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BEFORE THE

ARIZONA CORPORATION COMMISSION

AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission
Matter of the Commission's Inquiry)
Into Retail Electric Competition)

Docket No. E-00000W-13-0135

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JUL 15 2013

Comments of the
National Energy Marketers Association

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The National Energy Marketers Association (NEM)¹ hereby submits its comments on the Commission's inquiry in which it is considering, "whether it is in the public interest to implement retail electric competition in Arizona." In this regard, the Commission issued a series of questions for stakeholder comment. NEM applauds the Commission's efforts to examine all of the issues underlying a transition to a fully competitive retail electric market. NEM believes that it is in public interest to implement retail electric competition for all Arizona consumers and that it will yield significant benefits for all stakeholders. Consumers of all sizes will benefit from downward pricing pressure created by competitive markets, energy product and service innovation, and the ability to choose a product to suit their individual needs. Utilities will benefit because of the ability to focus their resources on delivery infrastructure maintenance and upgrades when they are no longer required to divert resources to the performance of competitive commodity-related functions. Retail choice markets implemented in other jurisdictions have yielded significant value. NEM strongly supports the Commission's efforts to harness those benefits for Arizona consumers.

¹ NEM is a non-profit trade association representing both leading suppliers and major consumers of natural gas and electricity as well as energy-related products, services, information and advanced technologies throughout the United States, Canada and the European Union. NEM's membership includes independent power producers, suppliers of distributed generation, energy brokers, power traders, global commodity exchanges and clearing solutions, demand side and load management firms, direct marketing organizations, billing, back office, customer service and related information technology providers. NEM members also include inventors, patent holders, systems integrators, and developers of advanced metering, solar, fuel cell, lighting and power line technologies.

NEM's answers to the Commission's questions are set forth below. In some instances, we have grouped the questions together for a response where the information was substantively interrelated.

- 1) **Will retail electric competition reduce rates for all classes of customers – residential, small business, large business and industrial classes?**
- 2) **In addition to the possibility of reduced rates, identify any and all specific benefits of retail electric competition for each customer class.**
- 3) **How can the benefits of competition apply to all customer classes equally or equitably?**
- 12) **How have retail rates been affected in states that have implemented retail electric competition?**

NEM RESPONSE TO QUESTIONS 1-3 and 12:

State economic regulation of the true distribution monopoly function reduces costs to society by eliminating unneeded duplication and by preventing utilities from extracting monopoly profits. The distribution monopoly function is the utilities' investment in and maintenance of a reliable electric delivery system. This is the utilities core competency, and they should be encouraged to focus on reliably maintaining the electric delivery system. However, by definition, limiting regulation to the natural monopoly function, while permitting robust competition on all other functions, products, services and technology, should maximize benefits of innovation, reduce prices and provide higher quality service to natural gas consumers, while minimizing the economic distortions inherent in monopoly economics.

The implementation of retail electric competition will significantly benefit Arizona consumers who have been limited to receiving commodity service from the utility commodity provider. The introduction of competition, characterized by a vibrant market with many buyers and many sellers, will result in lower rates, innovation in products and services, more efficient utilization of utility capital, and increased Arizona jobs.

Benefits to consumers of retail electric competition include:

A. Competitive Pricing Pressure

A fundamental driver of competition is downward pressure on prices. The ability to compete with lower prices allows competitive suppliers to attract and retain loyal and satisfied customers. In addition, lower energy prices will also benefit Arizona businesses that can conduct operations at a lower cost and on a more efficient basis, creating more in-state jobs and improving economic conditions for Arizonans.

The consumers in other states have already received significant price savings benefits. For example, in its 2013 report to the legislature on retail electric competition, the Public Utility Commission of Texas reported that, "Retail customers have benefitted from available rates well below, on an inflation-adjusted basis, the last regulated rates charged by electric utilities prior to the implementation of retail choice in 2002."² In addition, the PUCT observed that, "every competitive area in Texas has variable and one-year fixed rates that are up to three cents per kWh below the national average."³

After many years of artificial rate caps that stifled retail competition, the Illinois electric market recently underwent a series of rule changes and reforms that have resulted in millions of consumers switching and shopping over the past two year period. The Illinois Commerce Commission's Office of Retail Market Development has evaluated the savings achieved by residential electric customers. For the twelve month period of June 2011-May 2012, Illinois shopping customers saved \$24 million.⁴ For the twelve month period of June 2012-May 2013, customer savings were estimated to be \$268 million.⁵

