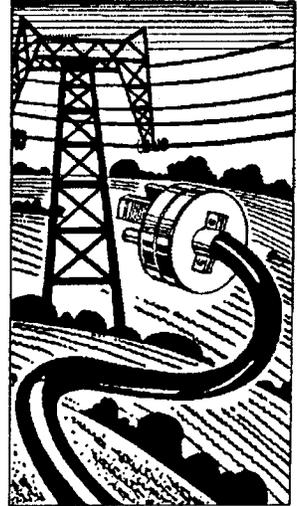


**Arizona Legislature
Joint Legislative Study Committee
on Electric Industry Competition**



LEGISLATIVE STUDY COMMITTEE FINAL REPORT

**Submitted to the Arizona Legislature
December 31, 1997**

CO-CHAIRS

Speaker Jeff Groscost

Senator John Wettaw

MEMBERS

Representative Ken Chevront
Representative Harry Clark
Representative Bill McGibbon
Representative James Weiers

Senator Scott Bundgaard
Senator Chris Cumiskey
Senator George Cunningham
Senator John Huppenthal

COMMITTEE AUTHORIZATION

The Joint Legislative Study Committee on Electric Industry Competition was established by Laws 1996, Second Regular Session, Chapter 276 (HB 2504). The committee membership consists of five Representatives appointed by the Speaker of the House and five Senators appointed by the President of the Senate. In conjunction with the Legislative Study Committee an advisory committee was established to provide technical assistance, support and information regarding electric industry competition.

COMMITTEE DUTIES

The committee duties were to:

- 1) Study and make recommendations on the following issues in regards to electric retail competition:
 - a) The financial issues including but not limited to the financial impact to customers, the financial impact to the utilities, state and local tax implications, and recovery of stranded costs.
 - b) The legal issues including issues of federal and state jurisdiction, current state law and rule, interstate reciprocity, universal service and the protection of proprietary information.
 - c) The social issues including the efficiency and sufficiency of an aggregate supply of energy, environmental impacts, the impacts on developing renewable resources, and the method to ensure fair and equitable treatment among all consumers.
 - d) Issues related to system planning, operation and reliability
 - e) Issues related to market structures
 - f) Additional issues related to retail electric competition
- 2) Complete a report to the Legislature with a proposal to implement electric retail competition.

COMMITTEE RECOMMENDATIONS

The Committee met a total of five times. The Committee heard testimony on the following issues:

- 1) October 9, 1996: An Overview of the Electricity Utility System and a History of the Electric Utility System in Arizona and Nationally
- 2) November 13, 1996: A Review of the Proposed Arizona Corporation Commission Rules on Retail Competition

- 3) April 18, 1997: Formation of three work groups to study 1) a date certain to begin competition; 2) Kilowatt taxes in lieu of property tax, and 3) the Legislative role in implementing competition.
- 4) June 19, 1997: Review of the work group work plans and testimony on the California deregulation legislation.
- 5) October 16, 1997: Review of the work group final reports and testimony from Legislative Counsel on legal issues involved in retail competition

The minutes from the meetings are attached in appendix A.¹

The Committee did not adopt any recommendations or proposals on how to implement electric retail competition. However, the work groups that were established by the Study Committee completed reports containing recommendations and testimony on specific issues relating to electric retail competition. The executive summary and recommendations from the work group reports are contained in appendix B. The complete reports are on file at the Chief Clerks Office of the House of Representatives.

¹Due to audio difficulties, the minutes from the June 19, 1997 meeting are not available.

Appendix A

Study Committee Meeting Minutes

ARIZONA STATE LEGISLATURE

JOINT LEGISLATIVE STUDY COMMITTEE ON
ELECTRIC INDUSTRY COMPETITION

Minutes of the Meeting

Wednesday, October 9, 1996
2:30 p.m., House Hearing Room 2

MEMBERS PRESENT

Representative Bundgaard
Representative Chevront
Representative McGibbon
Senator Barnes
Senator Huppenthal
Senator Peña
Senator Wettaw, Co-chairman
Representative Groscost, Co-chairman

MEMBERS ABSENT

Representative Clark
Senator Cummiskey

STAFF

Teri Grier, House Analyst
Debbie Johnston, Senate Analyst

Co-chairman Groscost convened the meeting at 2:45 p.m. and roll call was taken. He acknowledged Bill Twardy, Jack Davis, Gary Yaquinto, Charles Bayless, John Underhill, Tom Delawder and Steven Olea as members off the working group which would make the Electricity Utility System presentation later in the meeting. He additionally acknowledged Steve Glaser, Dennis Criswell, David Berry, Martin Schultz, Michael Curtis, Ray Williamson, Russell Smoldon and Tom Jones as members of the working group which would make the History of the Electric Utility System presentation.

Representative Groscost next introduced members of the Advisory Committee on Electric Industry Competition, established by law to provide technical assistance, support and information regarding electric industry competition to the Committee. He named George Allen, Mark Bonsall, Ken Evans, Steven Glaser, Jack Haenichen, Renz Jennings, Roy W. Jones, Tom Jones, Joe Lane, Thomas S. Martin, Bill Meek, David Mills, Greg Patterson, Pete Peterson, Darrell Pichoff, Martin Schultz, Chuck Shipley, Jeff Schlegel, David Spaur, Donald Vance, Lisa V. Wayne and Anne Wendell. Members' affiliations are listed on a handout distributed at the meeting (filed with original minutes).

Teri Grier, House Research Analyst, provided a brief overview of the Committee charge, noting that its report to the Legislature, due no later than December 31, 1997, shall include an assessment of areas including financial, legal and social issues, issues related to system planning, operation, reliability, identification and review of potential market structures and other issues not mentioned specifically but related to generation, sale and transmission of electric energy. Each aspect of the charge is further defined in a handout Ms. Grier distributed (filed with original minutes).

ELECTRICITY UTILITY SYSTEM PRESENTATION

Charles Bayless, Tucson Electric Power (TEP), gave a slide presentation (copies filed with original minutes) entitled "Electricity 101." He began with an explanation of how electricity is generated, continuing with a description of generation resources, generation dispatch, transmission and distribution. He noted that one of the major driving forces which has changed the electric industry is the gas turbine engine which can be now obtained for under \$500 per kilowatt hour (kwh). Mr. Bayless explained that in the past each generating station was unique, but since it is now possible to mass assemble gas turbine engines, prices have fallen. He noted that the idea of customers generating their own power is now plausible with the radical decrease in generation cost and plant size. Mr. Bayless explained that in Arizona, nuclear and coal energy resources dominate in producing power.

Mr. Bayless indicated the other thing that has changed the electric industry dramatically is transmission, changing the industry from a natural monopoly operating on rules and regulations passed in the 1930's to 1950's to a vast, interdependent interstate market. He explained that this interstate commerce is regulated by Federal Energy Regulatory Commission (FERC), which the states must now develop a working relationship with in considering deregulation.

Mr. Bayless explained that transmission has become very complex, noting that reliability is accomplished by linking companies' power plants to the same grid, allowing energy to be accessed from the most available source, thereby reducing the reserve margin necessary for any one company. He explained that in 1968 the North American Electric Reliability Council (NERC) was formed in response to the widespread power blackout in the northeastern United States. In contrast, Mr. Bayless noted the recent August 10, 1996 power loss in the western United States did not result in a blackout, but rather deliberately scattered outages in response to a voltage collapse in southern Oregon on that day. He indicated that 95 percent of customers' power was restored in less than 2 hours. Mr. Bayless noted the Western Systems Coordinating Council (WSCC), is also charged with setting reliability criteria to insure there are no repeats of blackouts, and setting up an interconnected system throughout the entire western United States. He explained that the generation of electricity constitutes 50 percent of energy costs, transmission constitutes 40 percent, and distribution constitutes 10 percent.

Mr. Bayless reviewed the events of the power outages on August 10, 1996 in the western United States, explaining this event was caused by neglected tree trimming at an Oregon plant. He explained how power was shifted all over the west to avoid major blackouts.

Mr. Bayless related that when TEP started in the 1930's it was a natural monopoly, unrelated to other Arizona Public Service or the Salt River Project, or any other power

company, and noted that laws passed then reflected this premise. He emphasized that this premise no longer exists; that it has been demonstrated the electric industry is not a natural monopoly and can transition to operate in a competitive environment. Mr. Bayless expressed his wish to work with the Committee to develop a rational transition process to competition, while at the same time, insuring that energy delivery remains reliable.

Senator Wettaw asked what the capability is of importing energy resources from outside the west and what safeguards exist to prevent blacking out the whole country in doing so.

Mr. Bayless responded that import limits into each area are observed, so it is known beforehand how much can be brought in on any transmission line. He acknowledged that amount of energy which can safely be imported is an issue that must be investigated.

Senator Wettaw asked if it would be possible to totally deregulate the electric industry across the states if there are import limits established for safety purposes.

Mr. Bayless acknowledged this is a critical question that needs to be answered, because there will be limits maintained. He noted that FERC is currently dealing with this problem and is considering the idea of an "independent system operator" that would take over transmission and operate it for all companies, insuring that whoever needed energy could obtain it.

Representative Groskost questioned what the chance would be that power would be transported grid to grid, suggesting that, realistically, competition will occur within each grid.

Mr. Bayless noted that the WSCC grid is so big, with a natural barrier of the Rocky Mountains, that not much transfer would be seen there. However, he noted that in the northeastern United States, there is no reason why there could not be such transfer. Mr. Bayless noted this is a FERC question and it is wrestling with how to operate the system under deregulation.

Representative McGibbon asked if by adding more potentially independent suppliers to the local grid, i.e. Fort Huachuca, more energy reserves might be added if out-of-state systems go down.

Mr. Bayless acknowledged it both helps and hurts. He noted it helps in the sense it provides more energy that can be generated quickly, but noted that in an unstable condition, it is sometimes harder for the small independents to follow. Mr. Bayless expressed his view, that the independent suppliers will overall create a more stable situation because they can come on line very quickly and are dispersed.

Representative Groskost suggested reliability may become an element of competition and the opportunity could arise to offer this as a sales point in imposing limits. He suggested a company such as Motorola may choose to pay a higher rate for 99 percent reliability, whereas another, such as one of the mines, may choose a lesser percentage of reliability for a lower rate.

Mr. Bayless agreed reliability will become a marketing tool, however, suggested it needs to be determined who is responsible for the system stability and noted utilities would want to be compensated if it was determined to be their responsibility.

Representative Groskost acknowledged that if additional effort is required that costs more than an incremental amount, the user should be paying more.

Senator Barnes asked Mr. Bayless to describe his view of the Committee's charge and also asked what he hopes to see happen in the Legislature as a result.

Mr. Bayless expressed his view that the charge of the Committee is to explore a move towards competition, but acknowledged it is a very delicate matter. He noted it would take a cooperative effort, with the outcome being a fully competitive, reliable electric market, and the Legislature assessing what laws are necessary to put this into place.

Senator Barnes asked Mr. Bayless whether he thinks the Corporation Commission is more responsible for making rules, or the Legislature more responsible for making laws, in regard to this move toward competition.

