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BEFORE THE ARIZONA CORPORATION COMMISSION

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8 IN THE MATTER OF THE COMMISSION'S  
9 INQUIRY INTO RETAIL ELECTRIC  
10 COMPETITION.

Docket No. E-00000W-13-0135

**RUCO'S COMMENTS TO COMMISSION'S INQUIRY**

11 The Residential Utility Consumer Office ("RUCO") hereby offers the following

12 comments in response to the Commission's inquiry into electric competition in Arizona.

13 RUCO appreciates the Commission's inquiry into this subject and looks forward to

14 participating in the process. Undoubtedly this subject is very complex, and similar to the

15 Commission, RUCO is in the process of researching the subject. This research is intensive

16 and ongoing. One certainty is abundantly clear however, the answers to the questions

17 below are dependent on the countless policy details that will ultimately guide the transition,

18 form the market structure, and finally govern the market. As such, answering the

19 questions below is mainly a theoretical exercise. With the residential ratepayer our upmost

20 concern, obtaining these details is crucial to RUCO's assessment of electric competition in

21 Arizona. Since the investigation of this subject matter is disruptive in nature to a segment

22 of businesses and communities in Arizona, RUCO would appreciate seeing a

23

24

1 comprehensive proposal put forward by the supporting parties as soon as possible and  
2 certainly before our workshop on the matter.

3  
4 Additionally, RUCO has a list of questions it would like to see get answered by  
5 participates in the docket. The questions are listed at the conclusion of our responses  
6 below. Finally, as noted, RUCO will be holding a full day workshop on this matter on  
7 **August 27<sup>th</sup>.**

8 RUCO reserves the right to modify any answers provided below:

- 9  
10 **1) Will retail electric competition reduce rates for all classes of customers  
11 – residential, small business, large business and industrial classes?**

12 In general, competition can reduce rates for market participates with sufficient  
13 bargaining power. RUCO believes that it might be possible to create a competitive electric  
14 market that bestows each customer class with sufficient market power to realize lower  
15 rates. However, RUCO also believes that it is important to assess possible savings under  
16 various time horizons and market conditions. Retail competition might save customers  
17 money now because natural gas prices are low; however, it could expose customers to  
18 price shocks if that situation ever changes.

- 19 **2) In addition to the possibility of reduced rates, identify any and all  
20 specific benefits of retail electric competition for each customer class.**

21 A focus on customer service, more consumer choice, rate offerings that align with  
22 the myriad of household lifestyles, lack of a monopoly utility with outsized political and  
23 market power.  
24

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

3               RUCO is not aware of a way that competition would result in the equal application of  
4 benefits in the absence of rules and/or regulation to at least some degree. By its nature,  
5 the purpose of competition is to provide choice, not necessarily equal benefits. As noted in  
6 response to question one, smart implementation and market design is needed to ensure  
7 that each customer class has sufficient bargaining power. Moreover, strong safeguards  
8 would need to be in place to shield certain customer classes from market excesses and  
9 deficiencies.

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

13               To start: market manipulation, lack of regulatory control, "slamming" and  
14 "cramming", consumer inertia, price gouging, naked exposure to pricing fluctuations,  
15 confused consumers, loss of sovereignty around in-state assets, reliability issues.

16               At this point in our research, RUCO believes that the default service/provider of last resort  
17 ('POLR') could be based on specific regions in the state. At first it would be the distribution  
18 utility then possibly a bid structure which replaces the incumbents. After that, RUCO could  
19 see a default service with residential customers equally spread among market participates.

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

23               The Commission cannot guarantee that zero abuses will take place. But Arizona  
24 could learn from other states and be thoughtful when designing the market to minimize  
these occurrences.

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

- 5 • Stringent licensing standards
- 6 • Grid operator
- 7 • Features to break down incumbent market power
- 8 • Performance based regulation of transmission and distribution monopolies
- 9 • Narrow payment of stranded cost and a smart allocation of those stranded costs.
- 10 • A default service rate that shields from fuel spikes
- 11 • Sensible switching fees and timelines
- 12 • Comprehensive website to show pricing and facilitate market transactions
- 13 • Consumer education campaign
- 14 • Standardized labeling
- 15 • Smart aggregation policies

16 RUCO is not sure as to the timeline. It could take three years to implement key features  
17 and around seven plus years to realize a fully functioning market.