There has been a robust retail gas market for consumers in Ohio for many years. The Public Utilities Commission of Ohio approved the use of an auction mechanism to transition the gas utilities out of the commodity merchant function role and to remove the pricing distortions associated with the gas cost recovery mechanism. In PUCO Staff's evaluation of the savings achieved for consumers under the auctions versus the traditional utility GCR pricing mechanism, it found that DEO customers saved over \$2.4 million per month (9%), VEDO customers saved almost \$1 million per month (9%), and Columbia customers saved almost \$2.4 million per month (15%).

B. Product and Service Innovation

Retail electric competition can provide consumers with many more choices of rate plans to fit an individual consumer's needs, including variable and fixed rate offers of varying durations, green products, time differentiated products, and other innovative offerings. In the absence of a competitive market, consumers receive a single tariffed commodity rate from the utility regardless of preference or need.

Regulated utilities have very limited incentive to innovate and are slow to adopt new products, services and technology relative to firms in the competitive market. Competitive suppliers are directly incented to better meet a consumer's individual needs. In other states with customer choice, a wide variety of

² Public Utility Commission of Texas, Scope of Competition in Electric Markets in Texas, January 2013, at page 1.

³ Id. at 21.

⁴ Illinois Commerce Commission Office of Retail Market Development, 2013 Annual Report, at page 24.

⁵ Id. at 25-26.

innovations have emerged in the areas of customer service, rate plans, promotions and rewards programs, and energy efficiency initiatives.

C. Utility Focus on Core Competency of Infrastructure Maintenance and Upgrades

The implementation of retail electric competition coupled with the utility exit from the commodity merchant function will permit the utility to focus its capital and other resources on its core competency of delivery infrastructure maintenance, improvements and upgrades. This will allow the utility to focus on building the smart grid of the future in order to permit increased product and service innovation, to better detect and prevent service outages, as well as to safeguard the delivery system against terrorist attacks.

D. The Intrinsic Value of Customer Choice

Common sense and empirical surveys suggest that a large majority of energy customers prefer a choice over a monopoly. The simple freedom to “choose” a supplier or demonstrate loyalty or affinity to a company that has proven value to the customer is in itself a benefit to Arizona residents. Indeed, in each of the states of Georgia, Illinois, New York, Ohio, Pennsylvania and Texas there are over one million residential consumers shopping for energy. In the recent inaugural JD Power Study of Retail Electric Provider Satisfaction it was found that retail choice customers surveyed were more satisfied with price than were customers of local electric utilities. The majority of consumers surveyed cited price competition as a primary reason for shopping for a competitive provider.⁶

4) Please identify the risks of retail electric competition to residential ratepayers and to the other customer classes. What entity, if any, would be the provider of last resort?

In order to become a certificated supplier eligible to do business in the state of Arizona, suppliers must satisfy technical and managerial fitness requirements established by the Commission. The supplier will also be subject to credit requirements as a condition of participating in the wholesale market. This will mitigate any risk to consumers of supplier non-performance.

Competitive suppliers have long been involved in aggregating electric generation supply, and providing utilities with energy as a commodity. Indeed, in many cases marketers have supplied utilities with energy and related services on an outsourced basis for years, enabling those utilities to provide energy supply services. A utility supplying delivery is not inherently more reliable than a contractual obligation to serve by a qualified supplier, unless there are anti-competitive remnants that remain in law or practice. In addition, competitive suppliers have risk management assets that historically have not been part of a utility’s business model since the Commission normally has acted as the utility’s risk manager.

⁶ JD Power 2013 Retail Electric Provider Satisfaction Study.

5) How can the Commission guarantee that there would be no market structure abuses and/or market manipulation in the transition to and implementation of retail electric competition?

