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**BEFORE THE ARIZONA CORPORATION COMMISSION**

10 IN THE MATTER OF THE  
11 COMMISSION'S INQUIRY INTO RETAIL  
12 ELECTRIC COMPETITION

DOCKET NO. E-00000W-13-0135

**FREEPORT-MCMORAN COPPER &  
GOLD INC. AND ARIZONANS FOR  
ELECTRIC CHOICE AND  
COMPETITION INITIAL COMMENTS  
AND RESPONSE TO STAFF'S MAY 23,  
2013 LETTER CONCERNING  
ELECTRIC RETAIL COMPETITION**

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14  
15  
16 Freeport-McMoRan Copper & Gold, Inc. and Arizonans for Electric Choice and  
17 Competition (collectively, "AECC") hereby submit these Initial Comments and Response  
18 to Staff's May 23, 2013 letter concerning retail electric competition.

**INTRODUCTION**

19  
20 The adoption of the rules which implemented retail electric competition in the State  
21 of Arizona involved a long, deliberate and well-considered process. The Arizona  
22 Corporation Commission ("Commission") first opened an investigation into retail electric  
23 competition in 1994. The first version of the Retail Electric Competition Rules ("Rules")  
24 was adopted by the Commission in 1996, and thereafter modified a number of times until  
25 the current version finalized by the Commission in 1999.

26 Concurrently with the adoption of the Rules by the Commission, the Arizona

1 Legislature passed legislation which provided that: "It is the public policy of this State  
2 that a competitive market shall exist in the sale of electric generation service." The  
3 Legislature confirmed the Commission's authority to "transition to competition for  
4 electric generation service" and set forth certain conditions relating to the transition  
5 (A.R.S. § 40-202(B)). The Arizona Legislature also passed legislation in 1998 which  
6 enabled public power entities, such as the Salt River Project ("SRP"), to transition to  
7 competition in electric generation service (A.R.S. §§ 30-801 and 30-813 "Electric Power  
8 Competition").

9 Adoption of the Rules by the Commission resulted in immediate rate decreases for  
10 investors-owned utility ("IOU") customers. The IOU rate decreases were negotiated in  
11 tandem with the adoption of direct access. SRP customers also received a decrease in  
12 rates during the period in which the Rules were adopted. During the years 1999 and 2000,  
13 approximately fifteen entities known as electric service providers, or ESP's, received  
14 Certificates of Convenience and Necessity ("CC&N") to provide competitive electric  
15 service, meter services and/or meter reading services.

16 On September 10, 2002, the Commission issued an Order commonly referred to as  
17 the "Track A Order" (Decision No. 65154). This Order reversed the requirement of the  
18 Rules that the affected utilities ("Arizona Public Service Company, Tucson Electric Power  
19 Company, UNS Electric Company, Arizona Electric Power Cooperative and various other  
20 Electric Cooperatives") ("Affected Utilities") divest their generation assets, and  
21 suspended the requirement that provided for the affected utilities to purchase all of their  
22 power in the competitive market.

23 In 2004, the Arizona Court of Appeals issued a decision commonly referred to as  
24 the "Phelps Dodge" Decision. (*Phelps Dodge v. Ariz. Elec. Power Coop.*, 207 Ariz 95, 83  
25 P.3d 573 (App.2004)). Although the Court in *Phelps Dodge* held that a provision in the  
26 Rules relating to the setting of rates (A.A.C. §14-2-1611(A)) was unconstitutional, the

1 Court stated that “The remaining Rules, however, can be applied in a manner consistent  
2 with the Constitution.” *Id.* at 109, 587. In addition, the Court determined that the Rules  
3 were independent of the unconstitutional provision and were “enforceable standing  
4 alone”. *Id.* at 110, 588. The Court severed the provision and left the remaining Rules  
5 intact, stating that “the remaining Rules are workable and can therefore continue to exist  
6 intact”. *Id.* at 111, 589. The Court expressed concern with some other provisions of the  
7 Rules, which concerns are discussed more fully in AECC’s answers to the Commission  
8 Staff’s questions. Subsequent to the adoption of the Rules by the Commission in 1999,  
9 hearings were held for the recovery of stranded costs by the Affected Utilities. Affected  
10 Utilities were permitted to, and have recovered, stranded costs resulting from the  
11 implementation of retail electric competition in Arizona.

12 Currently, retail electric competition is available in seventeen (17) States and the  
13 District of Columbia. These jurisdictions account for over forty percent of all electricity  
14 consumption in the United States. Experience of those jurisdictions with competitive  
15 markets demonstrates the following reasons customers support retail electric competition:  
16 (i) the rising cost of electricity; (ii) a greater selection of providers; (iii) more  
17 choices in energy service offerings and a more diverse fuel supply including  
18 renewable energy options; (iv) the means to better manage their electricity costs, and for  
19 ways to decrease the amount of power and thereby reduce the cost of electricity; (v) real-  
20 time control of electricity consumption through smart meters; (vi) more pricing plans;  
21 and (vii) newer and better products and services as demonstrated by the deregulation of  
22 telecommunications terminal equipment.

