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August 16, 2013

Arizona Corporation Commission
DOCKETED
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DOCKETED BY nr

Bob Stump, Chairman
Gary Pierce, Commissioner
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Susan Bitter Smith, Commissioner
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007-2996

Re: *In the Matter of the Commission's Inquiry into Retail Electric Competition; Docket No. E-00000W-13-0135*

Dear Commissioners:

Arizona Public Service Company ("APS" or "Company") has thoroughly reviewed the voluminous comments filed in response to the Commission's Notice of May 23, 2013 and attached are the Company's Reply Comments. Simply put, none of the proponents of restructuring Arizona's retail electric industry has offered a persuasive answer to the fundamental question of what are we trying to fix about a system that clearly is not broken.

Is it price? Arizona electric rates, despite the harsh climate and low population density, are already below the national average and below those of virtually all the states where the retail electric industry has been deregulated.

Is it customer service? APS and other Arizona electric utilities are already rated higher in customer satisfaction than any of their potential competitors and are amongst the highest rated utilities in the United States.

Is it reliability? APS is in the top one-tenth of all American utilities in terms of service reliability, and its reliability indices have improved in the more than a decade since Arizona abandoned its last efforts at restructuring.

Is it innovative service offerings? APS offers five varieties of residential time-of-use ("TOU") rates as well as TOU options for virtually all its commercial and industrial customers, including a TOU offering for schools specifically designed at their request. The Company offers demand response and energy efficiency programs, interruptible rates (as requested by some of the Company's larger customers), special contracts, combined metering and billing, and other rate or service offerings. One would be hard pressed to find any electric utility in this country that provides such a wide range of options to over one million customers.

As it has in the past, this Commission will work with the State's regulated utilities and other affected parties to continuously improve the quality, variety, and affordability of electric service to Arizonans without abandoning a system that was embedded by the State's founders in our Constitution and that has worked for over a century. For these and the reasons identified in APS's Reply, the Company urges the Commission to vote promptly against deregulation and close this docket.

Sincerely,

Thomas L. Mumaw

Thomas L. Mumaw
Attorney for Arizona Public Service Company

cc: Parties of Record

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Arizona Public Service Company ("APS" or "Company") provides these comments in reply to certain comments submitted to the Arizona Corporation Commission ("ACC" or "Commission") on or after July 15, 2013, regarding electricity industry restructuring. APS has reviewed all of the comments submitted in this docket and provides the attached response to the key points raised by the parties to the docket.

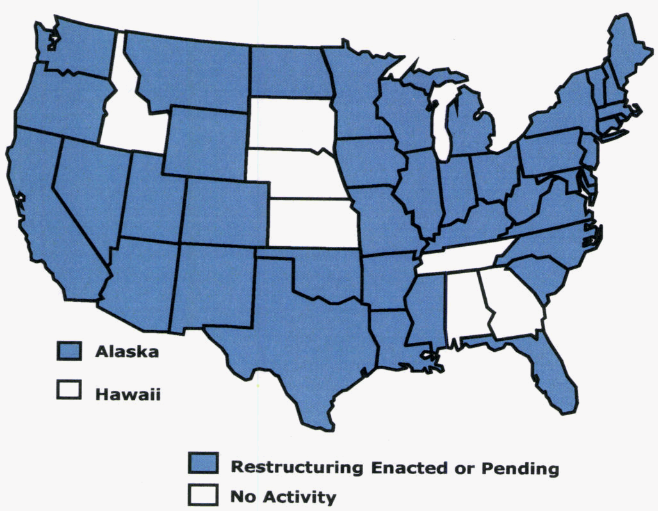
I. EXECUTIVE SUMMARY

In the 1990s, when lobbyists, regulators, and government leaders were discussing the pros and cons of deregulating the electric industry, Enron CEO Jeff Skilling said:

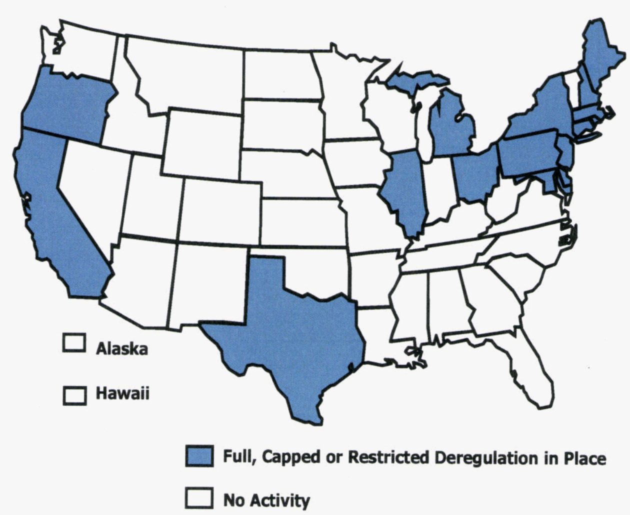
> Every day we delay [deregulation], we're costing consumers a lot of money . . . . It can be done quickly. The key is to get legislation done fast.[1]

Working under a sense of urgency, the states that deregulated did it wrong and suffered the consequences. As shown below in 2001, forty-two states had started the restructuring process or were considering restructuring. Today, the number of full or partially restructured states has dwindled to only sixteen and the District of Columbia.

Electricity Restructuring Status 2001



Electric Restructuring Status 2013



In response to shocking price increases and threats to system reliability, many of those that had once supported deregulation have since expressed regret. Responding to Maryland's failed experience with restructuring, a Maryland Senator commented:

> Deregulation has failed. We are not going to give up on re-regulation till it's done.[2]

[1] Keating, Christopher, "Eight Years Later ... 'Deregulation Failed,'" *Hartford Courant*, January 21, 2007.

A Connecticut leader who participated in restructuring that state's electric market expressed a similar thought:

> Probably six out of the 187 legislators understood it at the time because it is so incredibly complex. . . . If somebody says, no, we didn't screw up, then I don't know what world they are living in. We did.[3]

Arizona has the benefit today of learning from the experience of these states and protecting its residents from the risks to price and reliability that a move to deregulation inevitably brings.

No party has identified any specific problem in Arizona that deregulation is intended to solve. Arizona's current regulatory structure has been effective in Arizona for over 100 years and is providing safe, affordable, reliable, and innovative electric service to all Arizonans. As the experience in California and other states has proven, replacing a successful regulatory model with one that is fraught with the risk of negative long-term consequences for the state exposes today's leaders to leaving a tainted political legacy.

Amidst thousands of pages of comments filed by well over 60 parties, key facts remain undisputed:

1. No party can assure this Commission with any degree of certainty that restructuring the market will improve rate affordability and protect service reliability for all customers.

2. With restructuring comes a corresponding loss of most of this elected Commission's jurisdiction over energy planning and policy, including generation rates, which would be transferred to the appointed members of the Federal Energy Regulatory Commission ("FERC"). In practice this means:

   a. The Commission will lose its ability to balance customer and provider interests when setting electric generation rates.
   b. The integrated resource planning ("IRP") process will be meaningless, with the Commission no longer able to ensure appropriate resource planning decisions are made for the state of Arizona.
   c. The Commission will lose its ability to implement energy policies that are best for Arizona and its ratepayers, and FERC's broad national agenda may not align with the best interests of Arizona customers.

3. The legal challenges to deregulating the electric market are real. If the Commission moves forward with any form of industry restructuring that is

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[2] Hill, David, "State Legislators Say Utility Deregulation Has Failed in its Goals," *The Washington Times*, May 4, 2011.
[3] Keating, *Ibid.*

inconsistent with the Commission's Constitutional responsibilities, lengthy litigation will not be far behind, as evidenced by this state's prior experience with restructuring.

Other points raised by restructuring advocates are simply wrong. To set the record straight:

1. Restructuring primarily benefits large commercial and industrial customers to the detriment of residential and small commercial customers.

   a. Energy marketers cherry-pick the most profitable customers to serve, leaving residential and small business customers facing comparably higher provider-of-last-resort rates.

   b. APS's experience under the Alternative Generation Supplier program has thus far confirmed that in a restructured or "hybrid" model, significant costs will be shifted to non-participating customers.

2. In a restructured market, any decision on moving forward with a long-term capital investment, such as the Four Corners acquisition, is not about long-term economics. Simply put, no utility can make a long-term generation investment decision when it does not know what the generation market looks like. APS has gone to great efforts to maintain the viability of Four Corners. It has negotiated for years with the Environmental Protection Agency, other Four Corners participants, fuel providers, and the Navajo Nation on many complex issues.

   The Company fought hard to protect the transaction. APS has had numerous opportunities (both before and after the Commission's May 2013 decision to explore the possibility of deregulation) to walk away from Four Corners without liability. These opportunities went unexercised because APS believes in the plant's multi-faceted value. That belief continues today. It defies all the facts and history surrounding this transaction to suggest that APS would use the deregulation conversation as an excuse to get out of the deal now.

3. Rate reductions in the 1990s were the product of traditional cost-of-service regulation, not restructuring. Any statement to the contrary is simply inaccurate.

4. A functioning Regional Transmission Organization ("RTO") and wholesale market are prerequisites for retail competition. The Arizona Independent Scheduling Administrator ("AZISA") is simply not enough. The initial formation of an RTO and establishment of energy markets, ancillary, and potentially capacity markets, and related financial hedging tools should be expected to take as long as five years, if not longer, and require investment in the hundreds of millions of dollars. Moreover, restructuring, at the wholesale or retail levels, is not a "one and done" event. Restructured markets throughout the U.S. continue to evolve, repeatedly changing rules

and structures in attempts to address unanticipated issues or market manipulations.

APS respectfully requests that the Commission bring an expedient halt to this investigation before spending any more time and money on this inquiry. APS and others have established that restructured states are suffering substantial challenges that Arizona does not face today. APS reiterates its recommendations that the Commission should: (1) find that restructuring is not in the public interest; (2) retain its jurisdiction over the generation and resource actions of Arizona's regulated electric utilities; and (3) vote in Step One to close this Docket, and no longer devote its and other stakeholders' resources to the consideration of electric restructuring.

II. INTRODUCTION

APS's reply comments focus primarily on the fundamental question before the Commission—should Arizona restructure its electricity industry? While the questions regarding how such a restructuring might be implemented are important—and, in fact, bring focus to the many obstacles to restructuring—there is no credible evidence that Arizona will be better off if it restructures its electricity market. Rather, there is considerable persuasive evidence that Arizona will be made worse off. The Commission was right to abandon restructuring in 2002, and nothing in the decade since indicates that the enormous effort required to restructure the industry will yield benefits for all customers.

In fact, the current regulatory structure is providing safe, affordable, reliable, and innovative electricity service to all Arizona citizens and provides a better platform for making adjustments that accommodate emerging trends in the industry, such as distributed generation, demand response, dynamic pricing, and other new services made possible by utility investments in smart grid technologies.

Should Arizona restructure its electricity industry? The obvious answer is no.

Looking to the experience in other regions of the country, restructuring has failed to deliver the promised benefits of lower prices and more innovative products and services. Restructuring may offer the allure of unleashing "competition" and "market forces" with the promise of driving efficiency and innovation in the power sector. In reality, however, restructured states and RTOs/Independent System Operators ("ISO") have had to create sophisticated regulatory regimes for these "competitive" markets with complex and ever-evolving rules to protect, as best they can, against adverse outcomes. Restructuring has presented several states with serious resource adequacy and fuel diversity challenges that threaten the reliability of their critical electricity supply, and several states have responded with actions to partially re-regulate the resource supply function in order to attempt to resolve market deficiencies with various regulatory constructs. The results of these re-regulation efforts are uncertain.

The experience of restructuring in other jurisdictions shows that the vast majority of customers have not benefited from restructuring. Rather, energy marketers cherry-pick large commercial and industrial ("C&I") customers that can be served most profitably, leaving remaining customers behind to bear additional costs.[4] Independent evaluations conducted for regulators have confirmed that energy marketers target large customers, noting, for example, that in Connecticut "[a]s with other states that deregulated their electric markets, competitive retail suppliers primarily focused on large industrial customers."[5] This point is even acknowledged by proponents of restructuring in this proceeding. A recent story about The Goldwater Institute's support for restructuring explained that: "when asked what happens to residents in remote areas of the state, where companies might not necessarily want to go because of higher operating costs, [one of the authors of The Goldwater Institute's deregulation policy paper] acknowledged that they could pay a higher electricity rate." [6] As another party expressed, under restructuring, the so-called "subsidy-receiving classes", will "have less potential for savings."[7] This admission is a deliberate euphemism for "higher rates for residential customers."

