

September 1, 2000

The Honorable David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: Arizona Independent Scheduling
Administrator Association,
Docket No. ER00-____-000

Dear Secretary Boergers:

Pursuant to Section 205 of the Federal Power Act (“FPA”), 16 U.S.C. § 824d, and Section 35.12 of the regulations of the Federal Energy Regulatory Commission (“Commission” or “FERC”), 18 C.F.R. § 35.12 (1999), the Arizona Independent Scheduling Administrator Association (“Az ISA”) hereby submits documents comprising an Az ISA Tariff, including a Protocols Manual, two Pro Forma Agreements, and Rate Schedule No. 1, as well as supporting documentation, including the Affidavit of Jerry W. Smith (“Smith Affidavit”), Articles of Incorporation, and By-Laws. In addition, this filing includes certificates of concurrence executed by those transmission providers in Arizona that are subject to FERC’s jurisdiction under Section 201 of the Federal Power Act (“FPA”), 16 U.S.C. § 824. The Az ISA respectfully requests that the Commission accept these components of the Az ISA Tariff for filing, and permit them to take effect November 1, 2000.

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In this filing, the Az ISA seeks authority to implement the Protocols Manual, related contracts and rate schedule, all in order to facilitate retail electric competition in the State of Arizona. The Protocols Manual provides for a State-wide uniform system for addressing core elements of retail transmission service on most transmission and distribution systems in Arizona. The Az ISA's participating transmission providers ("TPs") consist of Arizona Electric Power Cooperative ("AEPSCO"), Arizona Public Service Company ("APS"), Citizens Utilities Company ("Citizens"), and Tucson Electric Power Company ("TEP"). The protocols complement the FERC-filed open access transmission tariffs ("OATT") or other tariffs pursuant to which each TP provides retail transmission service. For those TPs with FERC-filed OATTs, retail transmission service will continue to be provided under their tariffs, but with the TP's commitment to also follow the Protocols Manual, which addresses such issues as retail transmission capacity allocation and scheduling and balancing in a retail environment. For this reason, the Az ISA does not have its own open access transmission tariff.

Each feature of the Protocols concerning a provision of the Commission's *pro forma* OATT is consistent with or superior to the OATT, and the Arizona Corporation Commission staff has participated actively in shaping the Protocols. The Az ISA expects the full support of the ACC in seeking FERC approval of this filing.

The stake holder process culminating in this filing was a completely open process with numerous communications and meetings from the earliest stages of Az ISA development. Drafts of all major Az ISA documents were made available to all interested parties via the internet. Naturally, the consensus-building process led to many exchanges of consideration delicately balancing conflicting interests of market participants to arrive at the current filing package.

With the prospect of broader regional transmission organization filings due at the Commission in

the near future, the Az ISA will address below the reasons that the Commission should act expeditiously on this filing, rather than wait for a larger regional organization to take control. First, the Az ISA is ready to implement its initial features as soon as the Commission approves this filing. Unlike some of the larger independent system operator proposals, the Az ISA is a much more focused organization. The Az ISA's intent is to facilitate retail competition in Arizona consistent with the stated policies of the ACC. The Az ISA is not a large organization with complicated systems that take time to debug. To the contrary, it can hit the ground running immediately on startup and enhance retail choice in Arizona at an insignificant expense. The Az ISA is not an organization designed to continue beyond the formation of a southwestern regional transmission organization that includes the Az ISA's participating TPs. As soon as its functions are no longer needed, it will cease operations. The Az ISA urges the Commission to approve this filing on an expeditious basis precisely because it is focused and will improve retail competition in Arizona immediately. There is no reason to delay the pro-competitive benefits the Az ISA will bring in the period before larger regional organizations are developed and capable of functioning.