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

21 Yes, there should be full divestiture. Also, the incumbents' spin offs may only be  
22 allowed a specific percentage of market. Safeguards would have to be in place to avoid  
23 collusion between the new generation side and wires side of the business.

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

The payment for stranded assets, the establishment of a grid operator, consumer  
tools/ education, and additional state employees tasked with consumer protection efforts  
will surely be expensive. Research should be done to obtain the transition cost per meter.  
Energy suppliers and industrial customers should bear most of these costs.

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

2 Yes, improper market structure can reduce reserve margins and overly zealous cost  
3 savings measure can reduce system quality and long-term reliability. Moreover, the  
4 transmission system might be utilized more intensively while transmission investments  
5 could be cut back due to the market uncertainties that a competitive market brings. The  
6 Texas market is a prime example of a market structure that does not encourage  
7 investment in new generation. In fact, in an effort to improve the situation ERCOT pays  
8 generators around \$5,000 per MWh (or \$5 per kWh) during the summer peak. Although  
9 that rate is paid out on a limited basis, it is 20 times higher than any peak rate in Arizona.

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

13 One issue is Arizona losing control over in-state assets. Some suggest joining  
14 California's ISO others propose an Arizona only ISO. Even with an Arizona only ISO it  
15 would be governed by an unelected board and looked after by FERC. Other issues pertain  
16 to how Arizona facilitates transmission upgrades, minimizes pancaking, and prevents  
17 pricing distortions in transmission constrained areas.

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

21 In our current state of research we see no model to fully emulate. PJM has perhaps  
22 the most developed capacity and ancillary market. Texas has a high rate of participation  
23 but a suboptimal investment environment. Each market we researched thus far has its  
24 benefits and short comings.

1 12) How have retail rates been affected in states that have implemented  
2 retail electric competition?

3 Studies are inconclusive; some suggest they have gone down, others claim just the  
4 opposite. That said, RUCO is still in the process of investigating the design and outcome of  
5 different state markets that have undertaken electric competition.

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

11 Without a proposal, it is difficult, if not impossible to provide a complete legal  
12 analysis of whether retail electric competition is viable in Arizona. It is certainly less  
13 clear given the Arizona Court of Appeals Decision in *Phelps Dodge v. AEPCO*, 207 Ariz.  
14 95, 83 P.3d 573, (App. 2004)(review denied). In addressing the degree to which market  
15 forces can be the basis for utility rates, the Arizona Court of Appeals concluded in the  
16 *Phelps* case:

17 Although the Commission may be influenced by market forces in  
18 determining what rates are "just and reasonable," the Commission  
19 may not abdicate its constitutional responsibility to set just and  
20 reasonable rates by allowing competitive market forces alone to  
21 do so.

22 *Phelps Dodge v. AEPCO*, 207 Ariz. 95, 107, pp. 32, 83 P.3d 573, 585 (App. 2004).  
23 Certainly, an argument can be made that such a rate-setting approach is prohibited in  
24 Arizona. (Arizona Const. Art. XV, § 3 requires the Commission to set "just and  
reasonable" rates.) RUCO believes that at the very least, the *Phelps* case would be legal

1 precedent for an appeal should the Commission transition to and/or implement retail  
2 competition.

3  
4 **14) Is retail electric competition compatible with the Commission's**  
5 **Renewable Energy Standard that requires Arizona's utilities serve at**  
6 **least 15% of their retail loads with renewable energy by 2025? (See**  
7 **A.A.C. R14-2-1801 et seq.)**

8 Yes. It is compatible because the REST is based on renewable energy credits  
9 ("RECs"). Similar to Eastern states, a REC market would be developed and parties would  
10 transact in that process enabling the market to find an equilibrium for price. With or without  
11 restructuring the Commission should consider setting up an online REC market.