Restructuring would severely restrict the Commission's jurisdiction over the process of selecting resources to power Arizona's energy future: with a move to direct access comes a loss of the utility's obligation to build and a corresponding loss of ACC jurisdiction over power prices. Instead, jurisdiction over regulatory policies that drive electricity prices will be transferred from elected Arizona policymakers to the FERC, a federal agency whose broad agenda may not always align with Arizona customers' best interests from both a cost and reliability standpoint.[8] Under direct access, energy marketers and independent power producers under FERC-jurisdictional RTO tariff rules, rather than state-regulated utilities, decide whether, when, and how to enter the market and what supply and demand side resources to develop. The supporters of restructuring acknowledge the expansive role that FERC would have under restructuring but ask the Commission to view FERC's role in wholesale market operations through rose-colored glasses, due, perhaps, to the fact that it is not possible to implement restructuring without a viable wholesale (i.e., FERC-jurisdictional) market. Critically, FERC's jurisdiction covers all wholesale electricity transactions, even under the most limited restructuring approach.

Contrary to restructuring proponents' claims, restructured wholesale electricity markets in other U.S. regions are not working as hoped. As APS and other commenters have explained, restructured electricity markets have demonstrably failed to provide incentives for investments in generation necessary to ensure reliable service, and what non-wind generation has been built is almost entirely natural gas-fired.[9,10] This outcome could place customers (and the continued viability of critical baseload coal and nuclear plants) at the mercy of historically unpredictable natural gas prices. Evidence indicates that large baseload plants are disadvantaged by current market designs that recover fixed costs through either energy sales or capacity markets that exhibit year-to-year price swings.

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[4] Keating, Christopher, "Eight Years Later ... 'Deregulation Failed,'" *Hartford Courant*, January 21, 2007.

[5] *State Analysis and Survey on Restructuring and Reregulation: Final Report*, dated December 1, 2008, prepared for the Maryland Public Service Commission by Kaye Scholer LLP, Levitan & Associates, Inc. and Semcas Consulting Associates, at 28.

[6] *Arizona Capitol Reports – Yellow Sheet Report*, July 17, 2013, at 3.

[7] Freeport-McMoRan Copper & Gold, Inc. and Arizonans for Electric Choice and Competition Comments, at 4.

[8] Arizona Public Service Comments, at 7-9.

[9] Arizona Public Service Comments, at 9-10.

[10] Arizona Public Service Comments, Attachment A, at 15-19.

Merchant generators' short-run, profit-driven decisions to construct and retire generation capacity replace the vital role served by IRP, precisely at a time when fuel price, technology, and environmental regulation uncertainties necessitate constructive, long-term resource planning among regulators, utilities, and the broad group of stakeholders that depend on a reliable, affordable, environmentally responsible portfolio of resources.[11,12] Wholesale markets have also exhibited extreme price volatility and remain subject to market manipulation by profit-motivated market participants.[13,14] The so-called "competitive markets" are characterized by protracted litigation at FERC and in the courts and a number of regulatory "belts and suspenders" to protect against adverse outcomes.[15] Arizona's unique circumstances also make restructuring especially problematic, given the presence of a large public power sector that is outside the Commission's jurisdiction, and the extreme desert environment, which makes reliability and price certainty critical for customers.[16] The states and regions that implemented restructuring—a path from which return is costly and difficult—are still, 15 years later, trying to figure out how to design a "competitive" electricity industry that can deliver the same benefits already enjoyed by Arizonans under the present regulatory framework.

One proposal to pursue limited restructuring that could allegedly coexist with traditional cost-of-service regulation warrants special attention.[17] Most importantly, such limited restructuring would inevitably result in large C&I customers opting out of cost-of-service regulation when energy marketers can offer favorable rates during periods of low natural gas prices. This would shift their current share of utilities' embedded costs onto smaller businesses and residential customers. Once natural gas prices move higher or again experience large swings, those large C&I customers would likely opt back in to the cost-of-service model (subject to any restrictions on returning to regulated supply service) to once more benefit from the stable, affordable, reliable service made possible by regulated utilities' long-term investments in a diverse portfolio of resources.

Proponents make numerous assertions as to the purported benefits of restructuring. However, as summarized in the table below, and explained in detail in the following sections, these assertions do not withstand scrutiny.

[11] Arizona Public Service Comments, at 10-12.
[12] Arizona Public Service Comments, Attachment A, at 32-34.
[13] Regarding price volatility, see Arizona Public Service Comments, at 11, and Attachment A, at 8.
[14] Regarding market manipulation, see Arizona Public Service Comments, at 14, and Attachment A, at 33.
[15] Arizona Public Service Comments Attachment A, at 16-19.
[16] Arizona Public Service Comments, at 3, Attachment A, at 35.
[17] Freeport-McMoRan Copper & Gold, Inc. and Arizonans for Electric Choice and Competition Comments, at 12-14.

Restructuring Supporters' Claims	**Reality**
Reliability will not suffer under restructuring.	Several states have taken re-regulation actions to address reliability concerns caused by restructuring. In particular, they have taken steps that require regulated utilities or state agencies to promote development of new generation. The success of these actions is uncertain at this time. Texas's model of restructuring, while held up as a shining example of success by proponents, has fallen so far short of incenting needed generation investment that the North American Reliability Corporation ("NERC") has publicly warned Texas of its reliability concerns.
Restructuring leads to lower prices across all customer classes.	At best, select large C&I customers may enjoy lower prices by shifting costs that must be reallocated to residential and small business customers.
Restructuring shifts risks from customers to generators and energy marketers.	Merchant generators eschew risk and eliminate new competitive generation by avoiding needed investments in new capacity, threatening reliability and exacerbating price volatility. Customers face greater risks under restructuring from reliability concerns, undermined fuel diversity, price volatility, and market manipulation and abuses.
Restructuring leads to valuable product and service innovations that are not possible under the traditional regulatory model.	APS and other Arizona utilities already offer a wide array of innovative rate plans and value-added services to customers and have been nationally recognized for their innovation.[18,19] Restructuring does not offer materially more or better services or products.
Restructuring is working well in other jurisdictions, and deregulation has worked well in other industries.	Electricity is unlike any other industry in its complexity and importance, so whether or not deregulation worked in, for example, the telecommunications industry is irrelevant. The fact that restructured states generally have higher prices than traditionally regulated states, growing concerns over reliability, and lower customer satisfaction demonstrates that restructuring has not worked well in other jurisdictions.

[18] APS, "APS Recognized Among Top 10 Nationally for Energy Innovation," Press Release, April 26, 2012.
[19] Feblowitz, Jill and Kate Rowland, "2011 UtiliQ Rankings," *Intelligent Utility*, January/February 2012.

Restructuring Supporters' Claims	**Reality**
The *Phelps Dodge* decision does not present a significant legal obstacle to restructuring.	The *Phelps Dodge* decision presents significant and likely insurmountable obstacles to even a partial restructuring of the industry covering only certain customers. The requirements that the Commission and not the market set just and reasonable rates and that those rates consider in some meaningful way the fair value of the provider's assets are part of Arizona's Constitution. They cannot be waived or ignored by the Commission or even modified by statute. Even the Commission's own Staff has expressed concerns over the viability of the Electric Competition Rules in the aftermath of *Phelps Dodge*. The proponents of restructuring were dead wrong on their interpretation of Arizona law 10 years ago, and there is every reason to believe they are wrong today. Moreover, *Phelps Dodge* did not address issues of rate discrimination and rate transparency that would be likely sources of litigation even should *Phelps Dodge* be ignored, explained, or simply wished away as urged by proponents of restructuring.
Restructuring would not be overly complex, time-consuming, or expensive.	Arizona learned the hard way in the last attempt at restructuring how complex, time-consuming, and expensive it is to go down this path. The road to restructuring has only gotten harder in light of *Phelps Dodge* and the fact that the decade since Arizona abandoned restructuring has demonstrated that states that did restructure still have not arrived at a model that delivers benefits for all customers. The experience in other states has shown that restructuring requires a highly developed wholesale market with central energy markets and financial transmission rights. These are time consuming, complex, and expensive to implement.

Arizona Public Service Recommendations

APS respectfully requests that the Commission bring an expedient halt to this investigation before spending any more time and money on this inquiry. APS and others have proven that restructured states suffer substantial challenges that Arizona does not face today. APS reiterates its recommendations that the Commission should:

(1) find that deregulation is not in the public interest;

(2) retain its jurisdiction over the generation and resource actions of Arizona's regulated electric utilities; and

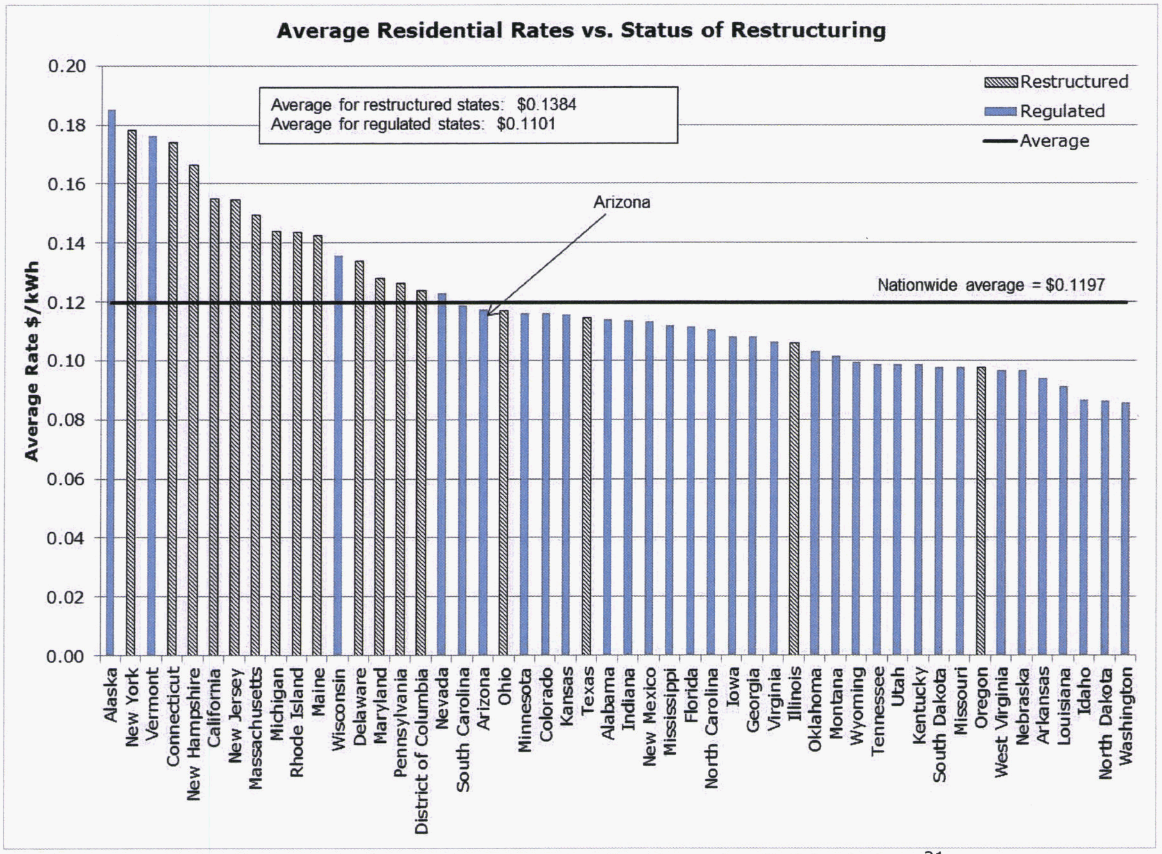
(3) vote in Step One to close this Docket, and no longer devote its and other stakeholders' resources to the consideration of electric restructuring.

Rather than focusing its own resources and the resources of all stakeholders on restructuring, Arizona would be better served if regulators and industry stakeholders articulated the specific policy goals that underlie the present investigation of restructuring. Once those policy goals are articulated, the Commission could work within the current regulated environment to further those goals in a manner consistent with the long-held principles of electricity regulation: reliability, affordability, and environmental responsibility. A complex, lengthy, expensive, and contentious restructuring process that would put the reliability and affordability of electricity supply at risk is simply unnecessary. APS stands ready to work with its customers and the Commission on efforts to achieve desired goals under the current regulatory model.

III. In Arizona Today, Electricity Restructuring Is a Solution in Search of a Problem

Arizona customers currently benefit from reliable, affordable, and safe service. As highlighted in APS's Initial Comments (see chart below), Arizona's residential customer rates are below the national average, and lower than 13 of the 17 restructured states across the nation. Conversely, rates in restructured states are generally well above the national average. As explained in APS's Initial Comments, though all prices have risen over time, prices have risen faster in states with restructured markets. From 1990 to 2011, the average price in restructured states grew by approximately 60 percent, while prices in regulated states during the same time period rose by 50 percent.[20]

[20] Source: U.S. Energy Information Administration. For purposes of this analysis, restructured states include: CA, CT, DC, DE, IL, MA, MD, ME, MI, NH, NJ, NY, OH, OR, PA, RI, and TX. Regulated states exclude Hawaii, owing to its idiosyncratic fuel and resource planning issues.