Mr. Bayless expressed his opinion that both the Legislature and the Corporation Commission have authority to effect different parts of the move to competition. He suggested it may take a constitutional amendment, because the Commission is a constitutional body with rate-setting powers. Mr. Bayless expressed his hope that the entities with specialized powers work together and realize it must be a cooperative effort.

Mr. Bayless emphasized it is generation of electricity where competition is going to happen and will start with the high megawatt users and go on down.

Representative Groskost commented that certainly electric deregulation will be different than long-distance telephone calling, but suggested that in the future competition may develop in the elements of transmission and distribution and reliability, elements that we now take for granted.

Senator Wettaw asked if all 50 states develop multiple power companies and facilities, the net effect down the road will be to merge into 3 or 4 different power companies.

Mr. Bayless suggested there will be a radical "unbundling" of services first, e.g. meter reading companies, transmission companies, etc. and this will drop prices. Later, he suggested, "rebundling" would occur in a move to market the convenience of buying all services from one company. Mr. Bayless acknowledged there may be massive aggregation and mergers.

In response to Representative Chevront's inquiry about the relative cost-effectiveness of different energy sources, Mr. Bayless acknowledged the price of the cheap gas turbine energy will go up as everyone seeks it.

HISTORY OF THE ELECTRIC UTILITY SYSTEM IN ARIZONA AND NATIONALLY

Michael Curtis, Arizona Municipal Power Users Association (AMPUA), explained his organization of 17 entities represent over 1.5 million customers throughout Arizona. He presented an historical account of the electric industry in Arizona, emphasizing the electric industry is one of the most extraordinarily well-designed and well-built systems of providing comfort and convenience the world has ever seen. Mr. Curtis emphasized the industry was not built to "overkill," but to withstand the demands of a growing economy.

Mr. Curtis presented overhead slides showing pre-1935 Arizona when generators existed in cities in towns and operated independently. Mr. Curtis related that in the mid-1930's, with the Rural Electrification Act, isolated cooperatives with diesel engines sprang up in rural areas as an element of economic development. He noted there was no participation in plans or transmission, but starting in 1948, Arizona Public Service had an operation in West Phoenix that, at the time, was projected to take care of all conceivable needs into the future.

In 1937 and 1940's the Parker-Davis system was built and the private utilities and cooperatives decided to join with them and the phenomenon of participation was seen. He noted that most of the present integrated, monopolistic, centralized system has developed since 1968 and now will be broken up by the move to competition. Mr. Curtis emphasized that this proves that resources are a function of technology; that as technology improved, resources were found. He suggested the Committee will need to consider how technology creates resources and how these will be allocated legislatively.

Mr. Curtis pointed out that 32 power entities are now operating on the strength of the security afforded by their certificates of convenience. He explained these plants were built to fulfill the bargains they made to sell electricity at reasonable rates. Mr. Curtis noted that now technology poses the possibility of bringing all these entities into generation companies, buyer companies, transmission companies and distribution companies, each competitively priced to reduce the cost of electricity to everyone. He asserted this

transition can be made and should be made with concomitant restructuring of rules and regulations to be competitive.

Senator Huppenthal asked, in regard to the loss in value in California, if there has been any action in the Arizona equity values in the time preceding the Corporation Commission's deliberations.

Mr. Curtis indicated that everyone else discounted the electric utility; and since notice of what is going to happen in Arizona has been sufficient, adequate and long enough, all the rating agencies and investor groups throughout the country have sized-up and published a valuation of every one of Arizona's utilities. He cautioned this multi-million dollar situation should be treated with a certain amount of predictability and rules.

Senator Huppenthal asked what the "book" value is of Arizona's aggregate utility system.

Mr. Curtis responded it is worth approximately \$15 billion to \$20 billion, with the Palo Verde plant being valued at \$10 billion. He noted most of this money has been borrowed, so therefore represents a lot of debt and must be made secure.

Representative Groskost asked what has happened in California since they seem to have gotten back on track.

Mr. Curtis explained investors in California are now beginning to explore diversity opportunities. He noted discussion is ongoing about developing generation or transmission companies and diversified energy investment organizations. Mr. Curtis further explained California Edison has divided, renamed and created a cluster of organizations, as has San Diego, to take advantage of the economy which exists when properly-structured group competition in power transmission takes place in an honest market. He emphasized there will be hundreds of millions of dollars in savings if this is properly done. Mr. Curtis acknowledged California is still proceeding in a rush and figuring things out "on the fly."

Representative McGibbon asked how Arizona would encounter problems meshing with the schemes of other western states once it determines its own scheme.

Mr. Curtis indicated the activities of other states are being monitored hourly, noting that if Arizona begins in the time period it seems to be allocating right now, it will not be behind or too far in front. He emphasized that the electric industry is working three years ahead and therefore, any decision made today will not have an impact for three years into the future.

**STUDY COMMITTEE ON ELECTRIC
INDUSTRY COMPETITION**

**October 9, 1996
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Mr. Curtis expressed his eagerness to work with the Committee and cautioned members to keep an eye on the pocketbooks of the residential, commercial and industrial customers as well as the billions of dollars which have been borrowed and the commitments already made by the electric industry.

Representative Groskost thanked presenters for educating the Committee, indicated the next meeting time and date will be decided next week and notification will be issued. He also indicated the next meeting would be either one all-day seminar or a two-day seminar, meeting the afternoon of one day and the morning of the next. The topics tentatively to be covered include: an historical overview of the deregulation of transportation and public service industries, an overview of the Energy Policy Act of 1992 and timelines; an overview of the FERC regulatory rulings and an overview and examples of other states' electric competition programs. Representative Groskost additionally mentioned as topics: an overview of the actions taken by the Arizona Corporation Commission regarding deregulation and a brief explanation of major issues, such as stranded investments, universal services, market organization, renewables, conservations programs, unbundling of services, certificates of conveniences and spot markets.

Without objection, the meeting was adjourned at 4:35 p.m.

Respectfully submitted,



Alice Kloppel,
Committee Secretary

(Tape and attachments on file in the Office of the Senate Secretary)

Chief Clerk

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ARIZONA STATE LEGISLATURE

JOINT LEGISLATIVE STUDY COMMITTEE ON
ELECTRIC INDUSTRY COMPETITION

Minutes of the Meeting

Wednesday, November 13, 1996
2:30 p.m., Senate Hearing Room 1

MEMBERS PRESENT

Senator Stan Barnes
Senator Chris Cumiskey
Senator Manuel "Lito" Peña
Representative Scott Bundgaard
Representative Bill McGibbon
Representative Harry Clark
Representative Ken Chevront
Representative Jeff Groscost, Co-chair

MEMBERS EXCUSED

Senator John Huppenthal
Senator John Wettaw, Co-chair

STAFF

Debbie Johnston, Senate Analyst
Alan Ecker, House Analyst

Senator Barnes, serving as Chair *protempore*, convened the meeting at 2:50 p.m. and the attendance was noted.

**REVIEW OF PROPOSED ARIZONA CORPORATION COMMISSION RULES ON RETAIL
ELECTRIC COMPETITION**

Gary Yaquinto, Director, Utilities Division, Arizona Corporation Commission (ACC), presented overhead slides relating the development of rules for retail electric competition, begun in 1994 and drafted in 1996, and the rationale for them. He noted that draft rules were submitted to the ACC in October 1996 and public comment about them was then solicited in Phoenix, Tucson, Yuma, Flagstaff and Kingman.

In talking about changing what has been a monopoly to a competitive product, Mr. Yaquinto discussed six guiding principles which have been employed:

- ◆ To provide opportunity for customer choice
- ◆ To avoid unnecessary disruptions to the extent possible
- ◆ To preserve and protect system reliability
- ◆ To protect the small consumer
- ◆ To protect utility investors
- ◆ To promote development of solar generation sources

Mr. Yaquinto indicated a working group on electrical reliability, which first met October 30, 1996, has been set up to develop recommendations on ways to maintain reliability when the transmission and distribution of electricity is sold competitively. He also indicated this working group is charged with examining whether an Independent System Operator (ISO)

ought to be established. Mr. Yaquinto explained an ISO insures that electricity is transmitted into our state grid and that it is delivered to the proper places.

Mr. Yaquinto explained the ACC has chosen to set aside 15 percent of the first 20 percent of the electric market for residential customers when the electric industry is opened up for competition. He further explained there is requirement for incumbent utilities to provide a "standard offer" to those residential customers not wishing to choose a competitive supplier of electricity.

Mr. Yaquinto indicated that protection of public policy programs such as those designed for low-income residents, conservation, energy efficiency has been built into the rules as well through a "systems benefits charge" levied on new suppliers into the market. He also related that methods to recover "stranded investments," referring to the investments made by utility companies many years ago, will also be developed. Mr. Yaquinto related the intent to promote tapping solar energy in Arizona and create a viable solar energy industry.

Mr. Yaquinto indicated the ACC has no regulatory jurisdiction over city-owned utilities, municipal utilities or the Salt River Project (SRP) and its rules will affect only these investor-owned utilities: Arizona Public Service, Tucson Electric Power, Citizens Utilities, AEPCO (Arizona Electric Power Cooperative) and most cooperatives, including Navapche Coop. He explained the phase-in of the competitive generation supply of electricity will begin in January 1999 filling 20 percent of the retail demand, filling 50 percent by January 2001 and all retail demand by January 2003.

Mr. Yaquinto also related that a limit has been placed on the amount of competitive demand available to the very largest customers, restricting the competitive demand to one-half of the amount available for customers with demands larger than 3 megawatts.

Mr. Yaquinto reviewed charts showing competitive market estimates for the affected utilities and a map of affected utility service areas. He also reviewed competition rules related to certificates of convenience and necessity to compete; to services required of affected utilities; to stranded costs recovery from the competitive market; to a solar portfolio standard; to service quality, consumer protection and billing; in-state reciprocity and system benefits. Mr. Yaquinto also related that working groups have been created to consider participant selection, unbundled and standard offer services, stranded costs, system reliability and safety and legal issues.

Renz Jennings, Chairman, ACC, provided an overview of why he arrived at the decision to move from a monopoly to competition in the electric industry. He explained that new turbine technology and the concomitant decrease in energy prices created by its use in the energy industry nationwide drives the move to competition. Mr. Jennings also suggested the perception that competition is inevitable and that the generation of electricity is no

California is in this context currently. He suggested "merger mania" will be a hot topic in the not too distant future, as utilities will have to decide to "eat or be eaten" in order to survive. Mr. Jennings acknowledged the move to competition will be problematic, but emphasized the need to think about the long-term, not rig the marketplace, actively address research and development and determine how much of a safety net is necessary.

Senator Cummiskey asked how tariffs are going to be negotiated between affected utilities. Mr. Jennings indicated the transition costs will be recovered from the competitive market, and to the degree a challenging utility comes in to take customers away, the customer is going to have built-in to the price of electricity, fair charges for using that part of the incumbent's system which are used. He suggested it will be "open network architecture."