23 In addressing the questions posed by Commission Staff on May 23, 2013, AECC’s  
24 response will demonstrate how and why retail electric competition will provide benefits  
25 for all classes of electricity consumers.

26



1           **3. How can the benefits of competition apply to all customer classes equally**  
2           **or equitably?**

3           **Response:** Direct access service can coexist with retention of cost-based utility rates.  
4           The selection of direct access service by customers will vary by class, so participation  
5           will never be “equal.” However, the benefits can be equitable by permitting customers  
6           from every customer class to participate. Further, residential participation can be  
7           enhanced by allowing for municipal aggregation, in which local governments act as  
8           load aggregators on behalf of their residents. Forms of municipal aggregation are  
9           permitted in Ohio, California, Illinois, Massachusetts, and New Jersey.

10           **4. Please identify the risk of retail electric competition to residential**  
11           **ratepayers and to the other customer classes. What entity, if any, would be**  
12           **the provider of last resort?**

13           **Response:** The degree of risk of introducing retail competition would depend in part  
14           on the model selected. While AECC is open to the investigation of a wide range of  
15           models, AECC has consistently advocated a model in which there would be little  
16           downside risk to reinstating direct access service in Arizona. For example, AECC is  
17           not proposing that the Commission abandon current cost-of-service regulation. No  
18           customer would be forced from cost-of-service rates over which the Commission  
19           would still assert jurisdiction. Under AECC’s recommended approach, customers  
20           would simply have an alternative option for obtaining generation supply through direct  
21           access service. Because utility service would remain intact under this approach, the  
22           incumbent utilities would remain providers of last resort. This is a very low-risk  
23           proposition.

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

1        **Response:** Under AECC’s recommended approach, cost-of-service pricing options  
2 would remain in place under the full jurisdiction of the Commission. Additionally,  
3 because ESPs will need to be approved through the issuance of competitive CC&Ns,  
4 their conduct – and prices offered – will still require Commission oversight. Finally,  
5 Affected Utilities choosing to participate in the competitive market through an affiliate  
6 will need to adhere to a strict Code of Conduct filed with the Commission and the  
7 Federal Energy Regulatory Commission (“FERC”).

8        **6.        What, if any, features, entities or mechanism must be in place in order for**  
9 **there to be an effective and efficient market structure for retail electric**  
10 **competition? How long will it take to implement these features, entities or**  
11 **mechanisms?**

12        **Response:** For direct access to be successful, there must be non-discriminatory access  
13 to the transmission system. Moreover, there must be a means for equitably  
14 apportioning the rights to use transmission paths that access liquid trading hubs (e.g.,  
15 Palo Verde). In most direct access states, FERC-regulated Regional Transmission  
16 Organizations (“RTOs”) fulfill this role. However, FERC also requires that  
17 transmission providers outside of RTOs offer non-discriminatory access to the  
18 transmission system, a principle that applies to competitive retail providers in direct  
19 access states.

20        In the absence of an RTO, Arizona stakeholders formed – with the encouragement  
21 of the Commission – the Arizona Independent Scheduling Administrator Association  
22 (“AZISA”), which is a FERC-jurisdictional entity charged with supporting the  
23 provision of comparable, non-discriminatory retail access to the Arizona transmission  
24 system, and to facilitate a robust and efficient competitive electric market in Arizona.  
25 AZISA’s FERC-approved Phase 1 protocols govern the allocation of the first 300 MW  
26 of direct access service.

1 If and when direct access service exceeds 300 MW, the AZISA would need to file  
2 Phase 2 protocols with FERC, along with a business plan covering all AZISA  
3 activities, including monthly Allocated Retail Network Transmission (“ARNT”)  
4 auction mechanism, Must Run Generation Procedures and an energy imbalance  
5 trading mechanism. In recent Board meetings, AZISA members have generally agreed  
6 that the AZISA can incorporate present Western Electricity Coordinating Council  
7 (“WECC”) practices and requirements regarding scheduling and delivery of retail  
8 competitors’ power, and that the AZISA must focus on transmission allocation issues.  
9 FERC approval is required for any changes to the AZISA’s Phase 1 Protocols and, as  
10 noted, any Phase 2 Protocols necessary to facilitate competitive load beyond 300 MW.  
11 Thus, while certain federal approvals are still necessary to fully implement retail  
12 competition in the state, the structure is already in place for the Commission to  
13 facilitate an expedient and smooth transition towards choice and competition.