Source: U.S. Energy Information Administration, April 2013 data[21]

Moreover, Arizona utilities are nationally recognized for innovation and customer satisfaction. Working in partnership with the Commission, Arizona utilities already lead their industry peers in implementation of advanced technologies and new, innovative products and services, supported by the current regulatory model which provides for a transparent, deliberative public process that is designed to serve the broad public interest and not the more narrow profit-driven interests of market participants. APS, for example, offers a host of innovative products and services to customers, many supported by advanced technology. The current regulatory framework has enabled APS to work with the Commission and other stakeholders to identify promising innovations, engage in pilot projects where appropriate, and roll out the most valuable and effective new products and services to all customers. Certain technology trends (e.g., distributed generation, demand response, time-varying rates) are reshaping the traditional model of electricity generation and delivery. It is entirely possible and reasonable to continue to address these trends and take advantage of beneficial new technologies within the current regulatory model.

[21] Based on U.S. Energy Information Administration, Table 5.6.A "Average Retail Price of Electricity to Ultimate Customers by End-Use Sector, by State", Form 826, April 2013 data. Due to its geographic isolation and associated resource planning and ratemaking issues, Hawaii was excluded from this analysis. Oregon has extraordinarily low retail prices for a restructured state. It is important to note that Oregon's market currently allows customer choice for only a limited number of large customers. Oregon's historical reliance on low-cost hydroelectric generation and cost-based rates for residential customers helps explain the comparatively low customer rates.

Overall, Arizona customers are highly satisfied with the current state of affairs. In 2013, J.D. Power ranked both APS and the Salt River Project ("SRP") in the top three and top four among large utilities in the West for business customer satisfaction and residential customer satisfaction, respectively.[22,23] Rather than representing any widespread dissatisfaction with the current regulatory model, the support for restructuring comes almost exclusively from a handful of large C&I customers and out-of-state energy marketers. These large C&I customers hope to contract directly for their electricity supply out of dissatisfaction with their existing cost responsibilities under the current regulatory model. The energy marketers, of course, stand to profit by inserting themselves as middlemen in a restructured market. The Commission has the authority to review the current allocation of the cost of service to these large customers. Of course, cost allocation is a "zero sum" game. Any costs re-allocated from large C&I customers must be borne by residential and small business customers. Nonetheless, an examination of cost allocation under the existing regulatory model would be superior to the mistaken vision of restructuring proponents that would subject all Arizona customers, and the Arizona economy, to an often unstable, less reliable wholesale supply market, simply in order to alleviate select large C&I customers of their current cost responsibilities.

It is critical to appreciate the current regulatory framework and its advantages for Arizonans. The present regulatory model provides the stable structure necessary for utilities to make major capital investments in a portfolio of long-lived generation assets with a diverse fuel mix that align with Arizona's energy policy and the long-term interests of the state and its business and residential customers. Under the present model, Arizona regulated electric utilities are directly accountable to the publicly elected ACC Commissioners for reliability, cost management, product offerings, customer service, and overall effective management. Arizona utilities report regularly to the Commission on all critical aspects of their businesses, and these reports are available to the public. Customers of Arizona regulated utilities can contact the Commission if they have issues concerning any aspect of their utility service. Arizona utilities invest $2 billion a year in energy infrastructure, focusing on long-term reliability and cost-effective management.[24] Utilities cannot change customer pricing without Commission review and approval, and all stakeholders have an opportunity to participate in these decisions.

The current circumstance contrasts sharply with a restructured model that relies heavily on complex new markets. The Commission would give up its influence over the prices that all customers pay, including customers that do not choose an alternative supplier. The Commission would transfer most of its authority over electric generation to FERC, and, as generators become "merchant" generation instead of regulated utility generation, decision-making on new generation shifts to independent investors that focus on profits over a much shorter time horizon. Arizona's electricity market will be increasingly regulated at the federal level, which may not always align with local policy. Critical decisions

[22] J.D. Power, "2013 Electric Utility Business Customer Satisfaction Study," Press Release, February 13, 2013.
[23] J.D. Power, "2013 Electric Utility Residential Customer Satisfaction Study," Press Release, July 17, 2013.
[24] Note that just the Pinnacle West Capital Corp. and UNS Energy Corp. operating companies and the Salt River Project account for roughly $2 billion per year in capital expenditures. SNL Energy, *Financial Focus: Capital Expenditure Update*, May 31, 2013. Salt River Project 2012 Annual Report.

on pricing, resource planning, and products and services will be left to a collection of mostly out-of-state companies who care little about the public interest of Arizonans and whose own interests often run counter to those of Arizona customers (e.g., higher power and capacity prices are good for merchant generators but increase customers' bills). The less powerful, less informed, and underfunded groups (e.g., the elderly, low-income customers) will no longer be able to rely on the protection of a local regulatory body that understands their interests. These groups are resource-constrained and may be underrepresented before FERC.

As described further below, restructuring is enormously time-consuming and expensive, and there is a very good chance that it will result in weakened reliability, higher costs, and less fuel diversity. Given the present level of safe, reliable, affordable, and innovative electricity service available to all Arizona customers, there is no reasonable justification to pursue restructuring any further.

IV. The Arguments in Support of Restructuring Are Not Strong Enough to Support Further Study

While these comments focus on refuting the assertions made by restructuring's supporters, the Commission should take note that several of the key points made by APS have not been contradicted by the proponents of restructuring. Proponents acknowledge, for example, that restructuring requires the Commission to surrender its authority over critical generation matters (e.g., energy and capacity pricing) to FERC. Most supporters of restructuring also acknowledge that the IRP process will necessarily be abandoned. They concede (and even celebrate) that the continued operation of the Four Corners and Navajo Generation Station baseload coal plants will be put at risk without any apparent concern for the negative impact that those plants' closures would have on employment as well as the economies of surrounding rural and Native American communities.

Further, certain proponents of restructuring approach this inquiry with political, ideological, or academic points of view. The comments of the Federal Trade Commission ("FTC") and the Goldwater Institute are particularly noteworthy in this regard. These parties appear to have an ideological and academic commitment to "competition" and "free markets" that they apply to the electricity industry despite the practical realities of the electricity industry, the real-world experience of restructuring in other states, and the absolute necessity of ensuring resource adequacy and reliability.

The remaining supporters of restructuring are primarily out-of-state energy marketers and large C&I customers whose support for restructuring promotes their own narrow self-interests at the expense of the broader Arizona public interest. These proponents of restructuring offer several themes for the Commission to consider, but they can all be reduced to a pursuit of self-interest over public interest.

Restructuring Will More Likely Harm Reliability and Has Zero Chance of Improving Reliability

The proponents of restructuring advance three main points in support of their position that reliability will not be harmed by restructuring and may even be improved. These reliability claims and APS' response are summarized in the table below.

Proponents' Claims	Reality
The reliability of the bulk power system[25] will not be affected by restructuring.	Several states (e.g., Connecticut, Illinois, Maryland, and New Jersey) have taken re-regulation actions to address concerns regarding the reliability of generation supply caused by restructuring, with as yet uncertain success; Texas, on the other hand, is already in trouble and sinking fast.
Demand response, facilitated by retail competition, will contribute to improved system load profiles and enhanced reliability.	Demand response may be a valuable resource under certain circumstances, but it is not a substitute for "steel in the ground" from a reliability standpoint. Arizona's unique climate and customer base limit the availability of this resource. It can also be promoted within the current regulatory model as it is today.
The reliability of the distribution system will increase as utilities focus on distribution system infrastructure.	The focus of APS and other utilities on their distribution systems will not be affected by restructuring. APS already operates its distribution system near the top of industry rankings. However, a reduction in the financial integrity of regulated utilities because of industry restructuring could have a negative impact on the ability of those utilities to invest in their distribution systems at the expected levels.

More specifically, a few proponents assert that restructuring will have no bearing on reliability, often citing the continued federal role of NERC and FERC in overseeing reliability standards.[26,27,28] The Retail Competition Advocates and Retail Energy Supply Association ("RCA/RESA") also cite the requirement that retail suppliers maintain an adequate reserve margin.[29] The Goldwater Institute and Roy Miller cite growth in generation capacity in certain restructured states and regions as evidence of continued resource adequacy.[30] Finally, the National Energy Marketers Association ("NEMA") claims that reliability may be enhanced if utilities are able to focus exclusively on transmission and distribution infrastructure.[31] The FTC claims that retail competition will take advantage of smart meters and other technological advancements to offer demand response and other new services that will result in improved system load profiles that will "ease the challenges that grid operators face."[32] Each of these assertions is simply wrong.

[25] The bulk power system includes all of the interconnected transmission and generation facilities and the control systems that are used to operate the grid.
[26] Compete Coalition Comments, at 8.
[27] Wal-Mart Stores Comments, at 7.
[28] Freeport-McMoRan Copper & Gold, Inc. and Arizonans for Electric Choice and Competition Comments, at 10-11.
[29] Retail Competition Advocates and Retail Energy Supply Association Comments, at 29.
[30] Goldwater Institute and Roy Miller Comments at 2, 9-10.
[31] National Energy Marketers Association Comments at 6.
[32] Federal Trade Commission Comments at 18.

The consequences of an interruption of service for even a few hours can be severe in terms of public safety and lost business. For this reason, distribution and transmission networks are designed, operated, and maintained to meet stringent reliability objectives. APS agrees with the proponents that acknowledge that restructuring should have little or no impact on the reliability of distribution networks as these will continue to be designed and operated by local distribution utilities under the watchful eye of state regulators.

However, as described in its Initial Comments, APS believes the evidence supports a starkly different view from that of the proponents of restructuring with respect to the impact of restructuring on the reliability of generation.[33]

Reliability of the Bulk Power System

The proponents' claims with respect to the reliability of generation are the most concerning. They are correct when they point out that reliability of the bulk power system is overseen by NERC. However, in regions that have restructured, the actions of RTOs/ISOs have a significant impact on the reliability of generation supply as they operate wholesale power markets, including capacity markets that are designed to incent new generation (and, on the flip side, generation retirements).

In APS's initial comments, APS pointed to three elements of restructuring that combine to give Arizona and Arizonans reason to be concerned about the impacts of restructuring on reliability. These are: (1) the transfer of jurisdiction from the Commission to FERC; (2) the abandonment of IRP; and (3) the failure of wholesale power markets to incent new generation.[34] It is precisely these three factors that have caused several states (e.g., Connecticut, Illinois, Maryland, and New Jersey) to take belated "re-regulation" actions in an attempt to address reliability concerns that restructuring theorists, led by Enron and academicians, had successfully argued would be taken care of by "the market."[35,36,37]

Because new generation resources were not being constructed in sufficient quantities or at locations sufficient to meet system needs, at least five restructured states have taken actions to partially re-regulate their electricity markets, by requiring incumbent utilities to enter into long-term contracts for new resources and/or taking other actions to incent new generation: Connecticut, Maryland, New Jersey, Delaware, and Illinois. In each state, policymakers were motivated by concerns that reliability of service was being threatened by a failure of wholesale market designs to spur investment in new generation. Although the response differed by state, the basic elements of the legislative and regulatory responses included a focus at the state level on resource planning (which was no longer being performed by the utilities) and the development of new generation resources (which can take three to five years) at locations necessary to meet system reliability needs or remedy transmission constraints.

[33] Arizona Public Service Comments, at 9-10, and Attachment A, at 15-19.
[34] Arizona Public Service Comments, at 7-14.
[35] Arizona Public Service Comments, at 19.
[36] Wayne, Leslie, "Enron's Many Strands: The Politics; Enron, Preaching Deregulation, Worked the Statehouse Circuit," *New York Times*, February 9, 2002.
[37] Hogan, William, "Restructuring the Electricity Market: Institutions for Network Systems," Harvard University, April 1999.

The experiences of Maryland, New Jersey, and Delaware indicate that, while generation resources may be adequate from an RTO/ISO-wide basis, reliability must be achieved for each load area. Ultimately, the failure of PJM capacity markets to incent new generation within these transmission-constrained areas contributed to state actions to re-regulate their electricity markets. The fact that RTO/ISO rules require each load-serving entity (both regulated utilities and energy marketers) to acquire sufficient resources to satisfy a prescribed capacity and reserve requirement to meet their current obligation does not ensure that sufficient resources will be available at the right time, in the right quantities, or at the right locations to satisfy those requirements.

