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IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA	DOCKET NO. RE-00000C-94-0165 **AEPCO, DUNCAN AND GRAHAM'S COMMENTS**

In response to the Procedural Order dated January 6, 1999, the Arizona Electric Power Cooperative, Inc. ("AEPCO"), Duncan Valley Electric Cooperative, Inc. ("Duncan") and Graham County Electric Cooperative, Inc. ("Graham") (collectively, "the Cooperatives") submit these comments concerning their suggestions on resolution of remaining issues in electric industry restructuring.

The Cooperatives will first address what major Arizona and federal transmission issues need to be resolved.[1] Then, we will offer comments on the points raised in the January 4, 1999 correspondence of the Attorney General and RUCO.

<u>The Commission Should First Resolve the Issue of its Ability to Implement Electric Competition</u>.

In 1912, the people of this State adopted the Constitution and established this Commission. With specific reference to electric rate setting issues, the people stated, among other things, that the Commission shall prescribe rates for public service corporations and shall do so based upon fair value. Obviously, electric competition and privately negotiated, market based rates involve a fundamental shift away from this plain mandate. No longer will the Commission

[1] To the maximum extent possible, the Cooperatives will limit these Comments to major procedural matters and avoid specific Rules' substantive issues.

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prescribe rates and no longer will those rates be based upon a reasonable return on the provider's investment.

As the Attorney General stated in a February 25, 1998 letter to the Speaker of the House concerning the then pending HB 2663:

> We think it highly probable that the Arizona Supreme Court will hold, when presented with the issue, that the ratemaking envisioned by the Corporation Commission and its rule R14-2-1612 and by the Bill are inconsistent with the Arizona Constitution. That being the case, <u>we think it would be wise, before the Corporation Commission attempts deregulation, to have this basic issue resolved by the Supreme Court or by the people through an amendment to the Arizona Constitution</u> to remove "electric generation service" and "electricity supplier" from the list of entities that are regulated as public service corporations. (Emphasis supplied.)

The Cooperatives wholeheartedly agree. So long as this jurisdictional uncertainty remains unresolved, the most well crafted electric competition strategy will be subject to challenge. So long as this issue is ignored, no consumer nor provider will have rates upon which they can rely. Literally billions of dollars of economic activity will remain in limbo pending a definitive resolution of this matter.

A closely related issue concerns the scope of the Commission's constitutional power. No one argues its exclusive rate setting jurisdiction when exercised consistent with Constitutional standards. But, does that power also allow it to restructure the industry or must it follow legislative direction? For example, can the Commission (as provided in the now stayed Rules) require that Standard Offer service be made available to <u>all</u> consumers or instead must it limit that requirement to the Legislative policy of <u>small</u> customers only (HB 2663, Section 23; A.R.S. §40-202.B.5). Until this issue is resolved, major Rules' provisions remain subject to challenge. Even if all parties to this docket are ultimately satisfied, any citizen who prefers a legislative policy to a Commission Rule can file suit to disrupt the system.

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The Cooperatives suggest two alternative procedures to address these issues. If the Commission is prepared to conclude that it does not have the jurisdiction to shift from a Commission prescribed fair value rate setting process to a provider prescribed market based process, then it should issue a decision to that effect and instruct the parties to formulate a proposal which could be presented to the Legislature and forwarded to a vote of the people in November of 2000. As part of this process, necessary amendments to Title 40 of the statutes would also be crafted.[2] The Cooperatives anticipate that a comprehensive constitutional and statutory proposal could be presented to the Commission for public comment and its consideration by July 1 of this year.

The Cooperatives consider this to be the superior approach. A constitutional amendment will remove all doubt and authorize this Commission to move to true competition and true deregulation. Over the years, Arizonans have been given the opportunity to decide on several occasions whether Commission jurisdiction should be enlarged or contracted.[3] Why deprive them of that constitutional choice as to electric choice?

Alternatively, if the Commission wants to continue to maintain that it has the power to implement competition, the Commission should instruct its Legal Division to join with other interested parties who have litigation on these issues currently pending to seek rapid appellate resolution. For example, the Superior Court has already issued a ruling on the Commission's ability to authorize market based rates and to restructure the electric utility industry. Either by special action or an expedited appeal, these and other threshold issues could jointly be presented to the Appellate Courts for a definitive ruling as to whether constitutional and/or statutory amendments are required.