14 7. **Will retail electric competition require the divestiture of generated assets**  
15 **by regulated electric utilities? How would FERC regulation of these**  
16 **facilities be affected.**

17 **Response:** No, the reinstatement of direct access service does not require divestiture  
18 of generation assets by regulated electric utilities. Although retail electric competition  
19 can be accompanied by required divestiture of generation assets, divestiture is not a  
20 necessary component of allowing direct access to proceed. Michigan and Oregon  
21 each permit direct access without requiring divestiture of utility assets. In both of  
22 these states direct access service coexists with state-regulated cost-based utility  
23 service.

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

26

1        **Response:** The costs of the transition to retail electric competition are typically placed  
2 into two general categories: “stranded” cost and compliance/implementation costs.  
3 Stranded cost generally refers to that portion of the embedded cost of utility-owned  
4 fixed generating assets that is rendered uneconomic as a result of retail competition,  
5 i.e., it is the difference between “cost” and “market.” Stranded cost has received  
6 considerable attention from the Commission in the past.

7                Stranded cost is defined in R-2-1601(40) as:

8                    a. The verifiable net difference between:

9                                i. The net original cost of all the prudent jurisdictional assets and  
10                                    obligations necessary to furnish electricity (such as generating plants,  
11                                    purchased power contracts, fuel contracts, and regulatory assets),  
12                                    acquired or entered into prior to December 26, 1996, under traditional  
13                                    regulation of Affected Utilities; and

14                                ii. The market value of those assets and obligations directly  
15                                    attributable to the introduction of competition under this Article;

16                    b. Reasonable costs necessarily incurred by an Affected Utility to effectuate  
17                                    divestiture of its generation assets;

18                    c. Reasonable employee severance and retraining costs necessitated by  
19                                    electric competition, where not otherwise provided; and

20                    d. Other transition and restructuring costs as approved by the Commission  
21                                    as part of the Affected Utility’s Stranded Cost determination under R14-2-  
22                                    1607.

23                The recovery of stranded cost is addressed in R-2-1607. The factors to be considered  
24                by the Commission are spelled out in R-2-1607.E, which provides that:

25                “The Commission shall, after hearing and consideration of analyses and  
26                recommendations presented by the Affected Utilities, staff, and intervenors, determine  
27                for each Affected Utility the magnitude of Stranded Cost, and appropriate Stranded  
28                Cost recovery mechanisms and charges. In making its determination of mechanisms

1 and charges, the Commission shall consider at least the following factors:

- 2
- 3 1. The impact of Stranded Cost recovery on the effectiveness of competition;
- 4 2. The impact of Stranded Cost recovery on customers of the Affected Utility who
- 5 do not participate in the competitive market;
- 6 3. The impact, if any, on the Affected Utility's ability to meet debt obligations;
- 7 4. The impact of Stranded Cost recovery on prices paid by consumers who
- 8 participate in the competitive market;
- 9 5. The degree to which the Affected Utility has mitigated or offset Stranded Cost;
- 10 6. The degree to which some assets have values in excess of their book values;
- 11 7. Appropriate treatment of negative Stranded Cost;
- 12
- 13 8. The time period over which such Stranded Cost charges may be recovered. The
- 14 Commission shall limit the application of such charges to a specified time period;
- 15 9. The applicability of Stranded Cost to interruptible customers.

16 Of note, R-2-1607.E (8) provides that Commission shall limit the application of  
17 such charges to a specified time period. In 1999, Arizona Public Service Company  
18 ("APS") entered a settlement agreement in Docket No. E-01345A-98-0473 at al,  
19 approved with modifications by the Commission that provided for full recovery of  
20 stranded cost by December 31, 2004. In a subsequent settlement agreement approved  
21 by the Commission in Docket No. E-01345A-03-0437, APS further agreed to  
22 permanently forego any stranded cost claims associated with the West Phoenix CC-4,  
23 West Phoenix CC-5, Saguaro CT-3, Redhawk CC-1, and Redhawk CC-2 units, which  
24 came into rate base in that case. Similarly, in 1999, TEP entered a settlement  
25 agreement in Docket No. E-01933A-98-0471 et al, approved with modifications by the  
26 Commission that provided for full recovery of stranded cost by December 31, 2008.

With the passage of time and new generation investments made by utilities, it is

1 conceivable that utilities may make new stranded cost claims if direct access is  
2 reinstated. However, these potential claims would have to be resolved taking into  
3 account the prior agreements and Commission orders addressing stranded cost  
4 recovery.

5 Compliance or implementation costs refer to going-forward administrative costs  
6 associated with accommodating a direct access regime. Both APS and TEP were  
7 previously permitted to recover in rates certain specific costs to implement direct  
8 access. In a settlement agreement approved by the Commission in Docket No. E-  
9 01345A-03-0437, APS was permitted to recover \$47.7 million through a Competitive  
10 Rules Compliance Charge ("CRCC"). The CRCC was recovered over a five-year  
11 period. Similarly, in a settlement agreement approved by the Commission in Docket  
12 No. E-01933A-07-042, TEP was permitted to recover \$14.2 million through the  
13 establishment of an Implementation Cost Recovery Asset ("ICRA") to reflect TEP's  
14 costs of transitioning to retail competition. The ICRA was recovered over a period of  
15 four years.

