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Docket #RE00000C-94-0165

Arizona Corporation Commission
DOCKETED
MAY 26 1998
DOCKETED BY

Mr. Ray T. Williamson
Acting Director
Utilities Division
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007-2996

Re: Comments on Staff's May 19, 1998 Statement of Position on "Important Issues of Retail Electric Competition"

Dear Mr. Williamson:

On behalf of Cyprus Climax Metals, ASARCO and Arizonans for Electric Choice and Competition, we appreciate the opportunity to comment on Staff's position on important issues of Retail Electric Competition as set forth in your letter dated May 19, 1998. Conceptually, Staff's position statement reflects a major step forward for resolving several important issues related to the introduction of competition. However, as explained in more detail herein below, we are proposing a number of specific changes and additions to clarify several issues. Moreover, the relationship between Staff's position and the Chief Hearing Officer's Recommended order dated May 6, 1998 is unclear. Are the issues addressed in Staff's position statement the only issues on which Staff disagrees with the Recommended Order and does Staff accept the order as to all issues that are not addressed?

A. Stranded Costs

Goals

We believe it is important to add as a goal that stranded cost recovery be structured in a manner which provides customers the opportunity to benefit from participation in the competitive market.

Given that a stated goal is to provide Affected Utilities an opportunity for full recovery of stranded cost, it appears redundant to also list as a goal "to ensure the financial viability of all Affected Utilities."

Stranded Cost Recovery Mechanism

Collection of any stranded cost should be through a usage-based competitive transition charge (CTC) levied on "wires" service. (A customer-optional exit fee should be allowed also).

Divestiture

We suggest the following approach for determining the recoverable amount of stranded cost under divestiture. This approach is intended to meet Staff's objective of providing the opportunity for 100% recovery, while providing the utility incentives for achieving the highest possible bid prices and offering some risk mitigation for customers.

Using the ratio of bid values to net book value, establish thresholds which define when 100% recovery is allowed. At ratios below the threshold, less than 100% recovery is allowed. For example, if the sum of bid values for generation assets exceeds 80% of net book value, 100% of stranded cost could be allowed. If the bid values fall between 60%-80% of net book value, then 25% of the shortfall below 80% (but greater than 60%) could be absorbed by the utility. If the bid values are between 40%-60% of net book value, then 50% of the shortfall below 60% (but above 40%) is absorbed by the utility, and so on.

Under this approach, if a utility's generation assets sold for 85% of net book value, 100% of stranded cost would be recovered; if they sold for 50% of net book value, 80% of stranded cost would be recovered.

Buy-through

Consistent with House Bill 2663, the Electric Competition Rules should be revised to provide that Affected Utilities **"shall"** not "may" provide for buy-through service at no additional charge above required transmission.

Employee Severance and Retraining Costs

The introduction of electric competition will create significant employment opportunities in the electric industry. Individuals who leave utility employment are likely to find opportunities with new market entrants, independent generators, independent system operators and consulting firms. Therefore, the inclusion of employee severance and retraining costs as a stranded cost to be borne by customers is inappropriate. Instead, to the extent these costs are warranted, the utilities and their shareholders should be responsible for providing for its severed employees.

Utility Purchases of Divested Generation Assets

Staff proposes that, following submission of a divestiture plan, the Commission may approve the purchase of generation assets by an Affected Utility or its affiliates if "good cause" is demonstrated. However, "good cause" is undefined and the factors to be considered are not enumerated. This provision should not allow an Affected Utility or its affiliate to buy back its own generation assets at a bargain basement price while requiring the consumers to pay the resulting stranded costs.

Transition Charge Cap

The statement of position lacks an explicit requirement for a cap on the transition charge. A cap which limits the transition charge to an amount no greater than the customer's current contribution to the utility's uneconomic (i.e., strandable) cost is essential. The purpose of a CTC cap is to ensure that the transition charge does not cause the delivered price of power to customers to be higher under competition than it was under regulation. In testimony and discussions, Staff has supported such a cap. It is necessary that such a cap be incorporated in the Rule.

A CTC cap should apply to all customers -- small and large. Without such a cap, customers would be exposed not only to *market risk* (which we accept), but to unwarranted regulatory risk, in which their obligation to pay a utility's uneconomic costs could actually be increased (via the CTC) upon taking competitive service. Such a policy would be unfair and potentially disastrous for the affected customers.

A violation of the CTC cap would mean that affected customers would very likely be made worse off under competition, not because of market conditions -- but because they would be required to enter the market already "in the hole", i.e., saddled with greater charges for stranded cost than they paid in their regulated rates. A customer in this situation would have to buy power *below* the competitive market price just to *stay even* with their prices under regulation. A customer unable to beat the market sufficiently would actually wind up paying higher prices under competition.

This point can be seen in a simple example. Suppose a customer pays 3.5 cents per kWh for generation under a special contract, and that the market price of power is 3 cents. The customer is then making a .5 cent contribution to the utility's uneconomic (or stranded) costs. Under a CTC cap, when the contract expires and the customer purchases from the competitive market, this .5 cent should represent the maximum CTC for this customer. If the customer pays .5 cent in the CTC and purchases at the competitive market price of 3 cents, the customer is in exactly the same situation as prior to competition -- no better or worse off. The utility is also in the same situation -- receiving a .5 cent/kWh contribution toward its uneconomic costs, and is able to sell the "freed up" output into the market at the 3-cent price. All other customers are also held harmless.