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[2] This process would be similar to the one followed by the Commission and Legislature in the mid-1980's on telecommunications competition.

[3] Voters included sewer corporations in Commission jurisdiction in 1974, deregulated motor carriers in 1980 and refused to change the fair value standard in relation to telecommunications competition in 1986.

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The Cooperatives would stress that this second alternative does not ask any party, nor the Commission, to change its position on the merits of these issues. Rather, they simply suggest that the Commission and others join in attempts to seek certainty. Under either alternative, work could continue on necessary Rules' amendments, stranded cost determinations and other matters critical to electric utility restructuring on the understanding that implementation would not occur until (1) appropriate constitutional amendments have been approved or (2) the courts issue their final opinion that constitutional and/or legislative amendments are not necessary.

The Commission Should Take a Different Approach in Formulating its Electric Competition Rules.

Many parties and, the Cooperatives believe, the Commission agree that the Electric Competition Rules need major revisions. Without attempt to be exhaustive, the Commission should re-examine the Rules' solar requirements and their provisions concerning monopoly and competitive services separations, affiliate transactions, transmission issues, reporting requirements and Standard Offer eligibility and delivery requirements. There are numerous substantial practical issues which have to be worked out on the distribution level for competition to work. The Cooperatives also would encourage a fresh look at including deregulation components in what is supposedly a deregulation initiative.

The primary problem associated with past Rules' promulgation efforts in 1996 and the emergency/permanent Rules' process of 1998 is that the Rules or amendments were drafted with very little, if any, public input. They were then sprung upon Interested Parties with severely restricted comment opportunities. The Cooperatives would suggest a different course of action in approaching Rules' amendments this time.

Because substantial Rules' amendments are contemplated which no doubt would require re-noticing of the Rules under the Administrative Procedure Act, the Cooperatives would recommend that the Commission not simply re-open the now stayed Rules for additional comment.

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Instead, using that version as a guide, the Commission should request comments from all parties as to what Rules should be noticed for possible adoption. These comments would be due by March 1. The Hearing Division could then assess those comments and forward to the Commission revised recommended Rules as soon as practicable. These revised Rules would then be authorized for posting and public comment under the Administrative Procedure Act.

In other words, the Cooperatives suggest that the Commission take public comment prior to deciding on a form of rule. This procedure will encourage more open, meaningful participation and should lead to a less contentious final product.

The Commission Should Continue the Application and Hearing Process for Competitive Certificates But Delay Issuance of Final Decisions.

The Cooperatives see no reason to delay the certification process for competitive electric service providers.[4] However, final orders in these dockets should not be issued until, at a minimum, final Rules' amendments have been promulgated, stranded costs have been determined and unbundled rates have been approved for all Affected Utilities. Depending upon Rules' amendments, it might be necessary later to re-open these dockets. But, at the completion of this entire process, a standard form of Certificate Order can be crafted which would impose uniform conditions on all competitive service providers and specify a coordinated competition start date consistent with the timing requirements of other issues.

If the Commission instead issues final decisions at various times, it will have to speculate about what compliance conditions will be necessary. Competition will proceed in fits and starts – advantaging or disadvantaging certain consumers, industries and providers based not upon the market, but instead regulatory timing. It will also be necessary for parties to appeal a number of different decisions if uniform implementation is not selected thus adding to the expense, uncertainty

[4] Applications for Rehearing and Stay of Decision No. 61303 (the PG&E decision) should be granted to place it on the same procedural path as the process described here.

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and complexity of these matters. The issuance of a standard decision will reduce this confusion greatly.

Finally, it is not necessary to re-litigate Section 40-252 issues in each of these competitive Certificate applications. The dispute over the amendment of existing Certificates is legal, not factual, in nature. No purpose will be served and considerable unnecessary Commission and party time and expense will be spent duplicating in every competitive docket the legal and factual record which already exists in the PG&E matter.

It should only be necessary to amend existing Certificates once for purposes of issuing competitive Certificates. Therefore, the Cooperatives suggest that the Hearing Officer forward to the Commission a Proposed Order providing that:

1. Absent special circumstances, existing certificates will or will not be amended based upon the record developed and Order entered in the PG&E matter; and

2. Subsequent competitive certification matters will not involve Section 40-252 issues, but will be subject to and conditioned upon the Commission (and, if appealed, the courts') final decision as to those issues in the PG&E matter.

