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July 15, 2013

Arizona Corporation Commission
Attention: Docket Control
1200 W. Washington St.
Phoenix, AZ 85007

Re: Docket No. E-00000W-13-0135

Dear Official of the Commission,

Please find enclosed an original and 13 copies of the Initial Comments of City of Mesa Energy Resources Department in Docket No. E-00000W-13-0315, the Commission's Inquiry into Retail Electric Competition.

Please let me know of any questions regarding this filing.

Sincerely,

Frank McRae
Energy Resources Department Director
City of Mesa Energy Resources Department
Frank.McRae@mesaaz.gov

Arizona Corporation Commission
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DOCKET CONTROL

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640 N. Mesa Drive
P.O. Box 1466
Mesa, Arizona 85211-1466

**IN THE MATTER OF THE COMMISSION'S INQUIRY INTO RETAIL
ELECTRIC COMPETITION**

GENERIC DOCKET NO. E-00000W-13-0135

Q.1 Will retail competition reduce rates for all classes of customers – residential, small business, large business and industrial classes?

A.1 It is virtually impossible to affirmatively answer this question with accuracy and confidence. This is especially true for customers of Arizona's utilities who benefit from effective regulation and prudent and efficient utility management. The City of Mesa, as both an electric utility customer of SRP and an owner and operator of a customer owned public utility, has significant concerns about whether Retail Electric Competition should be implemented in the State of Arizona.

Will continuation of the current electric industry structure or beginning the transition to Retail Electric Competition - provide the best opportunity for lower rates (or lower increases in rates) while enhancing reliability, quality of service and optional services? Mesa recommends that the Commission first consider whether enhancements and improvements in the regulation of Arizona electric utilities results in more benefits with a higher degree of certainty and lower risk before further considering the implementation of Retail Electric Competition.

The State of Texas' implementation of Retail Electric Competition, often portrayed as "working well", provides valuable information and data into whether a transition to retail competition or continuing traditional utility regulation is likely to generate material and sustainable benefits for customers. Implementation of Retail Competition began in Texas for the utilities in the areas under the operational auspices of the Electric Reliability Council of Texas ("ERCOT") in 2002 after investing vast resources to prevent repeating the failures made when other states introduced retail electric competition. Several non-ERCOT utilities have remained under traditional utility regulation. Since 2002, increases to residential rates and bills for customers under Retail Electric Competition have been significantly higher and alarmingly more volatile than customers served by utilities under Texas regulation that have not implemented retail competition. (See Attachment 1)

Q.2 In addition to the possibility of reduced rates, identify any and all specific benefits of retail electric competition for each customer class?

A.2 Any non-rate benefits are likely intangible and improbable and whether they could outweigh the significant negative consequences that have arisen in states who have implemented Retail Electric Competition is a complex questions that is unique to the selected market structure. If such benefits are identified and deemed to be real, then the

Commission should assess whether changes to current regulations can render the same benefits.

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

A.3 An affirmative answer to this question, with any degree of accuracy and certainty, is virtually impossible without assuming away the realities and risks inherent in the transition to and full implementation of retail competition. Mesa has not been able to identify an instance where the implementation of retail competition has allowed the benefits of competition to be shared equally or equitably. It is improbable, and likely inconsistent with the principles of competitive markets, for the benefits of competition apply to all customer classes equally or equitably. It is also very likely that retail competition will be a “zero sum game”.

Q.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?

A.4 The results of implementing Retail Electric Competition in other states provide little reason for the Commission to conclude electric utility customers will not experience inordinate risks ranging from shifting of costs to reductions in reliability and quality of service. The concept of a “Provider of Last Resort” is inconsistent with the principles of free enterprise markets and the costs to be capable of being a “Provider of Last Resort” are high and difficult to equitably recover.

Q.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?