Representative Groscoast suggested the unbundling and rebundling process could produce a cheaper cost for the rebundled services and Mr. Jennings agreed this is what is being attempted, though acknowledged there is a huge risk because the incumbent utilities will be prone to resisting full and fair competition. He explained that transmission of energy will probably remain as a public service or be highly regulated as a monopoly, as there are not an infinite number of natural corridors for competitors to run power lines through. Mr. Jennings suggested that in a future with roof-top solar panels and fuel cells in the basement, utilities will look like a battery, be brokered or be something other than a generator, distributor or biller of services.

Senator Barnes asked Mr. Jennings what the Legislature needs to do as opposed to the ACC needs to do in regard to the move toward competition. Mr. Jennings suggested the Legislature needs to become involved in regard to the SRP issue, who has joined in criticizing the ACC rules. He suggested SRP has had some advantages over the years and also suggested it cannot ultimately be compelled to be in a statewide reciprocal marketplace.

Mr. Jennings emphasized there are big issues to resolve and suggested it may take three months of hearings with sworn testimony, more appropriately accomplished through the offices of the ACC than at the Legislature. He asserted the hearings at the ACC could narrow the issues between utilities which the Legislature then needs to address.

Mr. Jennings indicated that ACC attorneys have said that what the ACC has put in motion is possible, whereas the utilities disagree with that position. He suggested the Legislature needs to empower the ACC to go forward or not, and set public policy, but suggested it would not want the day-to-day management of hearings.

Senator Barnes acknowledged the utilities' position that there are problems left to be resolved in terms of stranded investments, reliability and obligation to serve and asked Mr. Yaquinto to comment on all that seems undone while at the same time the ACC is moving

longer a monopoly has also driven the move to competition. He also noted the electric industry, almost from inception, has been a cost-declining industry. Mr. Jennings emphasized that the move toward competition in the electric industry will have a public interest like no other, as its product does not store well, its product is used simultaneously to its production and because the electric industry is the dirtiest in the country. He further emphasized that this is a big money issue, as one-quarter of the domestic private capital in the United States is invested in utility infrastructure and therefore has a bearing on how healthy the country is and what direction it moves in.

Mr. Jennings emphasized the need to address stranded investments, the need for legislators and regulators to ensure the incumbent utilities are treated equitably and the need to address the issues particular to SRP. He emphasized the need to move to a one-half percent solar energy standard because its cost is historically declining, because the U.S. may have to back out of using carbon intensive fuels in light of global warming and increasing prices and because the addition of solar energy will help fortify the competitive market with options that will contain the prices of coal and natural gas.

Representative Groskost asked how much faster solar can be moved along than it already is and how much effort Mr. Jennings foresees directed in this area. Mr. Jennings explained the range of technologies for solar energy will be explored to determine which are best suited to bulk energy delivery and indicated there will be continued federal participation in this. He explained the solar Sterling Engine looks plausible for use in the next three to five years and that along with Solar II, could be producing \$.07 electricity. Mr. Jennings also noted that once services are unbundled and rebundled it should be cheaper than the incumbent utilities' prices. He emphasized solar energy makes good public policy, noting there will be economic development benefits which flow from the concomitant research and development of solar energy.

In response to Representative Groskost's inquiry about what the comparative output of solar energy is now compared to the one-half percent standard, Mr. Jennings responded current output is very modest. Mr. Jennings clarified that one-half percent refers to the amount of generation of solar energy in the energy portfolio and not an amount of money.

Representative Groskost suggested an aggregate of consumers may develop who are willing to pay more for "green" energy because they know it is accomplishing good things. Mr. Jennings agreed this is a probable reality and also suggested that micro generators, gas feeds to property and fuel cell technology may bring energy back to the point of use as opposed to using huge remote energy plants.

Representative McGibbon asked whether out-of-state utilities will be able to physically come into Arizona and underbid its in-state utilities. Mr. Jennings explained that to some degree there will be some "gaming" between large buyers and large sellers, noting that

to a competitive plan. Senator Barnes suggested this seems bad for the utilities but also for customers who need electricity at their own residences.

Mr. Yaquinto explained it has not been the intention of the ACC to "flash-cut" to a competitive world, but to set up a process with a phase-in beginning in 1999, recognizing numerous issues, such as stranded costs, have to be fully developed. He emphasized the ACC rules incorporate a process to resolve the issue of stranded costs, for example, beginning 15 days after the rules are finally adopted. Mr. Yaquinto indicated the same goes for unbundled tariffs within 45 days after the ACC rules are finally adopted. He emphasized the rules set up a framework with target dates for all parties to meet and develop a transition from a monopoly to a competitive market.

Senator Barnes acknowledged that working groups address unanswered questions, but related the situation of a working group in another committee that could not arrive at a solid solution in a timely manner. He suggested working groups may produce reports that are inconclusive and cautioned that the process may be putting the "cart before the horse" at a time when investors' money is at stake and consumers are not assured of reliability.

Mr. Yaquinto acknowledged there are millions of dollars at stake in stranded costs, and agreed he would be surprised if the working group came back with a consensus answer to this issue. He suggested it will be found that parties taking a risk will begin to narrow the issue during the course of the year and it is anticipated, as well as required, that a series of evidentiary hearings with testimony by every stakeholder take place to determine how those stranded costs are to be recovered.

In response to Senator Barnes' request to know what will happen if the working group does not arrive at a consensus, Mr. Yaquinto indicated the ACC will decide the issue. He suggested that the working group report will look like a recitation on each party's view of the solution to stranded investments, but will also provide a forum for participation by the Commissioners, so their thinking on their issue can be shared as well.

Senator Barnes asked how the Palo Verde Nuclear Generating Plant plays into the plans, and Mr. Yaquinto explained the ACC has begun a process to help APS speed up the depreciation of the plant to allow the amortization of regulatory assets that would otherwise become stranded investments.

Senator Barnes asked about reliability to customers and Mr. Yaquinto explained competition will bring choices and build layers of quality of service at different prices which customers may choose from. He noted that the largest customers already have interruptible service in place, to reduce costs when energy is least used. Mr. Yaquinto emphasized that the ACC rules require that all new entrants into the market must follow National Electric Reliability Council guidelines and Western Systems Coordinating Council

guidelines. He also noted the reliability working group has three subcommittees developing recommendations for sustaining reliable service.

Representative Groskost asked about the obligation on the part of utilities to serve, suggesting this may be a highly political problem. Mr. Yaquinto indicated the rule requires that a standard offer be provided by incumbent utilities to customers not interested in shopping competitively for electric. He noted that utilities receive the ability to recover stranded costs from the competitive customers in return and entrance into other markets.

In response to Senator Barnes' concern that a constituent in a remote area may be denied service because the cost to run a line out to his property is competitively prohibitive, Mr. Yaquinto noted that this situation exists currently, as there is no requirement on the part of the utility to extend service under extraordinary circumstances if the customer does not want to pay the cost.

Senator Barnes suggested it is not right to ask the utilities in a competitive market to allow another utility to join the market. He asked where legal authority is derived to do this.

Mr. Yaquinto responded that the ACC has no regulatory jurisdiction over SRP, but stated the ACC rules enable it to become a participant. He explained that if SRP voluntarily decides to participate, it must reciprocate in terms of opening up its service territory to the other participants.

Senator Barnes questioned why the rules state that the other participants must unanimously agree to SRP's participation first. He questioned why the ACC has the power to delegate its authority to a competitor of SRP.

Mr. Yaquinto suggested it is not a delegation of authority or power, as much as a way to enable a situation to occur that otherwise would not happen. He indicated ACC has offered its good offices to help mediate this series of negotiations and emphasized all entities have to feel comfortable that SRP would enter the competitive market on a level basis and not have an unfair advantage. Mr. Yaquinto clarified that ACC cannot require, but can enable this to happen.

Senator Barnes asked whether Mr. Yaquinto believes there is any incentive for another utility to allow SRP to come into the competitive market. He suggested this amounts to an automatic veto of SRP's participation.

Mr. Yaquinto disagreed it amounted to a veto and explained to the extent that SRP is allowed to enter the competitive marketplace on an equal basis, the other utilities have the incentive of also benefitting from being able to enter into SRP's territory.

Senator Barnes questioned whether the ACC rules would create an island or fence around the SRP customers and not allow them to participate in the competitive market which will be available to all other residents in the State.

Mr. Yaquinto reiterated that the ACC rule does not create this situation and that incentive does exist for SRP's management to enable competition if their customers want it. He acknowledged statewide competition will not work very well if SRP is left on the sideline.

Mr. Jennings emphasized the related ACC amendment which passed unanimously was in the alternative, that if there was a way for SRP to voluntarily participate, it could and another way was if the Legislature authorized it. He suggested the ACC would be influenced by a thoughtful position taken by the Legislature.

Senator Barnes asked if Mr. Jennings feels comfortable allowing the competitors to veto another's entrance into the marketplace. Mr. Jennings indicated that as a practical matter, with SRP's current advantages, its entrance would not create a fair marketplace. He emphasized the Legislature has tremendous authority over SRP and could declare that it be in the competitive market.

Representative Groskost asked about the delineation between the co-ops and major competitors and Mr. Yaquinto indicated there is a special provision in the ACC rule that would enable the electric co-ops, given their tax exempt status, to modify the applicability of the transition to competition. He indicated there would also be a requirement that they show the ACC what progress they are making in allowing their customers some choice.

Senator Barnes inquired about the experiences of other states and Mr. Yaquinto indicated that California is being closely monitored and, from its experience with pooling, it was decided not to repeat this arrangement in Arizona. He also indicated the New Hampshire experiment is being followed to judge the manner in which customers are accepting competition as well as are the experiences of New York and Illinois.

In response to Senator Barnes' request to know what went wrong with the California model, Mr. Yaquinto explained the long time period for working out problems as well as the complex financing arrangements and customer surcharges for recovering stranded costs contributes to the complicated situation there.

Senator Barnes commented that the change to electric industry competition moved through the California Assembly with unanimous approval and acknowledged this must mean there is something worth looking into.

In response to Representative Groscost's inquiry, Mr. Yaquinto clarified that the set aside for residential customers was 15 percent of the first 20 percent in the 1999 phase-in, not 15 percent of 100 percent. Representative Groscost questioned whether this is enough.

Mr. Yaquinto acknowledged there will be a lot of inertia, barriers and hurdles that will have to be overcome to reach the residential sector to convince them choice and change is the appropriate way to go. He suggested, though the percentage sounds low, it is at least sufficient to begin to monitor and examine how competition will extend itself to the residential sector.

Representative McGibbon asked how the survival of the co-ops will be insured. Mr. Yaquinto acknowledged that rural co-ops with high revenue producing customers, such as the mines, are very much at risk. He explained the ACC rule addresses this in allowing the co-ops to petition the ACC for a delay in the implementation of competition in their service territories. He further explained these co-ops have been renegotiating their contracts with the mines to meet the competitive demands that are facing them. Mr. Yaquinto explained a particular co-op is currently operating as a pass-through, delivering electricity from a source identified by the mine and reaping a profit.