The Hearing Division would also make appropriate amendments to outstanding and future procedural orders to remove the requirement that all Affected Utilities participate in each docket on Section 40-252 issues.

The Commission Must Recognize FERC's Exclusive Jurisdiction Over Transmission in Unbundled State Retail Transactions; A Filing for Apportionment of Jurisdiction Must be Made.

The Commission Rules, particularly R14-2-1610, order certain uses of the transmission system, allocate transmission rights among customers, require ACC jurisdictional utilities to file for approval of an ISA, mandate specific work for the ISA, require Affected Utilities' participation in the formation of an ISO, set forth the duties of a scheduling coordinator

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and mandate conduct concerning must-run service, protocols and pricing. Other rules require the filing of unbundled transmission and ancillary service tariffs.

The Commission, however, lacks the jurisdiction to make these Rules. FERC has exclusive jurisdiction of these matters and has made that clear in Order 888 and numerous FERC cases overturning state PUC actions for retail access which encroach on its transmission jurisdiction.[5] Consequently, in all state moves to retail competition, FERC requires first that a determination be made by it classifying the wires as transmission or distribution for purposes of apportioning jurisdiction. This must be done on a line-by-line, system-by-system basis.

FERC consistently holds that whenever a line is used to make wholesale power sales (even if retail power sales are also made from the same line) the line is a transmission line allocated exclusively to FERC jurisdiction.[6] All remaining lines are subjected to FERC's seven-factor test (relevant only in the apportionment of jurisdiction in the context of unbundled retail wheeling) to determine whether they are transmission lines, subject to FERC jurisdiction, or distribution lines, subject to state regulation. Thus, even lines used only for retail sales may be found by FERC to be within its exclusive jurisdiction and the ACC Rules would not apply to their use. As the Commission's Legal Issues Working Group Report noted, Order 888 requires Public Utilities to consult with state regulatory agencies and file these classification/rates cases with FERC. If the state PUC has specifically applied the seven-factor test and state recommendations for allocation are consistent with the principles of Order 888, FERC will defer to them.

However, to date, the Commission has not recognized FERC's preemption of regulation of the transmission lines; instead it has attempted its own regulation. It has applied no tests - nor have the Affected Utilities, by a formal filing, requested FERC to make any

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[5] See, for example, Docket Nos. RM95-8-003 and RM94-7-004; Order No. 888-B at page 78.

[6] See Order No. 888, FERC Stats. & Regs. At 31,772; Docket No. OA96-168-001 at page 3, Seminole Electric Cooperative, Inc.

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transmission-distribution determination and apportion jurisdiction so that Commission Rules can properly be applied only to lines found by FERC to be distribution lines.

As other states have found, realistically these requests must be filed and decided by FERC before retail competition can begin.

The Commission Also Lacks Jurisdiction to Order Retail Transmission Tariffs and Pricing or Changes to the Open Access Transmission Tariff; FERC Approval is Required.

As discussed, FERC holds exclusive jurisdiction over transmission tariffs and unbundled pricing. The Commission may not change them or order their change. Instead, FERC approval must first be obtained for any retail component of a tariff before it can be used in retail sales. Should the Commission want tariffs amended, it may only make a specific request to FERC (referencing specific public utility tariffs) and seek a variance from the pro forma open access compliance tariff. (See, for example, Docket Nos. ER97-960-000 and ER 97-1112-000, The Washington Water Power Company and Portland General Electric Company.)

Should the Commission want such amendments, it must make the appropriate FERC filings and these can be made concurrent with filings seeking a determination of transmission/distribution jurisdiction as discussed above.

The Commission Lacks Jurisdiction to Order Statewide Protocols for Pricing and Availability of Services from Must-Run Generation.

Must-run transactions and must-run services are also FERC jurisdictional matters. FERC hears, decides and approves the tariffs for and pricing of such units, even in state retail access programs. (See Docket No. ER98-2668-000, et al., Duke Energy Moss Landing LLC.) However, these matters do not need resolution before Arizona can have a state retail access program. They only become relevant in the event of the divestiture of a generation unit and the ACC can govern must-run use (and seek necessary FERC approvals) in any order approving the sale of a must-run generation unit.

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Consequently, the Cooperatives recommend that the Commission simply avoid these problems, leave their resolution to FERC and delete these must-run provisions (R14-2-1610.H) from the Rules. Alternatively, the Commission should hold a full hearing on a plan proposed and filed by transmitting utilities so as to fully develop reliability and cost recovery issues posed by the development of statewide protocols. Then, it should seek approval of those protocols by FERC.

