

INTERVENTION



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BEFORE THE ARIZONA CORPORATION COMMISSION
AZ CORP COMMISSION

1
2
3 IN THE MATTER OF THE
4 APPLICATION OF TUCSON ELECTRIC
5 POWER COMPANY FOR APPROVAL
6 OF ITS STRANDED COST RECOVERY

DOCKET NO. E-01933A-98-0471
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7
8 IN THE MATTER OF THE FILING OF
9 TUCSON ELECTRIC POWER
10 COMPANY OF UNBUNDLED TARIFFS
11 PURSUANT TO A.A.C. R14-2-1601 et seq.

DOCKET NO. E-01933A-97-0772

12
13 IN THE MATTER OF THE
14 APPLICATION OF ARIZONA PUBLIC
15 SERVICE COMPANY FOR APPROVAL
16 OF ITS STRANDED COST RECOVERY

DOCKET NO. E-01345A-97-0473

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18 IN THE MATTER OF THE FILING OF
19 ARIZONA PUBLIC SERVICE
20 COMPANY OF UNBUNDLED TARIFFS
21 PURSUANT TO A.A.C. R14-2-1601 et seq.

DOCKET NO. E-1345A-97-0773

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23 IN THE MATTER OF COMPETITION IN
24 THE PROVISION OF ELECTRIC
25 SERVICES THROUGHOUT THE STATE
26 OF ARIZONA.

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APPLICATION FOR LEAVE TO INTERVENE AND
PRELIMINARY COMMENTS OF ARIZONA CONSUMER-OWNED ELECTRIC
SYSTEMS IN OPPOSITION TO COMMISSION APPROVAL OF SETTLEMENT

The Arizona Consumer-Owned Electric Systems ("ACES")¹ submit this application for leave to intervene and preliminary comments in opposition to Commission approval of the proposed settlement submitted November 5, 1998, by and among Commission Staff, Arizona Public Service Company ("APS") and Tucson Electric Power Company ("TEP") (APS and TEP collectively, the "Companies"), pursuant to the Commission's Procedural Order dated November 13, 1998 and Rule 105 of the Commission's Rules of Practice and Procedure

¹ The Arizona Consumer-Owned Electric Systems are: Electrical District No. 3 of Pinal County, Electrical District No. 7 of Maricopa County and Maricopa County Municipal Water Conservation District No. 1.

1 (A.A.C. R14-3-105). The exchange transaction and related undertakings contemplated by the
2 proposed settlements neither serve nor benefit the public interest, and in fact appear to be
3 detrimental to the public interest. Arizona Corp. Commission v. Arizona Water Co., 111 Ariz.
4 74, 523 P.2d 505 (1974); Pueblo Del Sol Water Co. v. Arizona Corp. Commission, 160 Ariz.
5 285, 772 P.2d 1138 (App. 1988); Arizona Corp. Commission v. Tucson Insurance and Bonding
6 Agency, 3 Ariz. App. 458, 415 P.2d 472 (App. 1966). Specifically, the transaction and
7 undertakings contemplated by the proposed settlement do not warrant Commission approval and
8 issuance of the requested certificates of convenience and necessity and amendments to existing
9 certificates of convenience and necessity under A.R.S. Sections 40-252 and 40-285 because:

- 10 1. **Proposed Facilities Exchange Is Anticompetitive, Not Procompetitive:**
11 The exchange of TEP's interests in the Navajo and Four Corners
12 generating stations for APS's transmission facilities rated 345 kV and
13 above (a) will not mitigate existing vertical market power, (b) will
14 significantly exacerbate present levels of horizontal market in generation
15 and transmission markets in Arizona, and (c) will create additional barriers
16 to entry in retail electricity markets in Arizona;
- 17 2. **Claimed "Stranded Cost" Recovery Will Exacerbate Barriers to**
18 **Entry:** APS's and TEP's proposed guarantees for recovery of claimed
19 "stranded costs" through the settlements are unwarranted and
20 inappropriate, and will likely exacerbate already existing barriers to
21 competitive entry into retail electricity markets in Arizona;
- 22 3. **Proposed Transco Undefined and Fails to Meet Open Access**
23 **Standards:** The post-exchange transmission regime set forth in the
24 proposed settlements (a) is murky to the point of being unintelligible, (b)
25 fails to provide any indication that rates, terms and conditions of
26 transmission service to be offered by the proposed "Transco" will be
27 consistent with, or superior to, the rates, terms and conditions of service
28 presently available under the APS or TEP open access tariffs currently
filed with the Federal Energy Regulatory Commission, and (c) provides
significant opportunities for additional and unwarranted pancaking of rates
and charges for transmission service and ancillary services; and
4. **Proposed Relaxation of Regulation and Financial Incentives Contrary**
to the Public Interest: The waivers of the Commission's Affiliated
Interest Rules, the "moderate level of oversight" and the various other
financial and ratemaking concessions contemplated by the proposed
settlements are unjustified, unwarranted, contrary to the public interest and
inimical to the emergence of full and fair competition as a means of
ensuring just and reasonable rates in Arizona retail electricity markets.

