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ARIZONA CORPORATION COMMISSION

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Director of Utilities

Commissioner Jim Irvin
Commissioner Marc Spitzer
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Re: Electric Competition: Electric Competition Rules Docket No.RE-00000C-00-0275
AISA Docket No. E-00000A-01-0630
APS Request for A Variance Docket No. E-01345A-01-0822

Dear Commissioners and Interested Parties:

This letter is the follow up letter on electric restructuring issues, referred to in my December 5, 2001 letter to Commissioners Jim Irvin and Marc Spitzer. First, I would like to thank them for their support of my efforts to bring developing issues in electric restructuring into an open forum with public participation. The Commission's Electric Competition Rules were first adopted in 1996. Since then, relevant circumstances have changed. I believe it is necessary to determine if changed circumstances require the Commission to take another look at electric restructuring in Arizona.

The purpose of this letter is to identify questions that should be answered before important Commission decisions are made concerning electric restructuring. At the present time, the Commission's Electric Competition Rules, along with the Settlement Agreements approved by the Commission for APS and TEP, establish the framework for a transition to a retail generation competitive market. Recent events such as California's disastrous experience with retail electric competition, as well an apparent trend of other western states to step back from competition to more traditional regulation, reflect problems in the transition to and implementation of a competitive market.

Many say the Arizona Commission, unlike some other states, has implemented electric competition correctly by safeguarding the public interest in the transition to a competitive market. I certainly believe the Commission's actions, to date, have been prudent and have also led to many customers enjoying lower—not just stable—rates. I have concerns, however, that before we continue at the same pace on the path existing, the Commission should continue its commitment to prudence and make an opportunity for consideration of whether circumstances have changed enough to compel a different pace or path.

Recent events within Arizona have heightened those concerns. For example, the APS request for a variance of the Electric Competition Rules' requirement, as modified by its Settlement Agreement and Commission order, that at least 50% of APS' electricity to serve Standard Offer

customers be acquired by competitive bid by 2003 does not reflect how we originally thought things would develop. Another example is the Commission Staff AISA Report filed on November 17, 2001, which raised similar issues on the direction of retail electric competition in the context of whether there should be continued support for the AISA. These dockets are part of a larger picture framed by the present Electric Competition Rules, and should not be considered or addressed in isolation. Rather than addressing these issues as discrete decisions, a look at both the Rules and their implementation under the Settlements is warranted before moving farther down the road. All of these factors lead me to believe that it is in the public interest to take a precautionary pause for an open forum to receive public comment and provide for full discourse by the Commission.

The matters addressed at these public proceedings are those identified by all of the Commissioners at the December 5, 2001 procedural conference in the APS' variance request docket. These matters include whether the Commission should continue implementation of the Rules as they now provide, without any changes like the APS variance request or modification of the Rule provisions establishing the AISA. In the alternative, the Commission could slow the pace of the implementation of the Rules to provide an opportunity to consider the extent to which Rule modification and variance is in the public interest, including changing the direction to retail electric competition. A third choice may be to step back from electric restructuring until the Commission is convinced that there exists a viable competitive wholesale electric market to support retail electric competition in Arizona.

In order to make these proceedings meaningful, interested parties should answer certain questions, and specific proposals should be made if alternatives are advocated. However, this is not the time to file comments on the generalities of retail electric competition. I think the Commission needs to hear **specific** answers and **specific** proposals from the interested parties on the identified issues, not the same global comments on the pros and cons of electric competition in general that have previously been given to this Commission. In light of this, I have attached a list of questions to be answered by interested parties. I invite the other Commissioners to docket their questions as well.

Because I believe that these matters cannot be addressed in isolation, I find that a new generic docket should be established to deal with the concerns expressed herein. The APS variance request docket and the AISA docket should be consolidated with the new generic docket for the same reason. By this letter I direct that the Chief Hearing Officer open the generic docket by procedural order, and consolidate it with the APS variance request and AISA dockets. I also direct that a procedural order set the times for written responses to the Commissioners' questions and an open meeting with public comment for the consolidated dockets. I am aware that certain time frames for the APS docket have been established, and these may remain in effect, unless consolidation requires some modification.