A.5 An affirmative answer to this question, with accuracy and certainty, is virtually impossible without assuming away the realities and risks inherent in the transition to and full implementation of retail competition. Other states’ experience implementing Retail Electric Competition, particularly in the wake of the California Energy Crisis, demonstrate that it can be difficult to distinguish whether pricing changes and other market dynamics are the result of market abuses or manipulation. See, for example, the California Attorney general’s Energy White Paper from April of 2004. Such strategies have a high level of sophistication making detection, proof and enforcement difficult. Additionally, the ability of the Commission in this regard is likely to be limited given that the Federal Energy Regulatory Commission retains almost exclusive jurisdiction over wholesale sales of electricity under the Federal Power Act, 16 USC 791 et seq. (2000). The Commission does not have jurisdiction over municipally owned utilities such as the City of Mesa under Article 15, Section 2 of the Arizona Constitution. Instead, the legislature promulgated consumer protection mandates in A.R.S. § 30-806 for city owned utilities such as Mesa to administer. In short, any attempts to “guarantee” against abuses and market manipulation are likely to be insufficient given the significant disconnections

and limitations on the enforcement authority of various jurisdictional entities, including the Commission.

Q.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?

A.6 The mechanisms needed to transition to Retail Electric Competition and the time needed to develop and administer such mechanisms are very specific to the selected market structure(s).

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

A.7 Whether regulated electric utilities should be required to divest their generation assets is very specific to the selected market structure(s) and should be determined by whether the regulated electric utility is capable and incented to exercise market power and if the utilities' exercise of market power will impair the development of an efficient retail market.

The City of Mesa's electric utility relies solely upon wholesale energy supply contracts to meet our customers' energy requirements. These contracts do not contain provisions for termination for such regulatory requirements.

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

A.8 The costs to transition to Retail Electric Competition and the best method for quantifying and allocating those costs are very specific to the selected market structure(s).

Implementing Retail Electric Competition will likely necessitate the Commission to modify its regulations. Retail Electric Competition generally requires independent regulatory agencies with the information, staff, and powers to provide some level of oversight of complex markets to ensure wholesale markets remain competitive and fair, at least during the transition phase.

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

A.9 It is very likely that Retail Electric Competition will negatively impact reliability of Mesa's electric utility and its customers. Building a reliable system and maintaining the reliability of the interconnected electric utility system, from the points of fuel supply for the generation plants to the meter at the customers' premises, is a very capital intensive endeavor. The Commission will be challenged to devise a market structure where incentives to minimize capital investments in the interconnected system to gain competitive advantages will not negatively impact reliability.

- Q.10 What are the issues relating to balancing area authorities, transmission planning, and control areas which must be addressed as a part of a transition to retail electric competition?
- A.10 The issues related to balancing area authorities, transmission planning, and control areas are numerous and extremely complex and are very specific to the selected market structure(s).
- Q.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?
- A.11 Mesa is not convinced that approaches that other states have taken to implement Retail Electric Competition provide any meaningful information for identifying a beneficial path to implement Retail Electric Competition in Arizona.
- Q.12 How have retail rates been affected in states that have implemented retail electric competition?
- A.12 For Texas residential rates and bills, please see Attachment 1.

There does not appear to be a direct correlation between the implementation of retail electric competition and a reduction in electric rates. States that have implemented retail choice electric plans were generally high cost states with hope that competition among electric suppliers would result in lower rates. Among states that have enacted electricity deregulation, consumer acceptance has been mixed, supply has been limited in some areas, and rates in regulated states from 1997 to the present have remained approximately 25 percent below rates in deregulated states. In 1997, the states in the deregulated category had average rates that were 2.8 cents per kWh above rates in the regulated states (average of 8.6 cents vs. 5.8 cents). In 2012, it appears that deregulated states retail rates are, on average, 3.0 cents per kWh above rates in regulated states (11.9 vs. 8.9).

- Q.13 Is retail electric competition viable in Arizona in light of the Court of Appeals' decision in Phelps Dodge Corp. v. Ariz. Elec. Power Coop., 207 Ariz. 95, 83, P.3d 573 (App. 2004)? Are there other legal impediments to the transition to and/or implementation of retail electric competition?
- A.13 At this time, it remains to be seen whether the Commission can develop or revise administrative rules in a manner which will pass Constitutional muster under Article 15 §§ 3 and 14 while facilitating retail electric competition. Certainly, the Court of Appeal's conclusion that "although the Commission may be influenced by market forces in determining what rates are 'just and reasonable,' the Commission may not abdicate its constitutional responsibility to set just and reasonable rates by allowing competitive market forces alone to do so" will be a significant limit on any such effort. The requirement that fair value of property be considered in the setting of just and reasonable rates also seems a significant limit to the viability of unbundling retail rates.

