

MEMORANDUM

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FROM: Steven M. Olea
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DATE: August 12, 2010

RE: STAFF REPORT FOR GENERIC PROCEEDINGS CONCERNING ELECTRIC
RESTRUCTURING ISSUES (DOCKET NO. E-00000A-02-0051 AND E-00000A-
01-0630)

Attached is the Staff Report for the Generic Proceedings Concerning Electric Restructuring Issues including Staff's recommendation as to whether or not retail competition should be implemented in Arizona and if so, how such implementation should proceed. Pursuant to Decision No. 70485 (Docket No. E-03964A-06-0168) this report is being filed in consolidated Docket Nos. E-00000A-02-0051 and E-00000A-01-0630.

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

GENERIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING ISSUES

DOCKET NOS. E-00000A-02-0051 AND E-00000A-01-0630

AUGUST 12, 2010

STAFF ACKNOWLEDGMENT

The Staff Report for the Generic Proceedings Concerning Electric Restructuring Issues, Docket Nos. E-00000A-02-0051 and E-00000A-01-0630, was the responsibility of the Staff member listed below.

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I. BACKGROUND

On May 20, 1994, the Arizona Corporation Commission (“ACC” or “Commission”) opened Docket No. U-0000-94-165 to investigate the introduction of retail electric competition in Arizona. On December 26, 1996, the Commission issued Decision No. 59943, which adopted Arizona Administrative Code (“A.A.C.”) R14-2-1601 through -1616, the Retail Electric Competition Rules. Through a series of workshops, hearings, and decisions, the rules were revised in 1998, 1999, and 2000.¹

A.A.C. R14-2-1603 specifically addressed the process by which a competitive electric provider could apply for a Certificate of Convenience and Necessity (“CC&N”). Approximately twenty entities received CC&Ns to provide competitive electric service, including meter services and meter reading services, in 1999 and 2000.

In response to concerns about the ability of the market to establish just and reasonable rates, the Commission issued Decision No. 65154 on September 10, 2002, commonly referred to as the “Track A” order, which halted the impending divestitures of Arizona Public Service Company and Tucson Electric Power Company and suspended a requirement in the rules that provided for the utilities to purchase all their power in the competitive market.

In 2004, the Arizona Court of Appeals issued a decision, commonly known as the “*Phelps Dodge*” decision, invalidating a number of provisions of the Retail Electric Competition Rules and all the CC&Ns for competitive electric service that had been granted by the Commission.² The combined, practical effect of the Commission’s Track A decision and the Court of Appeals’ *Phelps Dodge* decision largely halted the movement to restructure Arizona’s retail electric industry and provide for retail electric competition.

On March 16, 2006, Sempra Energy Solutions (“Sempra”) filed an application for a CC&N to provide competitive retail electric service. This was the first such application to be filed following the *Phelps Dodge* decision.³ In addition to the usual issues associated with CC&N applications, Sempra’s application presented the question of whether and under what circumstances the Commission will issue a CC&N for competitive retail electric service.

¹ On June 28, 1998, the Commission issued Decision No. 60977 on Stranded Costs, after holding hearings on the issue. On August 10, 1998, (Decision No. 61071), the Commission adopted amended rules on an emergency basis, and on December 11, 1998, (Decision No. 61272) adopted the emergency rules on a permanent basis. On January 11, 1999, (Decision No. 61311), the Commission stayed the Retail Electric Competition Rules and related decisions, including Decision No. 60977. Decision No. 60977 was amended on April 27, 1999, by Decision No. 61677, which ordered the Hearing Division to issue a Procedural Order to set dates for consideration of stranded costs and unbundled tariffs for each Affected Utility. On September 29, 1999, Decision No. 61969 approved the revised Retail Electric Competition Rules. The Commission adopted clarifying revisions to the Retail Electric Competition Rules in Decision No. 62924 (October 10, 2000).

² In February of 1997, TEP had filed a complaint in Superior Court challenging a number of the electric competition rules adopted by the Commission. Though TEP and APS eventually withdrew from the case, others continued to pursue the litigation. *Phelps Dodge v Arizona Elec. Power Coop.*, 207 Ariz. 95.83 P. 3d 573 (App. 2004).

³ Docket No. E-03964A-06-0168

Decision No. 70485 suspended Sempra's application pending the Commission's determination regarding whether the public interest would be served by authorizing the provision of competitive electric services to end users in Arizona.⁴

Decision No. 70485 also ordered Staff to commence public workshops within 90 days to address the underlying policy issue of whether retail competition is in the public interest and to examine the potential risks and benefits of retail competition. A December 31, 2009 deadline was set for Staff to file a report that provides Staff's recommendation as to whether or not retail competition should be implemented in Arizona and, if so, how such implementation should proceed. Staff held a workshop on November 14, 2008, with participants asked to file written comments on the following topics:

1. potential risks and benefits of retail electric competition,
2. whether or not retail electric competition is in the public interest,
3. provider of last resort,
4. whether the Commission's current electric competition rules are adequate,
5. costs of competition, and
6. other issues related to retail electric competition.

Comments were filed in Docket No. E-00000A-02-0051 in January 2009.

On December 29, 2009, Staff filed a Motion for an Extension of Time. In its Motion, Staff requested an extension of time until April 1, 2010, to file the report and recommendation. The Commission granted Staff's request for an extension of time for the filing of the Staff report ordered by Decision No. 70485 to 30 days following issuance of the Commission's decision in the SolarCity case (Docket No. E-20690A-09-0346). On July 12, 2010, the Commission issued Decision No. 71795 in the SolarCity case.

Given the amount of time that had passed since submission of workshop comments, on March 15, 2010, Staff sent a request for comments to interested parties who would like to refresh their responses or who had not previously responded. These comments were filed in April 2010. Staff also held a meeting on July 7, 2010, giving stakeholders the opportunity to voice any issues or concerns they had regarding retail electric competition in light of the Commission's decision in the SolarCity docket, announced at the June 30, 2010 Open Meeting. A summary of comments received by the Commission is attached as Appendix A.

II. SINCE THE COMMISSION'S LAST EFFORT AT IMPLEMENTING RETAIL ELECTRIC COMPETITION, THE ENVIRONMENT IN ARIZONA HAS CHANGED IN A NUMBER OF WAYS.

The current set of Retail Electric Competition Rules was most recently adopted in 2000. Since that time, a number of energy and environmental policies have been addressed by the

⁴ Docket No. E-03964A-06-0168, Decision No. 70485 (September 3, 2008).

Commission, some of which may impact, or be impacted by, the successful implementation of retail electric competition. In 2006, the Commission adopted the Renewable Energy Standard and Tariff rules,⁵ and in 2009 the Commission began the rulemaking process for energy efficiency rules⁶ and resource planning rules.⁷ Additionally, smart grid technology continues to develop, with advanced metering infrastructure slowly being adopted nation-wide, with consumers becoming more aware of their energy consumption and the associated financial and environmental impacts.

The interactivity of rules and policies that are potentially applicable to competitive services needs to be examined so that all of the rules and policies may function fully and as intended, leading to a robust energy future for Arizona businesses and ratepayers.

