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Arizona Corporation Commission
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BEFORE THE ARIZONA CORPORATION COMMISSION

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

DOCKET NO. E-00000W-13-0135

**COMMENTS OF JOE COBB
IN REPLY TO OPPONENTS OF
RESTRUCTURING ARIZONA'S
ELECTRICITY MARKETS FOR
CHOICE AND COMPETITION**

Joe Cobb, a ratepayer residing within the exclusive service territory of the Salt River Project and a retired professional economist with experience both in studying government regulation of markets and with teaching economic theory (see Appendix 1), hereby offers the following comments in response to the contentions made by advocates of the current government-imposed, centrally-planned monopoly system in opposition to restructuring Arizona's electricity markets for choice and competition, together with supporting documentation.

1 **Introduction**

2 A fact well proven by research in the economics of public choice, particularly as
3 it affects government regulation of the marketplace, is that “winners and loses” are
4 established on the basis of political priorities and pressures instead of on the basis of the
5 actual discovery of consumer preferences, benefits, and new innovations in supplying
6 the marketplace. The long, regrettable (and avoidable) history of government regulation
7 of railroads, trucking, airlines, telephone service, taxicabs, occupational licensing, and
8 many other sectors of the economy stand as witness to the tragedy of a false economic
9 idea: the claim by political “progressives” a century ago that government regulation is a
10 good and corrective measure to “market failures.” The prime example a century ago
11 was any large profitable corporation.
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15 More than a century of investigation has demonstrated how (1) the model of
16 “competition” invoked (classical “perfect competition”) is itself a simplistic and
17 artificial model. Patterns of industrial organization are complex and competition comes
18 from freedom of entry into a market, not by the structure of the market. (2) Even
19 markets long dominated by supposed “monopolies” – rarely true “single producers” –
20 have crumbled over time as market innovation and new methods of supply have been
21 discovered. Consider, most recently, the fate of municipal newspaper “monopolies” as
22 the Internet has vastly changed and improved the delivery of news as well as classified
23 advertising.
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1 Question 2: In addition to the possibility of reduced rates, identify any and all specific
2 benefits of retail electric competition for each customer class.

3
4 **Answer:** As economic history has shown, deregulation in other part of the economy has
5 increased in economic growth and employment (viz. airlines, trucking,
6 telecommunications). There is every reason to expect the same from a more efficient
7 electrical market, benefiting all customer classes.
8

9 Question 3: How can the benefits of competition apply to all customer classes equally or
10 equitably?

11 **Answer:** It is impossible for any economic model to demonstrate “equality” of benefits
12 from deregulation and increased supplier innovation and competition, but the proven
13 history of repealing the mistakes of government regulation – supposedly enacted to
14 promote “equity” – is that artificial “winners” under regulation are eroded and the
15 economic rent arising from government regulation is dissipated across the full consumer
16 spectrum.
17
18

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

22
23 **Answer:** There is no reason to believe residential ratepayers or other consumer classes
24 would be adversely impacted. Should a consumer omit to designate a provider or should
25 a provider fail, the ACC, ISO or RTO could be responsible for designating a provider of
26 last resort, preferably based on an RFP process or its equivalent. Some electricity
27
28

1 shoppers will be wiser in their choices than others and the most prudent will benefit
2 most.

3
4 Question 5: How can the Commission guarantee that there would be no market structure
5 abuses and/or market manipulation in the transition to and implementation of retail
6 electric competition?

7 **Answer:** As a transition is made from the current monopoly system, it will be the
8 continuing job of the ACC to monitor and implement a market with no special favors or
9 advantages to any producer or source of electricity.

10
11 Question 6: What, if any, features, entities or mechanisms must be in place in order for
12 there to be an effective and efficient market structure for retail electric competition?

13
14 How long would it take to implement these features, entities, or mechanisms?

15 **Answer:** The ACC should allow several years for the introduction of reforms in prudent
16 states, but the key steps are:

17
18 (1) the ACC should separate existing utilities from their generation, transmission,
19 and distribution capacity to prevent them from abusing the monopoly power they have
20 accrued under the existing regulatory system. At the same time, a system operator needs
21 to be empowered to neutrally balance the load on the grid that will be created by an
22 influx of competitive energy producers.