16 Affected Utilities should be required to identify any incremental  
17 implementation costs they would seek to recover from customers if direct access is  
18 reinstated. Any allowed incremental cost recovery should take into account the costs  
19 that have already been recovered from customers for this express purpose.

20 **9. Will retail electric competition impact reliability? Why or why not?**

21 **Response:** No. There is no reason to believe that retail electric competition will  
22 impact reliability. Direct access is not new or novel, and reliable electric service has  
23 been unimpaired in other direct access jurisdictions. If customers are allowed to take  
24 direct access service, the electric grid would still continue to be operated as it is today,  
25 pursuant to reliability standards developed and enforced by the North American  
26 Electric Reliability Corporation ("NERC") and WECC. It is financial transactions

1 relating to generation service that will be different. The distribution and transmission  
2 systems will continue to be owned and operated by the incumbent utilities with no  
3 implications for changes in reliability.

4 Long-term planning can still take place pursuant to the integrated resource  
5 planning ("IRP") process. Through the IRP process, utilities can manage their  
6 exposure to direct access service by planning their long-term and short-term resource  
7 acquisitions and constructing resource portfolios in anticipation that certain levels of  
8 loads will either depart or re-enter utility service. The IRP process already takes into  
9 account uncertainties such as natural gas prices, economic conditions, environmental  
10 requirements, renewable energy targets, energy efficiency, transmission system  
11 changes, and federal policy changes. Incremental shopping load is just one more  
12 variable to be evaluated and addressed. Utility IRPs should incorporate reasonable  
13 assumptions about the level of incremental direct access load to be expected across the  
14 relevant planning horizon. The resources selected in the IRP should include products  
15 that can accommodate departing loads or to hedge against inaccuracies in load  
16 forecasts.

17 **10. What are the issues relating to balancing area authorities, transmission**  
18 **planning, and control areas which must be addressed as part of a**  
19 **transition to retail electric competition?**

20 **Response:** There are no major implications for balancing area authorities,  
21 transmission planning, and control areas a result of direct access, except that there  
22 would be more parties scheduling on the transmission system and a larger number of  
23 transactions requiring after-the-fact accounting. As explained in the responses filed  
24 by the AZISA, the scheduling and delivery of power in a competitive retail market  
25 should be performed the same as any other energy transaction. Scheduling  
26 coordinators will schedule to the customer's balancing authority at interconnection  
schedule points. The balancing authority will deliver power and energy to the end use

1 customer and charge FERC-approved transmission rates and ACC distribution rates,  
2 plus appropriate ancillary services. If direct access service resumes, where the power  
3 comes from may change, and scheduled paths for delivery of power may change, but  
4 in general, service to retail customers will continue in much the same manner as it is  
5 today in that the multiple control area operators that exist in Arizona will balance the  
6 system and the issue will become more focused on the cost and the accounting for the  
7 energy imbalances. If transmission paths are congested, there are mechanisms for  
8 settlement to ensure that the utilities' existing customers are not harmed by cost  
9 shifting, as required under their FERC OATT, and those of the AZISA.

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

13 **Response:** AECC is not wedded to a specific model adopted in another state, but  
14 believes that aspects of certain models adopted elsewhere can be instructive in  
15 developing an "Arizona model." One model that may be particularly useful for  
16 Arizona, at least for an initial transition period, is the Multi-Year Opt Out program  
17 developed in Oregon for the Portland General Electric ("PGE") service territory.

18 By way of background, Oregon is a direct access state. Non-residential customers  
19 with billing demands of 30 kW or greater are eligible to shop. Oregon's incumbent  
20 utilities have *not* been required to divest their generation and each offers state-  
21 regulated cost-based bundled service to all customers. Under the direct access rules,  
22 Oregon utilities offer an annual shopping program pursuant to which customers can  
23 select direct access service for a one-year period. Shopping customers participating in  
24 this program are subject to a transition adjustment (i.e., stranded cost charge or credit)  
25 equal to the difference between cost-based generation and market prices. Because it  
26 is designed to repeatedly produce a breakeven value proposition for customers, the

1 *annual* shopping program in Oregon is not very popular and AECC does *not*  
2 recommend that it be used as a model for Arizona.

3 In contrast, the PGE Multi-Year Opt Out program was designed to offer a genuine  
4 transition to market pricing. Pursuant to this program, participants are subject to  
5 transition adjustments for five years, after which they migrate to full market pricing;  
6 that is, they are no longer subject to transition adjustments starting in Year 6 of their  
7 continuous direct access service. (Any application of transition adjustments in  
8 Arizona would need to take into account the prior resolution of stranded cost discussed  
9 above.) Participating customers must also provide advance notice (currently two years)  
10 of any intention to return to cost-based rates. To date, no participants in this program  
11 have requested to return to incumbent utility service.