The Commission's recent decision in the SolarCity docket⁸ may serve as useful background should the Commission choose to further pursue the issue of retail electric competition in Arizona. Similar to a competitive framework, the SolarCity model provides customers with an option to procure electricity from a source other than the incumbent utility, with customers making an individual and voluntary decision to acquire electricity from an alternative source, the result of which will reduce the load of the incumbent utility.

Unlike full competition, however, the SolarCity model is more gradual, offsetting part of the customer's load. The customer remains a customer of the incumbent utility, but with diminished loads during periods of solar energy production. Additionally, the SolarCity case addressed only schools, government, or non-profit entities. Under retail electric competition, the entire load of all customers could be met from sources other than the incumbent utility. Because competition is well-suited to larger commercial and industrial consumers, it is likely that these larger-load customers would choose to purchase their electricity from a competitive source.

III. REVIEW OF RETAIL ELECTRIC COMPETITION EXPERIENCES IN OTHER STATES

A number of states have examined and/or made efforts to implement various forms of retail electric competition. California enacted restructuring legislation in 1996. Other states also enacted comprehensive retail competition legislation in the late 1990s, including New Hampshire (May 1996), Rhode Island (August 1996), Pennsylvania (December 1996), Montana (April 1997), Oklahoma (May 1997), and Maine (May 1997). By January 2001, 22 states and the District of Columbia had adopted retail competition legislation.

Regulatory commissions in four other states (including Arizona, which also enacted legislation) had issued orders requiring or endorsing retail choice for retail electric customers. Several states, primarily those with low-cost electricity generation, such as Alabama, Colorado,

⁵ Docket No. RE-00000C-05-0030, Decision No. 6927; A.A.C. R14-2-1801, et seq.

⁶ Docket No. RE-00000C-09-0427, Decision No. 71436

⁷ Docket No. RE-00000A-09-0249, Decision No. 71722

⁸ Docket No. E-20690A-09-0346, Decision No. 71795 (July 12, 2010).

North Carolina, and Wisconsin, concluded that retail competition would not benefit their customers.

According to the U.S. Energy Information Administration (“EIA”), restructured states as of May 2010 include Maine, New Hampshire, Massachusetts, Connecticut, Rhode Island, New York, New Jersey, Delaware, Maryland, Pennsylvania, District of Columbia, Ohio, Michigan, Illinois, Texas, and Oregon. States that have suspended restructuring include California⁹, Montana, Nevada, Arizona, New Mexico, Arkansas, and Virginia.¹⁰

For the most part, the states that pursued early efforts to restructure their electric industries were ones that already had high electricity prices during the 1990s. Some of the disparity in retail rates was due to regional natural resource availability, with lower rates experienced as a result of hydroelectric resources in the Northwest and abundant coal reserves in such states as Kentucky and Wyoming. Moreover, some states required utilities to enter into Public Utility Regulatory Policies Act (“PURPA”) contracts at prices much higher than the utilities’ avoided costs.¹¹ The states that are typically evaluated, representing the various approaches to retail electric competition, include Illinois, Maryland, Massachusetts, New Jersey, New York, Pennsylvania, and Texas. Additionally, California tends to stand out as an example of poor restructuring design.¹²

Various reports have attempted to capture the results and effects of the competitive retail electricity market in these states. A number of these reports conclude that competition has not developed as expected for all customer classes in these states. Despite the decade since states started implementing retail competition, in general, small customers, especially residential customers, have little choice among electricity suppliers.¹³ However, other studies report favorable results in certain states. For example, some reports claim that, because the market

⁹ California SB 695 allows limited competition. See also CPUC Decision No. 10-03-022 (3/15/10).

¹⁰ U.S. Energy Information Administration, Status of Electricity Restructuring by State. Available at http://www.eia.doe.gov/cneaf/electricity/page/restructuring/restructure_elect.html

¹¹ The Electric Energy Market Competition Task Force. Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy, April 5, 2007.

¹² From late spring 2000 and into the spring of 2001, California experienced high natural gas prices, a strained transmission system, generation shortages that resulted in blackouts, and soaring wholesale electricity prices. Existing state law had capped residential provider of last resort service rates at levels that were soon below the market price for wholesale electric power. After a large investor-owned utility declared bankruptcy because it was unable to increase its retail rates to cover high wholesale power prices, the state stepped in to buy electricity on behalf of two of the state’s three IOUs. California eventually suspended retail competition for most customers while reconsidering how to assure adequate electric supplies and continuation of service at affordable rates in a competitive wholesale market environment. Although that suspension is still effective today, 12 percent of load in the state is supplied by alternative suppliers, some additional consumers remain eligible to switch to alternative suppliers, and new initiatives for municipal aggregation are being pursued.” See The Electric Energy Market Competition Task Force. Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy, April 5, 2007.

¹³ Susan Tierney, PhD. Analysis Group. Decoding Developments in Today’s Electric Industry – Ten Points in the Prism. October 2007; The Electric Energy Market Competition Task Force. Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy, April 5, 2007.

structure has advanced sufficiently for competitive markets to work effectively, residential consumers in Texas¹⁴ and New York have a choice of suppliers and a choice of products and services. These reports further state that consumers in these states can lock in current prices for various contract periods; select green power that is backed by production from renewable resources; and bundle appliance maintenance costs into the electricity bill.¹⁵

Larger customers appear to have had more opportunities to take advantage of retail access in several states.¹⁶ Large commercial and industrial (“C&I”) consumers were early beneficiaries of retail electricity choice largely because they were already knowledgeable about how to contract for power and associated services. In more than a dozen competitive retail electricity markets, this set of consumers has access to numerous retail power suppliers who offer options that vary with respect to contract term, price, risk, and other factors. Demand and price-responsive consumers can participate in wholesale markets for capacity, energy and ancillary services, including reserve markets, while building management systems continue to become more sophisticated to facilitate more real-time decision making. Large commercial and industrial consumers are able to invest in backup generation, on-site energy storage, and end-use load controls to participate in power markets to manage usage and lower costs.¹⁷ However, most large commercial and industrial customers do not have the option to take provider of last resort (“POLR”) service at discounted, regulated rates.¹⁸

Conversely, it has also been reported that where there are multiple suppliers, prices have not decreased as expected, and the range of new options and services often is limited. Electricity prices, in general, in both restructured and traditional regulation states, have increased over the past decade. This general increase can be attributed to escalating fossil fuel costs, the addition of generation capacity, and increasing environmental controls.¹⁹

Development of retail competition has been limited to a considerable extent in the several states that capped residential POLR rates, some of which remain in effect. Reductions in electric rates that have occurred during the early years of restructuring have evaporated in most states, as rate caps expire, and are threatened in others. In some states, the regulated rates were set below

¹⁴ As an example, Texas adopted rules that encouraged numerous retailers to enter the residential market and offer a variety of services. Residential customers that did not immediately select a competitive retail service provider received “price-to-beat” service from January 1, 2002 through December 31, 2006. At the end of that five-year transition, all residential consumers on price-to-beat service remained with their competitive retail provider. As a result, all (greater than 99%) Texans eligible to choose are now served by competitive retailers via non-regulated products and services with a significant number of retailers active in every portion of the state open to competition.