For these reasons, as more fully explained below, the exchange transaction and
related undertakings proposed by the Companies and Commission Staff in the settlements cannot

1 be approved by the Commission. The ACES are not, however, unalterably opposed to the
2 exchange transaction or other undertakings contemplated by the proposed settlements, provided
3 that the exchange transaction and related undertakings can be conditioned appropriately to
4 benefit affirmatively the public interest in full and fair competition in Arizona retail electricity
5 markets and to effectuate appropriately the policy objectives set forth in Commission Decision
6 Nos. 59943 and 61071. Toward that end, we discuss in Part IV below the minimum conditions
7 that the ACES believe are necessary to ensure that the public interest in full and fair retail
8 competition in the electric industry can be realized in connection with the transaction and
9 undertakings contemplated in the proposed settlements.

10 Finally, in light of the limited time available to review the proposed settlements
11 and related undertakings and investigate the relevant facts, and the fluid nature of the
12 Commission's procedural scheduling for consideration of the settlement to date, the comments
13 set forth below are necessarily preliminary in nature. The ACES are continuing to investigate the
14 issues raised by the proposed settlements and related undertakings, and will supplement (and, if
15 necessary, revise) these comments once Commission Staff and the Companies file their
16 November 20 testimony in accordance with the Commission's Procedural Order of November
17 13, 1998. One reason why the ACES have filed these preliminary comments early is to alert
18 Commission Staff and the Companies to their concerns about the proposed settlements, so that
19 Staff and the Companies will have the opportunity to address and allay those concerns in their
20 November 20 testimony.

21 I. APPEARANCE AND REQUEST FOR SERVICE

22 Pursuant to Rule 104 of the Commission's Rules of Practice and Procedure
23 (A.A.C. R14-3-104), the AZPSs enter their appearance through their counsel identified below,
24 and further request service of pleadings both on their counsel and on the individuals identified
25 below:

26 ...
27 ...
28 ...

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12 II. APPLICATION FOR LEAVE TO INTERVENE

13 The ACES state as follows, pursuant to Rule 105 of the Commission's Rules of
14 Practice and Procedure, as the bases for their application for leave to intervene. Each of the
15 ACES has otherwise previously intervened, either individually or as part of a group of
16 intervenors, in one or more of the proceedings set forth in the caption. The ACES jointly renew
17 their application for leave to intervene in connection with the Commission's consideration of the
18 proposed settlements in these proceedings (1) to ensure continuation of their status as parties
19 with respect to matters at issue in connection with the proposed settlements, and (2) to
20 particularize the presentation of their collective position with respect to the proposed settlements
21 and the exchange transaction contemplated therein. The ACES have not had time to confirm
22 with other members of their intervenor group the positions taken in this intervention. They will
23 endeavor to do so as soon as possible and to organize their participation in this proceeding to the
24 end that they will not attempt to duplicate their representation or "double team" the parties
25 proposing the settlements..

26 A. Description of the Arizona Consumer-Owned Electric Systems

27 The ACES are small utilities organized as political subdivisions under Arizona law in
28

1 order, inter alia, to provide electricity for irrigated agriculture and rural communities. As described in
2 more detail below, the ACES bring a unique perspective to the Commission, because of their uncommon
3 relationship with APS. While entirely "captive" to APS's transmission and distribution system and
4 ancillary services, each of the ACES is also a potential competitor with APS for loads served by the single
5 distribution system in each system's small geographic boundary, which is encompassed within APS' vastly
6 larger certificated service area. They depend on the transmission systems of both APS and the Western
7 Area Power Administration ("Western").

8 Maricopa County Municipal Water Conservation and Drainage District No. I is a special
9 district formed as such under the laws of the State of Arizona to provide irrigation water and electric
10 power primarily to agriculture. Electrical Districts Nos. 3 and 7 are also special districts formed under the
11 laws of the State of Arizona to provide electrical service primarily to agricultural loads within their service
12 areas.