Finally, please do not read conclusions into any or all of the attached list of questions. I have decided we need a thorough review and, consequently, a comprehensive list of questions is in order. I am particularly concerned that some of the more "elementary" questions not lead to a conclusion that abandonment of the existing plans is imminent. If readers must reach any conclusions regarding the intent of any question (or the entire range of them), it should be that I do not wish to take anything for granted in this inquiry. I believe there is simply too much at stake to be overly selective in what is asked and reviewed regarding the matter of electric restructuring in Arizona.

Interested parties should file and docket in the generic docket established by the Chief Hearing Officer their responses to the attached questions on or before February 1, 2002.

Sincerely,

William A. Mundell
Chairman

Attachment

cc: Brian McNeil, Executive Secretary
Ernest Johnson, Utilities Division Director
Chris Kempley, Chief Counsel
Lyn Farmer, Chief Hearing Officer
All Parties of Record

I. Identification of Retail Electric Products and Services for Which Competition Could Bring Benefits

A. What are the possible goods and services traditionally provided by the electric utility for which retail competition is possible? You may address the following categories of goods and services:

1. generation, including baseload, intermediate and peaking power; green power; distributed generation; firm and nonfirm power; long- and short-term contracts; backup and coordination services:

2. distribution services, including ownership, construction, maintenance and repair of the physical lines; metering ownership, installation, reading and data analysis; and the process of planning for and negotiating with distributed generators:

3. aggregation services, such as load profiling; load planning; customer services; data analysis; billing; generation planning; power supply acquisition; demand side management, energy efficiency and other services relating to matching supply and demand.

B. For each good or service for which competition is possible, what are the possible benefits of competition for each good and service?

1. What are the potential price benefits?

2. Do the potential price benefits differ in the short-term and long-term?

3. What are the potential non-price benefits?

4. Are there any other potential benefits (e.g., environmental, energy security, etc.)?

II. Determination of the Feasibility of Competition

A. Are the product and geographic markets for the good or service conducive to effective competition or manipulation by a single entity? For example--

1. Are there economies of scale which make it most efficient for the service to be provided by a single company?

2. Are there economies of scope which make it most efficient for the service to be provided in a bundle with certain other services?

B. Are or will there be a sufficient number of competitors in each potentially

competitive market?

1. Is the product or service one which viable competitors will actually be interested in providing?

2. Is the cost of aggregating customers sufficiently small, relative to likely revenues, which new suppliers will find it profitable to enter?

3. Are there technical, legal, or other barriers to entry in the markets? For example:

   a. Are there legal or technical barriers to the construction of the different types of generation plants by non-utilities?

   b. Is the cost of obtaining licenses, resources, knowledge and employees sufficiently small, relative to the expected revenues, such that new entrants will find the market attractive?

C. Is it necessary for the product or service to be provided by a single regulated company to assure reliability and safety, or can multiple companies that provide the service subject to reliability and safety rules?

D. For customers, is the cost associated with learning how to shop and actually shopping

sufficiently small, relative to the expected benefit, that customers will want to shop?

III. Relationship of the Current Regulatory Regime to Competition

A. For each potentially competitive product or service, how does current state and federal regulation foster or inhibit (a) retail competition and (b) wholesale competition?

B. How can the Commission protect Arizona customers from the risks of competition while promoting competition?

C. How have the interim rate reductions for customers receiving standard service affected the ability or desire of generation suppliers to compete in Arizona retail markets?

D. Do Commission policies or legal requirements ensuring that utilities recover investments from ratepayers affect the prospects for competition in any market for which competition otherwise would be possible?

E. Does continuing utility control of depreciated generation assets affect the ability of competing suppliers to enter retail markets?

F. How does current Commission regulation promote or deter the ability of (1)

renewables, (2) distributed generation, and (3) energy efficiency and demand side management to compete with traditional generation resources?

G. What are the risks of moving to a regime of retail competition for each product or service and what are the methods for managing those risks?

H. If the current regime is not conducive to retail competition for a particular product or service, what actions should the Commission take to promote its success in the future? Specifically --

1. Should the Commission require existing utilities to procure particular products or services from unaffiliated competitors?

2. Are utilities taking steps that will make competition more difficult down the road (e.g., retail marketing, internal restructuring, entering into agreement to avoid customer self generation)? If so, identify those steps and how the Commission should respond.

3. Are utilities entering into long-term contracts with existing customers? If so, how do they affect prospects for future retail competition? Should the Commission allow them?

4. Should the Commission consider instituting competition for billing and

metering services even if retail generation competition is premature?