¹⁵ Alliance for Retail Choice. ARC’s Baseline Assessment of Choice in the United States. May 2007. Available at <http://www.allianceforretailchoice.com/ABACUSpublication.pdf>

¹⁶ MSB Energy Associates, Inc., Lessons Learned: Michigan Restructuring Report (January 2007).

¹⁷ Annual Baseline Assessment of Choice in Canada and the United States. December 2009. Available at <http://www.defgllc.com/content/defg/errc.asp>

¹⁸ The Electric Energy Market Competition Task Force. Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy, April 5, 2007.

¹⁹ Annual Baseline Assessment of Choice in Canada and the United States. December 2009. Available at <http://www.defgllc.com/content/defg/errc.asp>; Susan Tierney, PhD. Analysis Group. Decoding Developments in Today’s Electric Industry – Ten Points in the Prism. October 2007.

market rates such that when rate caps expired, rate shock resulted. Higher, market-level prices (offered by the incumbent) are particularly painful for customers that have limited ability to limit consumption and lack competitive supply options as rate caps impeded new entrants to the market.²⁰

Restructuring has also impacted incumbent utilities and the grid. Technological, infrastructure and governance changes resulting from restructuring have left the electricity system increasingly dependent on natural gas, threatened by degradation in service reliability and more reliant on power purchases from wholesale electricity markets. Additionally, loosening of controls over regulated utilities has led to increased financial risk, impacting utilities' financial health and access to low-cost credit.²¹

The varied experiences of other states act as helpful guidance by showing the relative benefits, providing lessons learned, and pointing out potential pitfalls in implementation schemes. The historic experiences of other states, however, should not be the only guide if Arizona moves forward at this time to create a retail electric competition framework.

IV. POSITIVE AND NEGATIVE ASPECTS OF RETAIL ELECTRIC COMPETITION

When attempting to identify and evaluate the potential benefits of retail competition (as well as the potential detriments), Staff has thus far been unable to identify areas of consensus. In other words, Staff's review of the relevant literature and the parties' comments reveals that one's conclusions about the relative success (or failure) of retail competition often depends upon one's point of view. In general, large commercial and industrial customers tend to favor retail competition, as it tends to provide opportunities for them to reduce their electricity cost and to obtain services that might not be available from their incumbent provider. Advocates for residential customers and incumbent utilities tend to disfavor retail competition, as it tends to create risks for these groups that are generally not present in the traditional model.

The following discussion sets forth the potential benefits and risks of retail competition as identified in stakeholder comments and in the relevant literature. Staff's presentation of the information in this section is not intended to be interpreted as specific factual determinations or as final conclusions or recommendations. It is instead intended as a summary of the potential benefits and risks of retail competition as presented by the stakeholder comments and the literature.

²⁰ The Electric Energy Market Competition Task Force. Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy, April 5, 2007.

²¹ MSB Energy Associates, Inc., Lessons Learned: Michigan Restructuring Report (January 2007).

A. POTENTIAL POSITIVE ASPECTS OF RETAIL ELECTRIC COMPETITION

There are many goals of full competition and, as such, there are many ways to measure its successfulness. Measuring the success of competition with a single metric, such as prices, provides an insufficient evaluation. While it is true that many of the states that first implemented retail electric competition were those with higher retail rates, these states generally had several goals in addition to lower rates in mind. Such goals include reduced influence of utilities' investment preferences, the desire to produce and deliver power more efficiently, improved service and more options from new suppliers, innovation in generating technologies, grid management, use of information technology, and increased availability of renewable energy sources, energy efficiency options and demand response.²²

Larger customers in the competitive market, although not completely shielded from price increases that affect all consumers, realized savings relative to what prices would have been had they continued to purchase power from the incumbent utility.²³ Various proponents of retail electric competition tend to share the view that competition puts downward pressure on retail rates, as they contend has been demonstrated in several states with retail electric competition in place.²⁴ Retail merchants contend that cost savings realized as a result of competition are passed on to their customers and employees, benefitting society at large.

It should be noted that wholesale markets are a key component of a working retail market because a retail power supplier can manage physical and financial risk in a way that is beyond the capabilities of a residential customer. Through customer aggregation and an understanding of both the wholesale markets and the customers' needs, a retailer can provide customized risk management services that are not available under regulation, including integration of customers into demand response activities.²⁵ Aggregators can help make these benefits available to smaller commercial customers that have not benefited from competition as significantly as large C&I customers.²⁶

In a competitive market, the opportunity to profit by producing at a cost below market prices and increase output through productivity gains has created incentives for power producers to undertake needed investments and improvements in operating practices, resulting in cost savings. Competitive conditions have also led to increases in the efficiency of fossil fuel-fired

²² Susan Tierney, PhD. Analysis Group. Decoding Developments in Today's Electric Industry – Ten Points in the Prism. October 2007. See also The Electric Energy Market Competition Task Force. Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy, April 5, 2007; Annual Baseline Assessment of Choice in Canada and the United States. December 2009. Available at <http://www.defgllc.com/content/defg/errc.asp>

²³ Susan Tierney, PhD. Analysis Group. Decoding Developments in Today's Electric Industry – Ten Points in the Prism. October 2007

²⁴ See Comments filed in January 2009 and April 2010 in Docket No. E-00000A-02-0051.

²⁵ Alliance for Retail Choice. ARC's Baseline Assessment of Choice in the United States. May 2007. Available at <http://www.allianceforretailchoice.com/ABACUSpublication.pdf>

²⁶ See Comments filed in April 2010 in Docket No. E-00000A-02-0051.

power plants, decreasing the length of refueling outages, lower operations and maintenance expenses, and greater plant availability at nuclear power plants.²⁷

Restructured markets tend to improve power plant dispatch efficiency, typically through the use of a regional transmission organization (“RTO”) or independent system operator (“ISO”). Restructuring has allowed grid operators to make smarter dispatch decisions, reducing costs by using lower-cost resources in one region to displace higher-cost power resources in another. Additionally, barriers associated with layered transmission rates across multiple regions have been reduced or eliminated, further driving down the cost to supply power.²⁸

Competition could allow for the development of renewable resources and advanced energy technologies, increased demand response and energy efficiency, and support the innovation necessary to develop new technologies, products and services at lower costs than through government regulation while producing economic and environmental benefits.²⁹ Texas and New York, amongst other places that have restructured, have experienced rapid growth in renewable generation and offer numerous green pricing options.³⁰ Arizona is currently pursuing aggressive goals for energy efficiency, demand response and procurement of renewable energy resources, including distributed generation through the use of standards and rules. While there are various approaches to encourage the development of these resources, such as standards and codes or market-based incentives, the delivery of goods and services to a customer’s premises, including these alternative energy options, may be well-suited for competitive markets.³¹

Retail competition, and the associated increase in the number of suppliers, may also bring consumers more choice in the availability of renewable energy products. Renewable program competition could drive down the costs of renewable energy program implementation, forcing incumbent utilities to utilize ratepayer dollars more efficiently in implementing REST programs. In addition to giving customers a choice in the type of energy products available to them, a system based on real-time pricing has the potential to make power consumption more efficient.³²

Technological change tends to occur more quickly in industries that are exposed to market forces. The electric industry is in a position to combine new infrastructure investments, such as advanced meters, communications and controls, with the entrepreneurship of mass-market retailers. As technology develops, consumers may be able to lower their total energy

²⁷ Susan Tierney, PhD. Analysis Group. Decoding Developments in Today’s Electric Industry – Ten Points in the Prism. October 2007; Sean Casten, Deregulation, Phase II. Public Utilities Fortnightly, November 2007.

