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AZ CORP COMMISSION

ARIZONA CORPORATION COMMISSION

February 7, 2002

Chairman William A. Mundell
Commissioner Marc Spitzer
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

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

Dear Commissioners and Interested Parties:

In his book "The Wealth of Nations," Adam Smith writes, "The natural price, or the price of free competition ... is the lowest which can be taken, not upon every occasion indeed, but for any considerable time together...[It] is the lowest which the sellers can commonly afford to take, and at the same time continue their business." Watch the invisible hand of the free market at work.

In its purest form, electric restructuring is supposed to run on the power of competitive markets, free from government regulation and bound by the principles of supply and demand. Electricity, it seems, is turning into a commodity which can be traded alongside precious metals and luxury goods in the open marketplace. But as is often the case, theory does not fit squarely with reality.

I commend both Chairman Mundell and Commissioner Spitzer for their efforts in identifying the task before us – to take a look at Arizona's current restructuring efforts, and develop concrete solutions to potential problems so that consumers can enjoy safe, reliable power at a competitive price. Likewise, we must also balance those needs with environmental and public interest considerations; perspectives that are usually 'invisible' to the invisible hand. In doing so, our goal as regulators has been to improve the overall quality of life for people in Arizona.

I. Arizona Independent Scheduling Administrator

My position concerning the continued existence of the AISA is well documented (see letter dated November 19, 2001, Docket No. E-00000A-01-0630). Open Access Transmission Tariffs (OATT) currently on file with FERC should be changed to conform with the Protocol Manual developed by the AISA, and should be sufficient to facilitate Arizona's floundering retail market. Arizona cannot overlook FERC's determination that – once a state commission adopts a

system where generation service is available as a separate product – *all transactions* (even standard offer) fall within the federal government's exclusive jurisdiction [see Denial of ACC request for rehearing, FERC Docket No. ER02-348-000]. I am not willing to concede this point, nor am I willing to lightly concede state jurisdiction over such matters without **clear benefits** for all classes of Arizona consumers.

Questions:

Please address whether Arizona's Constitution prohibits the Commission from giving up *any authority* with respect to the pricing of services by public service corporations which occur solely within the state.

Should Arizona be willing to let the federal government take over pricing jurisdiction (market-based rates) for all retail transactions which occur in the state, or is this an inevitable (and proper) result of opening retail markets to competition?

Can Arizona's UDCs modify their tariffs with the FERC to conform with AISA protocols so that retail transactions can still take place without the AISA? How many times has the AISA been used to resolve disputes over transmission issues to date?

II. Retail Electric Competition Rules ("Rules")

Anyone who suggests that revisiting the ACC's current Electric Competition Rules will have a dramatic negative impact on investment, generation supply or the development of market rates fails to recognize reality. In the legal arena, these rules have been challenged and held to be "unlawful and unconstitutional under Article 15, section 14 of the Arizona Constitution and Ariz. Rev. Stat. § 41-1001 et. seq." [Tuscon Electric Power Company, et al. vs. The Arizona Corporation Commission, Case No. CV 97-0348 – Consolidated]. After Judge Campbell's decision I wrote, "Certainly, an opportunity to rehabilitate our electric competition rules pursuant to Judge Campbell's decision brings with it an ability to create more consumer protection provisions for Arizona ratepayers." [press release dated November 29, 2000].

No one argues that California's experience with 'deregulation' (a loosely used term) was, and continues to be a disaster. It should be noted that California has already began to 're-regulate' its electric industry with a myriad of new state agencies. Rolling blackouts, alleged price fixing in natural gas, and a highly volatile spot market for electricity have chilled restructuring plans in the western region. Arizona stands alone as the **only** state which has not suspended or postponed retail competition rules or laws.

Nevertheless, I have long since held the view that Arizona's move toward competitive markets will necessitate revisiting the Rules on a periodic basis. Like an architect's building specifications which are modified during the construction process, so too must this Commission look at existing electric competition rules to see if modifications are necessary, or as Chairman

Mundell writes, "[consider]...whether circumstances have changed enough to compel a different pace or path."