Representative McGibbon suggested that ultimately the isolated customer will be paying higher costs in making up the necessary revenues to keep the co-ops viable. Mr. Yaquinto asserted the co-ops are faced with this risk today and competition will not exacerbate this risk, at least in the short term. He explained in the long term the co-ops may be taken over by larger energy companies.

Representative McGibbon emphasized the co-ops are membership owned and may not be taken over as easily as a utility owned by stockholders.

Representative Groscost agreed with Mr. Yaquinto that the co-ops will be taken over by larger energy companies, noting the co-ops exist for the very reason that the investment to supply power to these areas was never made. He also suggested that in an unregulated environment utilities will be willing to acquire that investment. He suggested it will be a no lose situation for current co-op members because they have the ultimate say.

David Sparr, economic development representative to the Advisory Board, commented on the solar proposal, suggesting it should be freestanding and competing on its own as a utility and not be subsidized. He confirmed Senator Barnes' understanding that he feels it is incongruous to be requiring participation of a specific utility, i.e., solar generation, when the State is heading towards a competitive market.

Jay Moyes, Phoenix, AZ, attorney, explained he represents small municipal irrigation and electrical entities which serve without ownership of transmission facilities. He related his

**STUDY COMMITTEE ON
ELECTRIC INDUSTRY COMPETITION**

November 13, 1996

Page 9

experiences at a recent conference on ISOs put on by the Southwest Regional Transmission Association, where information was conveyed about states proceeding with implementation of plans pursuant to adoption of concepts, such as Arizona is doing pursuant to the adoption of the ACC rules. He concluded that after hearing this information that the difference between the conceptual framework and the reality of application is a vast chasm with many issues and problems to solve, and that resolving them is extremely expensive.

Mr. Moyes questioned where the savings or benefit to ratepayers will be in all of this. He suggested the move to deregulation is actually just reregulation self-imposed by the utilities among and between themselves; and that the resulting cost will be passed along to the residential ratepayers. Mr. Moyes emphasized the move to electric industry competition deserves an extremely careful study and analysis to see where the economic fallout is going to occur.

Representative Groscost envisioned electric industry competition will provide economic development incentives, producing cheaper power rates across the board with the advantage of the creating more jobs and attracting new business to the State.

Maureen Bureson, Mesa, AZ, representing herself, asserted the impact of electric industry competition on residents and businesses in Arizona will be enormous. She expressed support for the ACC intention to have working groups to increase the consumer's opportunity to participate in proceedings, emphasizing that consumers cannot afford to be represented by attorneys in evidentiary hearings.

Representative Groscost asked how Ms. Bureson views the ongoing Rhode Island pilot project, for example, where rates have been shown to have decreased with competition. Ms. Bureson indicated she has not followed this project and Representative Groscost offered to provide this information.

Without objection, the meeting was adjourned at 5:00 p.m.

Respectfully submitted,



Alice Kloppel,
Committee Secretary

(Tapes and attachments on file in the Office of the Senate Secretary)

MEETING OF COMMITTEE ON

DATE 11-13-96

ELECTRICAL INDUSTRY COMPETITION

TIME 2:30

NAME
Please Print

REPRESENTING

BILL NO.

DARREL J. PICITOFF

City of Mesa

LARRY LUCERO

Tucson Electric Power

CHARLES E. HILL

City of Phoenix

MARY ROSENZWEIG

League Arizona Cities & Towns

KEVIN HIGGINS

ESI

LISA V. WAYNE

Dine' Power Authority

JIM HARTDEGEN

CYPRUS COPPER CO.

LAY MOYES

MEYER, HENDRICKS, BIVENS & MOYES

Janet Regner

ARIZONA COMMUNITY ACTION ASSN

Martin Shultz

Arizona Public Service

4-23-97

ARIZONA STATE LEGISLATURE
Forty-third Legislature - First Regular Session

**JOINT LEGISLATIVE STUDY COMMITTEE ON
ELECTRIC COMPETITION**

Minutes of Interim Meeting
Friday, April 18, 1997
House Hearing Room 1 - 8:00 a.m.

(Tape 1, Side A)

Cochair Groscost called the meeting to order at 8:55 a.m., and attendance was noted by the secretary.

Members Present

Senator Bundgaard
Representative Cheuvront

Senator John Wettaw, Cochair
Representative Groscost, Cochair

Members Absent

Senator Cummiskey
Senator Cunningham
Senator Huppenthal

Representative Clark
Representative McGibbon

Speakers Present

Carl Dablestein, Director, Utilities Division, Arizona Corporation Commission

Establish Subcommittee Assignments:

Cochair Groscost announced that subcommittees will be formed to review the following issues that may require the drafting of legislation prior to the next regular session of the House:

- 1) Date certain for deregulation
- 2) Kilowatt excise tax in lieu of property tax
- 3) Legislative role in process to parallel commission process

Cochair Groscost explained that members for the subcommittees will be assigned by the cochairmen within the next week, and notification of membership and the time line for upcoming summer meetings will be made available.

Corporation Commission (Update Status of Deregulation; Time Line Direction)

Carl Dablestein, Director, Utilities Division, Arizona Corporation Commission, summarized six committees formed by the Corporation Commission to address the following issues:

- Commission rules on regulating restructuring; examine various aspects of deregulation; review the technical and legal aspects requiring consideration.
- Evaluating reliability and safety; identify, define and calculate stranded costs. The most controversial issue in electric restructuring is stranded costs, dealing with how to handle the expenditures that utilities have made under a system of regulation that will likely be unrecoverable in a competitive power environment.
- Accounting, tax and finance issues in connection with stranded investment quantification recovery; evaluate the implications on state and local taxes as a result of electric industry restructuring.
- Legal issues and their implications on stranded costs, government, legislation and federal issues
- Customer selection will review the process for identifying which customers will be participating in the first phase of deregulation. Under present rules, 20 percent of the existing load of the utilities will be subject to retail competition on November 1999.
- Analyzing unbundling and standard offer; the distribution and delivery aspects of electricity under a competitive situation.
- Review the creation of an independent system operator and spot market development.

Mr. Dabelstein stated that the committees have identified September 30, 1997 (for most committees) as the delivery date for submission of reports and recommendations to the Corporation Commission. The charge of the committee reviewing unbundling and standard offer is to ensure that by December 31, 1997, companies will be able to provide the Commission with filings containing unbundled tariffs.

Senator Wettaw suggested expansion of agenda item 2© to include the federal government. Mr. Dabelstein concurred and explained that the charge of the committee (Legislative Role in Process to Parallel Commission Process) will require addressing four specific areas: stranded costs; governmental issues; state legislative issues; and federal government issues.

Senator Wettaw pointed out that because deregulation of utilities is a very complex issue and industry terms are confusing, the committees must consider language that can be comprehended by the public.

Mr. Dabelstein concurred and added that the Commission is reviewing deregulation activities in other states in an effort to develop recommendations that will enable Arizona to avoid the same mistakes. He advised that most of the Commission committees have a specific agenda item that recognizes the need to disseminate information to the public for understanding of options and expectations.

Cochair Groskost requested the Commission's time line regarding committee reports and recommendations. Mr. Dabelstein reiterated that the Commission has imposed a September 30, 1997 deadline on most of the subcommittees for submission of reports and recommendations to the Commission. The committee reviewing unbundling and standard offer has a deadline of October 31, 1997. By the end of 1997, the companies will have to file their unbundled tariffs.

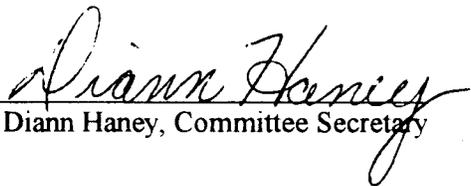
Cochair Groscoast requested the Commission's view on the statutory time line. Mr. Dabelstein responded that the Commission has rules in place for the time line described in earlier testimony. The committees will be reviewing the reasonableness of the obtainable goals in the time line. The intent is to move forward rapidly and diligently to open up the industry to competition.

Senator Wettaw queried if bond holders are being addressed by the Commission committees. Mr. Dabelstein replied that is basically the thrust of the stranded cost issue. He explained that the utilities have issued bonds and stock to acquire the funds to invest in the generation facilities under a traditional perceived regulatory contract where the state will regulate the prices it charges for its service, (and given a reasonable opportunity to recover those costs over a period of time.) With the influx of competition and industry deregulation, there is a strong potential that many of the costs will not be recoverable. In each of the subcommittees the Commission is attempting to include a broad representation of the public to deal with these issues.

Senator Wettaw proposed that the tax implications of deregulation (federal and local) is an issue that must also be addressed in determining required future legislation. Mr. Dabelstein concurred.

Cochair Groscoast pointed out that the Joint Legislative Study Committee on Electric Competition was formed as an implementation committee to oversee the activities of the Commission, not to parallel the committees formed by the Commission.

Without objection, the Committee adjourned at 9:26 am.


Diann Haney, Committee Secretary

(Original minutes and tape on file in the Chief Clerk's Office.)

ARIZONA STATE LEGISLATURE
Forty-third Legislature - First Regular Session

**JOINT LEGISLATIVE STUDY COMMITTEE ON ELECTRIC INDUSTRY
COMPETITION**

Thursday, October 16, 1997
Senate Hearing Room 1 - 3:15 p.m.

(Tape 1, Side A)

Senator Wettaw called the meeting to order at 3:32, and roll was called by the secretary.

Members Present

Senator Cunningham
Senator Huppenthal
Senator Wettaw, Cochair

Representation Cheuvront
Representative Groscost, Cochair

Members Absent

Senator Bundgaard
Senator Cummiskey

Representative Clark
Representative McGibbon

Speakers Present

Ken Behringer, General Counsel, Arizona Legislative Council
Tom Broderick, PG&E Energy Services
Martin L. Shultz, Lobbyist; Work Group Chairman; Arizona Public Service (APS)
Jack Davis, Executive Vice President of Commercial Operations, Arizona Public Service (APS)
Knox Kimberly, Lobbyist; Streich Lang Law Firm
Webb Crockett, Cyprus Minerals
Jim Bush, Lobbyist; Arizona Mining Association
Michael A. Curtis, Arizona Municipal Power Users Association

Guest List (Attachment 1)

Opening Remarks

Representative Groscost thanked the working groups for their hard work on the electric competition issues over the summer months. He referred to the Memo from Ken Behringer, General Counsel, Arizona Legislative Council, (Attachment 2), which is in response to questions concerning the

authority of the Arizona Corporation Commission (ACC) in deregulation of the electric utility industry and addresses changes that may need to occur. He requested input in writing on the legal opinions. He advised that there will be another meeting of the Committee on November 12, 1997, 2:30 p.m., with more time given for public input.

Senator Wettaw advised that the period for written comments on Mr. Behringer's legal opinions has been extended to October 27, 1997.

Review of Legislative Council Legal Opinion

Ken Behringer, General Counsel, Arizona Legislative Council, summarized the issues addressed in his Memo of October 1, 1997 (Attachment 2). He stated that the memo is in response to questions asked on behalf of the Committee concerning the authority of the ACC in deregulation of the electric utility industry.