²⁸ Susan Tierney, PhD. Analysis Group. Decoding Developments in Today’s Electric Industry – Ten Points in the Prism. October 2007; Sean Casten, Deregulation, Phase II. Public Utilities Fortnightly, November 2007.

²⁹ See Comments filed in January 2009 and April 2010 in Docket No. E-00000A-02-0051.

³⁰ Annual Baseline Assessment of Choice in Canada and the United States. December 2009. Available at <http://www.defgllc.com/content/defg/errc.asp>

³¹ Annual Baseline Assessment of Choice in Canada and the United States. December 2009. Available at <http://www.defgllc.com/content/defg/errc.asp>

³² See Comments filed in January 2009 and April 2010 in Docket No. E-00000A-02-0051.

costs, increase their reliability and control, reduce their impact on the environment, and increase the value of electric services in their lives.³³

Certain stakeholders also noted that Arizona is surrounded by states with retail competition. By not transitioning to a competitive market, these stakeholders believe that Arizona risks lagging further behind as a national and international business competitor, disadvantaging businesses that need to compete in today's global economy.³⁴

B. POTENTIAL NEGATIVE ASPECTS OF RETAIL ELECTRIC COMPETITION

In most restructured states, investor-owned utilities ("IOUs") were forced to sell their generation and transmission assets. Divestiture attempted to remove the discrimination inherent in transmission access if the same company owned and operated both the transmission lines and power plants.³⁵ It was expected that after a short transition period, alternative providers would serve virtually all customers. Retail competition was slow to develop in some states, however, leaving the IOUs to purchase power from the wholesale market to serve the large majority of customers still receiving regulated utility service.^{36,37}

Imperfections in the wholesale market tend to be reflected in competitive retail prices. Such imperfections include wholesale suppliers' ability to exercise market power, problems in market design that increase wholesale suppliers' costs, government subsidies to some suppliers, transmission discrimination preventing low-cost suppliers from reaching customers, or restrictions that delay or prevent entry and diffusion of low-cost generation technologies. Distortions in wholesale prices that lead to distortions in retail prices can cause economic inefficiencies both in retail customers' consumption patterns and in investment decisions.³⁸

Limited availability of suppliers prevents true competition. For example, for large C&I customers, there tends to be a large number of power suppliers to choose from in restructured states, helping such customers realize the benefits of a competitive retail electricity market. In Texas, where competition is claimed to be excellent, there are 60 retail suppliers for C&I customers while in both Oregon and Ohio, there are only 5 suppliers and competition has been

³³ Annual Baseline Assessment of Choice in Canada and the United States. December 2009. Available at <http://www.defgllc.com/content/defg/errc.asp>

³⁴ See Comments filed in January 2009 and April 2010 in Docket No. E-00000A-02-0051.

³⁵ National Council on Electricity Policy, State Policies for Financing Electricity Resources, Volume I: Paying for Power Plants in Restructured States. February 2007. Available at <http://www.ncouncil.org/Documents/FINALPayingPowerPlants.pdf>

³⁶ American Public Power Association, Retail Electric Rates in Deregulated and Regulated States: 2009 Update. March 2010. Available at www.APPAnet.org

³⁷ It is noteworthy that competition has been more successful in states that did not mandate divestiture, such as Texas and Pennsylvania, than in those that did. See Lynne Kiesling, Getting Electricity Deregulation Right: How Other States and Nations Have Avoided California's Mistake. April 2001. Available at <http://reason.org/files/a582f8b371deedf9add0afc332dc9e84.pdf>

³⁸ The Electric Energy Market Competition Task Force. Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy, April 5, 2007.

deemed less successful.³⁹ The situation is not as positive for residential customers. In Texas and New York, residential customers can choose from 30 and 27 retail suppliers, respectively. The number of suppliers in other restructured states drops quickly with the next state on the list, Connecticut, having 9 suppliers offering residential services. All other restructured states have even fewer options, the worst being Delaware with only one supplier.

Wholesale price distortions that impact retail rates can raise individual and social costs of producing goods and services made with electricity, having an impact economy-wide.⁴⁰ Rate increases subsequent to the expiration of rate freezes and caps can also have a significant impact on retail rates, increasing the prices for goods and services. In some instances the cost to keep a business running may be overwhelmed by the electricity costs needed to operate the facilities. When this cost cannot (or will not) be borne by customers of the business, the business may fail as a result, leading to increased unemployment.⁴¹

The issue of stranded costs associated with restructuring is contentious and uncertain, potentially increasing consumer costs. In regulated markets, utilities have a monopoly in their service area and regulators have set prices high enough for utilities to recover their costs and earn a reasonable rate of return. Restructuring would remove that protection, introducing competition into the market, possibly resulting in falling electricity prices. Those falling prices would diminish the value of utilities' assets, possibly leaving some of their costs unrecoverable, or "stranded."⁴² Some of these costs include losses on investments that the utility made in the public interest, perhaps required by state or federal government, that otherwise would not have been made in an unregulated market. Other investments may be more discretionary, making the argument for reimbursement less compelling.

There is disagreement about whether utilities should be compensated for stranded costs. On the one hand, utilities have been serving the public interest in a regulated atmosphere and many utilities believe they should not have to bear the cost of a change in rules. However, these costs may also be characterized as the cost of doing business in the electric industry. Moreover, utilities have earned a reasonable rate of return in the regulated market, making compensation for stranded costs unnecessary.⁴³ If costs are recoverable, it is likely that smaller customers with fewer options for competitive service will be left to pay those costs.

It was the opinion of a number of stakeholders that Arizona may not have developed an adequate POLR protocol, potentially creating another risk that will be borne by customers that

³⁹ Annual Baseline Assessment of Choice in Canada and the United States. December 2009. Available at <http://www.defgllc.com/content/defg/errc.asp>

⁴⁰ The Electric Energy Market Competition Task Force. Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy, April 5, 2007.

⁴¹ Mark Clayton, In deregulation of electric markets, a consumer pinch. Christian Science Monitor. April 25, 2006.

⁴² Congressional Budget Office, Electric Utilities: Deregulation and Stranded Costs. October 1998. Available at <http://www.cbo.gov/doc.cfm?index=976&type=0>

⁴³ Congressional Budget Office, Electric Utilities: Deregulation and Stranded Costs. October 1998. Available at <http://www.cbo.gov/doc.cfm?index=976&type=0>

choose to remain with the incumbent utility. However, it was also expressed that the current statutory and administrative authorities, along with incumbent utility tariffs, related to POLR may provide protection for residential and business customers. Moving forward, a challenge may exist involving POLR responsibilities of affected utilities to their short and long-term integrated resource planning activities.