Curiously, Texas is a state often cited by proponents of restructuring as having successfully restructured. The Goldwater Institute and Roy Miller attribute price decreases to growth in generation capacity and proclaim that growth in generation capacity has outstripped economic growth in Texas.[38] The truth, however, is that Texas is a great example of how tenuous a restructured electricity market can become. The grid operator itself seems to agree. As described recently in an industry journal:

> Additions of electric power generation capacity are not keeping pace with Texas' rising demand for electricity, particularly during peak-hours. A robust economy and population growth spurred the need for more electricity supply, according to the grid operator Electric Reliability Council of Texas (ERCOT). ERCOT . . . warned that regulatory and market uncertainty would limit incentives for investment in new sources of power supply within the region, which causes the risk of narrowing reserve margins. It's deemed "alarming" that ERCOT is the only region in the North American Electric Reliability Corporation's (NERC) 2013 Summer Reliability Assessment with a reserve margin below target level, which is based on the highest, or peak, hour of demand during the summer. . . . For the second year in a row, ERCOT has been below its target reserve margin of 13.75 percent.[39]

Even NRG Energy, a party to this docket supportive of restructuring, has publicly stated that the "ERCOT market design does not consistently support ERCOT's reliability standard."[40]

As the chart below shows, ERCOT's own projections for its reserve margin in the coming years highlight the magnitude of the reliability challenge ERCOT faces in light of a dearth of new investment in generation capacity. These facts fly in the face of the Goldwater Institute's claims about Texas. In referring to the growth in capacity in Texas, the Goldwater Institute apparently failed to take into account that more than one third of the new

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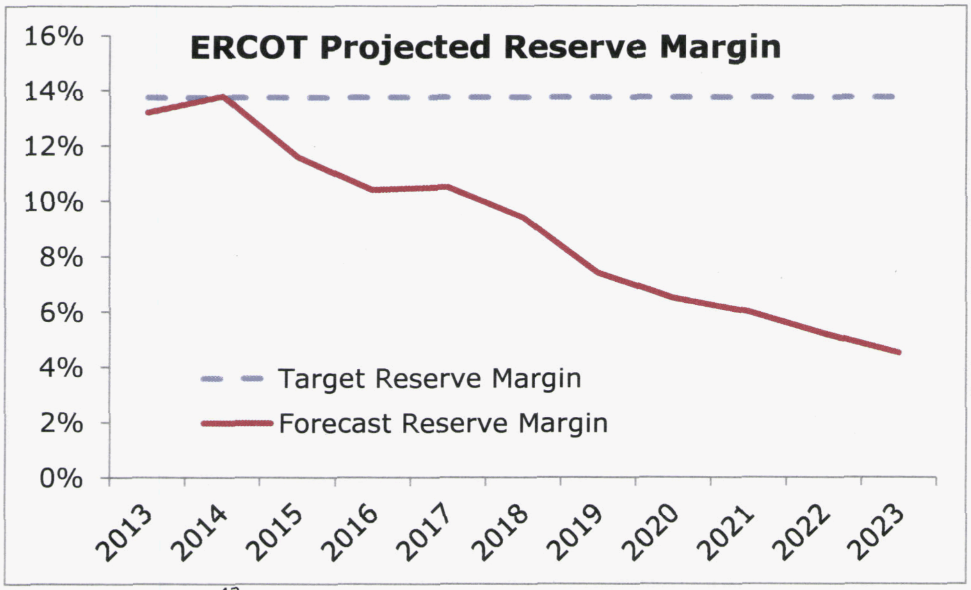
[38] Goldwater Institute and Roy Miller Comments at 2, 9-10

[39] "Capacity Additions Don't Keep Pace with Texas' Rising Peak-Hour Demand," *Gas to Power Journal*, June 25, 2013

[40] Walker, Mark (NRG Energy). "ERCOT Power Market," Presentation to the Texas Renewable Energy Industry Association, March 5, 2013, at 11.

generation capacity installed in ERCOT during the ten years ending in 2012 came from wind turbines (more than 10,000 MW).[41] However, because of wind's inherent intermittency, ERCOT credits less than one tenth of that large growth in installed nameplate capacity toward reliability planning purposes.[42]



Source: ERCOT.[43]

APS addressed the Texas situation in its initial comments.[44] As also pointed out in SRP's comments, the circumstances in Texas have been on NERC's radar screen for several months now, with communications from NERC's CEO to ERCOT.[45]

Some economists have argued that the answer to the current Texas electricity crisis is to allow more price volatility and price spikes to promote incremental electricity production from existing facilities, as well as new facilities, to alleviate the threat of brownouts. According to a recent news report, this solution will not solve the long-term reliability problem:

> The reaction from the power industry officials who testified at the hearing was generally positive, with many commenting it was unlikely to make the current situation any worse.[46]

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[41] SNL Energy.

[42] For reliability planning purposes, the currently approved Effective Load Carrying Capability ("ELCC") of wind resources in ERCOT is 8.7 percent of nameplate capacity. NERC, *2012 Long-Term Reliability Assessment*, November 2012, at 83.

[43] 2014-2023 reserve margins from ERCOT, *Report on the Capacity, Demand, and Reserves in the ERCOT Region*, May 2013, at 8. 2013 reserve margin from ERCOT, *Report on the Capacity, Demand, and Reserves in the ERCOT Region, December 2012 Winter Update*, at 8.

[44] Arizona Public Service Comments Attachment A, at 22.

[45] Salt River Project Comments, Position Paper, at 34-35

[46] "Texas Public Utility Commission Ponders Stopgap Measure for Electricity Grid", *The Dallas Morning News*, June 27, 2013.

Several Texas electricity industry stakeholders are advocating for creation of a capacity market in the state, including the Texas PUC Chairman.[47] ERCOT's own independent market monitor issued a report in June 2013 that concluded that "it is our view that if the planning reserve margin is viewed as a minimum requirement, implementation of a capacity market is the most efficient mechanism to achieve this objective."[48] Unfortunately, as the PJM experience indicates, it is not yet evident how to construct a capacity market that works as well as traditional regulation.

All of these experiences in other states show that restructuring would threaten the longstanding reliability of supply in Arizona by having the Commission give up jurisdiction over resource planning and critical decisions that ensure adequate resources are available to power Arizona's economy. The existing structure makes reliability an essential requirement and has served Arizona well. Over the last 15 years, new market structures have not proven that they can meet these same standards, and, in fact, substantial evidence indicates that some restructured states have been re-regulated, requiring their distribution utilities to return to long-term contracting in order to ensure supply adequacy.

The Role of Demand Response

The FTC is right to point to the potential for demand response to contribute resources at times of peak demand and the fact that development of the demand response resource is facilitated by the installation of smart meters. APS cited the contribution of demand response in its Initial Comments, while also expressing concern with regard to the cost of this resource and its reliability as compared to physical generation resources.[49]

APS supplements its Initial Comments by making two observations. First, it is not necessary to restructure the electricity market to acquire demand response resources. In fact, APS has been acquiring demand response resources since 2010 through its Peak Solutions program. In addition, APS has demand response rates such as Peak Event Pricing, Peak Time Rebates, and Time-of-Use rate options, and virtually all APS rates reflect seasonal price differentials.

Second, despite its enormous response to capacity price signals, it is important to keep in mind that demand response is a relatively new and untested resource that depends on the ability and willingness of customers to respond when called upon to curtail their electricity usage. This distinguishes demand response from "steel-in-the-ground" resources that are operated by owners whose primary business is generating electricity. The Maryland Public Service Commission addressed its concerns with overreliance on demand response when it approved its RFP for capacity resources:

> We are also concerned about the extent of Maryland's reliance on demand response to keep peak load demand in check. The evidence indicates that [the Southwest Mid-Atlantic

[47] SNL Energy, "PUCT Votes Unanimously to Raise ERCOT Price Caps to $9,000/MWh," October 26, 2012.
[48] SNL Energy, "Market Monitor Sees Capacity Market as Most Efficient Route to ERCOT Reliability Goals," June 24, 2013.
[49] APS Comments at 2, 9, and 13.

> Area Council] will rely on demand response and energy efficiency for 2,400 MW, or slightly more than 20%, of its total capacity needs in 2014/2015. Staff pointed out that Commercial and Industrial demand response may be close to saturation, and any additional relief by way of demand response is likely to have to come from the residential sector.
>
> We note that we are already seeing problems in Maryland with our Curtailment Service Providers being able to meet their contractual commitments for demand response. While we remain strong advocates for demand response as a low cost-effective way to address peak load growth, we are reluctant to rely on it to the exclusion of considering new generation.[50]

In addition, PJM's Markets and Reliability Committee is currently reviewing its rules concerning demand response. PJM has been increasing the documentation required by demand response providers and expects to explore changes to its rules to ensure that demand response and other capacity resources show up in their expected year of delivery.[51] Demand response market participants have also been investigated and fined by FERC for abuses related to demand response in PJM.[52,53]

<u>The Impact of Restructuring on Distribution System Reliability</u>

Finally, NEMA's claim that APS and other utilities will focus more on the distribution system than they currently do is grossly ill-informed. According to J.D. Power, APS currently ranks fourth in the nation among all large utilities for residential customer satisfaction with power quality and reliability.[54] APS and other vertically-integrated utilities are organized to meet their distribution service obligations and do so under the watchful eye of state commissions whether or not electricity markets have been restructured. APS will continue to devote the same attention to maintaining the reliability of its distribution network with or without restructuring. It is possible, though, that a reduction in the financial integrity of regulated utilities because of industry restructuring could have a negative impact on the ability of those utilities to invest in their distribution systems at the levels currently expected by the Commission.

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[50] Maryland PSC Order in Case No. 9214, issued April 12, 2012, at 21.
[51] See http://pjminsider.com/pjm-demand-response-providers-decry-scrutiny/. Original citations omitted.
[52] SNL Energy, "PJM Demand Response Provider Agrees to Pay Fine, Return Profits," October 28, 2010.
[53] SNL Energy, "FERC Staff Preliminary Finding: Demand Response Aggregator Violated Anti-Manipulation Rule," June 7, 2013.
[54] J.D. Power, *2013 Electric Utility Residential Customer Satisfaction Study: Industry Overview*, July 2013, at 12.

Restructuring Does Not Lead to Efficiencies and Lower Prices

The proponents of restructuring advance five main points in support of their position that restructuring will create efficiencies and lower prices to customers. As described below, this is simply not the case.

Restructuring Supporters' Claims	Reality
Electricity generation and retail supply are not natural monopolies.	Although electricity restructuring made for an interesting academic argument, the experience of states that have restructured demonstrates that electricity markets are dramatically different from other markets conducive to competition. There are suboptimal results and the loss of substantial economies of scope when generation and transmission planning are not integrated as they have been by regulated utilities. Generation and transmission are operated on an integrated basis, and they should be planned on an integrated basis, rather than by a combination of RTO/ISO transmission planning and separate markets that are supposed to incent new generation.
Restructuring will lead to better investment and operational decision and greater economic efficiency.	Under restructuring, generation development and operating decisions are largely rule-driven and hardly reflect the "invisible hand" of competition. While merchant generators are certainly driven by market forces, these rules, regulation, and litigation are equally, if not more, important.
Restructuring will lower prices for customers.	As acknowledged by proponents, empirical studies have not shown conclusive evidence of lower prices under restructuring. At best, a select group of large C&I customers may enjoy lower prices when they are cherry-picked by energy marketers and shift their current share of the cost of service to the remaining residential and small business customers.
Customers of energy marketers are more satisfied about price than customers of regulated utilities.	According to J.D. Power, in 2013, APS customers enjoy a higher level of overall satisfaction than any customers of energy marketers surveyed.
Arizona's last attempt at restructuring succeeded in lowering retail rates.	The Arizona Competitive Power Alliance ("AZCPA") misrepresents a series of rate decreases voluntarily agreed to by APS in 1996 and 1999 as being due to restructuring when, in fact, these were the product of declining costs flowed through to customers under the traditional cost-of-service regulatory model.

Proponents make several claims about the economic benefits of restructuring. They maintain that electricity generation and retail supply are not natural monopolies requiring traditional rate-regulation.[55] Proponents argue that restructuring will improve economic efficiency through better investments and operational decisions.[56] Most significantly, supporters claim that restructuring will lead to lower retail electricity prices (and to a stronger economy and job growth as a result).[57,58] According to these commenters, customers of retail energy marketers are reported to be more satisfied on price than customers of regulated electric utilities.[59] Advocates even claim that Arizona's prior, abandoned foray into restructuring succeeded in lowering rates for customers.[60]

As explained in detail below, contrary to restructuring supporters' assertions, academic theories about natural monopoly and competition have proven to be overly simplistic relative to the real-world complexities of the electricity industry. As a result, in restructured markets, rules, regulation, and litigation overwhelm the influence of competitive forces in guiding investment and operation decisions. Furthermore, there is no convincing evidence that restructuring has led to lower electricity prices. Customer surveys show that APS customers are more satisfied than those of any energy marketer surveyed. Lastly, claims that Arizona's prior, abandoned attempt at restructuring actually led to rate decreases by APS misrepresents the historical record of events.