13 I. Electrical District No. 3, Pinal County

14 Electrical District No. 3, Pinal County ("ED3") has been providing electric service
15 southwest of Phoenix since 1961. ED3 serves 432 meters comprised of agricultural pumping loads and
16 shares its staff of two with EDI. It owns a substantial amount of 12 kV distribution lines and a lesser
17 amount of 69 kV lines purchased from APS in 1961 under a 30-year leaseback arrangement whereby APS
18 leases all of ED3's electrical distribution equipment and is responsible for its operation and maintenance.
19 ED3 purchases power from the Authority (Hoover Power), Western (Parker-Davis Project Power and
20 SLCA/IP Power), and APS. In addition, ED3 is a party to an Integrated Resource Scheduling Agreement
21 and participant in an Experimental Hoover Power Layoff Program which permits ED3 and other similarly
22 situated utilities to integrate and exchange SLCA/IP, Parker-Davis and Hoover power resources,
23 respectively, on a monthly basis to fully utilize the resources. The power and energy from the Authority
24 and Western are transmitted over the Western Parker-Davis transmission system, the Pacific Northwest -
25 Pacific Southwest Intertie transmission system, and the CRSP transmission system to ED3's Maricopa
26 Substation on the Parker-Davis transmission system. From Maricopa Substation, the power and energy is
27 delivered over ED3's 69 kV transmission system and 12 kV distribution system to the customers of ED3.

28 ...

1 2. Electrical District No. 7 of Maricopa County

2 Electrical District No. 7 of the County of Maricopa and the State of Arizona ("ED7")
3 has served predominately irrigation pumping loads and certain other agriculturally related loads since 1960
4 in Maricopa County just west of the Phoenix metropolitan area. It presently serves 114 meters. ED7
5 purchases power from the Authority (Hoover Power), Western (SLCA/IP Power), and APS. In addition,
6 ED7 is a party to an Integrated Resource Scheduling Agreement and participant in an Experimental
7 Hoover Power Layoff Program which permits ED7 and other similarly situated utilities to integrate and
8 exchange SLCA/IP and Hoover power resources, respectively, on a monthly basis to fully utilize the
9 resources. ED7 does not own any electrical transmission or distribution system, however, certain
10 distribution transformers located at ED7 customer locations are owned by the ED7 customers. The power
11 and energy from APS, the Authority, and Western are transmitted over the Western Parker-Davis
12 transmission system, the Pacific Northwest - Pacific Southwest Intertie transmission system, the CRSP
13 transmission system to Western's Buckeye Substation on the Parker-Davis transmission system. From
14 Buckeye Substation, APS delivers the power and energy over APS's 69 kV transmission system and lower
15 voltage distribution system to the customers of ED7 under a wheeling contract with APS.

16 3. Maricopa County Municipal Water Conservation District No. I

17 Maricopa County Municipal Water Conservation District No. I ("MWD") serves
18 agricultural irrigation pumping loads on the western edge of the Phoenix metropolitan area and recreation
19 and marina loads at Lake Pleasant at 196 meters. MWD has a staff of 40 full-time employees supervised
20 by a General Manager. The staff is engaged in the irrigation and power service aspects of MWD's
21 operations. MWD purchases its power from the Authority (Hoover power), Western (SLCA/IP power)
22 and APS. MWD is a party to an Integrated Resource Scheduling Agreement and participant in an
23 Experimental Hoover Power Layoff Program which permits MWD and other similarly situated utilities to
24 integrate and exchange SLCA/IP and Hoover power resources, respectively, on a monthly basis to fully
25 utilize the resources. The power is transmitted over Western's Parker-Davis transmission system to
26 Buckeye Substation and Westwing Substation distributed to MWD loads over some APS distribution
27 facilities and an extensive distribution system which MWD owns and leases to APS.

28 ...

1 B. The Exchange Transaction and Other Elements of the
2 Proposed Settlements Directly and Substantially Affect the ACES

3 The ACES are each wholesale transmission service customers of APS and
4 purchasers of electric power or energy from APS at wholesale. In addition, each of the ACES is
5 physically and electrically embedded in APSs electric transmission (and, in some cases,
6 distribution) system and certificated service area. In their present configurations, each of the
7 ACES provides the prospect — if not the present reality in all cases — of direct, head-to-head
8 retail competition with APS. At the same time, as small distribution systems dependent on
9 transmission service provided by APS in order to serve their present loads, the ACES are
10 uniquely vulnerable to price squeeze and other potential anticompetitive effects that may flow
11 from the enhancement of APS's existing generation dominance and from the possibility of
12 increased transmission costs (and increased concentration of control of key transmission
13 facilities) that appear likely to result from implementation of the proposed settlement — at least
14 in the absence of adequate mitigation of the increased horizontal market power in generation and
15 transmission that the exchange transaction and related undertakings in the proposed settlement
16 threaten.

17 In short, the unique and presently fragile competitive position of the ACES in
18 placed at significant additional risk as a result of the exchange transaction and other undertakings
19 contemplated by the proposed settlements. In these circumstances, the ACES will be directly
20 and substantially affected by these proceedings, and are therefore entitled to full party status as
21 intervenors in order to protect their competitive viability. Accordingly, they should be granted
22 leave to intervene pursuant to Rule 105 of the Commission's Rules of Practice and Procedure
23 (A.A.C. R14-3-105).