BACKGROUND

The Az ISA is a voluntary non-profit corporation, created under the laws of the State of Arizona, for the purpose of facilitating the development and functionality of competitive retail electric markets in Arizona. It is governed by a Board of Directors that includes the Executive Director and two representatives from each of the following classes of members: (1) local load serving entities ; (2) transmission facilities providers; (3) aggregators; (4) independent generators and wholesale power marketers; and (5) end-use customers. The Board of Directors cannot be driven by the agenda of any particular member or member class. All matters pending before the Board can be passed only by a two-thirds majority vote to do so. Consequently, no one stakeholder group can veto the Board's decision; and no two stakeholder groups are able to control Board decisions.

This filing, which is the result of extensive negotiations among the stakeholders, marks an important milestone in the deregulation of retail markets in the State of Arizona. The process of opening the retail market began nearly six years ago, on September 7, 1994, when the Arizona Corporation Commission ("ACC") initiated a workshop to explore the possibility of bringing competition to the retail electric market. Ultimately, the result was Decision No. 61071, issued by the ACC on August 10, 1998, which required those utilities subject to ACC jurisdiction that own or operate transmission facilities to file with FERC for approval of an Independent Scheduling Administrator.

On October 29, 1998, the Az ISA submitted to FERC a transmittal letter, the Az ISA Articles of Incorporation, the Az ISA By-Laws, a draft Az ISA Schedule Administrator Agreement and a draft Tariff, along with supporting documentation. However, shortly thereafter, procedures were initiated

which led to a formal stay of the rules that had required this filing. On December 22, 1998, the Az ISA submitted a letter to FERC indicating that no action was necessary at that time. Eventually, the Az ISA filed a motion to withdraw its initial filing, which FERC granted in a letter order issued on June 14, 2000. In that motion, the Az ISA committed to submit a comprehensive filing within 90 days once the initial filing was deemed withdrawn. Accordingly, the Az ISA now submits this filing.

There have been more than seventy meetings dedicated to the purpose of developing the Az ISA. In addition to the representatives of these member classes, the staff of the ACC has attended the meetings of the Board. In fact, the meetings are open to the public for anyone to attend. As reflected by the diverse representation on the Board, and the openness of the Board meetings, broad stakeholder participation has been fundamental to the initial development and continuing operation of the Az ISA.

EVOLUTION OF THE INDUSTRY IN ARIZONA

The Az ISA is the next step in the evolution of the electric utility industry in Arizona. It is an interim organization that will facilitate the development of a robust retail electric market that functions on fair and open terms, while serving as a bridge to implementation of a regional transmission organization (“RTO”) in the southwestern United States. As such, the Az ISA is designed with the flexibility necessary to accommodate any schedule associated with the implementation of a southwestern RTO. As the Commission established in Order No. 2000:

[A]ll public utilities that own, operate or control interstate transmission facilities must file with the Commission by October 15, 2000 . . . a proposal to participate in an RTO with the minimum characteristics and functions to be operational by December 15, 2001, or, alternatively, a description of efforts to participate in an RTO, any existing obstacles to RTO participation, and any plans to work toward RTO participation.

Order No. 2000-A, Slip Op. at 4 (February 25, 2000).

According to this schedule, a southwestern RTO is expected to file a plan with FERC by October 15, 2000, with the intent of becoming operational on December 15, 2001, so that certain transmission owners in Arizona and surrounding states can make timely filings, as required by Order No. 2000. Assuming a southwestern RTO follows that ambitious time line, the Az ISA still would be needed to oversee development of the Arizona retail market during the next 18 months. Even if the Az ISA continues to implement only Phase I features during that 18-month period (as discussed *infra*), the implementation of the temporary transmission rights allocation process, in and of itself, can be expected

to provide a significant boost to the retail market in Arizona. In addition, the oversight provided by the Az ISA and the availability of a fast track ADR process, two additional features to be implemented during Phase I, will be of great benefit to the marketplace. Moreover, these features fulfill the mandatory policy objectives adopted in Arizona.¹