There are two main models for POLR service. The first is similar to traditional utility service, with prices that are fixed over an extended period of time. This regulated service competes with others in the market place, but POLR service likely retains a substantial percentage of sales, especially in the residential sector.

The second model operates as more of a stopgap service with retail access to wholesale supply, primarily for customers that are temporarily between suppliers. In this model, alternative suppliers serve the majority of retail customers, competing against each other with a variety of price and service offerings designed to attract different types of customers.

The design of POLR service is one of the most significant factors that determines the success of retail choice among residential consumers. It is generally agreed that after a century of regulated tariffs, the typical residential consumer requires some time and education to understand what new options are available, how to evaluate the alternatives and how best to align market choices with individual need. A poorly designed default service undermines retail competition. If default service is designed so as to attempt to address all residential consumers' needs, or if it bundles and spreads risks among all consumers, or if it is priced below cost, then it is unlikely that energy retailers will enter the market. According to a 2009 report, to encourage the development of a competitive retail market, default service must reflect market rates in the near term while providing opportunities to competitive retailers.⁴⁴

Some stakeholders believe that the introduction of retail electric competition will hinder the success of recent energy policies, such as the renewable energy and energy efficiency standards. If all suppliers are not subject to the REST rules, for example, the funding for the REST fund would either need to be diluted, delaying the procurement of renewable resources, or as certain customers find alternative suppliers, the burden for the program would shift to the fewer number of remaining incumbent utility customers, increasing their burden. Additionally, there is concern that competition would frustrate resource planning and hamper the effectiveness of the comprehensive resource planning rules.

Typically associated with restructuring, many regions, including restructured and non-restructured states, developed RTOs to independently operate the grid and to administer bid-based centralized wholesale power markets, using them to determine efficient dispatch as well as market-clearing prices.⁴⁵ Currently, the utilities that serve Arizona's electric consumers are not

⁴⁴ Annual Baseline Assessment of Choice in Canada and the United States. December 2009. Available at <http://www.defgllc.com/content/defg/errc.asp>

⁴⁵ Susan Tierney, PhD. Analysis Group. Decoding Developments in Today's Electric Industry – Ten Points in the Prism. October 2007.

members of an RTO or ISO. While this was a concern for some stakeholders, the Arizona Independent Scheduling Administrator (“AZISA”) states that it is prepared to schedule competitive retail electric transactions, potentially removing the risk of not having such an organization in the state.

In general, there is the overarching concern that rates will escalate, as has been seen in a number of states that currently implement retail electric competition. A number of stakeholders were also of the opinion that the potential benefits of implementing retail electric competition are relatively small, while the effort required to establish a functioning retail electric market is extensive.

V. CURRENT RETAIL ELECTRIC COMPETITION RULES

a. Stakeholder’s Comments

A number of stakeholders noted that the existing Retail Electric Competition Rules need a lot of work and that it would be “nonsense” to use the dated Rules without changes or further consideration. One set of stakeholders would prefer to see the Commission move in a new direction as the restructured system envisioned in the 1990s is inadequate, even in its most intact and complete state. Another stakeholder expressed the desire to see the Retail Electric Competition Rules repealed altogether.

By contrast, other stakeholders believe that the Retail Electric Competition Rules remain largely intact, are substantively workable, and provide a strong framework that can be modified as needed to address an ever-evolving market. Those stakeholders do not view the lack of a complete set of Rules as an obstacle or an impediment to the reinstatement of retail electric competition because they believe such Rules are not a condition precedent to the Commission granting an Energy Service Provider (“ESP”) a CC&N. Additionally, this set of stakeholders believes that the *Phelps Dodge* decision, which invalidated some of the Retail Electric Competition Rules, does not stand as a substantive legal impediment that would limit the Commission from considering a CC&N application at this time or from lawfully approving rates and charges for lawfully certificated retail energy suppliers for the provision of competitive retail electric service.

One stakeholder suggested that the Retail Electric Competition Rules should be modified to specifically address the distinction between an ESP who takes title to power and an aggregator who does not, with a specified code of conduct for aggregators.

b. Staff’s Analysis

Since retail electric competition was introduced in Arizona in 1994, Commission Staff has held a number of workshops on retail electric competition, revising the Retail Electric Competition Rules as needed to address issues as they arise. Currently, Staff considers the Retail

Electric Competition Rules incomplete and in need of modification to address the current climate of electric consumption in Arizona.

The current set of Rules was most recently adopted in 2000. Some provisions in the Rules address time frames that have passed. Since 2000, a number of energy and environmental policies have been addressed by the Commission, some of which may impact, or be impacted by, the successful implementation of retail electric competition. In 2006, the Commission adopted the Renewable Energy Standard and Tariff rules⁴⁶ and in 2010 the Commission adopted resource planning rules⁴⁷ and voted to adopt electric energy efficiency rules.⁴⁸ In revisiting retail electric competition, Staff recommends that the potential interaction of the renewable energy, electric energy efficiency, and resource planning rules with the Retail Electric Competition Rules be examined with appropriate revisions reflected in the Retail Electric Competition Rules, as needed.

Additionally, portions of the Retail Electric Competition Rules were affected by the Court of Appeals' *Phelps Dodge* decision.⁴⁹ Certain provisions in the current Rules were invalidated by the court because the Commission lacked legislative or constitutional authority to promulgate such provisions.⁵⁰ A number of other provisions were invalidated because the Commission failed to seek review and certification from the Attorney General.⁵¹

Despite the suggestion from certain stakeholders that these latter provisions may simply be submitted to the Attorney General, Staff believes that a better path forward would be to revisit the issue of retail electric competition as a whole, rather than revise the Retail Electric Competition Rules in a piecemeal fashion. This is especially so given the need to address any issues that may arise from the interaction of retail electric competition and the renewable energy, energy efficiency standards and the resource planning rules.

VI. RECOMMENDATION

At this point in time, Staff believes that although some form of retail electric competition may be in the public interest, in order to be sure, more analysis, discussion and study of all the aspects of the issue is required in order to perform a proper evaluation. The Commission should, however, approach this task with caution. The Commission should recognize that retail electric competition could bring benefits to some and could also present risks to others, especially in the transition period and especially to smaller customers and low income customers. If the Commission chooses to move forward with retail electric competition, it should do so only after a careful evaluation of the potential benefits and potential risks, as well as ways to mitigate those risks.

⁴⁶ Docket No. RE-00000C-05-0030, Decision No. 6927; A.A.C. R14-2-1801, et seq.

⁴⁷ Docket No. RE-00000A-09-0249, Decision No. 71722

⁴⁸ Docket No. RE-00000C-09-0427, Decision No. 71436

⁴⁹ *Phelps Dodge v Arizona Elec. Power Coop.*, 207 Ariz. 95.83 P. 3d 573 (App. 2004).