12 The drawbacks of this program are that participation is limited to customers with  
13 individual site demands of at least 250 kW that can aggregate at least 1 MW of load.  
14 There is also an overall participation cap of 300 MW. These specific restrictions are  
15 negotiated components of the PGE program and need not be applied to Arizona.

16 The appeal of this program is that it provides significant notice that allows the  
17 incumbent utility to plan for the departure (and potential return) of direct access  
18 customers. At the same time, it provides a pathway to genuine market pricing for  
19 participants by establishing a terminal date for transition charges. At the same time,  
20 customers that elect to remain on Commission-regulated cost-based rates may do so.  
21 In this sense, it is a conservative approach that offers genuine customer choice, while  
22 retaining many aspects of the status quo.

23 AECC does not offer a comprehensive list of programs to be avoided, but notes that  
24 California's initial restructuring requirement that all power be purchased in a short-  
25 term market (the ill-fated California Power Exchange) was a well-documented disaster  
26 not to be repeated. AECC also discourages the Commission from adopting approaches  
that provide for open-ended stranded cost recovery, such effectively occurs in Ohio,

1 which has an active retail shopping market, but which also requires substantial non-  
2 bypassable charges paid to incumbents in the interest of “rate stability.”

3  
4 **12. How have retail rates been affected in states that have implemented retail**  
5 **electric competition.**

6 **Response:** Retail electricity rates in states that have implemented direct access service  
7 have been affected not only by the transition to competition but also by factors such as  
8 changing fuel prices, transitional price caps and more. Nevertheless, many studies  
9 have evaluated the rate impacts associated with retail electric choice. As is often the  
10 case with studies that seek to isolate the effect of one of multiple variables, there are a  
11 range of conclusions. Study conclusions vary based on methodology, the geographic  
12 area studied, the study’s measurement technique, and other factors. Despite the  
13 variance in conclusions, most studies have shown that implementation of retail electric  
14 choice has led to lower retail electric rates for consumers.

15 Vince Persico and Phillip Novak<sup>1</sup> recently wrote an editorial for *The Daily Herald*<sup>2</sup>  
16 in which they assess consumer savings resulting from retail electric choice in Illinois.  
17 The analysis compares Illinois’s retail electric rates to the national average, both in the  
18 decade before the implementation of electric choice and in the decade following  
19 implementation of retail electric choice. The authors find that, in the decade before  
20 retail competition, Illinois consumers paid 12% more than the national average for  
21 electricity, but in the decade following restructuring Illinois retail electric prices have  
22 been 7% below the national average. The authors conclude that this price swing has  
23 saved electric consumers in Illinois \$31 billion. This analysis highlights the significant  
24 benefits attributable to retail electric choice.

25 <sup>1</sup> Vince Persico and Philip Novak were members of the Illinois House of Representatives who co-sponsored the  
26 electricity choice law in 1997.

<sup>2</sup> Vince Persico and Phillip Novak, *\$31 Billion in Benefits and Counting*, *The Daily Herald*, Dec. 27, 2012, available  
at: <http://www.dailyherald.com/article/20121227/discuss/712279988/>

1 A 2005 study by Paul Joskow<sup>3</sup> uses an econometric time-series model to estimate  
2 restructuring's effect on price. Joskow analyzed state-level retail electric price data  
3 from 1970-2003 and concludes that retail choice reduced retail electric rates by about  
4 5-10%, although his study has been criticized for not separating the price effects of  
5 competition from the effect of state-mandated price reductions, or price caps.<sup>4</sup>

6 Swadley and Yücel (2011)<sup>5</sup> addressed this criticism by performing a sophisticated  
7 econometric analysis of the effect of retail choice on retail electric rates, with a focus  
8 on the residential sector. They noted that previous studies attempting to isolate the  
9 effect of the transition to retail choice were complicated by the existence of temporary  
10 pricing schemes (such as transitional price caps). While the pricing schemes were in  
11 use their effect on rates was inseparable from the rate impact of retail choice.  
12 However, several years of data are now available following the expiration of many of  
13 these pricing schemes, allowing the authors to revisit the analysis in an attempt to  
14 isolate the rate effects of the transition to competition. They concluded that  
15 competition can reduce residential electric rates, but that increasing participating in the  
16 competitive market is a crucial element to achieving rate reductions.

17 A 2011 article published in the UCLA Undergraduate Journal of Economics<sup>6</sup> uses  
18 an econometric model to assess the effects of retail competition. It concludes that the  
19 effect of retail competition is significant and finds that, all else equal, those states with  
20 competitive retail electricity markets see electricity prices 0.6 cents/kWh below those  
21 that do not have competitive retail markets.

22 <sup>3</sup> Joskow, P. (2005). Market for Power in the United States: an Interim Assessment. *AEI-Brookings Center for  
Regulatory Studies*.