If a southwestern RTO does not become operational within the time frame envisioned in Order No. 2000, the Az ISA may implement its Phase II features, which include an auction and trading mechanism for transmission rights used for retail transmission, and a trading mechanism for energy imbalances. The Az ISA Board takes very seriously its responsibility to balance the facilitation of retail competition, the tenure of its mission, and the need for pragmatic cost-effectiveness. Accordingly, the Az ISA has approved an Implementation Plan that allows the Board to phase-in the implementation of features during both Phases I and II. For example, the Board will not implement Phase II features unless it determines that it is cost effective to do so and that the costs may be fairly allocated and recovered. Obviously, one key consideration in such a determination will be the realistic start date for an RTO that will supercede the Az ISA's functions. Regardless of the timeframe for RTO implementation in the southwest, however, immediate implementation of the Az ISA will enhance retail electric competition in Arizona in a fashion that in no way hinders RTO development.² Moreover, the Az ISA's form of "open architecture" allows it sensibly to implement those features that provide benefits to the market place commensurate with the costs of implementing the features. The Az ISA will not be a bloated bureaucracy with grandiose expectations regarding its mission or tenure.

Immediate implementation of the Az ISA may also assist in the RTO development process itself. The Az ISA presents a rare opportunity to implement manageable and focused retail access enhancements so the parties can gain valuable experience that may guide the broader future RTO features applicable to retail access. Additionally, many of the individuals involved in planning the Az ISA also participate in the discussions regarding a southwestern RTO. These individuals are splitting valuable time between the two organizations. Once the Az ISA becomes operational, the demands on those participating in the planning process will be less intense. Consequently, these individuals will be able to focus their time and effort on developing an RTO by the FERC-imposed deadlines.

INDIVIDUAL COMPONENTS OF THE AZ ISA TARIFF

¹ See ARIZ. REV. STAT. §§ 30-801 et seq.; Retail Electric Competition Rules, Arizona Admin. Code §§ R14-2-1601 et seq.

² The Protocols Manual is not intended to create precedent for any governing agreement, tariff, protocols or associated agreements of any RTO which may be formed that includes Arizona parties and transmission facilities.

Protocols Manual

The Protocols Manual establishes a comprehensive system of reserving and scheduling transmission and ancillary services for retail customers, to be implemented in a modular way, in two phases. *See* Smith Affidavit. The Az ISA model provides for Scheduling Coordinators (“SCs”) that will submit balanced schedules to the Az ISA and the host TP. Each SC will require transmission capacity on the host TP’s system. The cornerstone of the Az ISA model is Allocated Retail Network Transmission (“ARNT”), the right to deliver power over specific transmission paths based on the total transmission capability available over those paths, with adjustments made to account for the need to run generation in certain load zones. During Phase I, approximately 300 MW of firm capacity, divided among the transmission systems owned and operated by the four participating TPs, will be available for competitive retail customer use. This capacity comes from the TPs’ capacity committed for retail uses, and consequently does not impede any wholesale uses of the system. This capacity will give competitive SCs the opportunity to access the most liquid supply markets serving the relevant load areas. The use of this capacity is similar to the use of capacity through the designation of network resources pursuant to the Order No. 888 OATT.

After retail access conversions increase and the 300 MW of transmission capacity is fully used and the Board approves its implementation consistent with the criteria discussed above, then in Phase II, ARNT will be awarded to customers based on bids submitted in an auction procedure described in the Protocols Manual. SCs also will be permitted to trade their ARNT allocations amongst one another. SCs will pay for ARNT based on their auction bids, as well as the charges for transmission service under each particular TP’s OATT or tariff. Each SC, however, will receive a load ratio share of the total auction revenue, thereby off-setting its embedded cost OATT or tariff charges. Consequently, the ARNT auction payments in conjunction with OATT or tariff charges will not constitute impermissible ~~and~~ pricing under the Commission’s pricing policy. *See* Smith Affidavit at 12-13.³

