Comments of Constellation NewEnergy, Inc. and Strategic Energy L.L.C.
Regarding the Retail Electric Competition Rules
Submitted on April 14, 2003

In Decision No. 65154 (the "Track A Decision"), the Arizona Corporation Commission ("Commission") ordered that an Electric Competition Advisory Group ("ECAG") be formed. The Track A Decision also ordered that Commission Staff open a rulemaking to review and amend the Retail Electric Competition Rules and to address issues resolved in the Track B proceeding.[1] Parties were invited to join ECAG, regardless of whether or not they had participated actively in the Track A proceeding.[2]

Although a rulemaking has not yet been opened, Staff has indicated to ECAG members that it would like the group to provide preliminary feedback on issues associated with the review of the Retail Electric Competition Rules. Staff has stated that the purpose of this request is to identify some of the key issues impeding competition and areas of the Retail Electric Competition Rules that could be improved. Accordingly, a March 19, 2003, Memorandum from the Director of the Utilities Division asked ECAG members to provide information that relates to the Retail Electric Competition Rules and impediments to the facilitation of electric competition. The Memorandum propounded the following questions:

a. Please indicate what sections of the Retail Electric Competition Rules should be revised.

b. Please briefly summarize why the sections listed in part (a) above, require revisions.

c. Please identify market issues related to the provisions in the Retail Electric Competition Rules that generally impede or discourage competition

d. Please provide information on issues that the Retail Electric Competition Rules do not currently address but should.

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[1] Docket E-00000A-02-0051 24 focuses on Commission consideration of Competitive Solicitation issues, delineated as "Track B" issues.
[2] *See* December 30, 2002 Notice signed by Ernest G. Johnson, Director – Utilities Division; and January 17, 2003, ECAG Quarterly Report.

The primary purpose of this filing is to respond on behalf of Constellation NewEnergy, Inc. and Strategic Energy L.L.C. to the questions raised with regard to the Retail Electric Competition Rules ("Rules"). We begin first with certain general comments about the state of the Arizona competitive market and then provide comments with regard to specific elements of the Rules.

I. <u>Description of Constellation NewEnergy and Strategic Energy</u>:

Constellation NewEnergy is the nation's leading competitive energy supplier, serving over thousands of commercial and industrial customers throughout the United States that represent over 4,000 megawatts of peak load. Constellation NewEnergy has licenses to conduct business in deregulated markets across the country.[3] On April 21, 1999, the Commission granted NEV Southwest, L.L.C.'s application for a Certificate of Convenience and Necessity ("CCN") to supply competitive services as an electric service provider.[4] Constellation NewEnergy is a wholly owned subsidiary of the Constellation Energy Group (NYSE: CEG), a Fortune 500 company based in Baltimore, Maryland.

Strategic Energy has more than 33,000 commercial and industrial customers in states that have enacted retail choice, including Pennsylvania, Ohio, New York, Michigan, Massachusetts, Texas, and California – with the hopes of offering products to Arizona customers. More than 180 full-time energy professionals at its headquarters in Pittsburgh, PA and in offices across the country are devoted to objective electricity and natural gas management and consulting.

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[3] Constellation NewEnergy is licensed to serve commercial and industrial customers in California, Connecticut, Delaware, District of Columbia, Illinois, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Texas and Virginia.

[4] The initial filing was made under New Energy Ventures Southwest, L.L.C. with subsequent company name changes to NEV Southwest, L.L.C. and then NewEnergy Southwest, L.L.C. The company is in the process of filing a new CCN application to reflect the current company name, Constellation NewEnergy, Inc.

Strategic Energy procures and manages over $2 billion of electricity and natural gas per year and has never had a customer interrupted.

II. General Comments Regarding the State of the Arizona Competitive Market:

Constellation NewEnergy and Strategic Energy have reviewed the Rules and have identified several areas that are ripe for comment. First and foremost, the Commission must examine the critical question of "Why is the retail market not developing as expected." The answer to this question is abundantly clear – the Commission's "price to beat" is well below market. For example, an examination of the rates for the larger Commercial and Industrial customers on the Arizona Public Service system indicates that the variable cost of power for these rate classes is below the market price for power at this time.