⁵⁰ A.A.C. R14-2-1609(C)-(J), -1611(A), and -1615(A), (C).

⁵¹ A.A.C. R14-2-1603, -1605, -1609 (A)-(B), -1610, -1612, -1614, and -1617.

The current Retail Electric Competition Rules are incomplete and in need of modification. A number of provisions would need to be submitted to the Attorney General's office for review and certification. Moreover, a number of other provisions were invalidated by the Court of Appeals in the *Phelps Dodge* decision. It is also important that Retail Electric Competition Rules, and the implementation of retail electric competition in Arizona, not impede upon the goals and successfulness of the REST rules, the Electric Energy Efficiency rules and the Resource Planning rules.

Staff acknowledges that the various versions of the Rules adopted between 1996 and 2000 contain some useful provisions. However, the existing Rules were designed around objectives that may no longer be applicable in light of the many changes in Arizona since the 1990s. While some objectives of electric service are constant, such as reliability and affordability, other objectives, such as adoption and integration of new technology, consumer education and protection, diversifying resources, and increased energy efficiency should be embraced by the electric industry and incorporated into the competitive framework. If electric competition is to be revisited, the existing Retail Electric Competition Rules may not be the best path forward in light of the many new Commission policies and objectives that have developed in Arizona since the 1990s.

Given the varied experiences with the introduction and implementation of retail electric competition throughout the nation, Staff recommends that, in revisiting this issue, the Commission recognize the many perceived risks and benefits associated with a competitive retail electric market and proceed with caution. A number of factors require discussion and adequate evaluation, specific to Arizona's current environment, to properly assess how implementation of competition might affect Arizona businesses and ratepayers. Staff recommends that if the Commission wishes to revisit retail electric competition in Arizona, the best path forward is to initiate a notice of inquiry on this topic and to hold workshops to explore the many details involved in properly analyzing the issue of retail electric competition and whether it is in the public interest.

Appendix A

Docket No. E-00000A-02-0051 Comment Summary: January 2009 – August 2010

Stakeholders were asked to comment on the following topics:

1. potential risks and benefits of retail electric competition,
2. whether or not retail electric competition is in the public interest,
3. provider of last resort,
4. whether the Commission's current electric competition rules are adequate,
5. costs of competition, and
6. other issues related to retail electric competition.

No, Electric Competition is not in the Public Interest.

Arizona Investment Council ("AIC") is of the opinion that retail electric competition is not in the public interest. Competition presents a number of risks, including additional costs required to structure and implement a competitive framework and the loss of high-load, low service cost customers, putting upward pressure on the rates of remaining utility customers. AIC is also concerned that retail competition will result in underinvestment in adequate generation, transmission and distribution facilities, eroding grid safety and reliability. The reintroduction of competition places consumers at risk while burdening them with costs. Moreover, because a competitive market would place a premium on least-cost generation sources, retail electric competition would delay investment in renewable generation assets as they are currently more costly than traditional generation sources. AIC encourages the Commission to examine its goals for investment in renewable generation, energy efficiency, and resource planning to determine whether those goals are best met through competition or the current regulatory system, and to proceed cautiously. Additionally, AIC believes the current retail electric competition rules should be rethought.

Arizona Municipal Power Users' Association ("AMPUA") is an association of consumer-owned and operated electrical systems which collectively deliver almost one-third of the electricity in Arizona to over two million people. AMPUA joins in and supports the comments of SRP and NWE, maintaining the position that retail electric competition in Arizona is premature and not in the public interest, especially given the current economy, a number of significant barriers, and the lack of systematic technology to address restructuring. AMPUA asks the Commission to review the lack of success in other states' efforts to introduce retail electric competition. In support of its position, AMPUA submitted a report by the American Public Power Association entitled "Retail Electric Rates in Deregulated and Regulated States: 2009." AMPUA states that a premature commitment to competition would encourage cannibalization of existing utility facilities by reducing their customer base, devaluing their facilities, while burdening the existing utilities and non-departing customers.

Arizona Public Service Company (“APS”) does not believe that retail electric competition is in the public interest. APS states that the energy market in Arizona has changed since the 1990s when the State was pursuing a competitive framework. APS believes that the market has progressed in a different direction that makes implementation of retail electric competition a waste of time and resources. The introduction of retail electric competition will hinder the success of recent energy policies, including comprehensive resource planning regulations and one of the most ambitious energy efficiency standards in the U.S. Under competition, resource planning becomes frustrating and inefficient because unregulated power plant developers determine what, when and for whom resources should be built rather than having such decisions made through a comprehensive and public regulatory process. Also, other important policy considerations, such as renewable investments, energy efficiency, and limited income/public assistance programs, may be ignored or marginalized in a market-driven resource selection process.

There is still uncertainty regarding essential elements of retail electric competition in Arizona following the *Phelps Dodge* decision,⁵² and there are no clear cut examples of competition resulting in lower costs for all consumer classes, greater technological innovation or greater efficiency. Consumers are still paying the costs related to the last move toward retail electric competition in the late 1990s. Moving forward with competition will create a new generation of competition-related stranded costs for consumers to pay.

APS further notes that an essential element of a successful retail competition is a well functioning competitive wholesale market, something which is not present in Arizona. Moreover, the Southwestern wholesale market has not formed a Regional Transmission Organization (“RTO”) or Independent System Operator (“ISO”).

Arizona Transmission Dependent Utility Group (“ATDUG”) contends that, although theoretically, retail electric competition may be in the public interest, as a practical matter, in Arizona, it is not in the public interest. ATDUG believes that few utilities in Arizona have the size and resources to be the provider of last resort and that the current retail electric competition rules are not adequate to implement retail electric competition. Arizona is also lacking a competitive wholesale market, a necessary precursor for retail electric competition. ATDUG discussed the possibility of federal mandates related to a renewable portfolio standard and cap-and-trade, both requirements that could affect operations of Arizona utilities. These requirements could also affect the ability of the Commission to find common ground within which to structure a retail competition program so any effort should be taken with extreme caution. ATDUG also suggests that time be spent evaluating why prior regulatory efforts did not result in wholesale and retail electric competition as contemplated.

Grand Canyon State Electric Cooperative Association, Inc. provided comments on behalf of Arizona Electric Power Cooperative, Inc. (“AEPSCO”), Southwest Transmission Cooperative, Inc. (“SWTC”), Duncan Valley Electric Cooperative, Inc. (“Duncan”), Graham County Electric Cooperative, Inc. (“Graham”), Mohave Electric Cooperative, Inc. (“Mohave”),

⁵² *Phelps Dodge v Arizona Elec. Power Coop.*, 207 Ariz. 95.83 P. 3d 573 (App. 2004).

Navopache Electric Cooperative, Inc. ("Navopache"), Trico Electric Cooperative, Inc. ("Trico") and Sulphur Springs Valley Electric Cooperative, Inc. ("Sulphur") (collectively, "the Cooperatives"). The Cooperatives have grave concerns as to whether retail competition will benefit rural Arizona. Due to the relatively low number of commercial loads on the Cooperatives' systems, any loads lost will result in the remaining customers paying that portion of fixed costs previously covered by customers who choose direct access. Risks and complications arise when large customers want to return as resource planning spans many years and cannot be modified to allow the return of such customers, creating reliability concerns for the Cooperatives, their systems, and their customers.