24 III. THE PROPOSED SETTLEMENTS THREATEN COMPETITION

25 The proposed exchange of generation and transmission assets between TEP and
26 APS, and the related provisions of the proposed settlement pose a grave threat to the emergence
27 of vibrant competition in retail electricity markets in Arizona. At the transactional level, the
28 proposal before the Commission does not in fact mitigate vertical market power (indeed it leaves

1 much of the vertical integration of generation and transmission in the State's two largest
2 investor-owned utilities intact and unaffected), while it would significantly increase horizontal
3 market power in generation and transmission and simultaneously create additional barriers to
4 entry by potential retail competitors. At the regulatory level, the proposed settlements reinforce
5 barriers to entry at virtually every turn by:

- 6
- 7 • seeking to grab guaranteed stranded cost recovery without
8 any meaningful *quid pro quo* in the form of market power
mitigation;
- 9 • offering murky promises for a post-exchange transmission
10 regime, the very vagueness of which appears to place the
11 public interest at risk of additional layers of cost and
12 complexity in transmission service; and
- 13 • seeking waivers of significant, Commission-created
14 behavioral restrictions on incumbent utility market power
15 — virtually ensuring that the damage to market structure
16 created by increased horizontal market power in generation
17 and transmission will be exacerbated by a lack of even
18 minimal behavioral restraints on residual market power
19 accrued through decades of incumbency as monopolists.

20 The ACES believe that the proposal before the Commission offers no discernable
21 benefit to, or even mere consistency with, the public interest in facilitating the emergence of true
22 retail competition. Accordingly, the settlements should not be approved as proposed, and must
23 be the subject of significant additional conditioning by way of market power mitigation if the
24 public interest in this proceeding is to be appropriately protected.

25 A. Structural Anticompetitive Effects

26 The generation/transmission exchange transaction embedded in the proposed
27 settlement would exchange TEP's seven percent, 114.5 MW interest in the Four Corners
28 generating station and its seven and a half percent, 180.7 MW interest in the Navajo generating
station (a total of approximately 295 MW out of the approximately 1950 MW of operating
generation owned by TEP) for control of all of APS's transmission facilities rated 345 kV or
above. The stated rationale for the exchange transaction is that "Staff believes that APS'
divestiture of these Transmission Assets limits the potential for APS to exercise vertical market

1 power and as such constitutes a change in market structure in the transition to competition”
2 (APS/Staff Settlement Agreement at 1) and that “TEP’s divestiture of these generation assets
3 addresses concerns regarding TEP’s vertical market power and as such constitutes a change in
4 market structure in the transition to competition” (TEP/Staff Settlement Agreement at 1).

5 In general, the proposed transaction increases the concentration of control in two
6 relevant markets: retail requirements power and transmission. Increasing horizontal control in
7 two markets does not, in any manner or by any means, facilitate the emergence of workable
8 competition in retail electricity markets. Without workable competition, any effort to deregulate
9 those markets through direct competition at retail is foreseeably doomed to failure. Thus,
10 unfortunately for the public interest, the “changes in market structure” that would be wrought by
11 the exchange transaction are likely to ensure that the “transition to competition” is never
12 effectively completed, for at least three reasons.

13 First, it is difficult to see where there is any real mitigation of vertical market
14 power that would result from the exchange transaction. Both of the investor-owned companies
15 remain vertically integrated — APS retains its transmission facilities rated below 345 kV
16 (indeed, it undertakes to attempt to remove the greater part of those facilities from federal
17 regulatory jurisdiction) and increases its generation market share, while TEP retains over 85
18 percent of its generation and gains significantly expanded over key transmission interfaces
19 controlling transmission access into Arizona. The ultimate benefits of any “change in market
20 structure” resulting from the exchange transaction appear to inure largely, if not exclusively, to
21 the State’s two largest incumbent investor-owned monopolies, at the expense of developing
22 electricity market structures in Arizona that might actually enhance true competition.

23 Second, at least preliminarily, it appears that the proposed exchange of Tucson’s
24 interests in the Navajo and Four Corners generating stations for APS’s transmission facilities
25 rated 345 kV and above is likely to increase the effective concentration² of relevant generation

27 ² Market concentration can be measured by various means, including both market
28 Horizontal Merger Guidelines and the Federal Energy Regulatory Commission’s

1 markets from present levels that would be viewed as “highly concentrated” under the United
2 States Department of Justice/Federal Trade Commission Horizontal Merger Guidelines to levels
3 that are presumptively likely to create or enhance market power or facilitate its exercise. It is
4 simply inconceivable that permitting a horizontal increase in the concentration of control that
5 APS already has in relevant generation markets to levels presumptively likely to enhance market
6 and to facilitate its exercise will have any net positive impact on the emergence of true retail
7 competition in Arizona.