Academic Theories about Natural Monopoly and Competition

Theoretical arguments for restructuring held some appeal in the 1990s when electricity restructuring was a relatively novel concept, promoted by academics. However, more than 15 years of real world experience with restructuring has shown those theories to be ill-suited to the realities of the electricity industry. Electricity markets are incredibly complex and do not neatly conform to the simplistic assumptions of textbook economics. The wholesale markets that have been established, in part, to support retail restructuring, which must be closely monitored and the rules constantly updated at FERC after being subjected to a costly and time-consuming FERC jurisdictional stakeholder processes. Further, relying solely on market dynamics to assure supply adequacy under restructuring has proven to be problematic for many state regulatory commissions.

It is critical when considering these comments to keep in mind that a reliable, affordable supply of electricity is vital for the safety of Arizona's residents and for the health

[55] National Energy Marketers Association Comments, at 2.
[56] IO Data Centers, LLC, Comments, at 3; Arizona Competitive Power Alliance Comments, at 2; Retail Competition Advocates and Retail Energy Supply Association Comments, at 11.
[57] For claims that restructuring will lead to lower prices, see: Compete Coalition Comments, at 2; IO Data Centers, LLC, Comments, at 3; Retail Competition Advocates and Retail Energy Supply Association Comments, at 6; National Energy Marketers Association Comments, at 3; Federal Trade Commission Comments, at 11; Freeport-McMoRan Copper & Gold, Inc. and Arizonans for Electric Choice and Competition Comments, at 14; The Goldwater Institute and Roy Miller Comments, at 12; Retail Competition Advocates and Retail Energy Supply Association Comments, at 4.
[58] For claims that restructuring will improve the economy (e.g., by creating jobs), see: Compete Coalition Comments, at 3; National Energy Marketers Association Comments, at 2; Wal-Mart Stores Comments, at 3; IO Data Centers, LLC, Comments, at 1-3; The Goldwater Institute and Roy Miller Comments, at 5.
[59] IO Data Centers, LLC, Comments, at 3.
[60] See, e.g., Arizona Competitive Power Alliance Comments, at 1-2.

of its economy. As APS President and Chief Executive Officer Don Brandt explained in the company's Initial Comments, "[e]lectricity is fundamental to all advanced economies, but in Arizona—the hottest state in America—reliable electric service is literally a life or death necessity." Such a critical industry is not an appropriate test bed for academic economists' pet theories regarding natural monopoly and rate regulation.

Investment and Operational Decisions

Adherents of restructuring may elicit images of the "invisible hand" of competition guiding generators' and energy marketers' investment, operating, and pricing decisions to maximally efficient outcomes with resultant savings for customers. The reality in today's restructured states could hardly be more different. Organized electricity markets are highly contrived institutions with elaborate and ever-evolving rules and regulations—hardly a free-market ideal where competitive forces are set loose. Investment and operating decisions are largely driven by market-specific rules, rather than supply and demand fundamentals, with price caps, minimum-offer pricing rules, vestiges of cost-of-service regulation (e.g., reliability-must-run contracts), administratively determined demand curves, and numerous other complex rules and regulations. Regulation and litigation, rather than competition, are driving forces in organized electricity markets. Market participants and various stakeholders litigate among themselves and before FERC over market rules, market manipulation, and policy goals. As a result, it is FERC through its regulation, and not just market forces, that effectively determines winners and losers in electricity markets, how much money generators will earn, and how much customers will pay.

FERC also determines whether supply continues to be reliable, and FERC remains committed to organized capacity markets as a means of incenting new generation despite those markets' failure to spur investment in capacity where and when it is needed. Critically, in states that have restructured and removed the utilities' obligation to ensure adequate supply, the state public utility commissions are forced to participate as parties in FERC proceedings in order to advocate for generation resource adequacy on which their retail constituents depend.

Retail Electricity Prices

The primary justification for restructuring rests on spurious evidence that abandoning the proven traditional regulatory model will provide quantifiable, broad-based economic benefits to customers through lower prices. Why else would regulators and stakeholders endure the time- and resource-intensive process of restructuring and bear its substantial transition costs and risks? This central premise of the argument for restructuring fails to withstand empirical scrutiny. As explained in APS's Initial Comments, though all prices have risen over time, prices have risen faster in states with restructured markets. From 1990 to 2011, the average price in restructured states grew by approximately 60 percent, while prices in regulated states during the same time period rose by 50 percent.[61] Certain proponents themselves, when confronting the literature on the price impacts of restructuring, admit to a "range of" and "variance in" conclusions.[62] The FTC points to a single study supporting price benefits from restructuring, only to subsequently express

[61] See footnote 20.
[62] Freeport-McMoRan Copper & Gold, Inc. and Arizonans for Electric Choice and Competition Comments, at 14.

discomfort with the study's finding.[63] This limited evidence of lower prices under restructuring presented by proponents is hardly convincing.

The lack of empirical support for a conclusion that lower prices will result from restructuring may explain why advocates shift the focus from a promise of "lower prices" to a more nebulous objective to "maximize value to the customer."[64] Another advocate offers that "reference to prices alone is not a reliable way to gauge performance under retail competition."[65]

The reality is that the economic benefits from restructuring are limited to a relatively small number of large C&I customers and result from the cost-shifting that occurs as energy marketers cherry-pick those customers that are least expensive to serve. Generally, large C&I customers with substantial and relatively flat load profiles can be served at lower cost than customers within the same rate class who have less desirable load profiles and at lower cost than small businesses and residential customers in other rate classes. Since regulators define rate classes in order to group customers based on load characteristics and other attributes that determine the average costs to serve them, regulators can also employ rate design techniques that achieve particular allocations of the cost of service.

Customer Satisfaction

It is particularly worth looking more closely at the claim that, according to J.D. Power, customers in restructured states are more satisfied with price when served by energy marketers than by regulated utilities. Of particular importance, neither APS nor any other Arizona utility was part of that particular J.D. Power survey. Additionally, price was only one component measured by J.D. Power in terms of overall customer satisfaction. Clearly, the J.D. Power results need to be looked at as a whole in terms of overall customer satisfaction.

J.D. Power conducted surveys in 2013 of customer satisfaction with both regulated utilities (including APS) and retail energy providers.[66,67] Both J.D. Power surveys rank providers in terms of overall customer satisfaction on a 1,000-point "Customer Satisfaction Index." In fact, APS's score is higher than that of any of the 37 scores reported for retail energy providers.

Arizona's Prior, Abandoned Attempt at Restructuring

Finally, the claim that Arizona's prior, abandoned efforts at restructuring actually succeeded in lowering rates for customers is not credible. The Arizona Competitive Power Alliance ("AZCPA") made this assertion by attributing a series of rate decreases voluntarily

[63] Referring to a recent cross-state study of the price impacts of restructuring, the FTC explained that "[w]e have questions, however, about the sensitivity of the reported results to different interpretations of the data used in this study." Federal Trade Commission Comments, at 20.
[64] NRG Energy Comments, at 3.
[65] Federal Trade Commission Comments, at 20.
[66] J.D. Power, "J.D. Power Reports Price and Billing/Payment Are Primary Drivers of Increased Overall Customer Satisfaction with Electric Residential Utilities," Press Release, July 17, 2013.
[67] J.D. Power, "J.D. Power Reports: Satisfaction with Price Is Higher among Retail Electric Customers Than among Local Electric Utility Customers," Press Release, June 26, 2013.

agreed to by APS in 1996 and 1999 to restructuring even though there were no final competition rules in place until the fall of 1999. In fact, APS was still litigating the earlier version of the proposed competition rules and not a single customer had chosen an alternative supplier. The rate reductions cited by AZCPA were the product of traditional cost-of-service regulation, not restructuring. APS's costs were declining, and the Company agreed to a novel sharing arrangement as an incentive to continue cost-reduction efforts into the future. As part of this process, the Commission permitted APS to accelerate the amortization of regulatory assets (not depreciation, as claimed by the AZCPA). This acceleration had nothing to do with the rate reductions agreed to by APS, but rather was a prudent effort to minimize potential stranded costs should the ACC eventually transition to full restructuring. In fact, had the rapid amortization of regulatory assets not been authorized, the rate decreases would have been greater.

It is equally implausible to conjure up any connection between restructuring and the transfer of the Redhawk plant from Pinnacle West Energy Corporation ("PWEC") to APS as claimed by AZCPA. That transfer took place in 2005, nearly three years after the ACC effectively cancelled and reversed the movement toward restructuring in the so-called "Track A" order and a year after *Phelps Dodge* had legally killed the movement. Again, as part of a settlement, APS agreed to a write-off to the PWEC assets sufficient to compensate APS customers for the early termination of a favorable (to APS) below-market PPA with PWEC. This reflected the depressed prices in the wholesale market in the years following the California energy crisis.

In short, Arizona's earlier steps toward restructuring did not lead to any price decreases for customers. However, those earlier steps did saddle APS customers with nearly $47 million in administrative costs incurred to prepare for restructuring—a sum it took many years to finally pay off.[68]

[68] Arizona Public Service Comments, at 14, 18, Attachment A, at 4, 13.

Restructuring Will Increase Risk for Customers

The proponents' of restructuring argue that restructuring will shift risk away from customers. As described below, this is simply not the case.

Restructuring Supporters' Claims	**Reality**
Restructuring will shift risk from customers to shareholders.	In fact, restructuring creates a new set of risks for customers. Likely in response to an early-restructuring wave of bankruptcies, the more recent data on independent power producers' investments in generation capacity show that they actually take on little risk at all, focusing their investments almost exclusively on natural gas and renewable generation backed by power purchase agreements. This dramatic departure from a balanced, portfolio approach to fuel diversity and long-term resource adequacy in generation increases the risk of reliability challenges, price volatility, and supply disruption for customers. In addition, restructuring introduces the risk of market manipulation and energy marketer abuses and business failures.

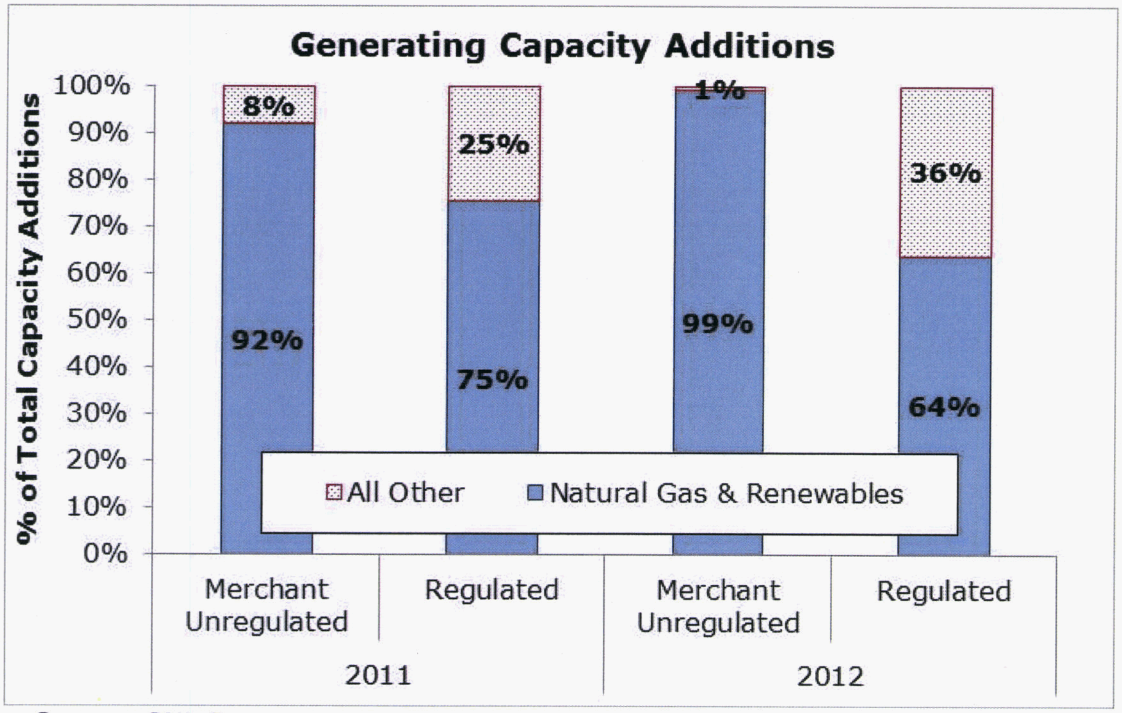
Proponents would have the Commission believe that restructuring will transfer risk from customers to electricity generators and retailers. The claim is that the cost of uneconomic investments or poor energy supply management will be borne by generation companies' and energy marketers' shareholders rather than customers.[69] They selectively omit the fact that restructuring will substantially increase other risks that customers face—risks of higher prices, weakened reliability, price volatility in the face of overreliance on natural gas, market manipulation, and energy marketer abuses and business failures.