23
24 (2) the ACC should take action to create competitive generation markets in which
25 energy producers can freely enter, exit and compete for business.

26
27 (3) customers should be empowered by the ACC with the freedom to choose
28 among competitive retailers of electricity.

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

3 **Answer:** Divestiture would be the recommended option, but restructuring could work, if
4 retail and generation units within a single overall corporate umbrella are thoroughly
5 firewalled so that cross-subsidization and collusion are not possible.
6

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

9 **Answer:** Establishing a grid operator that can neutrally balance loads will incur some
10 costs, but because the grid and system operator will continue to function as a public
11 utility, the associated costs could be recovered by traditional ratemaking. Stranded costs
12 have already been recovered by incumbent utilities. Special uncertainties and burdens
13 are being imposed by new EPA regulations, which, for example, threaten the viability of
14 the Navajo Generation Station and Four Corners facilities in that could impose a
15 dramatic reduction in generation capacity during restructuring, and if so, then special
16 consideration should be given to defraying those. To the extent the federal regulatory
17 agencies impose additional costs, the federal government should cover those costs.
18 Either policy solution should be narrowly tailored to the specific NGS/Four Corners
19 facilities.
20

21 Question 9: Will retail electric competition impact reliability? Why or why not?

22 **Answer:** Growth in capacity has outstripped economic growth in Pennsylvania and
23 Texas. Competition is primarily caused by incentives to innovate and implement cost
24 saving practices. Market processes have consistently demonstrated the cost-reduction
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1 effects and the stability of open markets. Moreover, demand mitigation technologies and
2 rate plans, such as the use of smart appliances and peak demand pricing further assure a
3 secure, stable supply. Regulators will continue to have the power to establish demand
4 mitigation policies to minimize non-essential consumption during supply shocks.

5
6 Question 10: What are the issues relating to balancing area authorities, transmission
7 planning, and control areas which must be addressed as part of a transition to retail
8 electric competition?
9

10 **Answer:** Currently in Arizona each of the three major utilities has its own “balancing
11 authority” that manages electricity systems in each territory with the Arizona
12 Independent Scheduling Administrator Association overseeing the whole grid. Current
13 balancing authorities could be turned into their own RTOs, but this is not optimal
14 because there would be available economies of scale in operating larger RTOs. For
15 example, Arizona’s largest utility, Arizona Public Service, only has about 9300
16 megawatts of capacity, while PJM (which includes Pennsylvania) has approximately
17 167,000 MWs of capacity, almost eighteen times larger. One possibility is to use the
18 AZISA to act in the role of an RTO, at least initially. The AZISA currently coordinates
19 transmission access between the seven balancing authorities, as well as interstate
20 shipments in and out of Arizona. Under such a plan, the AZISA would be responsible
21 for scheduling and dispatching the transmission lines between the three systems of the
22 incumbent utilities.
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27 Another possibility would be to expand the CAISO into Arizona. Expansions of
28 RTOs are not uncommon. Where PJM once consisted of Delaware, the District of

1 Columbia, Maryland, eastern Pennsylvania, and New Jersey, it has expanded into almost
2 the entirety of Pennsylvania, as well as most of Virginia and West Virginia, and parts of
3 North Carolina, Ohio, Indiana, Michigan and Illinois. The presence of economies of
4 scale implies that expanding an RTO is relatively inexpensive once the RTO has been
5 established. Expanding CAISO to Arizona would eliminate the current seam between
6 Arizona and California.
7

8
9 This in turn would encourage more building of generation facilities in Arizona, a
10 tremendous growth opportunity for Arizona since building electricity generators is so
11 much more difficult in California. All of the foregoing options may be viable means of
12 managing the grid in a way that would support competitive restructuring.
13

14 Question 11: Among the states that have transitioned to retail electric competition,
15 which model best promotes the public interest for Arizonans? Which model should be
16 avoided?
17

18 **Answer:** Arizona should adopt the essential features of the Texas and Pennsylvania
19 models and avoid the California approach.