8 Third, the proposed exchange transaction will significantly increase TEP’s control
9 over key transmission interfaces that control access from outside the State into retail electricity
10 markets within Arizona. Briefly, there are four transmission interfaces that establish electrical
11 boundaries between Arizona and the rest of the Western Systems Coordinating Council
12 (“WSCC”) — (1) the Arizona-New Mexico interface to the southeast, consisting in major part of
13 TEP’s Greenlee to Hidalgo and Springerville to Luna 345 kV lines; (2) the Four Corners Area
14 interface to the northeast, consisting of the 500 kV Four Corners to Moenkopi line and the 345
15 kV Four Corners to Cholla line; (3) the TOT 2B interface to the north, consisting of the 230 kV
16 Sigurd to Glenn Canyon line and the 345 kV Pinto to Four Corners line; and (4) the East of the
17 Colorado River (“EOR”) interface to the east, consisting of a group of 500 kV and 345 kV
18 transmission lines of which APS is currently a major owner. The transmission element of the
19 proposed exchange transaction (Settlement Agreements, Exhibit B (Memorandum of
20 Understanding between APS and TEP) at Attachment B) moves TEP from a controlling position
21 on only one of those interfaces (the Arizona-New Mexico interface) to a dominant position on all
22 four interfaces.

23
24 Merger Policy Statement (Order No. 592, Policy Statement: Factors to be Considered
25 in Merger Applications under Section 203 of the Federal Power Act, FERC Statutes
26 & Regulations, Regulations Preambles ¶ 31,044) — the sum of the squares of the
27 market shares of all participants in a relevant geographic and product market. The
28 ACES’s preliminary analysis of the effects of the exchange transaction on Arizona
retail requirements power and generation markets suggests that HHIs for those
markets currently exceed 1800 and will increase by more than 100 as a result of the
exchange transaction proposed in the settlements.

1 The threat to competition inherent in the concentration of control over key
2 transmission interfaces is well known in the electric power industry. See, for example,
3 Wisconsin Electric Power Co., et al., 79 FERC ¶ 61,158 at pp. 61,692-61,695 (1997). In this
4 particular situation, the creation of TEP and its affiliated “Transco” as, in effect, a single EHV
5 transmission “gatekeeper” into Arizona poses a particularly grave threat to the emergence of full
6 and fair retail competition in the State, primarily because it enhances the opportunity for
7 exclusionary conduct in the operation of the transmission interfaces, while largely leaving in
8 place the vertical integration of generation and transmission that provides the incentives for
9 incumbent utilities to engage in such exclusionary conduct. In short, the “cure” proposed in the
10 settlement agreements — expansion of horizontal market power in both generation and
11 transmission markets in Arizona — is likely to prove far more harmful to the emergence of true
12 retail competition than the “disease” it seeks to attack (vertical integration of generation and
13 transmission in the hands of two separate and presently competing utilities).

14 The ACES believe that the aggregate effect of the increases in horizontal market
15 power in relevant generation and transmission markets that would result from approval of the
16 settlement as proposed would be the imposition of practically insurmountable structural barriers
17 to entry by new competitors into retail electricity markets in Arizona, and concomitant
18 reinforcement of the already dominant competitive positions of the incumbent investor-owned
19 utilities in those markets. These structural barriers to entry would exacerbate the already
20 relatively high barriers to competitive entry into the market for retail requirements power in
21 Arizona (for example, the lengthy process of siting, obtaining environmental approvals for,
22 financing and constructing new generation — see Wisconsin Electric Power, et al., supra, 79
23 FERC at pp. 61,695-61,696), and would effectively insulate the market incumbents — APS and
24 TEP — from any meaningful competitive discipline on their retail (or wholesale) rates.