By comparison, Western Electricity Prices for the week of April 7-11, 2003, as reported in the April 11, 2003 issue of California Energy Markets indicate the following range of prices for two relevant electricity delivery points:

Location	Peak ($/MWh)	Off-Peak ($/MWh)
SP 15	$45.00-$58.00	$32.00-$41.50
Palo Verde	$41.75 - $56.50	$29.50 - $37.00
Average	$43.375 - $57.75	$30.75 - $39.25

From the chart above, it is readily apparent that a $31.26/MWh[5] variable price for Commercial and Industrial customers is well below market, except at limited, off-peak hours. Because the price to beat is a vestige from regulation, such distortions in prices make it difficult for customers to see an economic benefit in switching and deter Energy Service Providers ("ESPs")

[5] On the E-34 Rate Plan, customer pay 3.126¢ for each kilowatt-hour (kWh) used regardless of how much energy is used. This price is in effect throughout the year, unlike some rate plans that have higher summer prices

from entering into the Arizona market. This distortion prevents the development of a vibrant and healthy retail market that would benefit Arizona consumers.

The utilities' costs clearly do not seem to be reflective of market costs. Moving away from a "regulated" commodity/generation price to more of a market-based rate would significantly increase the ability of customers to make informed choices about their energy supply needs. This may happen, commensurate with the termination of the CTC recovery period, which should be the end of 2003.

In the interim, Constellation NewEnergy and Strategic Energy applaud the Commission's recent decision that provides an opportunity for market participants to bid for the utilities' net short position. It is clearly a move in the right direction. However, we would caution against rolling into a regulated rate base the unregulated assets of an affiliated company. Such a proposal would significantly diminish, if not eliminate, the need for a utility to go to a market to bid for supplies, thereby decreasing the opportunity for generators to bid to supply the utility's load. The result would be customers are no closer to making economic decisions about their energy supplier because the price they see from the utility bears no relationship to market prices.

Constellation NewEnergy and Strategic are also concerned about the possible elimination of the Arizona Independent System Administrator ("ISA"). The Arizona ISA is tasked with, among other things, ensuring that all market participants have equal access to transmission facilities on a non-discriminatory basis. ESPs, such as Constellation NewEnergy and Strategic Energy, would be concerned about their ability to deliver energy to customers behind the utilities' transmission systems if the operation of the transmission grid was returned to the utility-control area operators. Retailers will have significant concerns about having "fair" access to transmission facilities if the utility is controlling access to those facilities. Transmission access needs to be open and unfettered if retail competition is to develop properly. The Commission must recognize the relationship between a healthy retail market and open access transmission. Put simply, you cannot have the former, without the latter.

Constellation NewEnergy and Strategic Energy also suggest that the Commission should give serious consideration to the establishment of a core/non-core market for Arizona. The essence of such a market would be to divide the market along a consumption level, such as 500 kW. Customers below that level would be classified as core customers and remain bundled customers of the utilities, receiving generation, transmission and distribution service in a manner identical to that provided today. Customers with consumption above 500 kW, or who aggregate to this threshold, would be classified as non-core. They would continue to receive transmission and distribution service from their local utility. However, they would be required to contract for their generation needs with ESPs.

This market structure has existed with great success in the California natural gas market since the late 1980s. Moreover, the California Legislature is currently considering a bill that would establish a similar market structure for the state's electricity market.[6] The sponsor and various supporters believe that, if passed, a core/non-core market structure will bring some stability and certainty to the electricity market in California.

A core/non-core market structure clearly defines the group of customers for whom the utilities will continue to have a long-term supply obligation. This definition has been sorely missing from the restructuring process. The core/non-core structure also allows the utilities to plan their purchases with some certainty about its load and obligations. Finally, core/non-core also provides certainty to customers, and the ESPs who serve them, about the rules of the market

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[6] *See,* Assembly Bill (AB) 428 (Richman), which defines the difference between bundled core customers and non-core customers, as well as the utilities' service obligations with regard to each customer group.

going forward. Finally, we would suggest that (as proposed in California) customers be provided the ability to aggregate load to meet the 500 kW threshold. It is important, however, to allow such aggregation of customer load to be done on a state-wide basis, as opposed to on a utility–specific basis. This is an important aspect for customers who have multiple sites throughout the state.

Constellation NewEnergy and Strategic Energy support the continued extension of choice to all Arizona electric customers. In the past, Tucson Electric Power proposed that retail choice be limited solely to the few customers whose load exceeds 3 MW. A less restrictive approach would set a breakpoint at the 500 kW level, which offers choice to a broader spectrum of commercial and industrial users, provides the customer base for an active retail market and allows businesses and industries to manage their energy costs.