Under a traditional regulatory model, utilities recover their prudently incurred operating costs and earn a return of and on prudently invested capital. This cost recovery model provides regulated utilities with a lower cost of capital than merchant generators and energy marketers who must compensate their investors for the greater risks inherent in restructured markets. It is electricity customers, though, who ultimately pay this higher cost of capital embedded in energy marketers' prices.

When merchant generators bear the risks associated with building new capacity, they are either reluctant to build new capacity at all or focus their development efforts exclusively on natural gas-fired capacity (or heavily subsidized renewables), which poses less risk to generation owners. This dynamic threatens resource adequacy and reliability (as

[69] Compete Coalition Comments, at 4; Wal-Mart Stores Comments, at 3 and 10; IO Data Centers, LLC, Comments, at 3.

discussed in more detail above) and exposes customers to the threat of much greater price volatility as wholesale energy prices are set by natural gas prices. The chart below highlights the extent to which merchant generators' investments have been dominated by natural gas and renewables and the much greater fuel diversity shown by regulated generation additions in the past two years. The fact that a recent analysis of new generation capacity additions found that only 22 percent of 2011 capacity additions owned by independent power producers were built without the backing of a long-term purchased power agreement ("PPA") with a regulated utility and that less than 5 percent of the capacity built by independent power producers lacked any PPA backing at all shows just how unwilling merchant generators are to actually take on any risk associated with building new generating capacity.[70]



Source: SNL Energy.

Restructuring would also put existing coal plants in Arizona at risk, despite the important role these plants play in providing a reliable source of supply at relatively stable prices. These plants are essential to provide a balanced portfolio and maintain fuel diversity.

Restructured markets undervalue these baseload plants' contribution to resource adequacy.[71] Moreover, because large baseload plants have high fixed costs and low operating costs, their owners' cost recovery is highly exposed to risk of fluctuations in dispatch by regional markets. In contrast, natural gas-fired generators have relatively low fixed costs and higher variable costs, which makes gas-fired generation less risky to build and to own. The higher risks faced by coal plants makes it difficult for generators in a

[70] Electric Market Reform Initiative and the American Public Power Association, *Power Plants Are Not Built on Spec: An Analysis of New Electric Generation Projects Constructed in 2011*, March 2012.
[71] Arizona Public Service Comments, at 2, and Attachment A, at 33.

restructured market to justify investing shareholder capital in upgrading existing coal plants where such investments would otherwise be economically justified even with more stringent environmental regulations.

Under the current regulatory model, Arizona utilities conduct long-term planning under the oversight of the Commission and invest in adequate generation resources to meet their customers' demands. The current model ensures that Arizona utilities have "steel in the ground" sufficient to keep the lights (and air conditioning) on for their customers. In contrast, some restructured states make no such requirements of their energy marketers who need not own a single megawatt of generation capacity to make promises to deliver power to customers.[72]

Restructuring also introduces the risk of manipulation and abuses on the part of energy market participants.[73] Electricity market participants have financial incentives to exert as much market power as is legally permissible. Yet, as multiple other commenters noted, wholesale energy and capacity markets remain subject to substantial market manipulation despite FERC's efforts.[74] Such market manipulation increases costs for customers, and the Commission would have no jurisdiction over such practices and would be dependent on the federal government to police generators and energy speculators.

One need look no further than current headlines to see the potential for market manipulation that harms customers. On July 30, 2013, the *Wall Street Journal* reported that the number one bank in terms of commodities trading revenue, J.P. Morgan, agreed to a $410 million settlement with the FERC regarding allegations that the bank manipulated energy markets in California and the Midwest.[75] Two weeks earlier, Reuters reported that FERC is pursuing a record fine of $453 million against Barclays for manipulation of western power markets. In response to that announcement, Senator Ron Wyden (D-OR) stated what has become a common refrain in restructured markets, "[c]onsumers have the right to heat and power their homes without fear that traders are stacking the deck against them to rack up unjust profits."[76] In another recent series of headlines, the Federal Reserve announced on July 19, 2013, that it is reviewing its precedent that let deposit-taking banks trade physical commodities following a series of complaints of market manipulation, and a *New York Times* story detailed allegations that Goldman Sachs has devised a scheme to exploit commodities exchange regulations to artificially inflate the price of aluminum, costing consumers billions of dollars.[77,78] In the face of these developments, regulators should seriously question the degree to which customers' electricity bills are exposed to the risk of market manipulation by financial traders in a restructured market.

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[72] See, e.g., the requirements for energy suppliers in Maryland (available at http://goo.gl/S14NoZ) and for retail energy providers in Texas (available at http://goo.gl/S2nMbx).
[73] Arizona Public Service Comments, at 14, Attachment A, at 8.
[74] See, e.g., the list of recent FERC orders imposing penalties and disgorgement of unjust profits compiled in Tucson Electric Power and UNS Electric Comments, at 11.
[75] Tracy, Ryan and Dan Fitzpatrick, "J.P. Morgan Settles Electricity-Market Case," *Wall Street Journal*, July 30, 2013.
[76] Sheppard, David, "U.S. regulator upholds record $453 million Barclays power-trade fine," *Reuters.com*, July 16, 2013.
[77] Ivry, Bob, "Fed Reviews Rule on Big Banks' Commodity Trades after Complaints," *Bloomberg*, July 20, 2013.
[78] Kocieniewski, David, "A Shuffle of Aluminum, But to Banks, Pure Gold," *New York Times*, July 20, 2013.

Finally, restructured states often find that their residential—particularly low-income and elderly—customers are the victims of unsavory marketing practices by retailers and financially unstable retailers who default on their supply obligations, raising costs for all customers.[79]

There have been numerous actions taken by state utility regulators and attorneys general against energy marketers. The table below summarizes a selection of such actions just against companies that are members of trade associations that filed comments in this proceeding.

Company	**Entity Submitting Comments in this Proceeding**	**Illustrative Complaints, Enforcement Actions, Settlements, etc.**
Direct Energy	Compete Coalition / Retail Energy Supply Association	Ontario Energy Board fined Direct Energy for a string of forged signatures on energy contracts.[80]
Energy Plus	Compete Coalition / Retail Energy Supply Association	Target of a class action lawsuit for allegedly perpetrating an illegal bait-and-switch scheme and defrauding thousands of New Jersey consumers of millions of dollars.[81] Connecticut Attorney General and Consumer Counsel petitioned the Public Utilities Regulatory Authority to investigate the marketing practices of Energy Plus, after customers claimed the company failed to adequately disclose energy rates.[82]

[79] For a compilation of complaints against energy marketers in restructured states, see the attachment to the AARP Comments, "An Analysis of Retail Electric and Natural Gas Competition: Recent Developments and Policy Implications for Low Income Consumers," Prepared by Barbara Alexander, June 2013, at 25-31.
[80] Spears, John, "Energy Marketers Fined over Forgeries," *Toronto Star*, June 21, 2003.
[81] "Sanford Wittels & Heisler File Class Action Against Energy Plus," Press Release, May 2, 2012.
[82] Dowling, Brian, "State Officials Call For Investigation Into Energy Plus Holdings," *The Hartford Courant*, July 27, 2012.

Company	Entity Submitting Comments in this Proceeding	Illustrative Complaints, Enforcement Actions, Settlements, etc.
Just Energy	Compete Coalition / Retail Energy Supply Association	Illinois Commerce Commission fined Just Energy in relation to deceptive sales and marketing practices and ordered an independent audit of the company's sales program.[83] Illinois Attorney General reached settlement with U.S. Energy Savings Corp. (now Just Energy) allowing hundreds of customers to terminate contracts and receive $1 million in restitution for misleading sales tactics.[84] New York Attorney General reached a settlement with U.S. Energy Savings Corp. (now Just Energy) requiring the company to waive hundreds of thousands of dollars in customer termination fees and pay $200,000 to the state.[85] Ontario Energy Board fined Ontario Energy Savings Corp. (now Just Energy) for a string of forged signatures on energy contracts.[86]
North American Power	Compete Coalition / Retail Energy Supply Association	Maryland Public Service Commission fined the company $100,000 for misleading advertisements and ordered the suspension of telemarketing activities in the state.[87]
TES Energy	Compete Coalition / Retail Energy Supply Association	Fined by Maryland Public Service Commission for brokering electric service without a license.[88]

[83] Illinois Commerce Commission, "Illinois Commerce Commission Fines Just Energy For Deceptive Sales and Marketing Practices, Orders Audit," Press Release, April, 15, 2010.
[84] "Madigan Secures $1 Million in Consumer Restitution from Alternative Gas Supplier for Deceptive Claims," Press Release, May 14, 2009.
[85] "Attorney General Cuomo Reaches Agreement With WNY Natural Gas Provider After Consumer Complaints," Press Release, November 10, 2009.
[86] Spears, John, "Energy Marketers Fined over Forgeries," *Toronto Star*, June 21, 2003.
[87] Cho, Hanah, "Electric Choice: Know Your Rights," *Baltimore Sun*, January 7, 2012.
[88] "License Briefs," EnergyChoiceMatters.com, April 14, 2011.

Restructuring Will Not Spur a Wave of Valuable Product & Service Innovation

The proponents' of restructuring advance two main points in support of their position that restructuring will spur a wave of valuable product and service innovation. As described below, this is simply not the case.

Restructuring Supporters' Claims	Reality
Restructuring spurs product and service innovation.	Arizona utilities work with the Commission to offer products and services and have earned national recognition for their innovation. The current regulatory model is successful in identifying and implementing new products and services that offer value to customers and can continue to do so.
Growth in demand response, dynamic pricing, and renewable generation under restructuring will have reliability, economic, and environmental benefits.	The current regulatory model already supports demand response, dynamic pricing, and renewable generation. Moreover, resource planning under the current regulatory model can take into account long-term reliability, economic, and environmental policies and goals in a way that the investment decisions of merchant generators focused on short-run profits do not.

Supporters emphasize product and service innovation allegedly spurred by restructuring.[89] Such innovations include multiple rate plan options (including time-varying rates enabled by smart meters), renewable energy supply, and value-added services (e.g., energy management and distributed generation). Proponents argue that restructuring will lead to growth in demand response capacity, dynamic pricing, and renewable generation, which will provide reliability, economic, and environmental benefits.[90] Contrary to these claims, Arizona utilities are already recognized leaders in innovation, and there is no reasonable expectation that restructuring would lead to more innovative products and services than the current regulatory model.

Restructuring supporters' claim that "[r]egulated utilities have very limited incentive to innovate and are slow to adopt new products, services and technology."[91] Here in Arizona, nothing could be further from the truth. APS is widely recognized for the innovation that it has undertaken under the oversight of the Commission. For example, in April 2012, APS was recognized as one of the top 10 electric utilities in North America for energy

[89] Entrust Energy Comments, at 3; National Energy Marketers Association Comments, at 3-4; Federal Trade Commission Comments, at 8, 10, and 18; Wal-Mart Stores Comments, at 4; Freeport-McMoRan Copper & Gold, Inc. and Arizonans for Electric Choice and Competition Comments, at 4; Retail Competition Advocates and Retail Energy Supply Association Comments, at 6, 12; NRG Energy Comments, at 3.
[90] See: Compete Coalition Comments, at 4; Wal-Mart Stores Comments, at 4; IO Data Centers Comments, at 3.
[91] National Energy Marketers Association Comments, at 3-4.

innovation according to GTM Research.[92] Also in 2012, APS was recognized as fourth among the top 25 intelligent utilities in the nation as part of the *Intelligent Utility* UtiliQ rankings.[93] The wide array of products and services already offered by APS—including demand response, prepaid, pick-a-due-date, equal payment, electronic billing and payment, totalized and combined billing, interruptible rates, time-of-day pricing, demand pricing, and dynamic pricing—illustrates the success APS has had in working with the Commission to develop innovative products and services for all of its customers. This success is even acknowledged by the FTC, though, inexplicably, it does not temper the agency's call for restructuring based on the need to foster innovation.[94]

Arizona utilities' exemplary record of innovation deploying precisely the demand response, dynamic pricing, and renewable generation that proponents argue require restructuring undermines the claim of economic, reliability, and environmental benefits from innovative products and services under restructuring. Moreover, resource planning under the current regulatory model can take into account long-term reliability, economic, and environmental policies and goals in a way that the investment decisions of merchant generators focused on short-run profits cannot. In fact, as discussed above, the evidence shows that, far from enjoying improved reliability, restructured states face serious concerns over reliability.

The current regulatory model in Arizona does not impede innovation and the introduction of new products and services. The Commission and Arizona utilities can work together with customers to introduce new innovative products and services. In particular, regulated utilities are able to launch new pilot programs to test and refine new products and services that hold significant promise for customers but that might not be offered by energy marketers given their necessarily short-term, profit-driven focus. Under the current regulatory model, the Commission would retain the discretion to ensure that innovative products and services are made available to broad groups of customers. To the extent that there are value-added products and services best left to unregulated suppliers, nothing in the current regulatory model prevents independent energy services companies ("ESCOs") from offering energy management, on-site generation, or other products and services to customers where there is a demand for them.