25 The ability to compete in retail requirements power markets requires the assembly
26 of wholesale requirements power. Providing retail requirements power is risky unless the
27 supplier owns generation assets — hedging is inherently riskier than ownership. Entry into the
28 competitive sale of retail requirements power requires simultaneous entry into (a) wholesale

1 requirements markets and (b) retail requirements markets. There is a minimum efficient scale of
2 producing wholesale requirements power, and there is a risk that the market entrant will not
3 acquire sufficient market share at retail to justify the cost of acquiring minimum efficient scale
4 at wholesale. Incumbent electric utilities may have absolute cost advantages in the sale of
5 capacity that is part of wholesale requirements power because of depreciated plant or prior
6 recovery of stranded investment (both of which advantages already belong to APS and TEP, and
7 the latter -- recovery of stranded investment -- would be significantly reinforced by the proposed
8 settlements without concomitant benefit to the public interest in ensuring the emergence of full,
9 free and fair retail competition, as discussed in greater detail immediately below). Entry with
10 energy efficient plants takes four to six years, which does not meet the Merger Guidelines criteria
11 for entry sufficiently timely to deter supracompetitive pricing (two years): "Entry is that easy if
12 entry would be timely, likely, and sufficient in its magnitude, character and scope to deter or
13 counteract the competitive effects of concern" Horizontal Merger Guidelines, Section 3.0
14 (Antitrust and Trade Reg. Rept. Par. 13,104 at p. 20,573-10.

15 In summary, for the reasons set forth above, the structural anticompetitive effects
16 of the generation/transmission exchange embedded in the proposed settlements pose a number of
17 grave threats to the emergence of full, free and fair retail competition in Arizona. Moreover, as
18 we show in the following sections, the regulatory elements of the proposed settlements —
19 guarantees of full stranded cost recovery without an appropriate *quid pro quo* of full divestiture
20 of generation to independent third parties; a confused, confusing and at best half-baked proposal
21 for a post-exchange transmission regime that provides no meaningful assurance of conforming to
22 federal open access requirements and that may actually be inimical to Commission policy
23 supporting functional unbundling of transmission through an Independent System Operator; and
24 unwarranted relaxation of behavioral restrictions against affiliate abuse — all conspire to
25 aggravate these structural anticompetitive impacts.

26 B. Unjustified Stranded Cost Treatment Reinforces Barriers to Entry

27 The Companies have extracted major and inappropriate concessions from
28 Commission Staff for guarantees of stranded cost recovery in connection with the settlements

1 (APS Settlement Agreement, Articles III and IV; TEP Settlement Agreement, Articles III
2 through VI), which effectively exchange (a) any meaningful leverage the Commission may ever
3 have had in using stranded cost recovery as an incentive for structural changes in the Arizona
4 electric power industry to ensure a truly competitive market structure for (b) the market power
5 exacerbating features of the generation/transmission exchange embedded in the proposed
6 settlements. This proposed trade-off does considerable violence to the Commission's own
7 recognition, in its industry restructuring rules (A.A.C. R14-2-1607), that stranded cost recovery
8 is appropriately limited to the economic impacts flowing from the change in the "regulatory
9 bargain" that retail competition represents.

10 In short, for the reasons explained in detail above, there is no improvement in
11 competitive market structure that would follow from the exchange transaction or other elements
12 of the proposed settlements. The stranded cost provisions of the settlements effectively require
13 Arizona's retail electricity customers (and its small wholesale market participants) to pay the
14 major investor-owned incumbents in the Arizona electricity market for reinforcing their
15 structural dominance of that market. As a business proposition, the bargain struck in the
16 settlements is a very bad one for Arizona's consumers.

17 The settlements' proposed guarantee of full stranded cost recovery, without
18 insistence on a complete transition to a fully competitive market structure, accomplishes nothing
19 more (or less) than a wholesale evisceration of the public welfare for the purpose of reinforcing
20 incumbents' market dominance by — in addition to the problems in market structure discussed
21 above — creating an additional disincentive to competition and a heightened barrier to
22 competitive entry. In these circumstances, imposing full stranded cost recovery on a market that
23 has not achieved (and is unlikely, if the settlements are approved as proposed, ever to achieve) a
24 fully competitive structure simply adds another obstacle to full and fair competition. Burdening
25 retail competition with full stranded cost recovery in the face of a proposed market structure that
26 is demonstrably anticompetitive simply provides belt and suspenders insurance that full and
27 effective retail competition will never emerge in Arizona.

28 ...

1 C. The “Transco” Proposal Is Grossly Deficient

2 Apparently not content with the structural reinforcement of horizontal market
3 power in transmission that is inherent in the generation/transmission exchange transaction
4 contemplated by the settlements, the Companies propose that TEP will create an affiliated
5 “Transco” that will then pursue additional transmission hegemony over Arizona by seeking to
6 acquire the transmission assets of Arizona Electric Power Cooperative and Salt River Project, in
7 addition to the transmission facilities of APS rated 345 kV or above, and ultimately to function
8 as “the sole builder and owner of transmission assets in the state” (TEP Settlement Agreement,
9 Article VIII). This proposal, an integral element of the post-exchange transmission regime
10 contemplated by the settlements, is presented with a level of detail that, while barely embryonic,
11 promises significant harm to the notion of open access transmission at just and reasonable rates
12 in Arizona, and therefore poses yet a third threat to the emergence of full, free and fair retail
13 competition. The outline of the Transco proposal presented in the proposed settlements is
14 unworthy of Commission acceptance for at least four reasons.