Senator Wettaw addressed the Arizona Constitution regarding regulation of utilities as compared to other states. Mr. Behringer stated that he believes the Arizona Constitution provision is relatively unique. Entities similar to the ACC exist in other states, but are not created by the Constitution, and it is that facet that causes additional issues to arise in deciding what entity has authority over regulation. There is a mandate in the Arizona Constitution that the ACC must deal with these issues, but a different scope will exist if these provisions are in statute rather than in the Constitution.

Presentation and Comments by Date Certain Work Group

Tom Broderick, PG&E Energy Services, representing Jerry Porter, Chairman, Date Certain Group, stated that the work group received testimony, asked many questions and drafted recommendations, which are contained in the report (Attachment 3). After considering the testimony presented before the work group, it made the following recommendation:

Legislation to establish a date certain for electricity competition is unnecessary. Only legislation which clarified the authority of the ACC is appropriate. The ACC is in the best position to evaluate any on-going date certain issues.

Although the work group recommended that legislation was not necessary, alternatives to the current phase-in approach to the existing ACC rules were discussed and are contained in the report (Attachment 3 - pages 3-4). Mr. Broderick emphasized that the Committee does not support a flash-cut delaying the January 1, 1999 start date, except for the Tucson Electric Power Company.

Senator Wettaw asked for comments on the relation of the time certain to the memo issued by Mr. Behringer, since it appears some of the legal opinions may have enormous ramifications on the time table that various alternatives put forth. Mr. Broderick answered, on behalf of himself and his

employer, that comments submitted on the legal opinion support a minimum legislative agenda; i.e., legislation which only clarifies the authority of the ACC.

Representative Chevront noted that the conclusions state that the Legislature has no role to play in setting a date certain, but Mr. Behringer's memo states that the ACC does not have jurisdiction over municipalities such as SRP (which is considered a municipality). He questioned if the Legislature is not involved, how will the electric providers be brought into competition with the other providers. Mr. Broderick advised that Salt River Project (SRP) testimony indicates that it believes it can open up in time for the January 1, 1999 start date, and does not believe it requires regulatory or legislative approval to immediately begin competition.

Mr. Chevront asked if the ACC will be mandating to other electric providers, but on SRP's good will, it will implement its deregulation in compliance with the other providers. Mr. Broderick responded that entering into an intergovernmental agreement is one option for ACC and SRP.

Representative Groscoast asked if the work group discussed modifying the current phase-in being anticipated, and if the current time schedule is retained, did it discuss implementation that will focus on how to encourage participation. Mr. Broderick advised that the work group spent very little time on that issue once the decision was reached that legislation is not necessary. He referred to Alternatives 2 and 3 on that issue in the report (Attachment 3). He stated that there was some support to transition without regard to restrictions on customer class, and ideas for opening the market and allowing the motivated and interested customers to obtain contracts and request service dates. He said that he believes the general sentiment was to accelerate the 2003 date up to the 2001 time frame.

Representative Groscoast queried whether, if there was a lack of enthusiasm towards moving rapidly and allowing the market to determine who was going to compete, discussion was held to open up the market and begin with 20 percent. That will allow the first 20 percent, on a certain date, through the door to be the 20 percent that participates and then move forward on the remainder of the schedules to some degree.

Mr. Broderick concurred that was discussed, noting that the percentages in the ACC rules were minimums. Testimony was received about the possibility of stair stepping once at the 20 percent level, not waiting until two years later to get to 50 percent, but going on the capabilities of the utilities.

Representative Groscoast requested that, as an economist, Mr. Broderick state his opinion on the best method to determine those functions of the market necessary to prepare for deregulation; i.e., to motivate the largest number of persons with innovative technology and upgrades necessary. Mr. Broderick advised he would emphasize market parameters and not encourage regulatory back stops. He advised that he is in favor of a situation where the utilities have to provide the reasons for the weights and provide that information to customers.

Mr. Chevront voiced concern about moving too quickly, since Arizona has had a regulated monopoly for many years, consumers are not as educated as they should be and may make rash decisions. If that occurs, the state may have to expend more money and time to fix the mistakes. Mr. Broderick indicated that Arizona utilities are learning much from their experience in California. He pointed out that Arizona is still a year away from the January 1, 1999 start date, and can learn still more from states elsewhere.

Senator Wettaw pointed out the need to educate the public regarding deregulation of electricity, since the average person does not understand deregulation other than what is presented in television ads. Mr. Broderick concurred and offered to assist in the educational process.

Presentation of Working Group on Taxation Work Group Report

Martin L. Shultz, Work Group Chairman, Arizona Public Service, summarized the Taxation Work Group Report (Attachment 4). The goal of the Taxation Work Group was to look at the effect of electric competition on Arizona's current tax structure and to provide the Joint Legislative Study Committee on Electric Competition with tax alternatives that are revenue neutral. Based on the facts and conclusions the work group made the following recommendations:

- The effective date for changes, if any, to the tax laws is not necessary until restructuring is implemented or until a need is demonstrated for the change.
- The work group recommends that the tax issues related to electric competition continue to be studied. The Committee may want to consider session law to require update reports on the tax revenue impacts restructuring has had on neighboring states and on Arizona once competition is implemented.

Senator Wettaw questioned California's approach to Arizona's exported power regarding taxation. Mr. Shultz said that all the states that have enacted competition are looking at that issue. He noted that he is not aware of any significant changes that have been enacted in law. He stated that he believes the Transaction Privilege Tax (TPT) in California will apply to in-state sales.

Representative Groscost queried if any states in the region have onerous property tax on electric utilities such as Arizona. Mr. Shultz said that in the Western grid, there is no state that has the same level of onerous burden of property tax on electric utilities.

Representative Groscost indicated there may be a necessity to look more closely at that issue through other states who do not have such a dependency on that taxing stream. Mr. Shultz advised that Arizona has historically relied on electric utilities on all class 1 and 2 properties in Arizona.

Senator Wettaw questioned whether another state can be emulated as far as changing Arizona's tax structure. Mr. Shultz responded that one reason Arizona has an onerous burden on class 1 (mines), and class 2 (utilities) properties is because the assessment ratio is 2.6 times higher than home owners. He opined that Arizona has an assessment ratio that discriminates against business generally (class 3), and classes 1 and 2. Some kind of equity in the assessment ratio will actually create more equity in the tax system. He opined that there are many ways the state can create equity within its property tax system, and expressed willingness to submit a program in writing to the Committee on how to create more equity in the property tax system in Arizona.

Mr. Shultz stated that the work group was specifically charged to consider the implications of a new kilowatt hour (kWh) tax in lieu of the current Arizona property tax paid by electric providers. The kWh tax will be a tax on the end consumer of electricity in Arizona. As discussed in the report (Attachment 4, pages 12 and 13), this is not the only alternative that the work group considered, nor is this alternative necessarily the choice recommended by the work group.

Mr. Shultz commented that no one disagrees with the proposition that should the structure of electric utilities change marketably due to regulation or deregulation that the tax laws will not apply in the TPT, use tax, property tax (PT), and sales tax areas and must be examined. Also, that the PT laws are onerous and burdensome and must be examined as well, in order to have a competitive industry in Arizona. He concurred that there may be some unintended shifts, not only to customers in Maricopa County. The state impact on rural areas who depend largely on PT from electric utilities must be examined carefully before structuring the new ACC regulations and new statutes.

Senator Cunningham pointed out a possible error on page 1 of the Executive Summary (Attachment 3) which states "The electric utilities participating in the report paid over \$250 million in state and city TPT and use taxes in 1996." He suggested that the word "paid" be stricken and insert "collected from utility customers." Mr. Shultz said he believes that is a typographical error. The work group recognized the error and noted that the second line of the same paragraph is correct on this issue.

Senator Cunningham said currently about \$2.9 billion in property tax liability is collected by all jurisdictions; approximately 11 percent from utility property. He questioned, if equity is created in the system by either lowering the assessment ratio with the result of decreasing the burden on utilities (assuming revenue neutral is maintained), whether the tax will shift to other types of properties. Mr. Shultz advised that it will.

Senator Cunningham questioned whether Mr. Shultz recommends that the tax shift onto residential property. Mr. Shultz replied that it is not a targeted recommendation that will impact just residential property taxpayers. Under the scenario, taxes will shift to other classes of property, and also back to the utilities and the proportion of property they have, particularly in school districts. He explained that the issue must be examined district by district and area by area in order to get a true impact.

Representative Groskost requested the amount of taxes Arizona Public Service (APS) currently pays that are not collected from the utility customers. Mr. Shultz said that taxes are reflected in the rate structure, and the property tax payment to the jurisdictions in Arizona is approximately \$100 million.

Representative Groskost questioned, beyond the taxes represented in the rate structure, what other taxes APS is collecting and paying and where they are collected from other than utility bills. Mr. Shultz responded that APS pays federal and state taxes, franchise fees, license tax, TPT, use tax, and property tax. He noted that in a regulated environment the consumer is ultimately paying the tax. However, in a deregulated environment the property tax (PT), the generation component, is another onerous cost of doing business. Because it will be subject to market forces rather than regulated rates, the customer may not be paying all of the cost, and market forces may cause other shifts internally.

Representative Groskost recapped that currently APS customers are paying the taxes, but under deregulation they will be paying only some of the taxes, and taxes may be lowered. Mr. Shultz replied that historically, the policy of the Legislature has been a special focus on electric utilities (classes 1 and 2) and commercial property (the assessment ratio has been two and one-half times higher). He concurred, that in the case of electric utilities, those costs shifted from an equitable burden to an inequitable system, and tax costs have been shifted through electric rates to the customer.

Senator Cunningham asked if there are currently consumers outside the state that are paying for electrical services and as a result reducing the burden on Arizona consumers. Mr. Shultz said the cost of taxes is reflected in the wholesale rates and some are paid by out-of-state people.

Senator Cunningham contended that if the state converts to where other taxes are paid out-of-state, no analysis has been conducted to determine if taxes will be more or less if paid out-of-state as a result of deregulation. Mr. Shultz stressed that is the point of the report (Attachment 4). A more careful analysis needs to be completed based on the tax implications of the new market structure.

Senator Cunningham addressed the concept of inventory burden and who is actually paying for services and taxes. He further noted the concept that certain products and services and certain mandatory services like taxes, if paid by a business, are in part paid by the owners of capital. If it is paid directly by a consumer, the consumer is disadvantaged as a result of paying it direct. Mr. Shultz agreed.

(Tape 1, Side B)

Mr. Shultz explained that regarding the regulated electric utilities, the legislators that made the conscious decision about societal benefits knew that the regulated utilities would ultimately take that new burden to the ACC and attempt to have them reflected in the rate structure.

Senator Wettaw asked currently what percentage of power generated is exported out-of-the state and imported into Arizona.

Jack Davis, Executive Vice President of Commercial Operations, Arizona Public Service (APS) advised that he can provide the 1996 figures for all suppliers within the state.

Representative Groskost maintained that the prime directive of the work group was to come up with a revenue neutral structure that maintains the tax flow while reducing the possible impact on indigenous providers. He noted that if the in lieu tax is not the answer, then other avenues must be explored.