The Commission can prevent market structure abuses and market manipulation by adopting strong code of conduct regulations. Code of conduct regulations should:

- a) Prohibit cross-subsidization between the utility and its affiliate(s);
- b) Prohibit the regulated utility from selling or transferring assets that have been included in regulated rates, at less than market value;
- c) Prohibit regulated utility services from being preferentially tied to products or services provided by nonregulated market participants (affiliated or nonaffiliated);
- d) Require that tariff provisions be applied in an equal, non-discriminatory manner to all market participants (affiliated and non-affiliated);
- e) Require information to be made available and disseminated on a non-discriminatory, competitively neutral basis;
- f) Require communications by a regulated utility within an exclusive franchise territory to be competitively neutral;
- g) If regulated utilities are permitted to engage in unregulated activities (either through affiliated or non-affiliated entities) safeguards must be implemented to protect against the disclosure of proprietary or competitive information, including corporate firewalls and the separation of functions, information, operations and personnel.

6) What, if any features, entities or mechanisms must be in place in order for there to be an effective and efficient market structure for retail electric competition? How long would it take to implement these features, entities, or mechanisms?

The Arizona Independent Scheduling Administrator's Association (AISA) was formed in 1998 and continues to exist to provide services as an independent electric transmission scheduling administrator. AISA is the appropriate entity to ensure open, non-discriminatory transmission access for participants in a retail electric market. AISA should be encouraged to update its protocols and to perform the role of scheduling administrator.

7) Will retail electric competition require the divestiture of generation assets by regulated electric utilities? How would FERC regulation of these facilities be affected?

The utilities should be encouraged to divest their generation assets. In other retail choice jurisdictions, the divestiture of generation has been a critical component to ensuring a level playing field for competitors. In the absence of generation divestiture, the critical point is the corporate separation of the delivery company from the generation provider that is reinforced with strong codes of conduct. The utilities should be required to adhere to strict codes of conduct. Firewalls and the separation of functions, information, operations and personnel must be effective and enforceable. Enforceable standards of conduct must ensure that proprietary and confidential competitor information is

scrupulously safeguarded. Under no circumstances should the electricity commodity supplies of an unregulated affiliate be subsidized by regulated rates.

8) What are the costs of the transition to retail electric competition, how should those costs be quantified, and who should bear them?

To the extent that utilities incur costs to implement retail electric competition, such costs should be recovered from all consumers on a competitively neutral basis through a non-bypassable charge. Migrated consumers should not be penalized with an exit fee for taking service from a competitive provider. Utility costs of implementation should be aggressively managed and prudently incurred in furtherance of facilitating consumer participation in energy choice.

9) Will retail electric competition impact reliability? Why or why not?

Retail electric competition will not negatively impact reliability. Indeed, retail electric competition can enhance system reliability. This is because when the delivery utility no longer performs the commodity merchant role it will be able to focus its resources on the performance of its core competency of infrastructure system maintenance and upgrades.

11) Among the states that have transitioned to retail electric competition, which model best promotes the public interest for Arizonans? Which model should be avoided?

NEM recommends that the desired market end state is the competitive provision of default service and the utilities exit from competitive functions. NEM alternatively recommends a two-prong transitional approach to the market structure, for any interim period during which the utility might be retained in the default commodity provider role. First, utility default commodity service should utilize timely, market based pricing signals to consumers to provide an environment for sustained competitive activity and an accurate basis upon which consumers can evaluate competitive energy offerings. Default service rates should be adjusted on a monthly basis for mass market consumers and on an hourly basis for large commercial and industrial consumers who can be billed hourly. Second, utility default commodity service pricing should fully capture the cost of providing no-notice last resort service. In other words, utility delivery service rates should be unbundled to separate out and properly allocate the full retail costs to the utility of providing 24/7 no-notice, last resort default commodity service. Competitive suppliers must perceive a continuous opportunity to participate in a true market and provide consumers with value and options in order to justify substantive resource investments in the State. Permitting consumers to receive market-based pricing signals to which is added a utility's fully allocated embedded costs associated with providing all of the otherwise competitive commodity related products and services currently bundled in utility full service rates will contribute to the creation of a robust, competitive market.

Other jurisdictions have also undertaken a transitional path to move from a utility default service structure. Below are illustrative examples of these approaches.

A. Separation of Generation and Transmission

Texas law required that all electric customers have the option of choosing a competitive supplier by January 1, 2002.⁷ The electric utilities were required to unbundle their business activities into three entities: a wholesale power generation company, a retail electric provider (REP), and a transmission and distribution company.⁸ When competition began on January 1, 2002, standard offer service was transferred to the affiliated REP of the utility company, to provide service at the Price to Beat, which could be adjusted twice per year for fuel cost changes. Affiliated REPs were prohibited from offering competitive rates to residential and small commercial customers in the utility service territory, other than as the standard offer provider, until 40% of residential and small commercial customer load had chosen a competitive supplier. Provider of last resort service is rendered by competitive providers on a customer class-specific basis. Marketers serving customers in Texas perform their own billing and customer care.

