enron Exhibit 1. Direct Testimony of A. Rosenberg, at p. 8.

APS Witness Landon testified that an auction would be more costly than an inter-company transfer. Yet, the main cost of an auction that he was able to identify was that of APS personnel providing data to potential buyers in their due diligence efforts. While employees may spend time preparing data, it is not an incremental cost to APS. In fact, all of the significant costs of divestiture are the same, regardless of whether the recipient of those assets is an affiliate of APS or a third party: splitting jointly owned facilities, tribal approvals, and legal documentation.[29] Any notion that the inter-company transfer is a cost-saving measure, and this is thus more desirable than an auction, is false.

D. <u>AISA/Desert Star May Not Adequately Address Market Power Issues</u>.

Enron and others assert that transferring all of the generation APS currently owns to a GENCO affiliate simply transfers APS's generation market power to an unregulated company. APS responds, stating that the Arizona independent system administrator, the "AISA" and later the Regional Transmission Organization, Desert Star, will mitigate market power.[30] Enron Witness Delaney discussed at length the problems associated with the AISA and Desert Star, and this was echoed by APS's own witness, Mr. Propper, who stated that "the AISA had not completed its protocols or even filed them with the FERC." The Federal Energy Regulatory Commission would review and either approve, modify or reject the filing. He further stated that it is not known whether FERC will accept whatever the AISA files.[31]

Mr. Delaney explains in depth the shortcomings of the AISA which render its ability to address market concerns minimal at best. He recommends that the Commission impose a standard of conduct on the GENCO which would require it to sell a portion of

[29] Cross Examination of APS Witness Landon, Tr. at pp. 1286-1290.
[30] APS Exhibit 9, Davis Rebuttal, pp. 27-29.

its output to non-affiliated purchasers. He also suggests that some degree of divestiture of the generating assets could also effectively mitigate the market power that the GENCO would otherwise enjoy. In lieu of divestiture, APS (or the GENCO) could be required to exchange or sell output of load pocket resources to unaffiliated entities, or could be required to file, with the FERC, a "recourse tariff" which would cap the price at which APS/GENCO could sell in the identified load pockets. This would shift the risk of managing these assets from the ratepayer to the generator. Second, the recourse tariff should allow any potential purchaser to call on APS/GENCO to sell power in the load pockets and in Northern Arizona, and third, the tariff should cap ancillary services sold by APS/GENCO.[32]

IV. The Commission Should Condition Approval Upon Satisfactory Resolution of Key Issues Which are Not Addressed in this Settlement.

The significance of the instant Settlement to the creation of competitive market in APS' service territory cannot be overstated. This Settlement will govern the marketplace for at least 6 to 8 years. While we would hope that the Commission would entertain proposals for change once the market is open, if such changes are warranted, clearly the proponent of such change has an uphill battle if the settlement is deemed controlling. In fact, however, the Settlement itself contains language that could constrain the Commission from modifying terms of the Settlement in the future.[33] Therefore, the Commission should not approve the Settlement to the extent it leaves some very significant issues inadequately addressed. APS and the other parties should be required

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[31] APS Exhibit 11, Propper Rebuttal, at p. 12.
[32] Enron Exhibit 5, Direct Testimony of T. Delaney at p. 8.

to answer the following questions before the Settlement is approved, so that the Commission can meaningfully analyze the Settlement and its impact on Arizonans.

A. APS has not Definitively Described the Assets it will Retained and Which it will Transfer.

It is clear that certain generation assets are "competitive assets" under the ECR and will be transferred by APS to its affiliate, and APS Exhibit 9, Attachment JED-6R generally lists those assets. There are, however, a number of other assets that have not been identified by APS as being "competitive" and thus subject to transfer. Retention of these assets can give APS an undue advantage in its competitive activities, viz., Standard Offer service.[34] APS must identify all of the potentially competitive assets it will transfer so that the Commission can ascertain whether the Settlement will result in compliance with the proposed ECR or will enable APS to keep a competitive advantage.

B. Code of Conduct has not been Filed and When Filed Will be Immune from Protest or Comment.

Section 7.7 of the Settlement provides that within 30 days of approval of the Settlement, APS shall serve on the parties to the Settlement an interim Code of Conduct to address inter-affiliate relationships. APS will voluntarily adhere to this Code until the Commission approves a Code under the ECR. At the hearing, APS did agree to submit its proposed Interim Code to all parties by August 6, 1999. However, as the Settlement provides, APS does not intend to submit the interim Code to the Commission for approval, and if there are areas of disagreement between APS and the parties as to what should be in the interim Code, there is no process to air these disagreements. APS alone has the final say as to what the interim Code will be. Thus, the very real potential exists

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[33] See *e.g.* Sections 3.5 and 7.1 of the Settlement.

that the interim Code of Conduct voluntarily adopted by APS will not prevent all of the potential abuses that APS and its affiliates that a comprehensive code would. Just as serious is the fact that there would be no remedy or provision for redress if violations of the code took place. The Code of Conduct to which APS must adhere should be available to the Commission before it approves the Settlement and the Code itself should be approved as part of APS's tariff so that parties can bring alleged violations before the Commission.[35]

C. The Delay in Transferring Assets Leaves Open Potential for Market Power Abuse.

Section 4.1 of the Settlement allows APS to delay transferring its competitive assets to an affiliate until Dec. 31, 2002.[36] Thus for the first three years of open markets, APS will continue to own and operate all of the competitive assets it now has, including generation and those assets associated with customer (revenue cycle) services. It appears that the interim Code of Conduct will not govern APS's activities during this three-year period, as Section 7.7 states that the interim Code will address inter-affiliate relationships. The Settlement is completely silent as to how APS will manage the competitive assets while it still owns them. APS must be required to spell out how it will manage its generation and other competitive assets during this transition period, to avoid giving itself undue advantage over the ESPs in the marketplace. The potential for APS to

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[34] See, e.g. discussion of Enron Witness Rosenberg re: advantages of certain purchase contracts, Enron Exhibit 1, at pp. 3-4.
[35] While the FERC Code of Conduct provisions would apply to APS transmission service, APS Witness Landon admitted that the "FERC affiliate rules are generally light-handed and do not keep utilities from sharing financing costs and personnel costs broadly." Tr., p. 1294, lines 5-7.
[36] APS Witness Davis testified that while APS could transfer the assets at any time during that three-year period, it would likely not be done much before the 12/31/02 date, and that all assets will be transferred to GENCO simultaneously. Tr. at p. 334, line 4 through p. 335, line 8.

use these assets to make its services more attractive than those of competitors is so great, that any Commission action on the Settlement must close this door.

The delay in transferring generation and other assets has implications under the Commission's proposed ECR as well. R14-2-1606B requires the utility to supply the Standard Offer service through the open market. If for the next three years APS retains all the generation it currently owns, it is hard to see how it will be supplying Standard Offer service from the open market. The "open market" requirement in Rule 1606B will prevent the utility from using its monopoly power to give it a better competitive product than ESPs can provide in the marketplace. If APS does not explain how it will comply with this rule, there are serious questions about the fairness of the marketplace in which ESPs are expected to compete with APS.

WHEREFORE, in light of the discussion above, Enron submits that the Settlement be rejected as filed, and that, if the Commission is to approve the Settlement, then modifications as described in this Brief be adopted to ensure that the resulting open marketplace in APS's service territory is fair and level and permits ESPs to bring products and services to APS's customers.

Dated: August 5, 1999

Respectfully submitted,

ENRON CORP.

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