Given that Arizona customers already enjoy innovative products and services and that the current regulatory model can accommodate additional such options sought by the Commission, it becomes clear that the claim that restructuring will spur product and service

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[92] APS, "APS Recognized Among Top 10 Nationally for Energy Innovation," Press Release, April 26, 2012.

[93] Feblowitz, Jill and Kate Rowland, "2011 UtiliQ Rankings," *Intelligent Utility*, January/February 2012. According to the rankings, "[a]n intelligent utility is one that is productive, uses resources wisely, deploys information and technology to the best advantage, provides options to its customers, maintains reliability, and runs a sustainable business. The intelligent utility is steadfastly and thoughtfully re-aligning its objectives, business processes and technology to prepare for the future."

[94] Specifically, the FTC writes that: "Few utilities asked or were allowed to offer time-varying prices until the introduction of retail competition. (The prominent exceptions are those listed in the previous paragraph and the investor-owned utilities in California and Florida.)" Those "prominent exceptions" are APS and the Salt River Project, with the FTC explaining that: "Arizona is in the enviable position of already having active dynamic pricing programs that have attracted customers in areas served by Arizona Public Service and the Salt River Project." Federal Trade Commission Comments, at 8-9.

innovation is merely a pretext for the proponents' primary goal—i.e., lower costs for a select few customers and cost-shifting to residential and small commercial customers.

Experience in Other Jurisdictions and Industries Does Not Show that Restructuring Would Provide Benefits for Arizona

The proponents' of restructuring advance four main points in support of their position that restructuring has worked well in other jurisdictions and will deliver benefits for Arizona. As described below, this is simply not the case.

Restructuring Supporters' Claims	**Reality**
Deregulation in other industries has worked well, indicating that restructuring the electricity industry in Arizona would yield similar benefits.	Irrespective of the actual track record of deregulation in other industries, the unique complexities of the electricity industry render the experience in other industries irrelevant. Rather, the Commission should look to the actual experience in other states with electricity restructuring and note the lack of economic benefits or increased innovation and the widespread concerns among policymakers about reliability.
States like Texas offer models of successful restructuring.	Not only do restructured states fail to offer evidence of lower prices or more innovative products and services, but policymakers in several restructured states have serious concerns about the ability of restructured markets to provide for reliability, and several states have taken steps to re-regulate generation.
Market manipulation and other abuses can be adequately addressed via federal and state oversight.	The recent cases of record settlements against financial speculators for energy market manipulation and the litany of settlements and fines against energy marketers show that market manipulation and other abuses are real and substantial threats to customers in restructured states.
Restructuring has created jobs in other states and would do the same in Arizona.	Any new call center or sales jobs created by energy marketers would be far outweighed by the drag that higher prices and weakened reliability would put on the Arizona economy. Restructuring threatens the future of the Four Corners and Navajo Generating Station coal-fired power plants, and their closures would lead to large job losses in local communities, the coal industry, and particularly among the Navajo Nation.

Proponents point to the deregulation of industries other than electric power as evidence that restructuring is appropriate for Arizona's electricity industry.[95] They also portray electricity industry restructuring as having succeeded in producing benefits for customers in other states.[96] Specifically, several proponents of restructuring hold up the experience of Texas with restructuring as a model for the Commission to replicate in Arizona.[97] Advocates maintain that market manipulation and other abuses are easily avoided via oversight.[98] Lastly, supporters claim that restructuring has created jobs in other states and would do the same in Arizona.[99]

As discussed in more detail below, restructuring proponents' assertions do not withstand scrutiny. The unique complexity of the electricity industry renders the experience with deregulation in other industries irrelevant. The states held up as models of success (e.g., Texas) actually have serious reliability concerns and no convincing evidence of economic benefits from restructuring. Recent record fines for market manipulation and the long list of retail market abuses prove that those are real threats to customers. Finally, claims of economic and employment gains from restructuring ignore the drag that higher prices, weakened reliability, and coal plant closures would have on the Arizona economy under restructuring.

It is beyond the scope of this docket to evaluate the extent to which deregulation has or has not worked well for other industries (e.g., telecommunications), but the success or failure of deregulation in those other industries is irrelevant. The key fact is that the electric industry is unlike any other both in terms of its complexity—e.g., the need to constantly balance supply and demand across the grid on a moment-by-moment basis—and in terms of the critical, even life-and-death, role that electricity plays in the economy and customers' lives. The only relevant precedent for what Arizona would face under restructuring is the experience of those states that have already gone down that path. As detailed elsewhere in these comments, those states have not seen lower prices or more valuable innovation than Arizona already enjoys, and restructuring has led to serious concerns about reliability and increased risk to customers. As discussed above, policymakers in several restructured states have taken steps to re-regulate their electricity industries by re-inserting themselves into the resource planning function and circumventing organized markets to try to ensure adequate capacity is built where and when it is needed. Such re-regulation is not indicative of restructuring success.

In fact, Texas—held up as a model of successful restructuring by proponents—is actually the state with the most acute reliability concerns because of the failure of its

[95] See Wal-Mart Stores Comments, at 4-5; Ambit Holdings, LLC, Comments, at 1; The Goldwater Institute and Roy Miller Comments, Exhibit 1, at 2.
[96] See, e.g., Compete Coalition Comments, at 9.
[97] See The Goldwater Institute and Roy Miller Comments, at 12; Wal-Mart Stores Comments, at 8; Federal Trade Commission Comments, at 19.
[98] See Compete Coalition Comments, at 5; National Energy Marketers Association, at 4-5; NRG Energy Comments, at 5; Freeport-McMoRan Copper & Gold, Inc. and Arizonans for Electric Choice and Competition Comments, at 6; Arizona Independent Scheduling Administrator's Association Comments, at 4; The Goldwater Institute and Roy Miller Comments, at 7; Retail Competition Advocates and Retail Energy Supply Association Comments, at 21.
[99] See Entrust Energy Comments, at 2; Retail Competition Advocates and Retail Energy Supply Association Comments, at 10.

electricity market construct to incent adequate investment in new generation capacity. Moreover, as other commenters pointed out, the evidence from Texas also shows that the customers subject to restructuring in Texas have experienced higher and more volatile prices than customers of municipal and public utilities in Texas not subject to restructuring.[100]

Finally, proponents' argument that restructuring will create jobs rests upon faulty logic and a glaring omission. First, no doubt energy marketers will hire sales and operations staff, perhaps some of them from Arizona, but the most important economic impact is the effect of restructuring on the reliability of supply and electricity prices. As already shown above, proponents do not present convincing evidence that restructuring has lowered prices; in fact, electricity price data show larger increases in electricity prices for restructured states.[101] Higher electricity prices under restructuring would be a significant drag on Arizona's economy now and in the future. If households and businesses have to pay more for their energy, they will cut back on spending, investment, and employment—far more than offsetting the economic impact of hiring that energy marketers might undertake. Second, the glaring omission is the deleterious impact that restructuring would have on Arizona's coal industry jobs.[102] As explained in APS's and SRP's initial comments, restructuring would put at risk required investments in and the continued operation of the Four Corners and Navajo Generating Station coal-fired power plants.[103] The loss of these plants would lead to large job losses at the plants and coal mines and impact the many Arizonans who supply or otherwise benefit from the coal industry. The local communities whose economies and tax bases depend in large part on these plants would suffer, and the Navajo Nation would be especially devastated.[104]

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[100] See: Salt River Project Comments, Position Paper: Responses to the Eighteen Questions, at 2-3; AARP Comments, at 21; City of Mesa Energy Resources Comments, at 1; Tucson Electric Power and UNS Electric Comments, at 5.
[101] Arizona Public Service Comments Attachment A, at 23.
[102] In fact, the Arizona Competitive Power Alliance celebrates the deleterious impact that restructuring would have on these coal plants and the resultant economic harm, writing that: "APS's reluctance to buy the Four Corners plant in a competitive environment is not a bug of retail electric competition, it's a feature." See, Comments of the Arizona Competitive Power Alliance, at 2.
[103] Salt River Project Comments, Cover Letter, at 2-3; Arizona Public Service Company Comments, Cover Letter, at 2.
[104] The Navajo Nation Comments, at 1.

Implementation of Restructuring in Arizona Would Be Complex, Lengthy, Contentious, and Expensive

The proponents of restructuring ignore the complex, time-consuming, contentious, and costly nature of pursuing restructuring in Arizona.

Restructuring Supporters' Claims	Reality
It would be a relatively smooth process to transition to restructuring because of the existence of the Arizona Independent Scheduling Administrator.	The role of the AZISA was purposefully designed to be limited in scope and will not support restructuring. Every restructured jurisdiction (except for a small portion of northern Maine) has had to join a large-scale RTO, with complex energy markets (both day-ahead and real-time) and financial transmission rights. The same would be true for Arizona.
Restructuring is not at odds with the significant presence of non-investor owned utilities in Arizona.	Since the Commission lacks the authority to compel Arizona utilities outside of its jurisdiction to participate in restructuring, pursuing restructuring could create a complex patchwork since no utility is likely to opt-in to restructuring given its dubious benefits and likely risks. In fact, state legislation would be required to compel non-jurisdictional utilities to participate in restructuring.
The *Phelps Dodge* decision does not present a significant legal obstacle to restructuring.	The *Phelps Dodge* decision presents significant and likely insurmountable obstacles to even a partial restructuring of the industry covering only certain customers. The requirements that the Commission and not the market set just and reasonable rates and that those rates consider in some meaningful way the fair value of the provider's assets are part of Arizona's Constitution. They cannot be waived or ignored by the Commission or even modified by statute. Even the Commission's own Staff has expressed concerns over the viability of the Electric Competition Rules in the aftermath of *Phelps Dodge*. The proponents of restructuring were dead wrong on their interpretation of Arizona law 10 years ago, and there is every reason to believe they are wrong today. Moreover, *Phelps Dodge* did not address issues of rate discrimination and rate transparency that would be likely sources of litigation even should *Phelps Dodge* be ignored, explained, or, rather, wished away—as urged by proponents of restructuring.

Supporters of restructuring in Arizona contend that it would be a relatively smooth process because of the existence of the AZISA and the protocols that support the AZISA's operations.[105] Other supporters argue that "[t]here is nothing inherently incompatible between retail competition and the presence of other types of power entities [e.g. public power entities, coops, and federal power districts]." [106] Finally, proponents of restructuring argue that "the *Phelps Dodge* decision does not affect the Commission's authority to move forward towards to [sic] re-establish a plan to implement electric Competition, and as such rules authorizing such implementation are still in effect."[107]

While the proponents of restructuring have painted a relatively smooth, quick, and inexpensive picture of the path to a restructured marketplace in Arizona, as APS discussed in its Initial Comments, the steps necessary to establish an organized wholesale market and retail access for electricity in Arizona would be anything but easy.[108] In particular, the creation of an RTO to operate a restructured electricity system in Arizona would take roughly five years and cost hundreds of millions of dollars.[109]

<u>The Role of AZISA and the Need for an RTO/ISO</u>

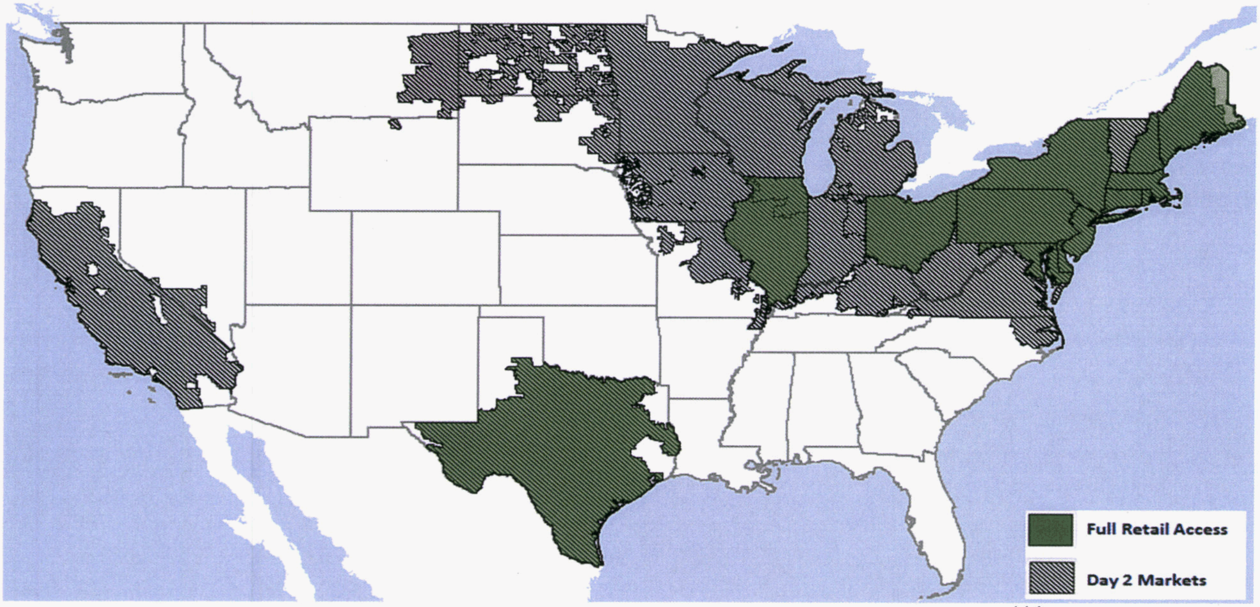
As a preliminary matter, the role of the AZISA was purposefully designed to be limited in scope. In fact, FERC approved only the first phase of the AZISA's operations in order to encourage transmission-owning utilities under its jurisdiction to join in a larger regional RTO.[110] As part of the initial Order approving the establishment of Phase I operations of the AZISA, the FERC specifically stated that:

