

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 0074 2501 SCOMM 109: JNT. COMM. ELEC. UTILITY RESTRUCTURING, 1998

- **Generation:** Electric restructuring in the lower-48 arises from regulatory and technological changes affecting electric generation.

PURPA created new classes of generation sources, separate from the vertically integrated regulated utility structure. Technology made smaller units more economical, reducing the size/cost/time to construct, further accentuating power generation outside an integrated utility structure.

Multiple, active generators of electrical supply, offering energy under different price schedules, formed the basis of competitive provisioning. Multiplicity in generation sources was further encouraged by the Energy Policy Act of 1992 (exempt wholesale generators).

Currently, many policy makers are concerned that joint ownership of generation facilities and bottleneck transmission facilities (below) presents anti-competitive opportunities which must be addressed through some form of separation, such as code of conduct requirements or asset divestiture. Conversely, divestiture or lesser forms of safeguards (e.g., structural or accounting) may result in loss of economies and efficiencies or in the imposition of unnecessary costs adversely affecting consumer prices.

Another current issue arises from the concern that insufficient competition may exist now or in the future in generation, whereby certain generators may be able to exercise "market power" in a monopolistic or oligopolistic fashion.

- **Transmission:** For consumers to benefit from price differences in generation nationwide, electrical power must be moved from the source to a consumer/buyer located beyond traditional utility boundaries. This implicates facilities and regulatory issues.

Facilities issues: In the lower-48, the transmission of electrical energy across large geographic distances between states is physically possible. The interstate power grid is structured and intertied physically in a pyramid fashion into 5 interconnected areas encompassing 20 power pools and 137 control areas. This arrangement generally permits consumers in one state to access power produced in a different state.

Regulatory issues: Transmission facilities are asserted to be "bottleneck" facilities, in that they cannot be economically replicated or effectively substituted for by competitors. Vertically integrated utilities could arguably use control of the bottleneck transmission facilities (for which there is no competitive market) to favor sales of their own electrical generation (for which there is a competitive market).

Congress in the 1992 Energy Policy Act encouraged Federal Energy Regulatory Commission (FERC) efforts to open up the nationwide electric transmission system to wholesale suppliers. Order No. 888 established open access tariff requirements that provide non-utility wholesalers with access to the grid "comparable" to that afforded by the utility to itself and its affiliates. Order No. 889 provided for the establishment of real-time information systems and a code of conduct to ensure that all parties received non-discriminatory dispatch of their power.

Alternatively, potential discrimination in transmission can be addressed by requiring operation of the transmission network by an independent, non-utility entity, often called an

"independent system operator" or "ISO." The creation, costs, and operations of an ISO are matters still to be tested in the lower-48.

- **Local distribution:** Historically, the typical local electric utility offered electric energy as part of a "bundled" service offering which included (i) the electric energy itself, (ii) delivery of that energy to the customer's premises, (iii) meter reading, (iv) billing, (v) customer services, and other matters.

Under local distribution competition, described as "retail wheeling" or "direct access," electric energy is sold to end users separately from other services ("unbundled").

From the utility perspective, retail wheeling raises many issues. Utility costs and rate processes are not geared to reflect unbundling and pricing of discreet services. Multi-party access to the local distribution system requires extensive operational, financial, and ratemaking adjustments. The local distribution system itself (like the transmission system) is a bottleneck facility, and thus issues concerning equal access, ownership, and operation also arise at this level.

From a consumer perspective, retail wheeling raises consumer information, universal service, and consumer protection issues. Rates for energy may increase as unbundling occurs, since under competition rates are driven towards cost (cost causation, supply and demand). High cost low volume customers may prove unattractive and therefore may be unserved or served at higher prices in a competitive market. Large volume customers (industrial and commercial) may receive more (or all) of the benefits of competition. The appearance of unregulated, non-utility sellers of energy can obscure accountability for service provisioning, create consumer confusion, and result in abuse of consumer interests through improper business practices. Most important, the duty to provide electricity to any customer desiring same must be clearly addressed ("default provider: or "provider of last resort" issues).