Q.14 Is retail electric competition compatible with the Commission's Energy Efficiency Standard that requires Arizona utilities to serve at least 15% of their retail loads with renewable energy by 2025? (See A.A.C. R14-2-1801 et seq.)

A.14 Such standards are generally inconsistent with competitive markets and the compatibility of the Commission's Energy Efficiency Standard with Retail Electric Competition will be very specific to the market structure(s) selected. Competitive retail suppliers of electric energy will likely be incented to sell their product at the lowest possible cost at the behest of their customers-which is inconsistent with the "need" that is met by regulatory mechanisms such as net metering and resource portfolio standards.

Q.15 Is retail electric competition compatible with the Commission's Energy Efficiency Standard that requires Arizona utilities to achieve a 22% reduction in retail energy sales by consumption by 2020? (See A.A.C. R14-2-2401 et seq.)

A.15 See response to Q.14.

Competitive retail suppliers of electric energy will likely be incented to sell more of their product, not less.

Q.16 How should the Commission address net metering rates in a competitive market?

A.16 Incentive programs such as Net Metering are generally incompatible with competitive markets. The revenue losses associated with the continuation of such incentive programs should be a cost that all customers should continue to maintain responsibility for.

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

A.17 Resource Plans subject to regulatory review and approval are generally inconsistent with competitive markets and the impacts on such activities and regulations will be very specific to the selected market structure(s). For ongoing resource planning activities, Retail Electric Competition presents new and unprecedented levels of uncertainty associated with forecasting customer requirements and the least cost resource(s) to meet the customers' requirements.

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

A.18 Retail Electric Competition is likely to have serious negative consequences for publicly owned utilities such as the City of Mesa.

1. City owned electric utilities are generally an important component of a City's financial resources. Mesa's electric utility has endured several years of customer and revenue loss due to the region's economic conditions – yet has not had to increase General (i.e. non-energy supply costs) rates. The potential for additional loss of

customers and revenue to Retail Electric Competition would have a negative financial effect on Mesa's financial health (e.g. bond ratings) and budget which has already endured several years of strain. Additional losses of customers and revenues would likely require unforeseen increases to General rates.

2. Mesa's electric utility purchases all of its energy supplies in the wholesale competitive market. The current wholesale market's price stability is likely to become dramatically volatile in supply and prices as uncertainty increases.
3. Mesa is especially concerned about tactics that might employed by competitive suppliers in retail markets that significantly affect the reliability of the electric interconnected system in Arizona in order to generate the perception of efficiency and low cost. Some these tactics include:
 - Reducing equity in generation assets and heavily leverage the capital structure of a very capital intensive component of the electric utility industry;
 - Reducing operating and planning reserves needed to ensure that contractual commitments to deliver electric capacity / energy are met. Minimizing reserves increases risk that contracts will be breached and suppliers are not able to fulfill delivery requirements /capacity when financial losses are incurred; and
 - Avoid responsibility for, and divert to others, the costs incurred to provide safe, reliable and high quality of services.

Mesa is not aware of a market structure and associated regulatory framework for Retail Electric Competition that mitigates the risks of reduced reliability associated with such tactics.

ATTACHMENT 1

Graph of the Average Annual Cost Of Texas Residential Electric Bills for areas of Retail Competition (TXU & Centerpoint) Vs Non-Retail Competition

NOTE: The data for the chart was derived from monthly reports on the Public Utility Commission of Texas (PUCT) website. The PUCT collects average monthly rate data for residential customers from both utilities in retail competition and utilities not subject to retail competition. The two areas within retail competition used for the comparison are the TDU (formerly TXU) and the Centerpoint Service Areas. A sampling of Retail Electric Providers (REPs) that provide service to both service areas were used to give a full picture of the options available to residential customers. In the areas not subject to competition, the Investor Owned Utilities (IOUs) regulated by the PUCT in the comparison are El Paso Electric, Entergy, Southwestern Public Service, and Southwestern Electric Power. All bills are based on 1000 kWh of monthly consumption.

Average Annual Cost of Texas Residential Electric Bills Retail Competition vs Non-Retail Competition