IV. Retail Generation Competition

A. Regarding each identifiable generation product --

1. Identify with particularity any defects in the wholesale market structure affecting Arizona.

2. Are there an adequate number of competitors to sell in Arizona to make the product sufficiently competitive? How many sellers are there?

3. How have mergers and consolidations in the industry affected the competitiveness of the product in the region at the wholesale and retail levels?

4. Are competitors building new generation able to price their generation at rates competitive with existing generation?

5. How has the Independent System Administrator affected the success of (a) retail competition and (b) wholesale competition?

B. Regarding the transmission and distribution infrastructure necessary to support competition for each identifiable generation product --

1. Are there transmission constraints inside or outside Arizona that currently impede the ability of competitors to reach Arizona customers during any seasons of the year or times of the day?

2. What plans are in place to relieve transmission constraints?

3. How long will it take to relieve any existing transmission constraints and what factors are affecting and will affect prospects for relief?

4. Are the owners of constrained transmission facilities, or holders of transmission rights, able to use their control to affect market prices?

5. Are these transmission owners currently doing things that will allow them to exert more or less control in the future? If so, please detail.

6. Will the transmission system be adequate prospectively (e.g., in the next, 5, 10, 15, 20 years) to deliver power from new generation plants?

7. Is the natural gas pipeline infrastructure adequate to support all proposed new

gas-fired generation plants? How many plants can it support?

8. Does the transmission and distribution system facilitate or deter --

a. the development of renewable energy technologies?

b. the development of distributed generation?

c. the development of demand-side management and energy efficiency?

C. Regarding competitive bidding --

1. Identify with particularity any adverse consequences that would result from Commission approval of a substantial variance to the electric competition rules that require competitive bidding for 50% of the electric supply for standard offer customers, starting in 2003. Specifically:

a. How would retail customers be affected?

b. How would retail generation competition be affected?

c. How would wholesale generation competition be affected?

2. Are sufficient competitors available for an effective bidding process for 50%

of standard offer service? A higher or lower percentage?

3. Can retail competition develop if current rules are modified to allow a utility to procure all its generation for standard service from an affiliated company?

4. How would retail competition be affected by other deviations to the competitive bid rules? Be specific about the changes in the rules and their consequences.

5. Instead of entertaining individual requests for substantial variances to the competitive bid requirements, should the Commission proceed on a generic basis to modify the rules for competitive bidding?

6. If the Commission would change the 50% bidding requirement for standard offer service, are there other specific measures the Commission can take to promote retail competition?

D. Regarding the pricing of power supply contract rates --

1. Identify any advantages that would result if the Commission approved a long-term supply contract for standard offer customers that was based solely on cost-based rates. (Your answer should define "long term" as compared with "short term" contract.)

2. What if the contracts are based solely on market-based rates?

3. Describe how FERC's new approach for analyzing the ability of sellers with market rate authority to exercise market power affects generation companies selling into Arizona.

4. Does the Commission have the ability to assure that approval of a long-term contract would protect ratepayers receiving standard offer service as well as foster competition?

V. Industry Events External to Arizona

A. Describe in detail developments you believe will occur in both the wholesale and retail competitive electric generation markets nationally and in Arizona over the next 12 months, 24 months, 36 months, 48 months and 60 months.

B. Is there anything the Commission should do to continue to avoid California's retail electric competition experience? Please be specific.

C. Does the Enron bankruptcy have any lesson for retail electric competition in Arizona?

D. How will FERC's RTO initiative affect the realization of effective retail generation competition in Arizona?

E. Do you anticipate changes in federal utility statutes to affect the jurisdiction of the Commission and its ability to foster retail competition in Arizona? Please detail.

VI. System Security

A. Are there compelling reasons to be concerned about security for electric generation facilities since the Sept 11, 2001 tragedy? Please include discussion of interconnection at a central location such as Palo Verde/Hassayampa.

B. Does transferring ownership of generation facilities out from traditional Commission jurisdiction have any potential negative security consequences?

C. What if ownership after transfer results in a foreign corporation eventually controlling Arizona's generation?

D. Does such a transfer to a non-Arizona entity potentially impact security issues for Arizona?

E. Are there any positive security aspects to transferring electric generation out from Commission traditional regulation to a foreign corporation?

F. Provide specific examples to support your answers.

VII. Vision

Please provide your vision for how viable competitive wholesale and retail electric markets will (or will not) develop in Arizona. Please be specific regarding dates, the development process, and measures for determing at various stages how successful the process has been.