- Competition in the local distribution market, where it has been attempted, has been based upon the developments arising in connection with generation and transmission, as described above. Pilot projects are one way among several of transitioning a regulated local market to a competitive one. Incentive regulation, regulatory forbearance, and selected market experiments represent others, but all of these rely on antecedent developments in generation and transmission.

3. Alaska is Different

- Conditions and antecedents in Alaska are significantly different from those in the lower-48. These differences diminish the precedential value of lower-48 competitive efforts and increase the risk of competitive experimentation.

- The total energy market in Alaska is extremely small compared to outside.

In 1996, electric consumption was:

	(Consumers - All Sectors)	(Thousand kWh)
U.S. Total (50 states)	120,002,093	3,097,809,945
California	12,671,531	218,112,485
Idaho	568,180	21,119,253
Alaska	256,103	4,779,562

(Source: "Electric Sales and Revenue 1996," Energy Information Administration, DOE/EIA-0540(96))

The railbelt marketplace, which looks large here, is extremely small comparatively. Competitive factors which work in the lower-48 may not work in a materially smaller, wholly isolated Alaskan market. It may well prove too small to induce enough competing generation to sustain competition, particularly since the lack of a lower-48 intertie (below) prevents the sale of any excess power elsewhere.

- Alaska's system is completely isolated from the lower-48 grid.

Alaska cannot physically participate in the lower-48 marketplace and thus cannot obtain benefits from competitive pricing in such markets.

If competitive policies here should produce declines in the quantity or quality of electric energy, Alaska cannot look to the lower-48 for compensating or emergency sources of power.

- Alaska's system in general, and the railbelt's in particular, is not a true power grid in the sense of the lower-48 interconnected areas.

Within each interconnected lower-48 system, individual utility systems are connected by AC transmission with the same frequency of current at all points within the connected area. Significant constrictions are minimized.

Even with the Northern Intertie, the railbelt system has significant points of constriction and lacks redundancy/alternate dispatch routing in the event of system failures.

Power cannot move in an unrestricted fashion as competitive markets require.

- Alaska has no significant non-utility generation base from which competition in generation could emerge.

In the railbelt, most significant generation is utility-owned and operated.

While the opportunity for increased efficiency exists, imposition of retail wheeling is neither the only nor the best way of going about achieving those efficiencies.

The absence of competitive generators limits the sources of power for market middlemen (marketers, brokers, arbitrageurs, etc.)

- There is no competitive Alaskan wholesale electric market structure comparable to that in the lower-48.

FERC Order No. 888 does not legally apply to Alaska. No federally-mandated, supervised structure for equal access, comparability, and real time information – the underpinnings of a competitive wholesale market – exists here.

The APUC could create one, in theory, but would have to do so from whole cloth.

- Thus, none of the key building blocks upon which competition at the local distribution level is being considered elsewhere exists in Alaska. These differences make a significant difference in charting a course toward restructuring in this State.

4. Additional Problems

- In addition to the absence of a proper foundation, the matter of electric industry restructuring in Alaska raises many other important issues. Three such issues are addressed below, but many more would require the attention and effort of public policy makers.

- **Stranded investment**

Investment becomes “stranded” when the transition to competition reduces the price for which electricity can be sold. At a lower price, only a portion of previously invested capital can earn a fair rate of return. The rest of the invested capital earns nothing and is therefore stranded.

Preliminary consultant estimates place the potential amount of stranded railbelt investment at \$30 – 40 million a year.

If not recovered, serious issues arise, including those legal (confiscation of property; bonding and financing restrictions) and public policy (deterrence to future investment).

Recovery poses significant issues in terms of who pays for the stranded costs (exiting customers, all customers, all market participants, the State?) and how the costs are to be identified and monitored.

- **Public ownership**

Unlike the lower-48, there is no significant investor-owned utility in the railbelt. All electric utilities are owned directly or indirectly by their customers.

MI & P is a division of the Municipality of Anchorage. It is capitalized in part through revenue bonds issued by the Municipality, which bonds contain multiple restrictions on the ownership and use of the assets securing those bonds.

The implementation of competition will generate complex issues concerning the nature of utility ownership in the State. For example, divestiture of generating capacity (being

discussed in the lower-48, as described above) in Alaska would raise serious issues since, in ML&P's case, privatization would first be required.