23 <sup>4</sup> See: Kwoka, J. (2008). Restructuring of the U.S. Electric Power Sector: A Review of Recent Studies. *Review of  
Industrial Organization*, 32, 165-196.

24 <sup>5</sup> Swadely, A. and Yücel, M (2011). Did residential electricity rates fall after retail competition? A dynamic panel  
analysis. *Energy Policy*. 39(12). 7701-7711.

25 <sup>6</sup> Andrews, R. (2010). Giving Customers a Choice: Examining the Effect of Retail Competition on the Electric Power  
Industry. *University of California, Los Angeles Undergraduate Journal of Economics*. 1 (2). Available at:  
26 <http://www.uclaeconjournal.com/issues/w10/2.pdf>

1           These and other studies showing significant benefits to retail competition are  
2 encouraging. Yet irrespective of the study results from other states, an Arizona  
3 approach that provides customers with an opportunity to shop, while retaining cost-  
4 based utility service under Commission jurisdiction, will place downward pressure on  
5 rates, as utilities experience an added incentive to operate efficiently. Customers  
6 should have the ability to save money from shopping if they so choose, while  
7 customers preferring to remain on utility service should also be free to do so.

8           **13. Is retail electric competition viable in light of the Court of Appeals decision**  
9 **in *Phelps Dodge Corp. v. Ariz. Elec. Power Coop.*, 207 Ariz. 95, 83 P.3d 573**  
10 **(App. 2004)? Are there other legal impediments to the transition to and/or**  
11 **implementation of retail electric competition.**

12           **Response:** The Court of Appeal's holding in the *Phelps Dodge* case has been widely  
13 misconstrued as one finding the Rules unconstitutional. This is not the case. The  
14 court determined that only one specific rule [R14-2-1611(A)] was unconstitutional on  
15 its face because it allowed the competitive market *alone* to determine just and  
16 reasonable rates.

17           **A. Market Rates**

18           R14-2-1611(A) states that "Market determined rates for Competitive Services, as  
19 defined in R14-2-1601 shall be deemed to be just and reasonable." In *Phelps Dodge*,  
20 the court found R14-2-1611(A) unconstitutional because the Commission was  
21 essentially allowing the market to exclusively set rates, thus abdicating its  
22 responsibility under Article 15, Section 3 and Section 14 of the Arizona Constitution.  
23 That responsibility includes the requirement to ascertain the fair value of an electric  
24 providers' property within the state, as well as considering the interests of consumers  
25 and providers in setting just and reasonable rates. Adhering to the precedent  
26 established by the Arizona Supreme Court in *US West Communications, Inc. v.*  
*Arizona Corp. Comm'n*, 201 Ariz. 242, 34 P.3d 351 (2001), the Court held that while

1 the Commission was required to ascertain and consider a competitive provider's fair  
2 value of property located within the state when setting rates, it retains "broad  
3 discretion in determining the weight to be given that factor in any particular case."

4 To the extent necessary, R14-2-1611(A) could be modified to provide for a range  
5 of rates. However, because the requirement to ascertain fair value is a constitutional  
6 mandate, the Commission can fulfill its duty absent a specific rule in the process of  
7 granting competitive CC&Ns to ESPs, and consider fair value as one of many factors  
8 when establishing a range of rates that a provider can charge for retail electric service.  
9 *Phelps Dodge* left intact the Commission's ability to establish a range of permissible  
10 rates.<sup>7</sup> The Court held that "Nothing in the plain language of Article 15, Section 3  
11 requires the Commission to prescribe a single rate rather than a range of rates." *Id.* at  
12 109, 587.<sup>8</sup> Indeed, the Commission has the discretion to adopt various approaches to  
13 fulfill its functions "as long as the method complies with the constitutional mandate  
14 and is not arbitrary and unreasonable." *Arizona Corp. Comm'n v. Arizona Pub. Serv.*  
15 *Co.*, 113 Ariz. 368, 371, 555 P.2d 326, 329 (1976).

16 **B. A.A.C. R14-2-1609(C)-(J); R14-2-1615(A), (C)**

17 A.A.C. R14-2-1609(C)-(J) established the requirement for Commission-regulated  
18 transmission and distribution owners in Arizona to provide non-discriminatory access  
19 to competitive electric service providers, so that they could effectively market  
20 generation services to retail consumers. The Court held that the Commission was  
21 without constitutional or legislative authority to promulgate R14-2-1609(C)-(J), and  
22 declined to infer any grant of authority for the Commission to interfere with the  
23 management decisions of Affected Utilities. However, invalidating this portion of the  
24 Rules does not render the remainder of them inoperable; open access to transmission

25 <sup>7</sup> Rates for competitive telecommunication services include a range with a maximum and minimum rate. See A.A.C.  
26 R14-2-1109.

<sup>8</sup> See also A.R.S. §40-368, which allows the Commission to establish a sliding scale of charges and rates.

1 and distribution is a matter of federal concern regulated by the FERC.