B. Establish Date Certain for Utility Exit of Merchant Function

Atlanta Gas Light exited the merchant function in 1999. Georgia's Natural Gas Competition and Deregulation Act of 1997⁹ permitted gas utilities to elect to exit the merchant function upon a showing that sufficient competition existed in their service territory. Once the determination was made that market conditions were sufficiently competitive, customers that had not chosen a marketer were randomly assigned to one based on the marketer's market share at the time. The Georgia PSC instituted an interim pooler to serve customers in the event their marketer can no longer provide service.¹⁰ Legislation in 2002 provided for the creation of a "regulated provider" to serve low income and high-risk customers unable to receive service from a marketer.¹¹ Marketers serving customers in this service territory perform their own billing and customer care.

C. Auction of Supply Obligation

In Ohio, beginning in the service territory of Dominion East Ohio¹² and then subsequently followed by the additional natural gas utilities in the state, the

⁷ Texas Utility Code Ann. Section 39.102.

⁸ Texas Utility Code Ann. Section 39.051.

⁹ O.C.G.A. § 46-4-150 et. seq.

¹⁰ Georgia Public Service Commission Docket No. 8390-U, Order Designating Interim Pooler, November 4, 1999.

¹¹ Natural Gas Consumers Relief Act of 2002. See O.C.G.A. § 46-4-166.

¹² See, e.g., Public Utilities Commission of Ohio, Case No. 05-474-GA-ATA, In the Matter of the Application of The East Ohio Gas Company, dba Dominion East Ohio, for Approval of a Plan to Restructure Its Commodity Service Function; Case No. 07-1224-GA-EXM, In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Approval of a General Exemption of Certain Natural Gas Commodity Sales Services or Ancillary Services.

utilities utilized a transitional, phased process to exit the gas merchant function. This began with the recognition that the Gas Cost Recovery Mechanism that had been in place was hampering retail market development. In its place, the utilities first used a descending clock auction, called a Standard Service Offer (SSO) Auction, through which suppliers bid to provide wholesale supply volumes. Through the auction a Retail Price Adjustment is derived to which is added the monthly NYMEX settlement price to arrive at the SSO rate for customers. Subsequently, in Phase 2 of the exit from the commodity merchant function, a Standard Choice Offer (SCO) Auction was utilized through which suppliers bid to provide commodity to choice eligible customers. In other words, suppliers establish a direct retail relationship with the consumer as a result of the SCO auction.

D. Declaration of Competitive Service

A transitional mechanism in place in the electric market in Illinois involves the declaration of a utility's tariffed service to become a competitive service.¹³ A service can be declared competitive by the Illinois Commerce Commission upon a showing that 33% of eligible customers have migrated from the tariffed service to a competitive supplier and that at least three competitive suppliers provide a comparable service in the utility's service territory.¹⁴ The Illinois statute explicitly declared that the provision of electric power and energy to retail customers in the service territories of ComEd and Ameren for customers with peak demands of 400 kilowatts and above is a competitive service.¹⁵ Upon the declaration of service as competitive, service to those customers by the utility will only be rendered on an hourly-pricing basis. The Illinois Commerce Commission also granted ComEd's petition to declare the provision of power and energy to customers with peak demands of 100 kilowatts and above but less than 400 kilowatts as a competitive service.¹⁶

¹³ Illinois Public Utilities Act, Section 16-113.

¹⁴ Illinois Public Utilities Act, Section 16-113(a).

¹⁵ Illinois Public Utilities Act, Section 16-113(f).

¹⁶ Illinois Commerce Commission Docket Nos. 08-0619, 08-0620, and 08-0621.

Conclusion

NEM strongly believes that the public interest would be well-served through the implementation of a retail electric choice program in the State of Arizona. We look forward to working with the stakeholders in this proceeding to achieve that goal.

Sincerely,



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Dated: July 12, 2013.

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon each person designated on the official service list in this proceeding.

Dated at Washington, D.C. this 12th day of July, 2013.



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