III. <u>Specific Comments Regarding the Retail Electric Competition Rules</u>:

Constellation NewEnergy and Strategic Energy offer the following comments and suggestions with regard to the Retail Electric Competition Rules:

1. The Commission approval process for Certificates of Convenience and Necessity needs to be streamlined. The current process takes up to 300 days, and requires an order by the ACC. This is ridiculously long and frustrates prospective entrants to the Arizona retail market. Other states have processes that are more streamlined, but no less rigorous.
2. The Commission permits the utilities to require written signatures for ESPs to get access to customer information. The age of information has advanced, in many other states, to include electronic or voice approval subject to independent verification. We recommend that Arizona should adopt a similar, more streamlined method for authorizing the release of customer information to ESPs.

3. We note that other states, such as Pennsylvania, routinely provide customer lists to registered ESPs, in order to increase the ability for ESPs to successfully market to customers. If Arizona truly wants to facilitate development of a vibrant competitive market, it should do the same. Access to the lists would be restricted to registered suppliers and only for the purposes of marketing electricity. In no event would such lists be permitted to be sold or used for other purposes.
4. ESPs are currently provided only a customer's last 12-month consumption data, demand and power factors. This is limited amount of information, compared to what is regularly provided in other states with a more robust retail market. For example, ESPs should also be provided meter information, the customer's current rate class, load factor, account number(s), and other relevant information needed to enroll the customer accurately.
5. There is a requirement (R14-2-1611 D.) that if an ESP/customer contract does not comply with the ESP's tariff, it must be filed with the director of the utilities division and shall not become effective without a Commission order. This process makes it very difficult for ESPs to structure customer-specific deals, unless the ESP's tariff is overly vague. This creates problems because of how much time it takes to obtain Commission approval, the potential for jeopardizing the confidentiality of the deal, and the likelihood of having the length of time required to obtain Commission approval affect the ESP's ability to follow through on the pricing offered in the original contract. There is no need for Commission approval for large customers. These are sophisticated consumers who have the expertise and judgment to make informed contracting decisions for their energy supply. Constellation NewEnergy and Strategic Energy suggest that for customers with demand of 500 kW or greater, and for those customers who aggregate to this threshold,

the Commission should not need to approve structured deals. Customers will always have recourse to file a complaint or seek civil remedies through the courts if they do not believe that a contract was negotiated in good faith or performed in accordance with its provisions. It is simply over-reaching and unnecessary for large customers to have this level of Commission intrusion into their contracting decisions.

6. Under 14-2-1612 I, the Rules provide for restoration of service interruptions by ESPs within the shortest time possible. It should be clarified that these requirements pertain to those interruptions that are under the direct control of the ESP.
7. Under 14-2-1612 J, there is a time schedule of notification that the ESP must provide to the customer and the utility for switching a customer back to standard offer service. We would suggest that the Commission adopt a similar timeframe for a utility-customer switch to an ESP. Therefore, with 15 days advance notice, the utility should effect such a switch by the next meter read date.
8. The Rules also have a requirement that customers above 20 kW have hourly consumption measurement meters or meter systems. The Commission needs to determine if that requirement is applied equally as between utility-served and ESP-served customers. Having hourly meters for consumption levels as low as 20 kW seems a bit unnecessary. Of course, should the Commission adopt the core/noncore approach recommended above, this would become a non-issue.
9. The Rules provide for very significant amounts of data that need to be reported twice a year, in addition to an annual report. The Commission should reconsider the intent of the required reports. Reporting just for the sake of reporting is not an appropriate policy, unless the Commission can clearly enunciate why such frequent and extensive reports are

necessary. Such reporting is burdensome and costly and also serves to frustrate would-be participants in the Arizona retail market.

10. Finally, Constellation NewEnergy and Strategic Energy believe that the Commission should pay serious attention to the strengthening of its current code of conduct. It is necessary to have a clear and stringent code, especially in order to prevent any blurring of the lines between utility-regulated and unregulated entities. The Commission should examine, for example, the California and Texas codes of conduct as good models to follow. In any event, the Commission should not weaken the existing codes, as suggested by APS.

IV. Conclusion:

Constellation NewEnergy and Strategic Energy appreciate the opportunity to participate in the Electric Competition Advisory Group and to offer these comments with regard to both the overall state of the Arizona retail market and these specific comments with respect to the Electric Competition Rules. Any party requesting more information with regard to these comments and the suggestions contained herein are invited to communicate with the following representatives of Constellation NewEnergy and Strategic Energy:

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