2 FERC Orders 888 and 889 require all public utilities that own, control or operate  
3 facilities used for transmitting electric energy to file “open access non-discriminatory  
4 transmission tariffs,” as well as establishing an open access internet-based system  
5 (“OASIS”) for obtaining transmission service. Simply put, the federal scheme  
6 established by FERC to facilitate the movement of electricity among markets  
7 supplants the requirements established in R14-2-1609(C)-(J), and the need for non-  
8 discriminatory access. Furthermore, the protocols established by the AZISA on file  
9 with FERC can facilitate direct access in the absence of R14-2-1609.

10 Likewise, R14-2-1615(A) and (C) – which required Affected Utilities to divest  
11 themselves of generation assets – are not needed in order for retail electric competition  
12 to work in Arizona. In many states with competitive markets, incumbent utilities  
13 continue to own and operate generation assets as part of standard offer service.  
14 Investor-owned utilities might wish to divest themselves of generation assets in a  
15 competitive market, but doing so voluntarily is not the same as being required to by  
16 rule, which the Commission is without authority to do.<sup>9</sup> Furthermore, since *Phelps*  
17 *Dodge* upheld the validity of A.A.C. R14-2-1616 [Code of Conduct], the Rules already  
18 contain a mechanism to address market power and cross-subsidization issues in the  
19 event any investor-owned utility chooses to participate in the competitive market  
20 through a competitive affiliate.

21 **C. A.A.C. R14-2-1603, 1605, 1610, 1612, 1614, 1617**

22 This portion of the Rules was declared invalid simply because the Commission  
23 failed to obtain the Attorney General’s certification, as required under the APA. In  
24 fact, the court in *Phelps Dodge* was persuaded that “remand to the Commission with  
25 instructions to submit the invalid rules to the attorney general is more appropriate than  
26 vacating the entirety of the decisions approving the Rules.” In fact, the court said it

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<sup>9</sup> Further, APS and TEP have been granted waivers to the invalid divestiture requirement in the Rules.

1 best when it found that “No reason appears why the Commission must repeat the  
2 process of crafting rules rather than simply allowing it to now submit the invalid  
3 provisions to the attorney general for the review required under the APA.” *Phelps*  
4 *Dodge* at 126, 604. AECC agrees, noting like the court in *Phelps Dodge* that repeating  
5 the entire process to craft rules which have already been vetted to the extent the Rules  
6 have is not necessary.

7 **14. Is retail electric competition compatible with the Commission’s Renewable**  
8 **Energy Standard that requires Arizona utilities serve at least 15% of their**  
9 **retail loads with renewable energy by 2025?**

10 **Response:** Direct access service is not incompatible with the Commission’s  
11 Renewable Energy Standard; however, modifications should probably be made to the  
12 Renewable Energy Standard to account for direct access service. AECC recommends  
13 that the Commission consider allowing an ESP the option of independently meeting  
14 this standard for its Arizona loads, in which case its direct access customers should be  
15 exempt from the RES surcharge and the applicable direct access load excluded from  
16 the “denominator” used for determining whether the incumbent utility is in compliance  
17 with the percentage requirement in the Commission’s rule. If ESPs are given the  
18 option not to meet this standard, then presumably the direct access customer would  
19 remain subject to the incumbent utility’s program, in which case some credit should be  
20 recognized for the portion of the customer’s generation service that is provided from  
21 the incumbent in the form of renewable energy.

22 **15. Is retail electric competition compatible with the Commission’s Energy**  
23 **Efficiency Standard that requires Arizona’s electric utilities to achieve a**  
24 **22% reduction in retail energy sales by consumption by 2020?**

25 **Response:** Direct access service is not incompatible with the Commission’s Energy  
26 Efficiency Standard. Direct access customers remain distribution service customers of  
the incumbent utilities that are subject to the requirements of this Rule, and therefore,

1 if the Commission wished to retain the program in its current form, it could do so  
2 irrespective of reinstating direct access service. At the same time, if the Commission  
3 is inclined to revisit the Energy Efficiency Standard, it may wish to consider the  
4 implications of direct access service, such as whether accommodation can be made for  
5 ESPs that wish to provide energy efficiency services for their customers.

6 **16. How should the Commission address net metering rates in a competitive**  
7 **market.**

8 **Response:** The subject of net metering should continue to be addressed on its merits.  
9 One of the issues of contention in the net metering discussion is whether net metering  
10 causes other customers to subsidize the program participants. To the extent such  
11 subsidies occur, they are primarily related to the provision of distribution service – a  
12 service from which direct access customers would not be exempt. If net metering is  
13 retained, the Commission may wish to consider treating any net subsidization as a  
14 distribution system cost, so as to not unfairly burden the incumbent utility or its  
15 bundled service customers.

