



RESIDENTIAL UTILITY CONSUMER OFFICE

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ELECTRIC DE-REGULATION

Summary of RUCO Findings for the Arizona Republic Editorial Board

September 24, 2013

Introduction:

RUCO's central mission was to determine if there is a competitive model Arizona can follow that can bring lower prices and more choice to ratepayers. Specifically, we wanted to know if this can be done in a way that benefits the residential ratepayer?

Over 16 different parties presented their perspectives at a day-long workshop hosted by RUCO in an effort to quantify definite ratepayer benefits. In addition, we researched other restructured states and carefully analyzed the filings submitted in the Corporation Commission docket. RUCO further requested that the proponents of restructuring provide a detailed plan of what a system tailored to Arizona could look like. Unfortunately, not one group responded. RUCO also submitted detailed questions to the docket in order to better understand some of the nuances of Arizona's system. RUCO determined the evidence does not support a restructured electric market especially when the unique characteristics of Arizona's market are considered. The benefits, if they did come, would be far down the road and coupled with risks both known and unknown.

RUCO's Specific Findings:

There are several models Arizona could follow – Texas or Pennsylvania, for example. Both the Texas and the Pennsylvania models would be a complete change of Arizona's regulatory paradigm -- from a regulated market to a fully competitive market. Finally, there is also the Oregon model which is a hybrid approach, still maintaining the cost of service regulatory framework (what our system uses today). RUCO finds that none of the three models could succeed in Arizona.

FACT: Arizona electric rates are lower and more stable than most deregulated states and below U.S. averages.

FACT: Arizona also has strong system reliability and favorable customer satisfaction.

FACT: The risks that deregulation would bring far outweigh the benefits Arizona would receive.

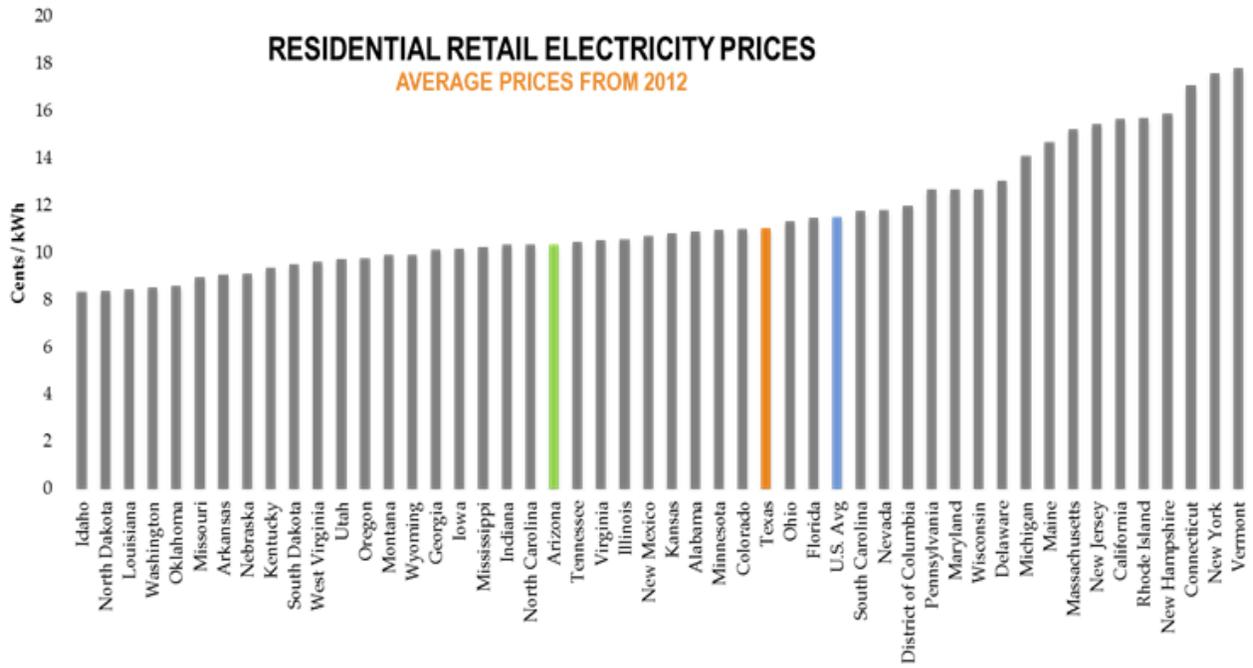
FACT: Due to Arizona's proximity to California, a high cost import state, losing the protections that cost of service regulation provides would expose Arizona to California pricing.