Mr. Shultz stated that he believes the work group provided some tools to accomplish that directive. He explained that other tools are becoming available such as the fact that the ACC is now considering an open ruling as far as the market is concerned. When that issue is determined there will be a clearer understanding of what the new structure is going to be. The tables in the report (Attachment 4), plus a joint study the Arizona Tax Research is conducting with mines and utilities, will add some additional data. Information is also forthcoming from a national perspective to assist in determining where Arizona is and what other states are doing.

Senator Cunningham pointed out that currently there is objective revenue neutrality, but that can change dramatically. He suggested that right now the consumer does not pay everything, and there needs to be a sensitivity to the shifting of the incidence and the burden as well as the revenue neutrality. Mr. Shultz concurred.

Presentation of Work Group on Legislative Role Report

Knox Kimberly, Lobbyist; Streich Lang, gave a brief summary of the Legislative Role Report (Attachment 5). The work group strongly supports electric competition and believes that customer choice will benefit all Arizonans directly or indirectly. The work group recommends that the Committee seek legislation during the 1998 Session to do what is necessary to bring electric competition to Arizona. The Legislature also has a role to provide clarifying legislation as necessary. However, legislation that will duplicate the ACC jurisdiction is not necessary and should be avoided, particularly if it delays bringing electric competition to Arizona.

The work group was established by the Committee to examine issues in regard to the legislative role and the necessary legislation to facilitate electric competition. Pursuant to the Committee's request, the work group has gathered information and testimony from interested parties on these issues and recommends the following:

The work group concludes that the only critical legislation necessary to implement electric competition is statutory language stating that the public policy of Arizona is one of competition with respect to the generation of

electricity, and statutory language confirming that the ACC has the full power and authority to establish rules and regulations necessary to implement such a competitive system.

The work group also identified several specific issues that may need clarifying legislation (Attachment 5 - page 2).

Webb Crockett, Cyprus Minerals, testified before the Committee. He opined that the consumers in Arizona will greatly benefit from the implementation of competition. He explained that in discussing the tax structure, it only applies to competition in the generating of electricity. The remaining services will still be fully regulated by the ACC (distribution and transmission).

Mr. Crockett advised that electricity is being imported into the state from generating units outside the state and being exported to areas outside the state. It must be ensured that cheap electricity generated in Arizona is not exported out of state, and residents being left with expensive electricity. He stated that he believes that can be the scenario if electric utilities remain regulated and competition is not allowed into the market.

Mr. Crockett stated that he believes the role of the ACC is constitutional. Regarding legislation changes, he advised that the public policy needs clarification that the state should be one of competition as opposed to regulated monopoly, which is consistent with the provisions of the Constitution.

Mr. Crockett submitted that before there is a loss of revenue from the generating units, there must be either a closure of the plant or a write-off of the plant.

Mr. Crockett explained that the kWh tax is an in-user tax on the customers, and the federal government will not pay an in-user tax. All of the revenue presently generated from any agency in the state of Arizona will be immune from payment of Kwh tax. If PT's are shifted, which are presently being paid by the federal government to an in-user, it will also be immune from paying any property taxes. The Department of Revenue has recently changed regulations to ensure that electricity coming from outside of the state will be taxed unless exempted. He submitted that ACC, who has the jurisdiction to determine under what conditions these providers will provide electricity, can establish the proper nexus so that the TPT can continue and that electricity coming from outside can continue to be taxed.

Jim Bush, Lobbyist, Arizona Mining Association, opined that the most significant and accurate finding in the report on page 8 (Attachment 4) states that, "At this point, predictions on tax revenue losses or gains are highly speculative." He advised that it is the Association's position that it will be an unwise decision to attempt to predict that there will be a loss of revenue before there is experience under deregulation to know if there is any revenue loss. It is known that Arizona residential consumers have a higher rate by 18 percent than the national average, and 27 percent more than

neighboring states. Mr. Bush indicted that if the tax rate drops 25 percent, it will result in a savings in electricity costs to consumers of \$925 million a year.

Mr. Bush stated that the Department of Revenue (DOR) has changed its rule on the TPT, which now states "a person engaged in business under the utilities classification is subject to tax on the gross receipts from sales of electricity, gas or water produced outside this state, that is delivered through transmission lines or pipe lines to a point for use in this state unless an exemption applies."

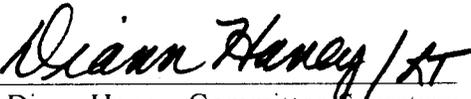
He emphasized that the clients he represents are opposed to replacing the PT with a kWh tax. He explained that utilities do not pay PT, franchise taxes, etc. They are all paid by consumers and users. In competition, the share holders will have to bear part of the burden of the property tax. If PT is replaced with kWh, industry will be able to compete in the free market without the burden of a PT. As far as changing the tax laws to level the playing field, the Association believes that is poor policy. The goal of competition is not to equalize the outcomes of competitors, but to ensure that the consumer gets the best price. Mr. Bush contended that as the state moves into deregulation, it should not alter the tax structure as a condition of deregulation.

Michael Curtis, Arizona Municipal Power Users Association, stated that he believes some legislation may be necessary to help the cooperatives, but supports the ACC process. He indicated that there may be some element of rates and rate making that perhaps have not been taken into account, which will be addressed in writing. Mr. Curtis noted that it may have been overlooked that municipalities, in order to compete, will, in the Association's opinion, adopt ordinances that are driven by the electorate, and those ordinance will allow the walls of competition to come down so that voters will have the right of customer choice. Regarding the legal opinions, he stated that he believes there are some clarifications that may be necessary.

Representative Groskost and Senator Wettaw expressed their appreciation to staff for their hard work.

Written testimony was submitted to the Committee from the Electric Competition Coalition (ECC) from Douglas C. Nelson, Executive Vice President (Attachment 6).

Without objection, the meeting adjourned at 5:04 p.m.


Diann Haney, Committee Secretary

(Original minutes with attachments on file in the Office of the Chief Clerk. Tape on file in the Office of the Chief Clerk.)

Appendix B

Work Group Report Executive Summaries

**Arizona Legislature
Joint Legislative Study Committee
on Electric Competition**

DATE CERTAIN WORK GROUP FINAL REPORT

**Submitted to the Joint Legislative Study Committee on Electric Competition
October 16, 1997**

Work Group Members:

Jerry Porter, Work Group Chairman, Governor's Office
Commissioner Carl Kunasek, Chairman, ACC
Tom Broderick, PG&E Energy Services
Ken Evans, Farm Bureau Federation

Steven Glaser, TEP
Jack Haenichen, Commerce Department
Bill Murphy, City of Phoenix
David Spaur, Mega. Corp.

Joint Legislative Study Committee on Electric Competition Date Certain Work Group

Forward

This report was prepared at the request of the Joint Legislative Study Committee on Electric Competition (JLSC-EC). The work group was established by the JLSC-EC to examine establishing a date certain for electric competition in Arizona. Pursuant to the JLSC-EC request, the work group has gathered information and testimony from interested parties on this issue.

Taped recordings of the work group meetings are available in the Chief Clerk's Office in the House of Representatives.

Recommendation Summary

After considering the testimony presented before the work group, the work group made the following recommendation:

Legislation to establish a date certain for electricity competition is unnecessary. Only legislation which clarifies the authority of the ACC is appropriate. The ACC is in the best position to evaluate any on-going date certain issues.

Although the work group recommended that legislation was not necessary, alternatives to the current phase-in approach to the existing Arizona Corporation Commission (ACC) rules were discussed. Following is a **brief** discussion of the ACC rules and the alternatives that were discussed by the work group. The alternatives are presented for information purposes only. Once the work group decided no legislation action was necessary, the alternatives proposed were moot as legislative proposals.

Overview of Arizona Corporation Commission Rule

In December 1996 the Arizona Corporation Commission adopted rules on retail electric competition. The adopted rules called for a phase-in of electric competition. The phase-in is structured in the following manner:

1. January 1, 1999: All affected utilities shall make at least 20% of its 1995 system retail peak demand available for competition.
 - a. No more than 10% of the demand can be procured by large customers (3MW)

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- b. At least 3% of the demand will be reserved for residential consumers.
- 2. January 1, 2001: All affected utilities shall make at least 50% of its 1995 system retail peak demand available for competition.
 - a. No more than 25% of the demand can be procured by large customers (3MW)
 - b. At least 15% of the demand will be reserved for residential consumers.
- 3. January 1, 2003: All affected utilities shall make all of their retail demand available for competition.

The following alternatives to the ACC rule were discussed at the last work group meeting. Again, the alternatives are presented for information purposes, only.

Alternative 1:

- ◆ Competition should begin as scheduled on January 1, 1999. The existing ACC rule provides that competition begin by January 1, 1999. The work group discussed that the start date be maintained.
- ◆ The Corporation Commission should set a time table for transitioning to competition. The transition should have a goal that choice will be available to all customers by a date certain {the work group never decided on an end date}. However, the ACC should be able to extend the deadline if necessary.

The work group discussed that there will be a natural transition to competition as customers become aware of their choices and as technology changes occur. However, in order to make sure that competition is not unduly delayed, the work group considered that the ACC should set a transition timetable. Based on the testimony that was presented before the work group, the work group discussed shortening the transition period.

- ◆ Transition to competition should be phased-in by load without restrictions on customer class.

In order to avoid customer discrimination, the work group discussed transitioning competition in by load without restriction to customer class. This allows the customers selection process to be decided by the customer. The transition schedule could be developed on a monthly or quarterly basis so that the availability of competitive choice is accessible more rapidly.

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Alternative 2:

- ◆ The current phase-in approach should be changed to a flash-cut with 100 percent customer access commencing January 1, 2001.

A flash-cut would lessen the potential for customer complaints of discriminatory treatment by those left out during a transition period. It would further avoid the adverse technical and operational consequences that Affected Utilities would encounter from operating in both a traditional regulated world and a competitive world at the same time. (See TEP's position paper filed in these proceedings).

- ◆ In order to help develop procedures for implementing full scale competition and work out operational and technical challenges that will attend the transformation to full competition, a pilot program should be adopted that allows a selected number of customers from each class to choose third party suppliers for competitive services beginning January 1, 1999 (this number would, however, be less than the 20% level contemplated by the current rules).
- ◆ To facilitate the development of operational and technical procedures and protocols designed to meet the requirements of the new competitive market, a protocol committee should be formed consisting of representatives of Affected Utilities, third party suppliers and the Commission.

Alternative 3

- ◆ Competition should begin as scheduled on January 1, 1999.
- ◆ The Corporation Commission should expedite the timetable for transitioning to competition. The transition should have a goal that choice will begin January 1, 1999 and all customers be fully eligible by September 30, 1999. The ACC can modify this second deadline if later found necessary.