> "The AZ ISA emphasizes that the AZ ISA Tariff is not intended to create any precedent for any regional transmission organization which may be formed that includes Arizona parties and transmission facilities."[111] Even after the Desert Star ISO had become defunct, the FERC, in an Order extending the term of the AZISA's operations, noted that "...we will accept the AZ ISA's proposed amendment to extend this temporary allocation mechanism until the earlier of the termination of services under the AZ ISA Tariff or the operational date of a Regional Transmission Organization that serves the retail load in the service territories to which the Protocols Manual applies."[112]

The fact is that the AZISA does not run an energy market, and APS and Tucson Electric use their FERC *pro forma* transmission tariffs, with support from the AZISA for a limited subset of market functions (e.g. dispute resolution), to manage their own respective transmission facilities. Only one small jurisdiction, the northern Maine control area, currently supports full retail restructuring, without joining an RTO, and this remote area is electrically part of Canada and is interconnected with the Canadian Maritimes transmission

[105] See: Compete Coalition Comments, at 7; National Energy Marketers Association Comments, at 5; Freeport-McMoRan Copper & Gold, Inc. and Arizonans for Electric Choice and Competition Comments, at 7; Arizona Independent Scheduling Administrator's Association Comments, at 2 and 5.
[106] Federal Trade Commission Comments, at 22.
[107] Retail Competition Advocates and the Retail Energy Supply Association Comments, at 33.
[108] Arizona Public Service Comments, at 12-18, Attachment A, at 9-10, 12-14, 20-21, 26-28.
[109] Arizona Public Service Comments, at 13 and 17, Attachment A, at 10.
[110] Arizona Independent Scheduling Administrator Association, et al., 93 FERC ¶ 61,231 (2000) (November 30, 2000 Order), at 3.
[111] Id.
[112] Arizona Independent Scheduling Administrator Association, 99 FERC ¶ 61,038 (2002) (April 11, 2002 Order), at 5.

system.[113] All other markets with full retail access also operate in "Day 2" wholesale markets, which are characterized by centralized energy markets and the use of locational marginal pricing for energy, transmission access and congestion-management. These FERC jurisdictional markets are operated by large-scale RTOs or ISOs.



Source: Compete Coalition; Ventyx Velocity Suite; The NorthBridge Group[114]

The fact that the vast majority of states that have implemented full retail restructuring are members of Day 2 wholesale markets supports APS's position that the elements of Day 2 markets (i.e., day-ahead and real-time energy markets and financial transmission rights) are prerequisites to retail restructuring. Without those central energy markets in place (and the balancing resources that are provided by those markets), a retail energy provider would have to self-schedule an extremely accurate amount of electricity to flow on the correctly pre-reserved transmission path at the correct hour, to meet the demands of its customers, to avoid penalties under the *pro forma* tariff, and to avoid placing an undue burden on the grid operator or incumbent utilities.

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[113] Interestingly, similar to the cases of reliability issues in Maryland and New Jersey, retail restructuring has also raised serious reliability issues in northern Maine. Representative Stacey Fitts (R-Pittsfield) noted that "Northern Maine faces a serious economic blow and potentially significant electricity supply problems based on a recent decision by the Maine Public Utilities Commission (PUC) [which] has awarded a contract to New Brunswick Power to supply the standard offer, or default electricity supply service . . . While New Brunswick Power's bid may have been the lowest, the contract award has negative implication for the northern Maine economy and the reliability of the electrical grid. By choosing a foreign energy supplier, the PUC's award strands a critical local generating facility in Fort Fairfield [biomass plant]. That plant will be forced to close in March . . . The PUC is right to be concerned about the costs of electricity. But the lowest bid is not always the best deal for the people of Maine. The PUC should consider the job losses and other economic implications of shutting down a local, renewable industry in order to buy power from a foreign utility." See, "New power deal poses risks for northern Maine", Rep. Stacey Fitts, February 26, 2009, http://www.maine.gov/legis/house_gop/opinion/fitts_nmepower.htm

[114] Retail access designations are from the Compete Coalition. Market footprints and designations are from Ventyx and Northbridge, respectively.

Perhaps most importantly, the AZISA is currently only authorized to coordinate the scheduling of 280 MW of transfer capability across the APS and Tucson Electric Power transmission systems.[115] Any increase in that amount (or expansion of transmission system coverage) would require reauthorization by FERC of the increased amounts and modification of both the AZISA and the transmission owners' open access transmission tariffs ("OATTs"), also before the FERC. Such a process is unlikely to be smooth, quick, or inexpensive—particularly given FERC's previously stated desire for creation of a western RTO.

The challenges above raise the question of whether Arizona might join the California Independent System Operator ("CAISO"). Such an approach may have cursory appeal since it avoids having to create a new RTO and transmission access already exists between Arizona and the CAISO. However, joining the CAISO would prove highly disadvantageous to Arizona. Arizona would cede control of its electricity grid and energy marketplace to California—a state whose policies and politics are not always in concert with those of Arizona. In particular, Arizona consumers would face higher costs due to California's aggressive mandates related to greenhouse gas emissions and renewable energy. The latest data from the U.S. Energy Information Administration show that California residential customers pay prices that are nearly 32 percent higher than in Arizona.[116]

Public Power, Coops, and Federal Power Districts

Is the existence of public power entities, coops, and federal power districts compatible with restructuring? Without the participation of large portions of the load-serving utility industry in Arizona, it is highly unlikely that the hypothetical benefits and certain risks of restructuring would be equitably spread among retail customers. Regardless of whether those entities can operate independently in parallel to a restructuring process, the real question should be whether it is possible to implement restructuring without unfairly benefiting entities that are allowed to opt out of it. Clearly, because the Commission does not have jurisdiction to compel a large portion of Arizona customers to take restructured retail service, it would be nearly impossible for the Commission to equitably restructure the electric industry on its own. For that reason alone, the move to restructure retail access in Arizona is virtually guaranteed to be contentious, time-consuming, and costly.

Phelps Dodge

The final added complication is the issue of the *Phelps Dodge* decision, which is unique to the Arizona situation. While the proponents of retail restructuring may like to believe that *Phelps Dodge* did not invalidate the Commission's Competition Rules, that is clearly not the case. *Phelps Dodge* identified fundamental Constitutional issues with the entire concept of competitively established electric rates, finding that it is the Commission's non-delegable duty to set just and reasonable rates for providers of electric service using in some meaningful way the fair value of the provider's assets.

[115] Arizona Independent Scheduling Administrator Association, 99 FERC ¶ 61,038 (2002) (April 11, 2002 Order), at 2.
[116] U.S. Energy Information Administration, *Electric Power Monthly*, Table 5.6.A. Average Retail Price of Electricity to Ultimate Customers by End-Use Sector, May 2013.

Even on a procedural basis, the original rulemaking proceedings are now over 15 years old and the record hopelessly stale. As noted in APS's Initial Comments, Commission Staff believes that the rules are significantly impaired by virtue of the uncertainty surrounding their application.[117] APS believes that, while proponents would like to convince the Commission that the existing Competition Rules will provide a sufficient basis to implement restructuring, the Commission should understand that the reality is likely to be far more complicated. As currently established in Arizona, the Commission's rules will need to be significantly revamped to bring those rules up to date to the current state of electricity markets.

Substantively, there is no way around *Phelps Dodge's* holdings on competitively set rates (unlawful), forced divestiture (unlawful) and forced participation in an AZISA, let alone an RTO (unlawful). These are not problems to be solved with more artful drafting or a more fulsome record, but rather represent fundamental inconsistencies between the type of electric regulation required by Arizona's Constitution and that non-regulation urged by proponents of restructuring. And whatever the Commission does, there is certain to be litigation if the Commission moves forward with any manner of industry restructuring that is inconsistent with the current regulatory structure.

V. Conclusions

APS respectfully requests that the Commission bring an expedient halt to this inquiry before expending more resources on an effort to restructure Arizona's electricity market. Arizona went down this path in the late 1990s and rightfully applied the brakes after the California Energy Crisis spilled over to several neighboring states, including Arizona. History has borne out the wisdom of that decision to halt restructuring. As clearly shown above, those states that did restructure suffer from impending reliability crises, loss of local control over critical industry policymaking, overreliance on natural gas-fired generation, never-ending litigation before FERC and in the courts over market rules, the need for policymakers to re-regulate the industry by re-injecting themselves into resource planning to avoid adverse outcomes, and market manipulation and abuses, particularly by financial speculators. And to what end? APS's national recognition for innovation leadership convincingly suggests that energy marketers will not surpass Arizona utilities' record delivering product and service choice and innovation. Data from J.D. Power show that APS customers are more satisfied than any customers of energy marketers surveyed.

There is also no convincing evidence that restructuring has led to lower prices for a majority of customers. Under restructuring certain large C&I customers may enjoy energy cost savings. However, any such savings would mostly, if not entirely, come from the ability of those customers to extricate themselves from the carefully constructed cost allocation system overseen by the Commission to fairly share the costs of providing electricity service across and within customer classes. In short, a clear-sighted appraisal of restructuring proponents' arguments will find them lacking merit.

APS reiterates its conclusions from its Initial Comments and notes, in light of the comments submitted by advocates of restructuring, that:

[117] Arizona Public Service Comments, at 16.

- Restructuring may threaten the reliability of supply to Arizona's customers and require the Commission to re-regulate at some point in the future if the experience of other restructured states is repeated in Arizona.
- The current regulatory model in Arizona is working well to provide safe, reliable, affordable electricity service and to foster nationally recognized leadership in delivering innovative products and services and high rates of customer satisfaction. The current state of affairs suggests that industry restructuring is a solution in search of a problem.
- The actual experience of restructured states has provided no convincing evidence for economic benefits to customers as a whole.
- IRP as practiced today in Arizona promotes resource adequacy, fuel diversity, Arizona energy policy, and the long-term interests of customers. Such planning is impossible under restructuring, and generation investments will be driven solely by the relatively short-term, profit-driven decisions of firms without the Commission oversight and public input and dialogue that are critical parts of current resource planning.
- Contrary to claims that it will shift risk to generators and energy marketers, restructuring dramatically increases the overall risks faced by customers—risks from higher energy costs, price volatility, worsened reliability, undermined fuel diversity, and market manipulation and abuses.
- The Commission, APS, and other Arizona utilities have already demonstrated that the current regulatory model can successfully foster the development of new products and services of value to customers and navigate the uncertainties of a changing industry landscape.
- Arizona started down the path toward restructuring once before and learned the hard way that it is a complex, expensive, and controversial process that consumes the time and resources of all industry stakeholders—and that was before the *Phelps Dodge* decision made the legal issues much more difficult to resolve.
- Since the Commission decided to abandon restructuring in 2002, the states that did pursue restructuring have had another 11 years to refine their market structures, but still they struggle to create organized electricity markets and retail choice programs that actually deliver benefits to customers.
- The Commission, Arizona utilities, customers, and other stakeholders should focus their efforts on addressing the key issues facing us today—e.g., looming environmental regulations, grid modernization, fuel market dynamics, and the growth of non-traditional resources such as distributed generation—rather than once again pursuing an industry fad from the 1990s.

Advocates have failed to present credible and concrete evidence that restructuring offers any likely benefits for Arizona. Some of the "benefits" touted by advocates of restructuring, such as innovation and customer satisfaction, are in fact already enjoyed by Arizonans today under the traditional regulatory structure and without the risk and cost that accompanies restructuring. As APS and others have convincingly shown, restructured states clearly suffer from substantial challenges under their ever-changing and flawed market structures. APS reiterates its recommendations that the Commission should: (1) find that deregulation is against the public interest; (2) retain its jurisdiction over the generation and resource actions of Arizona's regulated electric utilities; and (3) vote in Step One to close this Docket, and no longer devote its and other stakeholders' resources to the consideration of electric restructuring.

Should Arizona restructure its electricity industry? The obvious answer is no.