20 Question 12: How have retail rates been affected in states that have implemented retail
21 electric competition?
22

23 **Answer:** Retail prices in Pennsylvania were well above the U.S. average at the outset of
24 restructuring in 1998. Over the last ten years inflation-adjusted retail prices have fallen
25 in Pennsylvania, while U.S. average prices have increased slightly. By 2007 the retail
26 price for Pennsylvania was below the U.S. average retail price and despite recent
27 peaking above that standard, today Pennsylvania's average retail price of electricity
28

1 matches that of the U.S. Texas' average price of electricity is well below that of the U.S.
2 despite peaking well above the U.S. average earlier in the decade when natural gas
3 prices were spiking. Electricity restructuring reduces prices and costs. For the period
4 1970-2003, one major academic study found the higher the percentage of power
5 produced by non-regulated generators in a state, the lower the prices paid by residential
6 and industrial customers. Similarly, another study found the introduction of retail
7 competition in a state is associated with lower prices for residential and industrial
8 customers. Other studies found electricity plants in states have lower non-fuel expenses
9 per megawatt generated compared to plants in states that have not restructured, and
10 overall electricity restructuring has reduced retail prices by nine percent. Restructuring
11 has also reduced price-margins in the electricity industry, implying cost reductions are
12 being passed on to consumers. Where competition prevails in Texas, pricing plans offer
13 consumers electricity prices lower than the average price in Arizona—and even lower
14 than the lowest state average in the nation (just under 7 cents per kilowatt hour for the
15 lowest cost Texas plan versus approximately 11 cents per kilowatt hour in Arizona and
16 just under 8 cents per kilowatt hour in Louisiana).

21 Question 13: Is retail electric competition viable in Arizona in light of the Court of
22 Appeals' decision in *Phelps Dodge Corp. v. Ariz. Elec. Power Coop.*, 207 Ariz. 95, 83
23 P.3d 573 (App. 2004)? Are there other legal impediments to the transition to and/or
24 implementation of retail electric competition?
25

26 **Answer:** *Phelps Dodge* struck down various rules issued by the ACC during its first
27 restructuring effort; including: 1) rules that deemed market pricing “fair and reasonable”
28

1 without taking into consideration the “fair value” of property owned by electricity
2 service providers in the State of Arizona and without an actual exercise of discretion by
3 the ACC in verifying the fairness and reasonableness of such pricing or effective
4 consumer protections; 2) rules requiring the divestiture of generation assets held by
5 utilities even if those assets were not used to compete against new entrants; and 3) rules
6 relating to consumer protection and the prohibition of anti-competitive behavior that
7 were issued without Attorney General review, as is required for non-ratemaking
8 regulations. The Arizona Legislature fully authorized statewide competition in electrical
9 markets in 1998, including within territories outside of the Arizona Corporation
10 Commission’s regulatory jurisdiction. That law is still effective, waiting to be triggered
11 by appropriate ACC rulemaking and stakeholder coordination. Fortunately, the
12 necessary rules for restructuring Arizona’s electricity market can be designed to comply
13 with the holding of *Phelps Dodge*.

14
15 (1) Transitioning to market competition as the primary mode of setting specific
16 rates can be made consistent with *Phelps Dodge* because the court of appeals
17 specifically affirmed that competitive pricing of electricity can take place within price
18 ranges established by the Arizona Corporation Commission as “fair and reasonable,” so
19 long as the setting of the price boundaries for these ranges take into consideration all of
20 the factors that must be considered in the ordinary ratemaking process. Among those
21 ratemaking factors, perhaps the greatest barrier to competitive pricing would arise if an
22 excessive value were assigned to the fair value of the property owned by electricity
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1 service providers either for the recovery of post-reform investment costs or to provide
2 compensation for so-called pre-reform stranded costs.

3
4 (2) Rules requiring divestiture of incumbent utility assets can be sustained under
5 *Phelps Dodge* so long as the Commission builds an appropriate record that such
6 divestiture is necessary for competitive retail pricing to arise. This should not be difficult
7 even with respect to the divestiture of generation capacity that incumbents claim to use
8 exclusively to generate sales outside of Arizona because energy markets are
9 interconnected.