It is unclear that the State has the power to force such privatization. If it does not, issues concerning bottleneck facilities, open access, and comparability would have to be addressed in some other way.

Further, structural changes in facility ownership, facility operation, the creation of stranded investment, and so on, could implicate existing bond restrictions and requirements. This in turn could impact the credit worthiness of the Municipality, a matter of continuing focus for the Mayor and the Assembly of Anchorage.

- **Rate impacts**

Competition does not necessarily lower rates. Rather, competition tends to drive price towards cost. Where prices are above cost because of inefficiency or lack of competition, then the introduction of competition may lower those prices.

On the other hand, where prices are above cost because of public policy (e.g., implicit subsidies of one group of ratepayers by another group), the introduction of competition may destroy the basis for such subsidies. Some rates may go down, but others will go up.

Further, the benefits of price declines may not be equitably distributed. High volume/low cost consumers (e.g., businesses) may be able to bargain for advantages where high cost/low volume users (e.g., non-urban consumers) lack such bargaining power and could suffer higher prices.

Equally important, universal service policies could be impaired, in at least two ways. Increases in the price of electric energy may come to exceed the ability of individual consumers to pay. In the alternative, for some market segments (e.g., small communities located away from major transmission lines or poorer segments of urban areas) market forces may cause no competitive carrier to offer any electricity for sale. Some provisions for a "default carrier" or "provider-of-last-resort" would be required.

5. Recommendations

In light of these considerations, ML&P recommends that the Committee proceed in the "detailed, careful and informed" manner set forth in the Resolution. This would include:

- **Take steps in an orderly sequence**

The available experience of other states indicates that electric industry restructuring can and should be undertaken in a sequence of steps. At each stage, goals can be set, progress measured, and results assayed. The next step could then be pursued or forestalled as the empirical evidence gathered from the preceding step justifies. In this manner, the Committee maximizes the opportunity for achieving public benefits at each stage while minimizing the potential for serious error and harm to the public which overreaching could entail.

The logical and practical approach to restructuring in Alaska would entail the following three stages of activity -

Stage 1 - Power Pooling The power pooling concept, already under examination by the APUC (Docket U-97-140), focuses upon the improved coordination of utility generating resources and dispatch as a way to lower the effective cost of electric energy to Alaskan consumers.

Potential benefits include economy in dispatching power; attenuation and economies in future investment cycles; reduction of operating and generating risk; reduction in financial risk (through reduced costs of capital); and more equitable distribution of economic benefits among customer classes.

Successful pooling will also provide the regulatory and operational experience upon which the next stage of restructuring could be considered.

Stage 2 - Wholesale competition Building upon the pooling experience, wholesale competition may (or may not) prove feasible and a desirable means for securing additional consumer benefits. Like pooling, wholesale competition offers the prospect of more equitable distribution of consumer benefits. Unlike pooling, however, wholesale competition may raise issues (system operation, generation ownership, stranded investment, etc.) which cannot be solved at present on the basis of available experience, and may prove intractable in this market.

Stage 3 - Retail competition ML&P believes that for retail competition to be practicable, it must be grounded upon the restructuring included in the previous two stages. As with the prior stages, retail competition should be considered only when it can be established that the public interest benefits to be derived outweigh the costs and risks associated with the restructuring.

- **Utilize agency expertise.**

The Legislature should remain focused upon the overall role and effects of electric industry restructuring on the State as a whole. For example, as other states have done, the Legislature should consider commissioning a study of key variables in restructuring and the impacts of these on the State's economy and specific segments thereof.

The mechanics of restructuring could effectively be referred to the Alaska Public Utilities Commission. The Commission has already begun an inquiry into power pooling and has opened a general docket on restructuring issues. Further, the APUC has already demonstrated in a series of orders over the past 18 months its ability to address changing industry patterns in telecommunications. The Commission and its Staff have the resources and expertise to explore electric restructuring issues in more depth and breadth than the Legislature or this Committee reasonably can be expected to acquire or devote. Coordination between the Commission and the Legislature can be effected as the Legislature desires, including recommendations for changes in the APUC's powers.