The AISA is Best Left as a Voluntary Organization, Self-executing and FERC Jurisdictional, a Forum for Development of Protocols for Operating Procedures for Statewide Use.

The now-stayed Rules go to great regulatory lengths to set up, in minute detail, what is a voluntary organization subject to the approval not of the ACC, but of FERC. It is unnecessary. First, the organization, AISA, has already been formed and was being formed well before any Rule requirement to that effect. Second, as FERC has found, voluntary organizations such as NERC and WSCC, formed by industry participants, are the best place for problem solving, investigation of system incidents and the determination of procedures and processes necessary for open access and transmission system reliability. Third, transmitting utilities are already required by federal law to provide non-discriminatory open access to the transmission system and FERC enforces that requirement through hearings and dispute resolution. Fourth, the AISA requirements of R14-2-1610.C.1- 4 deal with the interstate transmission system, are beyond the Commission's jurisdiction and are duplicative of and potentially are inconsistent with FERC's requirements.

A better solution would be to delete all AISA Rules' references and informally encourage all transmitting utilities (whether ACC jurisdictional or not) to use the AISA to develop standard protocols to be used statewide to facilitate open access. The Commission should leave the AISA a voluntary membership organization: (1) responsible for oversight of the scheduling process used for the delivery of electricity to retail customers in Arizona; (2) to monitor and

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maintain non-discriminatory protocol applications; and (3) to resolve in a timely manner problems and issues that may arise in the acquisition of transmission services.

Reactions to the January 4, 1999 Joint Proposal of RUCO and the Attorney General.

The Cooperatives offer the following comments as to the seven subject areas covered in the Attorney General/RUCO letter of January 4, 1999:

1. Procedural Order. These suggestions have been mooted by the Hearing Officer's Procedural Order dated January 6, 1999.

2. Interim Unbundled Tariffs. For a variety of reasons, the Cooperatives do not support the concept of interim unbundled tariffs. First, implicit in this suggestion is the notion that competition will begin in stages as various issues are resolved concerning particular Affected Utilities' service territories and electric service providers. To be fair and to reduce confusion, competition should be implemented uniformly, statewide and at the same time. Secondly, decisions in certain dockets may impact rulings in others. The Commission should not adopt a piecemeal approach to the implementation of competition. Third, the Cooperatives do not believe that competition should commence until a new set of Rules is adopted by the Commission with sufficient time allowed for Affected Utilities to implement those Rules. Finally, as a practical matter, interested parties, Affected Utilities and the marketplace will not be comfortable with interim unbundled tariffs and the amount of time expended on reaching an interim agreement will probably be fairly consistent with reaching agreement on a final product.

3. Identification of Remaining Issues. This suggestion has been mooted by the Hearing Officer's Procedural Order dated January 6, 1999.

4. Consolidated Hearings on Each Affected Utility's Stranded Cost and Unbundled Tariffs' Filing. The Cooperatives believe the Attorney General and RUCO suggestions are workable as to timeframes for testimony filing, hearing and briefing. Allowance, however,

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should also be made for hearings, if necessary, on distribution cooperatives' unbundled rates and stranded cost filings.

5. Competition Rules' Amendments. The Cooperatives do not agree that the Competition Rules should be in effect during the other proceedings. As discussed previously, the Rules and various decisions' effective dates should be coordinated for a uniform, statewide commencement date. The Cooperatives would suggest the Rules' formulation and posting procedure outlined at pages 4-5 of this filing which they believe is consistent with the sprit of the Attorney General and RUCO suggestion.

6. Effective Date of Unbundled Tariffs. The Cooperatives agree that all unbundled tariffs and all other aspects of retail electric competition should be given the same effective date for all Affected Utilities.

7. Settlement. The Cooperatives are uncertain what the Attorney General and RUCO mean by an "order directing parties and stakeholders to continue settlement efforts until March 15, 1999." Certainly, all parties should be encouraged to continue settlement efforts on any outstanding issues and the Cooperatives will continue to participate in that process. We do not think it necessary to specify a particular date upon which settlement efforts would cease.

Conclusion

The Cooperatives request that the Hearing Officer enter a Procedural Order(s) consistent with these Comments and refer to the Commission those matters which require entry of a decision by it.

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RESPECTFULLY SUBMITTED this 20th day of January, 1999.

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