³ The Commission has determined that such pricing mechanisms do not constitute “and” pricing. *See, e.g., Pennsylvania-New Jersey-Maryland Interconnection*, 81 FERC & 61,257 at 62,259-60 (1997); *Pacific Gas & Electric Co.*, 77 FERC & 61,204 at 61,831 (1996); *Central Hudson Gas & Electric Co.*, 86 FERC ¶ 61,062 (1999). In these cases, the Commission determined that systems using congestion pricing and embedded cost postage stamp or license plate rates did not violate the prohibition against “and pricing” where the revenue requirements to derive the embedded cost charges under the applicable OATT were reduced by the amount of transmission congestion contract or firm transmission rights revenues received by the TPs. In this case, the allocation of ARNT auction revenue will place each SC in the same position in which it would have been had the TPs followed the more complicated process of decreasing transmission revenue requirements by the ARNT auction revenue and recalculating the unit rate, because each SC receives its pro rata share of the total ARNT auction revenue on each TP’s system on which it serves retail load.

In the stake holder process to develop the Protocols Manual and in certain ACC proceedings on individual utility restructuring, certain TPs (APS and TEP) developed must-run generation requirements for certain import limited load zones (“load pockets”), as described in the Must-Run Generation Protocol. Local generation is required to serve load in these zones because the transmission capacity into these zones is less than the load in these zones during certain times. SCs are required to satisfy local generation (energy) requirements based on their pro rata (load ratio) share of the load in each of these zones. TEP and APS charge SCs for this energy based on their incremental cost of local generation in these zones. TEP’s charges appear in Tariff Rider No. 2, Sheet 1, on file with the ACC. APS’s must run energy costs will be recovered in accordance with the methodology contained in the Must Run Generation Protocol. Subject to Az ISA monitoring, each TP determines the amount of must run energy which each SC must purchase in each hour in which the requirement applies. TEP and APS have asked the Az ISA to file certificates of concurrence to provide for FERC authorization for any jurisdictional service they provide to accommodate retail access in accordance with ACC rules and the Protocols Manual, including their implementation of the Must-Run Generation Protocol. Such certificates are included in this filing.

The Protocols Manual also addresses the six ancillary services established by Order No. 888, consistent with the Commission’s discussion in that order, except for Energy Imbalance Service. If Phase II is implemented, an Az ISA trading mechanism, managed by an independent trading entity, will be used so that SCs may trade their imbalances and thereby reduce their financial exposure when dumping or leaning on the system. In addition, Unaccounted For Energy (“UFE”) can be used to offset energy imbalances, further reducing the amounts that SCs must pay. *See* Smith Affidavit 17. In the meantime, during Phase I, the Protocols Manual requires an expanded energy imbalance deadband of plus or minus ten percent or 2 MW, significantly greater than the 1.5 percent parameters established in Order No. 888. This series of SC benefits exceeding the Order No. 888 requirements, including the more forgiving imbalance provisions, and SC obligations, including UFE, not addressed in Order No. 888 represent a balancing of conflicting interests and compromises in consideration made in a global stake holder process.

The Protocols Manual also includes guidelines related to Emergency Operations, so that the transmission grid in Arizona can continue to operate with the highest level of reliability. In addition, an after-the-fact checkout mechanism is provided so that the transmission providers and customers can review the levels of system use to be certain that the proper amounts are being paid.

Pro Forma Agreements

The heart of the Az ISA Tariff is two basic forms of agreement, negotiated by the stakeholders, which describe in detail the rights and obligations of the Az ISA, the TPs and the SCs: the ISA-TP Agreement and the ISA-SC-TP Agreement. They are intended to function in concert with the requirements in the Protocols Manual, so that retail electric competition may be implemented in Arizona in a fair and open manner.

There will be four ISA-TP Agreements, each one addresses various aspects of the relationship between the Az ISA and each participating TP. Among other items, included in this agreement are provisions relating to the funding mechanism, the exchange of information, standards of conduct, revisions to the TPs' OATTs, dispute resolution, how to address non-performance, termination of the agreement, winding up and limits on liability and indemnification. A pro forma version of the ISA-TP Agreement has been included in the filing, which reflects the four separate ISA-TP Agreements, one for each TP, that will be executed by the Az ISA and AEPCO, APS, Citizens and TEP. The terms of the pro forma agreement and each of the agreements that the TPs execute will be virtually identical.