15 First, the Transco proposal is inherently inconsistent with established Commission
16 policy favoring functional unbundling in the form of an Independent System Operator (A.A.C.
17 R14-2-1610 B. (“The Commission supports the development of an Independent System Operator
18 (ISO) or, absent an Independent System Operator, an Independent Scheduling Administrator”).
19 In contrast to a non-profit, independent ISO conforming to the eleven principles established by
20 the FERC’s Final Open Access Rule (Order No. 888), the establishment of a for-profit Transco
21 affiliated with an incumbent, investor-owned utility offers virtually no assurance of any actual
22 realization of comparable, open access transmission service. It is frankly impossible to imagine
23 that creating a single, profit-oriented transmission monopolist — not merely as the transmission
24 gatekeeper into Arizona (a bad enough idea) — but as the “sole builder and owner of
25 transmission assets in the state” would have anything other than a profoundly anticompetitive
26 effect on the operation of electricity markets in Arizona.

27 Second, elements of the Transco proposal itself reinforce the competitive failures
28 inherent in the newly proposed transmission monopoly. Thus, Commission Staff and the

1 Companies agree that transmission “allocation priorities and transmission constraints and/or the
2 definition and allocation of Available Transmission Capacity (ATC) established by the ISA/ISO
3 should not unduly frustrate competition” and that the Companies will, at some unspecified point
4 in the future “explain” their definitions of Committed Uses (i.e., their claims to a higher priority
5 of access to ATC than that generally available to transmission customers) “to the ACC’s
6 satisfaction.” The ACES are frankly at a loss as to how an investor-owned utility affiliate
7 Transco — inevitably beholden to the market share retention and expansion objectives of its
8 parent utility — could fairly construe the phrase “unduly frustrate competition” or why any
9 frustration of competition should be viewed as tolerable by the Commission in these
10 circumstances. This inappropriate lodging of the power to frustrate competition is, of course,
11 doubly frightening because Commission Staff is apparently unable at present to get its arms
12 around the games presently being played with ATC determinations in a transmission market
13 structure not yet thoroughly poisoned by single firm dominance. The running room allowed in
14 these elements of the Transco proposal for anticompetitive conduct in manipulating the
15 availability of transmission service is simply both staggering and frightening. Of course, the
16 opportunities presented for such anticompetitive manipulation of transmission availability fail
17 utterly to satisfy the foreseeable requirements of the FERC’s Final Open Access Rule.

18 Third, although the settlements appear to commit APS and TEP to “develop and
19 present to FERC a transmission pricing structure for the use of [the transferred] assets that will
20 not increase rates to customers in APS’s or TEP’s current service territories” (APS Settlement
21 Agreement, Article VI),³ the changes in TEP’s capital structure proposed in Article VI of the
22 TEP Settlement virtually assure that someone in the State is going to have to pick up the tab for
23 the Transco’s various proposed acquisitions (and for past events that have contributed to TEP’s
24 presently dismal capital structure). In short, the stated objective of assuring against transmission
25 rate increases to wholesale customers rings more than a little hollow in light of the financial

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³ We say “appears” to commit the Companies to this course because there is no correlative provision in the TEP Settlement Agreement.

1 promises made by Commission Staff to TEP in the settlements. Of course, all of this is before
2 we learn the ultimate costs to consumers and wholesale transmission customers of the
3 transmission cost “uplift” inherent in the “congestion management” viewed by Staff and the
4 Companies as “crucial to a successful implementation.”

5 Fourth, the very skeletal outline of the post-exchange transmission regime that
6 Staff and the Companies envision in the settlements appear both internally inconsistent and
7 overall inconsistent with the requirements of the FERC’s Final Open Access Rule. The
8 combination of zonal rates, “license plate” rates, “congestion management” transmission pricing
9 uplift and super-priority reservations of Available Transmission Capacity for unspecified and
10 apparently undetermined “Committed Uses” all hold the distinct promise of a transmission
11 pricing and service regime that will not even come close to the non-discriminatory, open access
12 transmission service requirements that are enforced by the FERC. In short, this proposal offers
13 no sound basis for the Commission’s approval. It amounts in substance to nothing more than a
14 license to attempt to impose a confiscatory rate regime of vertically cumulative charges to
15 replace the horizontally “pancaked” rates for service across multiple utilities’ transmission
16 systems that it offers the vaguest promise of eliminating.