If, on the other hand, the customer is charged a CTC greater than its contribution to uneconomic costs under regulation, such as 1 cent/kWh, the customer enters competition "in the hole". In this example, the customer would have to buy competitive power at 2.5 cents/kWh, beating the market by .5 cents - just to stay even. There is no question that a customer placed in this position is being denied a reasonable opportunity to benefit from competition, in violation of the Staff's first objective in Section C of its position statement.

While we are making this argument as a matter of principle, there are also serious practical consequences of failing to adopt the CTC cap. If industrial customers were forced to pay a CTC which exceeded their current contribution to the utility's uneconomic costs -- and were deprived the benefits of competition (or are made worse off), the impact could be devastating for them. In the case of copper mining, electricity represents the greatest component of variable cost besides labor. As you know, Arizona's copper industry is suffering from a depressed world market price. BHP's Pinto Valley operation was recently forced to cease production. Other properties are holding on, awaiting the outcome of electricity deregulation. If deregulation is accompanied by higher regulatory charges which eliminate the benefits, the retail competition program will end up a colossal failure.

Special Contracts

It is critical to clarify the intent of the second sentence of the paragraph devoted to special contract customers. Consistent with the CTC cap principle, the stranded cost "imputed" to special contracts should reflect only the contribution being made to stranded cost recovery implicit in the special contract price. Assignment of additional stranded cost would be inappropriate as it would violate the protections included in the CTC cap. We suggest the following modification to the second sentence: "However, a stranded cost or transition charge for the special contract customers will be imputed to the contracts in an amount equal to the contribution to stranded cost recovery implicit in each special contract price. This amount shall not exceed the applicable CTC cap, which is the difference between the existing special contract price and the competitive market price." In short, special contract customers extending or renegotiating their contracts should not be required to bear the burden of a larger proportion of stranded costs than they currently bear.

Proportionality

On page 2, Staff recommends that "stranded cost shall be allocated among customer classes in a manner consistent with the respective company's current rate treatment". This language includes only the first half of the statement recommended by consensus of the stranded cost working group, which goes on to say ". . . in order to effect recovery of stranded costs that is in substantially the same proportion as the recovery of similar costs from customers or customer classes under current rates."

The second half of the statement, while it may appear redundant, is critical because it spells out the intent. A customer's future stranded cost charges are to be proportionate to the customer's current contribution to the utility's stranded (or uneconomic) costs. This clause protects all customers from cost shifting in the design of the CTC. Moreover, the proportion of stranded costs assigned to retail customers should be commensurate with the portion of an

Affected Utility's generation plant dedicated to serving retail load (as opposed to wholesale service).

Interruptible Service

The special nature of interruptible service should be taken into account in determining stranded cost charges (*e.g.* completely interruptible services should bear no stranded cost burden).

Finally, allowing Affected Utilities an opportunity to demonstrate that divestiture is "not practical" and "not in the public interest" opens the door to Affected Utilities hand-picking the assets they wish to sell and those they wish to retain. An Affected Utility electing to divest its generation assets must divest itself of all such assets.

B. Affiliate Rules.

Staff is absolutely correct, Affected Utilities must offer the same terms and conditions of service to all competitors and customers as its offers to any of its affiliates and their customers. Preferential treatment of affiliates is inappropriate. There must be a strict code of conduct governing the interaction between generation entities and regulated entities.

Affected Utilities should be required to adopt a code of conduct to prevent anti-competitive activities that may result from the Affected Utility providing both competitive and noncompetitive services to retail electric customers. The code of conduct should address at least the following issues:

1. Policies for allocating costs between noncompetitive and competitive activities to avoid cross-subsidization.

2. Policies to prevent employees providing noncompetitive services from directing retail electric customers to the Affected Utility's competitive services.

3. Policies to prevent employees from transferring proprietary information gained in the performance of noncompetitive services to employees engaged in performing competitive services without the consent of the retail electric customer.

4. Policies to provide retail electric customers with complete and accurate disclosure of which services are competitive and which services are noncompetitive.

5. Policies to prohibit preferential treatment when providing non-competitive services based on a retail electric customer's provider of competitive service.

In addition, Affected Utilities should be required to have an annual independent audit performed to ensure compliance with the process and procedures established in a code of conduct. The results of the audit should be made available to the public.

C. Targeted Rate Decreases.

Rate decreases should also apply to customers who remain on standard offer service.

D. Metering.

Meter ownership by customers should be permitted.

E. Local Distribution Company Services.

While standard offer service should certainly be available, that service should also be subject to a competitive bidding process along with the "provider of last resort.".

F. Transmission and Dispatch.

We applaud Staff's recognition of the importance of fair and non-discriminatory access to the transmission and distribution system. Non-discriminatory access to the grid is imperative for the transition to a competitive marketplace. However, the statement of position indicates that ISA costs are to be recovered through charges on competitive customers. For the ISA to be useful, it must be used by *all* transmission customers in Arizona. Indeed, that is the consensus recommendation of the ISA Task Force. Therefore, ISA costs should be borne by all transmission customers. Further, the ISA will be an important precursor to the ISO and will convey important benefits to all customers; it would be inequitable for the first phase of customers to shoulder the full start-up costs for the ISA.

We would be happy to discuss with you any of the issues referenced above.

Very truly yours,

C. Webb Crockett
For the Firm

CWC/mlh

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