- **Focus on Consumers**

The Committee and the Legislature will hear much from existing and would-be industry participants. While their input is essential, their interests are diverse. Their views should be balanced against the larger public interest benefits (if any) which must result from a particular proposed course of restructuring.

Retail competition is elsewhere being built on wholesale competition, which in turn was built on competitive generation. Retail wheeling is the tail, not the dog of electric restructuring.

Alaska's railbelt electric utilities are consumer owned, directly or indirectly. Financial impacts from changes can be far-reaching and severe in their consequences. The potential for \$50-60 million per year in stranded cost recovery requirements is a clear example and warning.

Competition does not produce lower rates for everyone, and may produce higher rates for some.

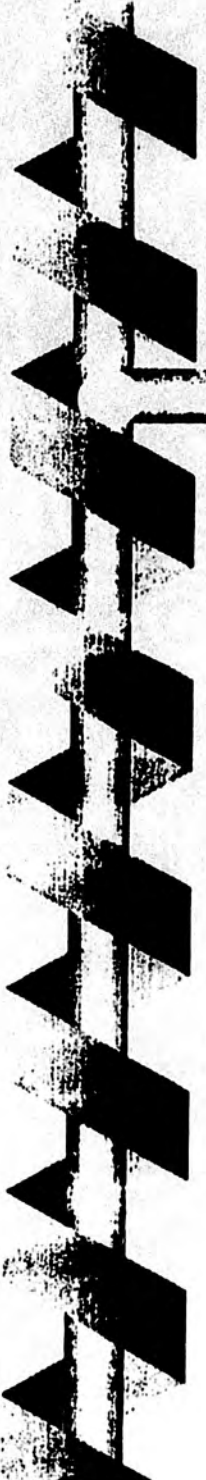
Although it seems large in relative terms, the Alaska railbelt energy market is quite small. It is also quite isolated. Mistakes in policy cannot be easily absorbed, and cannot be spread at all.



Aurora Power Presentation

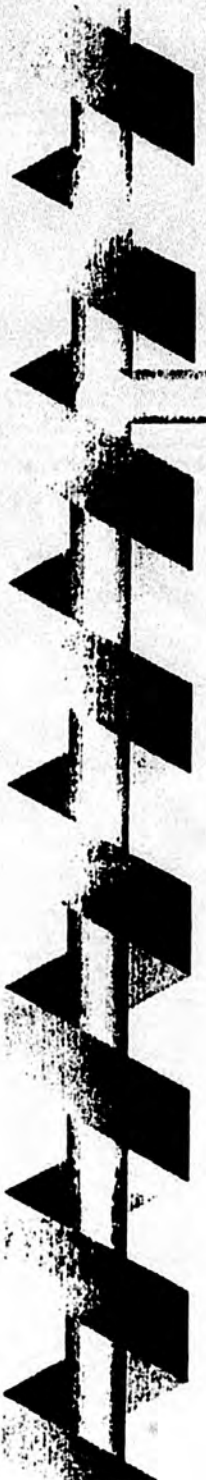
**“Joint Committee on Electric Utility
Restructuring “
August 6, 1998**

Legislative Presentation



Agenda

- ⊗ **Aurora Power**
- ⊗ **The Time is NOW**
- ⊗ **Benefits of introducing competitive forces**
- ⊗ **Various approaches**
 - **Study**
 - **Pilot Program**
 - **Full Retail Wheeling**
- ⊗ **Pilot Program**
- ⊗ **Legislative Considerations**



Description of Aurora Power

- **Established in 1994 as an Alaskan Company**
- **Largest independent Natural Gas Marketer in Alaska**
- **Sells natural gas to over 700 large commercial users**
- **Provides an avenue for competitive pricing of natural gas in the marketplace, resulting in substantial savings to end-users.**
- **Introduce restructuring in the electric industry**



The Time is Now

- ⊗ **Competition in Electricity**
- ⊗ **PILOT PROGRAM to accompany STUDY**
- ⊗ **Market vs. Regulation to determine the Price**
 - **“cost- based tariffs”**
 - **market model based on price**
- ⊗ **Economic Dispatch**



Benefits of Competition

- **Lower price**
- **Stimulates innovation / technological improvements**
- **Provides an avenue for “Customer Choice”**