12 **15) Is retail electric competition compatible with the Commission's Energy**  
13 **Efficiency Standard that requires Arizona's electric utilities to achieve a**  
14 **22% reduction in retail energy sales by consumption by 2020? (See**  
15 **A.A.C. R14-2-2401 et seq.)**

16 Yes, it is compatible. In many states with retail electric competition, the transmission  
17 and distribution companies (the "wires" companies) assume the responsibility of delivering  
18 energy efficiency services. However, another model could be considered whereby energy  
19 efficiency services would be consolidated for delivery via one single entity - an "energy  
20 efficiency utility." This model has been successful in the state of Vermont (via Efficiency  
21 Vermont). New York and Oregon have also consolidated energy efficiency service delivery  
22 via NYSERDA and the Energy Trust of Oregon, respectively, though energy efficiency  
23 programs are also offered by utility companies in both of these states. This model has the  
24 potential to be more administratively efficient. It also removes the responsibility for energy  
efficiency investment from local utilities and places it with a different entity that does not  
have the same disincentives as local utilities for pursuing energy efficiency. RUCO is not

1 necessarily endorsing this approach over another, rather we are suggesting being creative  
2 and aligning market incentives to encourage cost effective energy efficiency.

3  
4 **16) How should the Commission address net metering rates in a  
competitive market?**

5  
6 Retail net metering could continue to exist and work similar as to today. Ultimately,  
7 the method of accounting depends on the market's structure and the arrangement  
8 between the distribution company and energy suppliers. If the system is setup in such a  
9 way where there are hundreds of retail electric providers, a statewide policy may be  
10 needed to guide the range of the retail rate offset. Finally, care must be given to the  
11 thousands of existing solar customers. This could perhaps be done in the default service  
12 rate.

13 **17) What impact will retail electric competition have on resource planning?**

14  
15 To a large degree, price signals will guide resource planning, not the Commission.  
16 The Commission can put in pricing mechanisms to encourage certain forms of generation  
17 and to some extent provide guidance on the resource portfolio behind the POLR or the  
18 transitory standard offer rate.

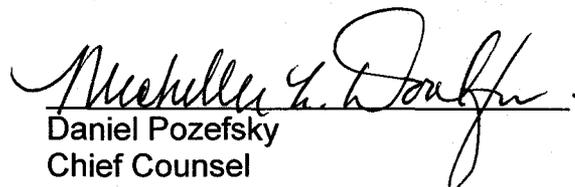
19 **18) How will retail electric competition affect public power utilities,  
20 cooperatives and federal controlled transmission systems?**

21 RUCO anticipates that cooperatives as well as SRP would be included in the new  
22 competitive market.  
23  
24

1 **RUCO's Questions:**

- 2 1. Would Arizona have to establish its own ISO? If so, what would be an estimate of  
3 the cost? How would this entity interact with other markets? How long would it take  
4 to get established?
- 5 2. What would be the benefits and disadvantages of joining the California ISO?
- 6 3. Are there transmission constrained areas in Arizona that could give certain  
7 generators oversized locational market power?
- 8 4. How could the state guard against the pivotal supplier problem, strategic bidding,  
9 and capacity withholding?
- 10 5. Could Arizona dictate that a residential default service rate be offered by  
11 competitive suppliers at a capped amount? If so, what happens if market prices  
12 increase above the cost to provide the service?
- 13 6. Would it be possible to set the default service rate at 10% less than the current  
14 average residential rate with the only increases pegged to inflation? Also, could  
15 Arizona have every market participant with greater than 5% market share be  
16 allocated some default service customers after an appropriate transition period?
- 17 7. Are incumbent utilities legally required to receive 100% of their stranded costs?  
18 Does the price of natural gas influence the stranded cost calculation? What are  
19 some different methodologies for calculating stranded costs?
- 20 8. Can Arizona get more customer choice within its existing framework? Could we  
21 form new rate designs to fit different customer preferences? Should we introduce  
22 more performance based regulation?
- 23 9. Is the AG-1 rate a success? Should it be expanded?
- 24 10. Under electric competition, will the cost of natural gas more significantly impact  
rates than under the current system?
11. What will happen to APS's share in Palo Verde under different competition designs?  
What will happen to the majority of TEP's coal plants?

RESPECTFULLY SUBMITTED this 15th day of July, 2013.

  
Daniel Pozefsky  
Chief Counsel

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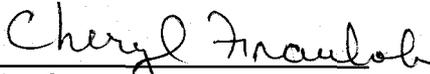
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