Markets

Functional wholesale markets are paramount before creating robust retail markets in electricity generation. Retail customers – especially residential consumers – desire reliability and price stability in addition to appropriately priced power. Arizona has yet to determine what a retail market should look like, and whether 100% participation provides sufficient benefits for consumers to warrant wholesale change. Perhaps its because Salt River Project's customers enjoy traditionally low electric rates; perhaps its because APS and TEP standard offer customers are currently protected by rate caps. Nevertheless, since the ACC adopted the current Rules in mid-1999 (and the Legislature's adoption of HB 2663 in 1998), there has not been ONE residential customer who has switched to a different provider in Arizona.

When in effect, R14-2-1606(B) requires each UDC to acquire all of its power purchased for standard offer customers to come from the competitive market – with a least 50% going to competitive bid. However, this rule fails to identify some unit of time which would characterize the power purchases of the UDC. Will independent power producers (IPP) bid their generation output in a spot, short-term or long-term wholesale market? Will IPPs market directly to retail consumers through and electric service provider – even though the number of ESPs continue to decline?

Questions:

If the majority of market participants intend to market electricity *only* to industrial, large commercial and load serving ESPs entities, should retail markets be limited by load size to allow those entities with true bargaining power to negotiate Direct Access?

What will be a UDC's primary functions in a competitive market?

Is it important to first establish functional wholesale markets before creating robust retail markets in electric generation? If so, why? If not, why?

When price caps are lifted for the majority of Arizona consumers, what assurances do we have that volatility in the market (for both natural gas and electricity) will not result in unstable or inflated rates? Will the generation price of electricity fluctuate with the price of natural gas?

Should there be a provision added to R14-2-1606(B) which would allow/limit a UDC to contract for wholesale power in three or five year intervals? What would be a proper length for contracts?

What are the real benefits to residential consumers and small businesses in retail competition, other than consumer choice.? Will IPPs market their power directly to retail customers, or are their efforts mainly focused on selling power to wholesale customers?

Currently, is residential choice a real option? If not now, when?

What provisions, if any, are necessary to effectuate a gradual replacement of those existing plants in Arizona which are older, more polluting and less efficient than the newer combined cycle plants currently being built?

What are the long-term effects of divestiture for APS? How does the Commission guard against a PG&E situation, where the distribution company declares bankruptcy after profits have flowed to its parent holding company?

Pricing

The three major components of pricing – generation, transmission and distribution – all require prudent planning in order to achieve a level of stability acceptable to the average consumer. Since 1999, we have seen wholesale prices for electricity fluctuate between $20.00 per megawatt to $2000.00 per megawatt. Likewise, the price of natural gas has moved from an approximate low of $2.50 a therm to a high of nearly $10.00 per therm. Volatility in these markets will only continue to hold both consumers and the economy at large hostage.

Since transmission is a major component of the price ultimately charged to the consumer, the establishment of a regional transmission organization for the southwest is vital, and should be accomplished as quickly as possible if competition – either wholesale or retail – is to take root in Arizona. To that end, I believe that this Commission should be working more closely with the FERC to make Arizona's concerns known in this matter.

Competition in Arizona

I am not prepared to announce the death of competitive energy markets in Arizona – but the fruits hanging from the vine of deregulation are in desperate need of nourishment. Restructuring the electric industry should be about consumer benefits and bettering the quality of life in the state, not appeasing Wall Street's earnings expectations for one company or the next. Left unchecked, corporate greed (i.e. Enron) can replace sound reasoning and result in highly volatile markets ultimately harming average consumers.

All of us should keep in mind that the vast majority of people (and businesses) are interested in the bottom line. We cannot accept a restructured system that benefits only a few without regards to the basic needs of the whole. If competition is to move forward in Arizona, sufficient consumer protections need to be in place to assure that a commodity as valuable as electricity is safe, reliable and affordable to all classes of customers.

I understand that the parties have until February 25, 2002 to answer the questions asked thus far. My questions are more general in nature than those posed by my colleagues, and I suspect that most will be answered in the course of answering theirs. To the extent that any party chooses to answer my specific questions, I will expect that such answers will be provided within the timeframe already established.

Sincerely,

Jim Irvin, Commission
Arizona Corporation Commission

Cc: Chairman William Mundell
Commissioner Marc Spitzer
Docket Control