The ISA-SC-TP Agreement focuses on the rights and responsibilities of the scheduling coordinators in relation to the Az ISA and the TPs. Among the topics in this Agreement are billing and payment, dispute resolution, non-performance, termination of the agreement, winding up and limits on liability and indemnification. Each TP will enter into a single agreement with the Az ISA, and each SC seeking service in the participating TP's service territory will sign its own separate copy of this Agreement. This filing includes a pro forma version of the ISA-SC-TP Agreement, which is virtually identical to the individual agreements that will be executed.

ISA Funding Mechanism

The rates that the Az ISA will be charging, as reflected in Rate Schedule No. 1, are just and reasonable under Section 205 of the FPA. The funding mechanism permits the Az ISA to recover its monthly operating costs, while also collecting monies to pay off loans that certain TPs advanced to the Az ISA during its developmental stage. To determine the charge for the recovery of operating costs each month, the Az ISA will estimate its total operating costs during the prior month and the TPs will estimate the Transmission Provider Retail Load. To the extent these estimations of costs and load turn out to be inaccurate, the funding mechanism includes a monthly "true up." Thus, the mechanism ensures that the Az ISA neither over-nor under-recovers. Pursuant to these rates, each month the Az ISA recovers its costs from retail customers, with the exception of AEPCO, who recovers Az ISA charges from its cooperative members. Accordingly, with the noted exception, the TP's wholesale customers will not bear any of the Az ISA's costs.

Dispute Resolution

Disputes between TPs and transmission customers, and among TPs, requiring immediate resolution, are reviewed using a “fast-track” process. Accordingly, the Director or Assistant Director of the Az ISA will render immediate decisions on matters related to the same day or next day. If that decision is disputed, the matter then may be referred to a panel of arbitrators, whose decision then may be appealed. Any decision, once final, serves as precedent for future disputes being resolved under the fast-track method.

For more complicated disputes, parties may choose a peer review process, a mediation process, arbitration procedures, or take the matter directly to FERC or the courts. However, peer review and mediation are available only if the disputing parties submit a joint request to use such procedures. If such procedures fail to yield a resolution, the matter shall be referred to arbitration. The parties also may choose arbitration, rather than peer review or mediation, as the initial method to attempt to resolve the disputed issues. Any arbitration decision that affects matters subject to FERC’s jurisdiction shall be filed at FERC, where it may be protested and the Commission can initiate an investigation. Both the fast track process and the procedures for more complicated disputes contemplate the Az ISA serving as an arbiter or administrator for the parties.

For disputes involving the Az ISA itself, the pro forma agreements provide for the use of the dispute resolution procedures described in Order No. 888 and the pro forma tariff.

COMPLIANCE WITH ORDER NO. 888

The Az ISA is Not Subject To The Requirements In Order Nos. 888 and 889.

Although this filing impacts the manner in which transmission service is provided to retail customers, the Az ISA is not submitting an open access transmission tariff (“OATT”), nor is it required to do so, because the open access requirements apply only to those utilities that own, maintain or control transmission facilities. *See* Order No. 888, FERC Stats. and Regs. & 31,036 at 31,635 (1996); Order No. 888-A, FERC Stats. and Regs. & 31,048 at 30,176 (1997). It is clear that the Az ISA will not take any ownership interest in the transmission facilities, nor maintain them; the existing TPs will continue to do so.