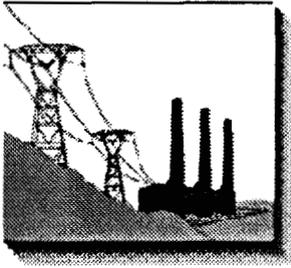
The work group discussed that there will be a transition to competition as customers become aware of choices and technology changes. To make sure that competition is not unduly delayed, the work group discussed that the ACC implement the transition timetable. Based on the testimony that was presented before the work group, the work group discussed shortening the transition period.

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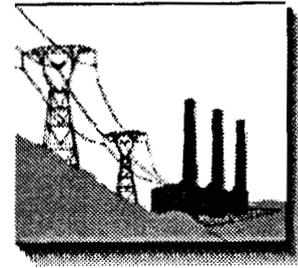
- ◆ Transition to competition should commence as described above without restrictions on customer class.

In order to avoid promulgated discrimination, the work group recommends that the transition provide choice to all customers seeking choice at the earliest time possible. This allows the selection process to be decided by customer preferences. The transition schedule should be made available on a monthly or quarterly basis so that information on the availability of competitive choice is accessible more rapidly. Any customer waiting for choice should be told the reasons for waiting by their incumbent utility.

Attached in appendix A are copies of the written testimony presented before the work group. Attached in appendix B is a summary of other state legislation in regards to establishing a date certain or phase-in approach.



**Arizona Legislature
Joint Legislative Study Committee
on Electric Competition**



**LEGISLATIVE ROLE
WORK GROUP
FINAL REPORT**

**Submitted to the Joint Legislative Study Committee on Electric Competition
October 16, 1997**

Work Group Members:

Dr. Michael Block, Work Group Chairman, Goldwater Institute
Commissioner Carl Kunasek, Chairman, ACC
Mark B. Bonsall, SRP
Tom Jones, GCSEC

Knox Kimberly, Steich Lang
Jerry Porter, Governor's Office
Ed Zub, Southwest Gas

**Joint Legislative Study Committee -- Electric Competition
Legislative Role Work Group**

Forward

This report was prepared at the request of the Joint Legislative Study Committee on Electric Competition (JLSC-EC). The work group was established by the JLSC-EC to examine issues in regards to the legislative role and the necessary legislation to facilitate electric competition. Pursuant to the JLSC-EC request, the work group has gathered information and testimony from interested parties on these issues.

At the first substantive meeting of the work group, work group members and interested parties identified a number of issues to consider. In subsequent meetings, the work group discussed these issues and heard testimony from the interested parties. The record reflects that electric competition is a complicated issue with numerous stakeholders articulating many strongly held views.

This report contains an outline of the identified issues and the work group's recommendations on those issues. For the most part, the work group's recommendations provide general policy direction without suggesting specific legislative changes. However, interested parties have submitted letters outlining specific legislative changes believed necessary to implement electric competition. Except as set forth herein, the work group does not make any recommendations on the specific changes suggested but have included these letters in an appendix for the JLSC-EC's consideration.

Recommendation Summary:

Competition in the free market is at the heart of the American and Arizona economies, and the electric industry may be among our Nation's last great industries to taste both the benefits and challenges of competition. Competition will bring customer choice of the kind enjoyed by Arizonans in nearly every other economic sector. Competition will bring lower prices and improved service through the time tested impact of customer choice. Competition will spur economic development and job creation, and the absence of competition will hinder economic development and job creation to the extent other states advance ahead without Arizona.

The work group strongly supports electric competition and believes that customer choice will benefit all Arizonans directly or indirectly. The work group recommends that the JLSC-EC seek legislation during the 1998 Session to do what is necessary to bring electric competition to Arizona. The Legislature also has a role to provide clarifying legislation as necessary. However, legislation that would duplicate the Arizona Corporation Commission's (ACC) jurisdiction is not necessary and should be avoided; particularly, if it delays bringing electric competition to Arizona.

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The work group concludes that the only critical legislation necessary to implement electric competition is statutory language stating that the public policy of Arizona is one of competition with respect to the generation of electricity, and statutory language confirming that the ACC has the full power and authority to establish rules and regulations necessary to implement such a competitive system.

The work group also identified several specific issues that may need clarifying legislation. While the work group indicated that legislation may be necessary for the following issues, the work group also indicated that the legislation should only be pursued if the ACC believed it was necessary to implement competition. None of the following issues were viewed to be exclusively legislative issues, but issues that the ACC and Legislature should work together to resolve.

- 1) **Recovery of Stranded Costs:** The work group believes that the ACC should be responsible for determining what stranded costs will be recoverable and how those costs will be recovered. However, legislation on this area may be necessary if the ACC determines that the ACC does not have the authority to implement the proposed recovery plan or if the proposed plan could be circumvented in any way.
- 2) **Protection of Proprietary Information:** During the transition to competition and if the ACC determines legislation is necessary, competitive information submitted by any utility to the ACC or other regulatory bodies should be protected from public disclosure so that a company's competitive position is not harmed.
- 3) **Continuing Obligation to Serve:** Legislation may be needed to clarify that there will remain an obligation for distribution utilities to connect customers. In addition, legislation may also be necessary to provide policy guidance on how a provider of last resort will be chosen and compensated. For example, if the ACC determines that a systems benefit charge and fund are necessary to guarantee access to electrons, legislation may be necessary to implement this policy.

In addition to the broad policy areas outline above, work group members and other interested parties participating in the process have submitted specific statutory changes. These submission include both technical and substantive changes to statute. The work group did not discuss the suggested changes at any length and, except as set forth herein, does not make a recommendation endorsing or opposing the changes. The work group has forwarded all suggested statutory changes to the JLSC-EC as part of the record of the work group's proceedings and for the JLSC-EC's consideration.

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Issue List

The following table contains the issue list that was developed and discussed by the work group. The table indicates which branch of government has primary oversight for the issue. Issues with "x's" in more than one column indicate that multiple jurisdictions may have oversight responsibility for that issue. The issue list also contains a brief description of the issue and the work group's recommendation.

The recommendations are the consensus opinion of the work group members. On issues where more than one work group member disagreed with the consensus recommendation, the dissenting view has been noted. Work group members were also invited to submit letters explaining their dissenting view on any issue not noted in the table. These letters are included immediately following the issue table.

The issue list was developed primarily from Laws 1996, Chapter 276 and a copy of this legislation is included in appendix A. A copy of the written testimony provided to the work group on these and other issues is included in appendix B. In addition, a summary of the legislation adopted by other states on the issues identified in this report is included in appendix C. And finally, a glossary of electric competition terms has been included in appendix D.

Taped recordings of the work group meetings are available in the Chief Clerk's Office of the House.

**Joint Legislative Study Committee on Electric Competition
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Issue List	Jurisdiction						
Issues	Market	Constitutional Change	ACC	Legislature		Congress/ FERC	Recommendations
				Critical	Clarify		
Policy Issues							
Endorse Competition				x			Recommendation: The work group recommends the Legislature adopt statutory language stating that the public policy of the State of Arizona is one of competition with respect to the generation of electricity, and statutory language confirming that the Arizona Corporation Commission has the power and authority to establish rules and regulations necessary to implement electric competition.
Clarifying Legislation					x		Recommendation: The work group received testimony from interested parties on technical statutory changes that may be necessary to implement competition. The work group presents these changes to the JLSC-EC for their consideration but does not make specific recommendations on any of the changes.
Financial Issues							
1. Residential customers, business customers, shareholders & stakeholders interests	x						<p>Issue Defined: This issue included the financial impacts electric competition will have on customers, investors and other stakeholders. Related issues included the fairness of rates, bills and services; the stability and predictability of rates and bills; the reliability and quality of the power supply; the ability of customers to understand the potential choices; the importance of a fair dispute resolution process; and the potential for rates to reflect the customer's desired level of reliability and availability.</p> <p>Work Group Recommendation: No recommended legislative action.</p>
2. Recovery of Stranded Cost			x		x		<p>Issue Defined: Stranded costs are costs incurred by a utility which may not be recoverable under market-based retail competition. Examples include un-depreciated generating facilities, deferred costs and long-term contract costs.</p> <p>Work Group Recommendation: Currently, the ACC is examining what costs will be recoverable and how those costs will be recovered. No recommended legislative action for this issue unless legislation is sought by the ACC to 1) implement the ACC proposed recovery plan and 2) ensure that the ACC rule can not be circumvented.</p> <p>The work group notes that some parties believe stranded costs may be a damage issue for the courts to resolve.</p>

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Issue List	Jurisdiction						
Issues	Market	Constitutional Change	ACC	Legislature		Congress/ FERC	Recommendations
				Critical	Clarify		
3. Pricing of Transmission & Distribution			x			x	<p>Issue Defined: There are three major electric services: generation, transmission, and distribution. Generation involves making the electricity while transmission and distribution involve transporting the electricity. Electric competition will deregulate generation while transmission and distribution will likely continue to be regulated.</p> <p>Work Group Recommendation: No recommended legislative action. FERC and ACC have jurisdiction over the pricing of transmission and distribution as long as these services remain regulated services.</p>
4. Unbundling Costs of Services			x				<p>Issue Defined: Unbundling refers to selling various component parts of a product or service separately, usually at a price that reflects costs for only that component of the product or service. To facilitate electric competition, the costs for generating, transmitting, distributing and ancillary services will be unbundled.</p> <p>Work Group Recommendation: No recommended legislative action since ancillary services will be competitive.</p>
Legal Issues							
5. State, tribal, and federal jurisdiction						x	<p>Issue Defined: This issue included a discussion of state, tribal and federal jurisdiction issues as it relates to electric commerce.</p> <p>Work Group Recommendation: No recommended legislative action. The work group discussed sending a JCR to Congress asking for clarification on this point. However, on further examination the work group decided that the JCR was not crucial and only if the ACC requested the clarification.</p>
6. Interstate reciprocity						x	<p>Issue Defined: This issue involves agreements between states to allow electric providers outside their territories to compete at the retail level. Basically, if competitors from outside of Arizona compete in Arizona, than Arizona utilities should not be barred from competing in those competitors' markets.</p> <p>Work Group Recommendation: No recommended legislative action. This is an interstate commerce clause issue under the jurisdiction of Congress.</p> <p>Dissenting View: Other states have passed legislation or adopted policies that require reciprocity. The Legislature does have a regional role and right to debate and take action on this issue.</p>

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Issue List	Jurisdiction					Recommendations	
	Market	Constitutional Change	ACC	Legislature			Congress/ FERC
				Critical	Clarify		
7. The use and protection of proprietary information in a competitive market					x	<p>Issue Defined: During the transition from regulation to deregulation, competitive information submitted to the ACC or to any other regulatory body should be protected from public disclosure.</p> <p>Work Group Recommendation: If requested by the ACC, legislation may be necessary that would ensure that competitive information submitted from any utility to the ACC or to any other regulatory body remain confidential.</p>	
8. Continuing obligation for a distribution utility to serve customers			x		x	<p>Issue Defined: Under competition will utilities be obligated to connect?</p> <p>Work Group Recommendation: Distribution will remain a regulated activity with ACC oversight. However, legislation providing a policy statement that there remains an obligation to connect may be advisable if the ACC determines statutory authority is necessary.</p>	
9. Continuing obligation of a generating utility to serve customers			x		x	<p>Issue Defined: Under competition what is the mechanism to determine provider of last resort for the generation of electrons?</p> <p>Work Group Recommendation: The ACC may need policy and enabling direction from the Legislature on this issue.</p>	
Social Issues							
10. Integrated resource planning			x			x	<p>Issue Defined: This issue relates to the planning by utilities to ensure that all possible supply options are explored.</p> <p>Work Group Recommendation: This will be a competitive issue and no legislative action is recommended. Oversight for integrated resource planning falls within the jurisdiction of the ACC and FERC.</p>
11. Efficiency & sufficiency of the energy supply	x		x			x	<p>Issue Defined: This issue provides assurance that supply for electricity meets demand for electricity.</p> <p>Work Group Recommendation: This will be a competitive issue and no legislative action recommended. Oversight for this issue remains an ACC and FERC issue.</p>