While the Cooperatives are continuously looking for ways to lower costs for all consumers, retail competition may decrease the costs for some, but just as assuredly will increase costs for others. Moreover, the Cooperatives believe that direct access complicates generation, transmission, and integrated resource planning, disturbing the balance that currently exists between the Cooperatives and their rural customers. They note that competition does not automatically provide benefits to consumers, with the electric competition experience in many states producing very negative impacts on consumers. Also, given that the basic underpinnings and assumptions concerning the competitive model have substantially changed, the Cooperatives believe that what remains of the existing electric competition rules should be repealed.

Mohave Electric Cooperative, Inc. and Navopache Electric Cooperative, Inc. supplement the comments provided by Grand Canyon State Electric Cooperative Association, Inc. and reassert that retail electric competition is not in the public interest. The structures and mechanisms necessary to successfully introduce electric competition do not exist in Arizona and the implementation of competition would be a substantial burden on cooperatives. This burden stems from the fact that Electric Service Providers ("ESPs") have not applied to serve residential and small commercial customers but, rather, large customers which comprise an essential portion of the Cooperatives' load. The Cooperatives fear that large customers will be skimmed, or "cherry picked," from each Cooperative's service area, shifting fixed costs to remaining, smaller customers, with benefits only being realized by the few larger customers able to choose a competitive supplier.

The **Residential Utility Consumer Office** ("RUCO") supports the concept of retail electric competition, in theory, and indicates that the threat of competition in itself has caused incumbent utilities to streamline overhead costs and consider cost savings structures for customers. However, RUCO questions whether retail competition in practice, in Arizona, at the current time can deliver on the promises of a competitive market such as lower prices, greater options, and innovation, all delivered in a non-discriminatory manner without compromising service or imperiling the Commission's Constitutional requirement to regulate monopolies in a manner that guarantees just and reasonable rates. RUCO has consistently stated to the Commission that restructuring is "tricky" and introduces risk and uncertainty into a well-understood system. RUCO supports retaining the Arizona Independent Scheduling Administrator ("AZISA") as a sort of protection against the potential abuse of monopoly incumbent utilities in an uncertain future.

Salt River Project Agricultural Improvement and Power District (“SRP”) and **New West Energy Corporation** (“NEW”) do not believe that retail electric competition is in the public interest. Now is not the time to experiment with restructuring, given the fragile economy, and the fact that Arizona’s last attempt at restructuring cost Arizona utilities close to \$100 million. SRP and NWE also express the need for Arizona to continue along a path which prioritizes renewable energy resources. Arizona has not developed an adequate provider of last resort (“POLR”) protocol, a crucial component of a restructured system, creating another risk that will be borne by non-departing customers, especially when considering a partial deregulation scheme where a few select large customers are allowed to choose alternative providers. The Companies contend that the obstacles and risks of restructuring far outweigh any potential benefits.

Looking forward to anticipated changes in the electric industry, a number of objectives, such as distributed generation, the changing structure of transmission, usage and resources driven by climate change concerns, and adoption of new and expensive technologies, cannot be achieved without significant centralized planning, which is the opposite of a competitive market.

The Companies feel that the current electric competition rules need a lot of work but would prefer to see the Commission move in a new direction as the restructured system envisioned in the 1990s is inadequate, even in its most intact and complete state. They additionally note that other interested parties to this matter, including some in favor of “deregulation,” recognize that it would be nonsense to use the dated rules without changes and further consideration, citing the comments of Residential Utility Consumer Office, Western Resource Advocates, Arizona Retailers Association, and National Energy Marketers Association.

On the issue of costs of competition, SRP and NWE note that competitive energy markets have raised costs for consumers but make clear that the “costs” associated with competition are the costs of missed opportunities while the state focuses on trying to resurrect deregulation.

The comments of **Trico Electric Cooperative, Inc.** (“Trico”) are aligned with those of the Cooperatives, stating that retail electric competition is not in the public interest. Trico shares the concern that cherry picking of large-load customers will hurt the existing structure of public service companies. Trico states that regulation by the Commission has been successful and protects consumers through the rate case process, while ESPs are not compelled to provide reliable and safe service and reasonable rates with the transparency of a public service company. Trico believes that the Commission’s current competition rules are inadequate and should be repealed.

Tucson Electric Power Company (“TEP”) and **UNS Electric** (“UNS”) do not believe that retail electric competition is in the public interest, especially if the Commission’s main objective in re-implementing competition is to provide the lowest cost service possible to customers. However, TEP and UNS support the evaluation of retail electric competition, provided that any discussion regarding retail electric competition weighs both the costs and the benefits of competition and recognizes the terms and conditions of TEP’s recent Settlement Agreement (Decision No. 70628, December 1, 2008) which TEP stated that it directed a return

to cost-of-service ratemaking. Any analysis of competition must also consider the renewable energy standard and tariff (“REST”), demand-side management (“DSM”), and integrated resource planning (“IRP”) to ensure that these policies are applied consistently to all providers and that the impact of competition does not conflict with or marginalize the desired outcomes and effects of these policies.

Western Resource Advocates (“WRA”) recommends that the Commission not pursue electric restructuring at this time. WRA believes that the potential benefits of retail electric competition are relatively small, if they exist at all, while the effort required to establish a functioning competitive market is extensive. Additionally, competition may weaken the Commission’s renewable energy and energy efficiency policies. Arizona’s experience with restructuring in the 1990s revealed the expense and complexity involved in creating a competitive framework. WRA recognizes the Commission’s advances with the renewable energy standard and energy efficiency programs over the last decade and suggests that these efforts not be jeopardized by an expensive experiment that may prove to have no public benefits.

Neutral In Opinion Regarding Electric Competition

The only interested party that expressed a neutral opinion regarding retail electric competition was the **Federal Trade Commission** (“FTC”). The FTC hoped that the Commission would use the Electric Energy Market Competition Task Force’s Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy (April 5, 2007) to better understand the complexity and challenges experienced by seven states that opened their markets to competition. The FTC noted that the states reviewed in the Task Force’s Report are a part of an organized wholesale power market, while Arizona is not, which could lead to some different results in Arizona. In the event that Arizona decides the benefits of retail competition outweigh the costs, the FTC recommends that the Commission observe the recommendations in the Task Force’s Report.

Yes, Electric Competition is in the Public Interest.

Arizona Competitive Power Alliance states that retail electric competition is in the public interest and is long overdue in Arizona. It states that AZISA has previously assured the Commission that it is prepared to ensure fair and non-discriminatory access to Arizona’s transmission grid and that customer groups, such as AECC, stand ready to provide the customer base needed to ensure that competition is successful. The Alliance characterizes the costs associated with competition as the costs of delaying implementation of a competitive framework.