Nor will the Az ISA exercise control over the transmission facilities; it will not provide transmission service, nor any of the ancillary services that support the transmission system. The Az

ISA's role is merely to ensure compliance with the Protocols Manual. It is the Transmission Providers, APS, AEPCO, Citizens and TEP, who will continue to provide transmission and related services pursuant to the terms of their OATTs and other tariffs. In this way, the TPs will both operate according to the terms of the Protocols Manual and also ensure SC compliance with the applicable provisions of the Protocols Manual. The SCs will make arrangements, pursuant to the terms of the TP's OATTs and tariffs, on behalf of the retail load that they are serving.⁴

Likewise, the requirements in Order No. 889 do not apply to the Az ISA. To mitigate the possibility of a utility favoring itself over other market participants, Order No. 889 requires utilities to: (1) establish standards of conduct to ensure that employees engaged in transmission operations and employees engaged in sales of energy function independently; and (2) operate an OASIS. *See* Order No. 889, FERC Stats. and Regs. ¶ 31,035 (1996). The Az ISA does not participate in the energy markets. Neither Phase I, nor Phase II, contemplate any Az ISA involvement in power sales. The Az ISA is an independent entity, with no interest in the success or failure of any particular participant in the sales or transmission markets. Hence, there is no advantage to be gained that the procedures in Order No. 889 would alleviate. The concerns underlying the need for standards of conduct do not exist. Nor does the Az ISA need its own OASIS, although the Protocols Manual calls for the eventual implementation of a statewide OASIS. *See* Smith Affidavit at 8-10. In the meantime, the TPs will continue to use their own OASIS sites, which already comply with Order No. 889. Alternatively, should FERC determine that the Az ISA is subject to these requirements, the Az ISA respectfully requests waiver of such requirements in this instance.

The Protocols Manual Is Consistent With the Requirements In Order No. 888.

The Protocols Manual, in all respects, is consistent with or superior to the requirements described in Order No. 888 and the pro forma tariff. *See* Smith Affidavit at 2.

Although the Protocols Manual is an integral part of this filing by the Az ISA, it is also required to be included in the OATTs of the two TPs that are subject to FERC's jurisdiction. *See Arizona Public Service Company*, 89 FERC ¶ 61,226 (1999); *Tucson Electric Power Company*, 90 FERC ¶ 61,108 (2000). Accordingly, as previously noted, APS and TEP have executed certificates of concurrence (included in this filing), as required when two or more public utilities are parties to the same

⁴ The Protocols Manual recognizes two types of SCs: Competitive SCs and Standard Offer SCs. Competitive SCs schedule power transactions for those retail electric customers that elect to purchase competitive electric service. Standard Offer SCs schedule power transactions for bundled retail loads under standard offer rates.

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rate schedule. *See* 18 C.F.R. § 35.1 (1999). If and only to the extent that the Commission determines that its acceptance of this filing constitutes an amendment to an OATT, then the Az ISA requests that the Commission require pursuant to FPA section 206 compliance filings by jurisdictional utilities to implement this filing.

WAIVERS

The Az ISA requests waiver of any regulations necessary to implement this filing, including the requirements in Sections 35.3(a) and 35.12(b) of FERC regulations, 18 C.F.R. §§ 35.3(a) and 35.12(b) (1999).

DOCUMENTS SUBMITTED

In addition to this Transmittal Letter, the Az ISA submits the following documents:

1. Az ISA Articles of Incorporation;
2. Az ISA By-Laws;
3. FERC Electric Tariff;
 - A. Protocols Manual;
 - B. Form Service Agreement Between ISA and TP;
 - C. Form Service Agreement Between ISA, TP and SCs
 - D. Rate Schedule No. 1
4. Resolution of Az ISA Board Adopting Protocols Manual;
5. Affidavit of Jerry W. Smith;
6. Certificate of Concurrence, executed by Arizona Public Service Company;
7. Certificate of Concurrence, executed by Tuscon Electric Power Company;
8. A form of Notice suitable for publication, in hard copy and electronically (in Word Perfect 6/7/8 on a computer diskette).

SERVICE COPIES

The Az ISA served copies of this filing on the Arizona Corporation Commission via U.S. Mail, first class postage prepaid, and on all persons listed in the Certificate of Service via electronic mail.

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CONCLUSION

As this filing is just and reasonable, the Az ISA respectfully requests that the Commission accept this filing and establish an effective date for Az ISA operations of November 1, 2000.

Respectfully submitted,

ARIZONA INDEPENDENT SCHEDULING
ADMINISTRATOR ASSOCIATION

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