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Issue List	Jurisdiction						
Issues	Market	Constitutional Change	ACC	Legislature		Congress/ FERC	Recommendations
				Critical	Clarify		
12. Environmental labeling			x				<p>Issue Defined: This issue involves a utility marketing its power as environmentally “friendly.”</p> <p>Work Group Recommendation: There are already truth-in-labeling statutes in other consumer areas. The Legislature may want to explore special truth-in-labeling statutes in order to protect utility consumers. <i>This issue is not critical to implementing competition;</i> but it is an issue that may need to be addressed in the future.</p>
13. Power plant siting			x			x	<p>Issue Defined: This issue involved a discussion regarding the issues involved the policy of how power plant sites are approved.</p> <p>Work Group Recommendation: No legislative action recommended However, the Legislature may need to examine existing siting statutes to determine if the statutes facilitate power plant and transmission siting in a competitive environment.</p>
14. System benefit charges			x		x		<p>Issue Defined: System benefit charges are charges for low income, demand side management, environmental, renewables, and nuclear power plant decommissioning programs.</p> <p>Work Group Recommendation: Because system benefit charges will continue to be charged by the distribution utility, the Work Group concluded that the ACC will maintain jurisdiction over these charges. Therefore, no legislative action recommended unless the ACC seeks statutory clarification.</p>
System Planning, Reliability, and Market							
15. System Reliability			x			x	<p>Issue Defined: This issue deals with the reliability of electric supply under competition.</p> <p>Work Group Recommendation: No legislative action recommended. The ACC will retain responsibility for system reliability issues.</p>
16. Administrative and Operational Issues			x				<p>Issue Defined: Administrative and operational issues include the applicability of regulatory reliability criteria to non-utility market participants, the form requirements of contracts for the sale or purchase of electricity, metering and billing issues, and the regulation of ancillary services.</p> <p>Work Group Recommendation: No legislative action recommended. To the extent that any of these activities remain regulated, the ACC retains jurisdiction.</p>

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Issue List	Jurisdiction						
Issues	Market	Constitutional Change	ACC	Legislature		Congress/ FERC	Recommendations
Critical				Clarify			
17. Independent System Operator			x			x	<p>Issue Defined: An entity that manages a regional transmission grid. This is a new concept, and is still being developed, but it is designed to prevent utilities from using their own wires to gain a price advantage over other power suppliers. In Arizona, the ISO under development is called Desert Star.</p> <p>Work Group Recommendation: Open access is an ACC question and the FERC must approve all ISO agreements. No legislative action recommended.</p>
18. Spot Market	x		x			x	<p>Issue Defined: A market that sets the price of a commodity or service for short-term transactions. This price can change with each transaction and this price reflects the continually changing balances between supply and demand. It may be used to set prices at numerous nodes in the system.</p> <p>Work Group Recommendation: No legislative action recommended.</p>
Equity Issues							
19. City Utilities							<p>Issue Defined: Any competitive advantages or disadvantages that city utilities may have as unregulated municipalities including tax and interest benefits.</p> <p>Work Group Recommendation: No legislative action recommended at this time.</p>
20. SRP							<p>Issue Defined: Any competitive advantages or disadvantages that SRP receives as an agriculture improvement district (enjoys municipal status).</p> <p>Work Group Recommendation: No legislative action recommended at this time.</p>
21. Electric Cooperatives							<p>Issue Defined: Electric cooperatives are non-profit customer-owned and run entities which however, are regulated by the ACC. The ACC rules require cooperatives to open their territories for competition, but current statutes prohibit them from competing to seek replacement customers outside their territories.</p> <p>Work Group Recommendation: If it becomes Arizona's public policy that cooperatives should be able to compete outside their service territories, revisions to title 10 will be necessary to allow the cooperatives to compete.</p>

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Issue List	Jurisdiction						
Issues	Market	Constitutional Change	ACC	Legislature		Congress/ FERC	Recommendations
			Critical	Clarify			
22. New Market Entrants							<p>Issue Defined: Any competitive advantages or disadvantages that new market entrants face.</p> <p>Work Group Recommendation: No legislative action recommended at this time. See tax work group report for specific discussion on tax issues.</p>

Work Group Member Dissents to Above Recommendations:

Policy Issues: Endorse Competition (Dissenting View, Tom Jones, Grand Canyon State Electric Cooperative Association (GCSECA)):

The Arizona Constitution contains some hurdles which stand between today's market and competition as provided for in the rules adopted by the Arizona Corporation Commission. The most critical are in Article 15, Sections 3 and 14 and in Article 15, Section 2. In addition, if the goal is deregulation to bring about true competition in the electric energy industry, many revisions to A.R.S. Title 40 are necessary to allow competition to work.

Financial Issues #1 Residential customers, business customers, shareholders & stakeholders interests (Dissenting View, Tom Jones, GCSECA):

Article 15, Sections 3 and 14 of the Constitution, prohibit the ACC from authorizing market based rates as it has in its rules. Left unaddressed, this issue will affect stability and predictability of customer rates and bills and will impact utilities and potential competitive suppliers as well.

Financial Issues #4 Unbundling Costs of Service (Dissenting View, Tom Jones, GCSECA):

Billing, metering and other services are not defined in the Constitution as functions of public service corporations so the ACC may not have the authority to oversee these services. Also, certain statutes don't allow the ACC to deregulate or streamline rate and other regulations concerning competitive services. Finally, the Constitution requires that rates be based on "fair value" not market value.

Legal Issue #7 Use and protection of proprietary information (Dissenting View, Michael Block, Goldwater Institute):

The legislative work group has recommended that during the transition from regulation to deregulation information submitted by any utility to a regulatory body remain confidential. This recommendation is too broad since by including any utility it encompasses utilities operated by the cities and Salt River Project. It needs to be emphasized that these organizations are public entities; and allowing government agencies undue power to keep secrets is an anathema to the principles on which government in this country and state are founded.

Private companies are allowed to safeguard proprietary information to protect the investment of their owners. Governments are allowed to keep secrets in situations where life and limb are at risk: soldiers during wartime, spies in enemy countries and witnesses against the mafia; or where confidential personal information might be at issue. Who needs to be protected by allowing public utilities to keep proprietary information? As customers of the utility, the public does not gain if certain information is kept secret. As taxpayers who are ultimately financially responsible for a public utility's liabilities, the public certainly does not benefit if the publicly owned utility can keep information from them. The sole rationale for publicly owned utilities is to serve the public, hence their name. Letting them keep secrets overlooks this crucial point, and sets a harmful precedent for future situations. Governments that operate in the dark are a breeding ground for mischief.

Legal Issue #8 Continuing obligation for a distribution utility to serve customers (Dissenting View, Tom Jones, GCSECA):

Constitutionally, the ACC has no jurisdiction over municipal utilities. There are several issues concerning service by them and competitive service in their territories which need to be addressed.

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TAXATION WORK GROUP FINAL REPORT

**Submitted to the Joint Legislative Study Committee on Electric Competition
October 16, 1997**

Work Group Members:

Martin L. Shultz, Work Group Chairman, APS
Commissioner Carl Kunasek, Chairman, ACC
Ron Ballard, City of Tucson
Jim Bush, Arizona Mining Association

Kevin McCarthy, ATRA
Greg Patterson, Director, RUCO
Jeff Schlegel, Schlegel & Associates
Russell D. Smoldon, SRP

Executive Summary & Summary of Recommendations

The taxation work group was established to provide information to the Joint Legislative Study Committee on Electric Competition (JLSC-EC) on the effect electric competition will have on Arizona's tax system. Specifically, the work group was asked to develop information on establishing a kilowatt hour (kWh) tax in lieu of the current property taxes charged electric utilities.

Pursuant to the JLSC-EC request, the work group has gathered data and information on utility taxation in Arizona and in surrounding states. The work group also sought to identify issues related to electric competition that may have considerable tax implications to state and local governments. Based on the information that the work group was able to gather, the following facts and conclusions were reached.

Findings of Fact

- ◆ Electric utilities provide approximately 11% of the total property tax revenue in Arizona. In those taxing jurisdiction containing power plants, electric utilities provide the majority of property tax revenues. In total, electric utilities paid over \$300 million in Arizona property taxes in 1996. Property taxes represent about 47% of all the state and local taxes paid by Arizona electric utilities. Traditionally, electric utility property taxes have been passed through to customers.
- ◆ Arizona's property tax burden (tax as % of full cash value) on electric utilities is one of the highest in the Western Grid.
- ◆ Transaction Privilege Tax (TPT) and franchise fees charged to electric utilities are paid by utility customers and are also major sources of state and local revenues. In FY 1996, TPT and use taxes charged to electric utilities represented approximately 7% of the total state TPT and use tax collections. The electric utilities participating in the report paid over \$250 million in state and city TPT and use taxes in 1996. In addition, the electric utilities participating in the report paid approximately \$30 million in franchise fees collected by the cities.

Conclusions

- ◆ The kWh tax, as discussed in this report, may be one way to address potential losses in revenue and therefore, legislation implementing such a tax change should be considered in the event that any losses should occur. However, implementing a kWh tax would be complicated and many issues would need to be resolved before implementing such a tax. These issues include, but are not limited to, amending the Arizona Constitution, developing a mechanism that would secure current and future bond issues, and developing

**Joint Legislative Study Committee on Electric Competition
Taxation Work Group**

a distribution formula for the tax. A discussion of the kWh tax begins on page twelve of this report.

- ◆ Specific statutory language changes to the TPT and use tax statutes should be considered by the JLSC-EC. Possible clarifications and changes include, but are not limited to, adding the definitions of generation, distribution, and transmission to the utility classification. This should help ensure tax revenue is not lost as a result of unbundling.

Because of the short time frame and the complexity of the issues involved, portions of the work groups study were not completed at the time of this report. However, based on the facts and conclusions the work group were able to reach, the work group makes the following recommendations to the JLSC-EC.

- ◆ **The effective date for changes, if any, to the tax laws are not necessary until restructuring is implemented or until a need is demonstrated for the change.**
- ◆ **The work group recommends that the tax issues related to electric competition continue to be studied. The JLSC-EC may want to consider session law to require update reports on the tax revenue impacts restructuring has had on neighboring states and on Arizona once competition is implemented.**