10
11 (3) Any rules issued in support of restructuring, which may only be debatably
12 related to the Commission's ratemaking power, can be submitted to the Attorney
13 General for his review prior to adoption. This would avoid any possible controversy over
14 the necessity of such review.

15
16 Question 14: Is retail electric competition compatible with the Commission's Renewable
17 Energy Standard that requires Arizona's utilities serve at least 15% of their retail loads
18 with renewable energy by 2025? (See AAC. R14-2-1801 et seq.)

19
20 **Answer:** The current regulatory standards should be revised, which can be done to
21 achieve the same policy goals even more efficiently. In other states, restructuring of the
22 electricity market has led to a regulatory environment in which each distribution entity is
23 required to buy permits from generators of renewable permits. If a renewable mandate
24 continues to exist, Arizona should replace its current renewable program with a program
25 that will require retail suppliers to purchase renewable credits equal to their required
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1 level. These credits would be purchased from free market providers who would have the
2 proper incentives to generate renewable energy at the lowest possible cost.

3
4 Question 15: Is retail electric competition compatible with the Commission's Energy
5 Efficiency Standard that requires Arizona's electric utilities to achieve a 22% reduction
6 in retail energy sales by consumption by 2020? (See AAC. R14-2-2401 et seq.)

7 **Answer:** Because an efficient, competitive electricity market is not subject to the
8 problems of a regulated monopoly market, which can lead to excess capacity and
9 consumption an efficient, competitive electricity market is not subject to the
10 inefficiencies of the regulated monopoly market, such as excess capacity and
11 consumption. The consumers can best judge the trade off between energy consumption
12 and other personal and family economic values.

13
14
15 Question 16: How should the Commission address net metering rates in a competitive
16 market?

17
18 **Answer:** There is no reason for the Commission to dictate the price of electricity
19 generated through net metering in the absence of a rate regulated system, Whatever the
20 market competitively yields as the price of such electricity when it is injected into the
21 grid, should be its price.

22
23 Question 17: What impact will retail electric competition have on resource planning?

24 **Answer:** In a deregulated market, will be decentralized and determined by market
25 players in developing their competitive strategies based on their available capital and
26 niche knowledge. The sole remaining rate regulated public utility would be the
27 distribution grid itself. The constraints of the current grid and the costs of expanding it
28

1 would continue to require planning when new generation and significant new loads are
2 contemplated. Centralized resource planning would be largely restricted to operating,
3 maintaining and expanding the grid.
4

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

7 **Answer:** Restructuring Arizona's electricity markets would break up the current
8 monolithic system where customers deal directly with monopoly utilities who provide
9 and control everything from the generator to electrical wires to transformers to meters.
10

- 11 (i) Generators would constitute a wholesale electricity market.
12
13 (ii) Retailers, as independent entities, would purchase electricity for resale to
14 consumers.
15
16 (iii) The local and regional electric grid would continue as one or more
17 integrated regulated utilities controlled by one or more "balancing
18 authorities" who schedule generation to instantly meet demand.
19
20 (iv) The role of exempted cooperatives and special districts would change in that
21 they would have many more transactional opportunities well beyond their
22 service areas.
23
24 (v) The grid would be operated as a utility, so the ACC would continue to play a
25 critical regulatory role.

26 The ACC, along with load balancing organizations, would help determine where it is
27 physically best for generators to connect, whether the local grid has the necessary
28 capacity, and what generators will have to pay in order to physically access the grid,

1 which would continue to be privately owned. To the extent that the grid needs upgrading
2 and expansion, the ACC and the load balancing organization(s) will be in the best
3 position to determine how costs should best be shared where the greatest needs present
4 themselves. It will also be the ACC's job to aid in integrating balancing authorities as
5 the need arises.
6

7
8 **RESPECTFULLY SUBMITTED** this 16th day of August, 2013.

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10 

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16 The undersigned declares under penalty of perjury under 28 U.S.C. § 1746(2), the laws
17 of the United States and of the State of Arizona, that the foregoing is true and correct to
18 the best of my knowledge, information and belief.