17 D. The Relaxation of Regulatory Restrictions Is Inimical to Fair Competition

18 Finally, the last wave of the proposed settlements’ assault on fair regulation and
19 free and open competition takes the form of an unjustified request for waivers of various
20 Commission behavioral regulations, adopted in 1992, designed to prevent anticompetitive
21 affiliate abuse (A.A.C R14-2, Article 8) (APS Settlement, Article XIV; TEP Settlement, Article
22 X). In connection with the damage to market structure that would follow from Commission
23 approval of the exchange transaction proposed in the settlements, the proposed waivers of the
24 Commission’s Affiliated Interest Rules portend additional opportunities for anticompetitive
25 behavior by the Companies without any discernable offsetting benefit to the public interest.
26 Accordingly, the Companies’ requests for waivers of the Commission’s Affiliated Interest Rules
27 should be rejected.

28 ...

1 IV. MITIGATION CONDITIONS

2 For the reasons explained above, the ACES believe that the Commission cannot
3 approve the settlements as proposed. The settlements are inimical to the public interest and fail
4 entirely to satisfy the public interest criteria incumbent on the Commission's consideration of
5 this proposal under A.R.S. Sections 40-252 and 40-285. The ACES believe, however, that
6 Commission imposition of certain conditions on approval of the settlements may serve to
7 dampen their anticompetitive effects sufficiently to avoid the worst of the harm that they would
8 inflict on the public interest. Preliminarily, the ACES believe that the following Commission-
9 directed conditions should be imposed:

- 10 1. The Commission should reject the Transco element of the proposed
11 settlements outright, as fundamentally inconsistent with the Commission's
12 expressed policy support for the development of an ISO with full authority
13 over the Arizona transmission system.
- 14 2. The Commission should, as a condition of approving the settlement,
15 require that APS and TEP support the development of a fully independent
16 ISO with complete operating authority over the Arizona transmission
17 system, including the authority to construct and own new transmission
18 facilities with the State.
- 19 3. The Commission should amend A.A.C. R14-2-1611 to eliminate the
20 reciprocity requirement as a precondition to allowing public power
21 systems to compete for retail sales. This provision is the minimum
22 necessary to offset the pernicious effects of the proposed settlements in
23 creating barriers to entry at retail competition. To the extent that the
24 Commission proposes to consider creating the structural barriers to entry
25 that would result from the proposed settlement, it should at least eliminate
26 other barriers to entry to retail competition created by its own rules.
- 27 4. The Commission should condition any acceptance of the settlement on
28 APS and TEP (along with other transmission-owning entities in the state if
those entities are willing) agreeing to file forthwith with FERC a single-
system, open access transmission tariff that:
- Is fully compliant with the non-rate terms and conditions set forth
in FERC's *pro forma* open access tariff, without any modification
that is neither consistent with nor superior to the terms and
conditions of the *pro forma* tariff;
 - Provides for just, reasonable and non-discriminatory single system
rates for network and point-to-point transmission service across the
transmission systems of APS and TEP, along with any other transmission-
owning participants, as well as appropriate provisions for self-supply of
ancillary services and all other transmission customer cost protections
provided by FERC's Final Open Access Rule;

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- Incorporates a demonstrated broad consensus among entrants and potential entrants into the Arizona electricity markets as to transmission provisions that will facilitate entry and full, free and fair competition in those markets; and
- Explicitly sets forth all assumptions, criteria and methodologies used in developing “Committed Uses” and other claims of priority access to Available Transmission Capacity, and explicitly makes those claims subject on at least a pro rata basis to the transmission requirements of other load-serving entities within the State of Arizona.

These conditions are necessarily incomplete, given the limited time available for review and analysis of the settlements proposed by Commission Staff and the Companies and the extensive, demonstrated deficiencies of those settlements as a vehicle for facilitating competition in Arizona. Accordingly, the ACES will recommend additional conditions to the Commission by the November 30 date established in the Commission’s November 13 Procedural Order for intervenor submissions on the proposed settlement.

V. CONCLUSION

For the foregoing reasons, the ACES request that the Commission make and enter an order:

1. Granting the ACES leave to intervene with full rights of participation as parties to this proceeding;
2. Rejecting the proposed settlements, or
3. Alternatively, conditioning acceptance of the proposed settlements as set forth above and in further submittals by the ACES in this proceeding; and
4. Granting such other and further relief as may be necessary, just and appropriate in the circumstances.

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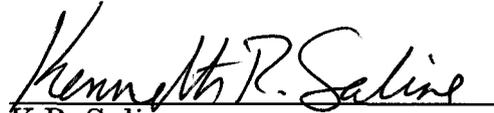
Dated at Phoenix, Arizona
this 17th day of November, 1998.

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document on all parties of record in this proceeding by mailing a copy thereof, properly addressed with first class postage prepaid to all persons listed on the attached service list.

Dated at Phoenix, Arizona this 17th day of November, 1998.



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