16 **17. What impact will retail electric competition have on resource planning?**  
17

18 **Response:** As discussed in AECC's Response to Question 9, above, long-term  
19 planning can still take place pursuant to IRP process. Through the IRP process,  
20 utilities can manage their exposure to direct access service by planning their long-term  
21 and short-term resource acquisitions and constructing resource portfolios in  
22 anticipation that certain levels of loads will either depart or re-enter utility service.  
23 Utility IRPs should incorporate reasonable assumptions about the level of incremental  
24 direct access load to be expected across the relevant planning horizon.

25 The terms of direct access service also have implications for long-term planning.  
26 For example, if migration of individual customers to 100% market prices occurs  
through a transition period (such as occurred in PGE's Multi-Year Opt-Out program

1 discussed in AECC's Response to Question 11) incumbent utilities have ample lead  
2 time to adjust their resource portfolios. Similarly, sufficient notice periods for  
3 customers indicating a wish to return to bundled service (e.g., three years) give  
4 incumbent utilities ample time to plan for any returning customers.

5 **18. How will retail electric competition affect public power utilities,**  
6 **cooperatives and federal controlled transmission systems?**

7 **Response:** The Arizona Legislature passed legislation in 1998 which enabled public  
8 power entities such as SRP to transition to competition in electric generation  
9 service. (A.R.S Sections 30-801 to 30-813 – “Electric Power Competition”) A.R.S.  
10 Section 30-803 (A) provides: “Public power entities may participate in retail electric  
11 competition statewide and *shall open their entire service territories to competition to*  
12 *electricity suppliers certificated by the commission* pursuant to Section 40-207 and to  
13 providers of other services.” [Emphasis added.] Moreover, A.R.S. Section 30-802  
14 (A) further provides in part “... Public power entities and the commission shall  
15 coordinate their efforts in the transition to competition in electric generation service to  
16 promote consistent statewide application of their respective rules, procedures and  
17 orders.”

18 Thus, reinstatement of direct access by the Commission would have implications  
19 for SRP. AECC supports the reinstatement of direct access service in the SRP service  
20 territory. The Commission's current retail competition rules apply to electric power  
21 cooperatives under the Commission's jurisdiction, which are named as Affected  
22 Utilities in R14-2-1601(1). AECC recommends continuing this applicability. The  
23 reinstatement of direct access service in Arizona is unlikely to have any material  
24 implications for federally-controlled transmission systems.

25 ///

26 ///

1 CONCLUSION

2  
3 There are no legal or regulatory limitations to the ability of the Commission to  
4 reinstate retail electric competition, i.e. Direct Access, in Arizona at this time. As  
5 indicated above, the public interest would be served by the reinstatement of electric retail  
6 competition.

7 More importantly, there is no need for additional analysis concerning market  
8 structure, or the benefits of retail electric competition. The issues and objections raised by  
9 opponents to electric competition have been addressed numerous times in the workshops  
10 and Commission proceedings conducted over the years since the Commission opened its  
11 investigation on retail electric competition in 1994. The issues addressed during the  
12 workshops included but were not limited to, the following: (i) Stranded cost recovery; (ii)  
13 Unbundled services; (iii) Standard Offer Service; (iv) Provider of Last Resort Service; (v)  
14 Competitive meter and meter reading; (vi) Exit and return fees; (vii) Code and Conduct  
15 requirements; (viii) Establishment of an independent scheduling administrator to facilitate  
16 nondiscriminatory retail Direct Access using the transmission system in Arizona; (ix)  
17 Self-build option; and (x) Divestiture. There are therefore no workshops or formal  
18 rulemaking procedures required in order to reinstate retail electric competition in Arizona.

19 There is considerable support for electric retail competition in those States which  
20 have implemented electric competition. The Commission could proceed to reinstate retail  
21 electric competition in Arizona in either of two ways:

22 First the Commission could proceed with the processing of ESP applications for  
23 CC&Ns. The Commission has the authority to grant CC&Ns to ESPs under the  
24 provisions of A.R.S. § 40-202(B). This statute does not require a rule or regulation in  
25 order to transition to competition for electric generation service. An ESP is not precluded  
26 from obtaining a CC&N under the provisions of A.R.S. § 40-281(A). As discussed above

1 in the comments on the questions, the provisions of the rules that were invalidated did not  
2 preclude Commission authority to issue CC&Ns. In fact, the Court stated that “the  
3 remaining rules are workable and can therefore continue to exist intact” (emphasis  
4 original). *Phelps Dodge* at 95, 111, 587, 589.

5 Second, the Commission could establish a proceeding to adopt any required  
6 amendments to the Rules in order to correct the issues referenced by the Court in its  
7 Decision.

8 Its time for the Commission to reinstate retail electric competition, i.e. Direct  
9 Access in Arizona in order for the electric consumers to enjoy the same benefits and cost  
10 savings that consumers have enjoyed in other States where electric competition has been  
11 implemented.

12 RESPECTFULLY SUBMITTED this 15<sup>th</sup> day of July, 2013.

13  
14 FENNEMORE CRAIG, P.C.

15  
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