Arizona Independent Scheduling Administrator (“AZISA”) informs the Commission that AZISA is prepared to schedule competitive retail electric transactions, thereby removing the risk of not having a regional Independent System Operator in the State.

Arizona Retailers Association (“ARA”) is a non-profit association of retail merchants which include corporations doing business in states where they enjoy the benefits of retail

competition for their electric service. ARA is convinced that its members would benefit from retail choice as it helps them manage their risks and the costs of doing business. ARA asserts that if its members are allowed to participate in a competitive market, cost savings would be passed along to consumers, benefitting society at large. Oral comments by Walmart and Safeway reiterate that assertion. ARA states that utility load management planning will have to be progressive in Arizona to assist incumbent utilities as large load users change utility companies as a result of competition.

The **COMPETE Coalition** is a representative of more than 400 customers, suppliers, generators, transmission owners, trade associations, and economic development corporations that support well-structured, competitive electricity markets. COMPETE states that electric competition will benefit all Arizona consumers, allow for the development of renewable resources and advanced energy technologies, demand response, and energy efficiency, and support the innovation necessary to develop new technologies at lower costs than through government regulation while keeping costs as low as possible and producing economic and environmental benefits.

COMPETE also notes that continued reliance on cost-based pricing and monopoly protection will impede innovation, place the financial risks associated with generating plants on captive ratepayers with limited, if any, accountability by utility management or consequences to utility shareholders, and will fail to incentivize investors to build new merchant generating plants. COMPETE provides examples of benefits (including consumer savings, rate impacts compared to the national average, generation fleet efficiency improvements, and renewable capacity additions) achieved in Pennsylvania, Illinois, New York, Texas and California, all of which implement retail electric competition.

Freeport-McMoRan Copper & Gold, Inc. and the **Arizonans for Electric Choice and Competition** (collectively "AECC") believe that the continued development of a competitive retail electric market in Arizona is in the public interest because of the benefits it can bring to consumers. Some of the benefits of retail competition include bringing consumers more choice in the availability of renewable energy products and encouraging growth of commercial-sized renewable energy projects. The market will allow these products to compete against those renewable energy programs made available to ratepayers through incumbent utility programs, potentially driving down the costs of renewable energy implementation, forcing incumbents to become more efficient in their use of ratepayer dollars to implement REST programs. In addition to giving customers a choice in the type of energy products available to them, a system based on real-time pricing is likely to make power consumption more efficient, provided that the proper price signals are being considered in the marketplace.

AECC believes that the current statutory and administrative authorities related to POLR provide protection for residential and business customers while APS and TEP tariffs regarding larger customers provide reasonable notice to the provider of POLR that a larger customer intends to return to Standard Offer rates. AECC recognizes that moving forward, a challenge exists involving POLR responsibilities of affected utilities to their short and long-term integrated

resource planning activities. This challenge may be addressed under recently promulgated IRP rules.

AECC believes that the rules regarding retail electric competition regarding certificates of convenience and necessity (“CC&N”) for prospective ESPs remain largely in tact, providing a strong framework that can be modified as needed to address an ever-evolving market. Additionally, the *Phelps Dodge* decision does not stand as a substantive legal impediment that would limit the Commission from considering a CC&N application at this time. For the reasons set forth above, AECC urges the Commission to move forward with retail electric competition in Arizona, even if in a phased approach as contemplated in the Retail Electric Competition Rules.

National Energy Marketers Association (“NEM”) believes that energy competition at both the retail and wholesale level is in the public interest. NEM points out that choice is the ultimate benefit to the consumer. NEM believes that retail competition promotes the environment through innovative offerings such as green products and energy management. NEM states that both retail and wholesale markets need to become competitive. NEM believes that a POLR should only be used in an emergency or under special circumstances. Consumers should be eligible but not required to receive POLR service when they are no longer being served by a competitive provider. POLR should have minimum stays and not mandated minimum terms and should be designed to be 24 hours/7 days a week/ 365 days a year full risk, no notice service. NEM recommends that a retail choice ombudsman become installed in each utility and at the Commission to facilitate retail market development.

Sempra Energy Solutions, LLC; Direct Energy LLC; Constellation New Energy, Inc.; and Shell Energy Northern America (US) L.P. (collectively “Competitive Electric Service Providers”) state that Arizona is surrounded by states with retail competition and risks lagging further behind as a national and international business competitor. As such, retail electric competition is in the public interest. Moreover, all consumers, not just large consumers, benefit as competition puts downward pressure on retail rates.

The Competitive Electric Service Providers do not believe that the concept of a POLR is an obstacle or an impediment to the reinstatement of retail electric competition, nor is the lack of a complete set of rules governing the transition to electric competition as such rules are not a condition precedent to the Commission granting an ESP a CC&N. Arizona’s current rules for retail electric competition are substantively workable and can be used as a starting point for the re-initiation of competition. Moreover, the *Phelps Dodge* decision does nothing to prohibit the Commission from lawfully approving rates and charges for lawfully certificated retail energy suppliers for the provision of competitive retail electric service. Sempra Energy Solutions, LLC encourages the Commission to move forward with its CC&N to provide competitive electric retail service in Arizona.

Regarding the costs of competition, the Competitive Electric Service Providers reiterate that retail electric competition puts downward pressure on retail rates and when discussing “cherry picking,” note that the “picking” is done by the customer rather than the ESP. The issue of load uncertainty is an issue that utilities are already in the business of evaluating and tariff

provisions currently in place, which require notice of return to utility service, mitigate uncertainties and risks associated with serving returning customers.

The Competitive Electric Service Providers inform the Commission that California has resumed retail electric choice and urge that Arizona rejoin progressive states such as California, Washington, and Oregon. Doing so would improve the competitiveness of Arizona businesses, allowing end-use customers to choose and tailor electric products and services that best meet their needs and manage their own costs. Retail electric competition would also significantly enhance alternative energy opportunities, including renewable energy products, sustainable and carbon-neutral packages, numerous demand response offerings, and energy efficiency services. The Providers remind the Commission that Sempra Energy Services' application for a CC&N meets all the statutory requirements, that the company is currently positioned to bring a value proposition to Arizona's consumers, and there is simply no justification for further delay.

Your Access to Marketing Services ("YAM Services"), while acknowledging the potential risk of predatory pricing, states that the benefits related to an open access market are numerous and proposes that all large commercial and industrial customers be allowed to participate (rather than the proposed 1 MW threshold). All commercial and industrial entities with whom YAM Services works are in favor of retail electric competition. POLR needs more clarification as the 100 MWh threshold is discriminatory as it relates to the practice of aggregation. YAM Services states that the Commission's current electric competition rules need to specifically address the distinction between an ESP who takes title to power and an aggregator who does not, with a specified code of conduct for aggregators. Regarding the costs of competition, YAM Services feels that an adjustment should be spread across all customer classes with an annual true-up. YAM Services lists the adoption of a code of conduct for utilities and their affiliates, rules and certification related to safety and reliability, service quality measures, valuation of utilities' generation assets, changing suppliers, and the use of an electronic data information system in Oregon as other issues related to retail electric competition.