This risk exposure is compounded by susceptibility to market manipulation, the formation of a costly grid operator, transmission constraints around cities, and stranded costs. Moreover, once restructuring is active, it is difficult if not impossible to revert back to cost of service model. For these reasons and many others RUCO is unreservedly and steadfastly opposed to electric deregulation.

There are eight hurdles that ALL need to be thoroughly addressed. The following list is not meant to be exhaustive:

1. **Legal hurdles:** Arizona has constitutional requirements that may interfere with the state's ability to deregulate
2. **There needs to be a plan specific to Arizona:** Arizona has unique features not present in other deregulated states. The differences start with the Arizona Constitution but span to SRP, Navajo Generating Station, and, again, the proximity to California, one of the country's largest electricity markets
3. **Savings must be shown to be worth the added risk:** Arizona is a relatively low cost state which alters the risk vs. benefit ratio of restructuring. This does not mean there are no potential savings, but the margins are much smaller than a high cost east coast state. Because of this, the risks and investments needed for the transition are not worth the cost.
4. **Stranded costs must be quantified:** Stranded costs (existing utilities investment in infrastructure that would be lost should the utility be required to divest its generation may present a financial disadvantage in a competitive market) of the incumbents will likely be over \$1 billion and wipe away any potential savings in the near term.
 - a. Stranded costs would transpire into non-by passable charges on every ratepayer's bill. Arizona's past look at de-regulation found over \$1 billion in stranded costs eligible for recovery for just APS and TEP.
 - b. IT upgrades alone could be over \$100 million.
5. **Clear benefit must be illustrated for residential customers:** Experience in other states has shown that residential customers are the last to benefit from competition. Establishing a competitive market takes both time and money. Most markets that have been deregulated for 10 years still have low residential switching rates.
6. **Grid operation needs to be determined:** If residential and small commercial customers are to take part in a competitive market, a full-fledged grid coordinator (RTO/ISO) will eventually be needed. Unlike many Eastern or Midwestern states there is no RTO to join, which would force Arizona to either join the California ISO or create our own – extremely small but likely very expensive ISO.
 - a. The New England ISO, one of the nation's smallest, requires 550 employees and a \$165 million operating budget to serve 14 million people.
 - b. Even with that budget there are still issues in the New England region. The ISO sent out a July 2013 press release urging customers to conserve energy to avoid energy shortages in an upcoming heat wave.

7. **Transmission must be adequate:** Arizona's transmission network is not currently setup to handle a large influx of competitive power from outside locations. Arizona utilities built a transmission and distribution system around their assets not competitive suppliers.
 - a. Load pockets (nearly every major city in Arizona) may develop import constraints due to inadequate transmission. This could distort pricing and cause other issues within vital economic hubs of the state.
 - b. Enabling a fully competitive market would require major and expensive transmission upgrades.
8. **State sovereignty should be guarded:** If more transmission is built into Arizona from California, Arizona will lose its ability to protect ratepayers under a cost of service rate.
 - a. Key points of control could be permanently given away to entities outside of Arizona's direct jurisdiction, for example the federal government through FERC.
 - b. California's market will dictate wholesale pricing. In the past TEP sought to charge market based rates, but Arizona's regulatory system saved ratepayers from the increase.
 - c. Wholesale prices in Southern California can be 15% to 40% higher for on-peak prices.



Electricity Prices Higher Under Deregulation

AVERAGE RESIDENTIAL ELECTRICITY PRICES INSIDE AND OUTSIDE DEREGULATED AREAS OF TEXAS
(Providers exempt from competition include investor-owned utilities outside the ERCOT region, municipally-owned utilities and electric cooperatives.)
 Source: United State Energy Information Administration <http://www.eia.doe.gov/cneaf/electricity/page/eia861.html>