19 Executed this August 16, 2013

20 

21
22
23 **NOTICE OF FILING AND PROOF OF SERVICE**

24 **ORIGINAL** and 13 copies, including exhibits, were filed this 16th day of August, 2013
25 with:

26 Docket Control
27 Arizona Corporation Commission
28 1200 West Washington Street
Phoenix, Arizona 85007

1 **APPENDIX 1**

2
3 **Joe Cobb**
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6 623-363-6369

7 A.B., The University of Chicago, 1966
8 M.B.A., Chicago Booth School of Business, 1977
9 American Economic Association
10 National Association of Business Economists
11 (National Capital Chapter President 1986)

12 **CAREER HIGHLIGHTS AND ACHIEVEMENTS**

- 13 * Adjunct Faculty member, Orange Coast College, Saddleback College, Santa Ana College, and
14 Concordia University Irvine, California (2000-06).
15 * John M. Olin Senior Economist, The Heritage Foundation, Washington, DC (1992-96).
16 Extensive public speaking and writing experience; over 1,200 articles published.
17 * Nine years of senior legislative staff experience with the United States Congress managing
18 federal budget, tax law, international trade, and regulatory issues (1983-91).
19 * Served in the White House and U.S. State Dept. during the Reagan Administration (1982-83).

20 **RESEARCH FELLOWSHIPS**

21 1993-96 John M. Olin Senior Fellow,
22 The Heritage Foundation, Washington, D.C.
23 Authored or co-authored 12 Heritage Foundation papers, contributed chapters to 5
24 books, and published more than 50 op-ed articles. Testified before Congress on U.S.
25 trade policy (5 times) and regulatory issues (3 times); provided policy advice upon
26 request to many members of Congress and several hundred congressional staff members.
27 Appeared on more than 100 radio and television programs as "expert guest" on the
28 federal budget, taxes, government regulations, and the U.S. economy; interviewed by
journalists regularly and cited or quoted in newspapers and magazines more than 400
times.

1991 Senior Fellow, Alexis de Tocqueville Institution, Arlington, Virginia
Served as Executive Director of the I.M.F. Assessment Project, in charge of research and
monographs on the results and effectiveness of the International Monetary Fund with
Third World and Eastern European countries; published in 1992 by the Alexis de
Tocqueville Institution.

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U.S. CONGRESS

1992-93 Chief Economist, Republican Policy Committee, U.S. Senate
Reporting to Senator Don Nickles (R-OK), responsible for publications, briefings, reports, and analyses of economic trends, statistics, and policy. Legislative responsibility for Senate floor consideration of bills reported from Senate Budget, Finance, and Banking Committees as well as Senators' floor amendments and conference committee reports; 'secret' security clearance.

1990-91 Staff Director, Congressional Joint Economic Committee
Reporting to Senator William V. Roth (R-DE), responsible for management, organization of Committee hearings, editing of research reports, and the preparation of Minority views for Joint Economic Committee 1991 Annual Report; 'secret' security clearance.

1987-90 Senior Economist, Congressional Joint Economic Committee
Detailed to Senator Steve Symms (R-ID) to work with the Senate Finance Committee and Budget Committee on issues of taxation, trade, and fiscal policy; 'secret' security clearance.

1985-87 Senior Economist, Congressional Joint Economic Committee
Reporting to Senator James Abdnor (R-SD), committee staff economist responsible for monetary theory and policy, international capital markets, and banking regulation; 'secret' security clearance.

1983-85 Economist, Banking Committee,
U.S. House of Representatives
Reporting to Congressman Ron Paul (R-TX), prepared research papers for use by the Committee, organized hearings, received constituents on behalf of members.

THE WHITE HOUSE & U.S. STATE DEPARTMENT

1982 Deputy Director, White House Office of Policy Information
Staff director, responsible for preparation of briefing papers on immediate-news issues for senior White House staff, reporting to Assistant to the President and Domestic Policy Advisor Edwin L. Harper; 'top-secret' security clearance.

1982-83 Economic Advisor, U.S. Mission to the O.A.S., U.S. Department of State
Reporting to Ambassador J. William Middendorf, conducted research and prepared reports on U.S. trade policy with Latin America and the international financial situation with particular focus on Latin American debt; participated in preliminary Administration concept-discussions for NAFTA; 'top-secret' security clearance.