Necessary Components of Competition in Electricity

- **Willing Buyers and Sellers of Electricity, at rates and structures different than available today**
- **Unbundling of Generation, Transmission, Distribution and Services components**
- **Resolve Billing and Metering issues prior to FULL Competition**



Various approaches to introduce competitive market forces

- **Study**
- **Pilot Program**
- **Full Retail Wheeling**



Electric Industry Restructuring - Box Score and Existing Pilots

- **Retail Wheeling Pilots - the first 6**
 - **Central Illinois Light Company (CILCO)**
 - **Illinois Power Company (IP)**
 - **Massachusetts Electric Company (MECO)**
 - **New Hampshire utilities**
 - **Orange & Rockland Utilities, (O&R)**
 - **Washington Water Power Company (WWP)**

Findings of Pilots

- ⦿ **Pilots are valuable**
- ⦿ **Technical implementation issues are important**
- ⦿ **Receptivity to pilots differs by customer class and size**
- ⦿ **Participating customers are content with Pilots**
- ⦿ **Need for customer education**
- ⦿ **Aggregation worked**
- ⦿ **Accurate load profiles are needed**
- ⦿ **Below-Cost offers existed**
- ⦿ **Design of Pilots has been evolutionary**
- ⦿ **Price is dominant**



Objectives and Goals of the Pilot Program

- **Reduce electric rates to consumers**
- **Allow competitive choice for consumers**
- **Educate and prepare consumers for a competitive retail marketplace for electric generation and capacity**
- **Test on a limited basis the effectiveness and readiness of the generation, transmission and distribution systems for a competitive marketplace**
- **Preserve and promote reliability, safety, and consumer protection**



Aurora Power - Pilot Program

- ⦿ **Limited Scope - 35MW**
- ⦿ **Limited Time - 2 years**
- ⦿ **Power Supplier- Wholesale Power Tariff**
- ⦿ **CEA/ML&P - Unbundled Transmission and Distribution**
- ⦿ **Qualified Power Marketer**
- ⦿ **Consumers in the Anchorage Service area can participate through any Qualified Power Marketer**
- ⦿ **Consumer Protection**
- ⦿ **Informational Reports furnished to the APUC on results of the pilot program**



Legislative Considerations

- ⦿ **Pilot Program to accompany any study**
- ⦿ **Test on a limited basis the readiness of the generation, transmission and distribution system to react to a competitive environment**
- ⦿ **Separate Rural and Railbelt Issues**
- ⦿ **Realize that Businesses, Organizations and Consumers want Competitive Choice Now**
- ⦿ **Act in a timely manner**

STATE OF ALASKA
THE ALASKA PUBLIC UTILITIES COMMISSION

COPY

Before Commissioners:

Sam Cotton, Chairman
Alyce A. Hanley
Dwight D. Ornquist
Tim Cook
James M. Posey

In the Matter of the Application by Aurora)
Power Resources, Inc. to Establish a Pilot Program)
to Allow the Limited Competitive Sale of)
Electric Power in the Chugach)
Electric Association, Inc. and Municipal Light &)
Power Service Areas)
)
)
)

U-98- _____

**AURORA POWER RESOURCES, INC.'S APPLICATION TO ESTABLISH A PILOT
PROGRAM TO ALLOW THE LIMITED COMPETITIVE SALE OF ELECTRIC
POWER IN THE CHUGACH ELECTRIC ASSOCIATION, INC. AND MUNICIPAL
LIGHT & POWER SERVICE AREAS**

I. INTRODUCTION

Pursuant to 3 AAC 48.600-.660, Aurora Power Resources, Inc. ("Aurora") respectfully requests the Alaska Public Utilities Commission ("Commission") approve a limited pilot program ("Pilot Program") to permit the limited competitive sale of electric power to consumers in the Chugach Electric Association, Inc. ("CEA") and Anchorage Municipal Light & Power ("ML&P") service areas ("Application"). The Pilot Program will provide consumers the benefits of competitive choice and reduced electric costs. The Pilot Program will also provide an opportunity for the Commission and its Staff to introduce competitive choice on a limited basis and thereby gain the knowledge necessary to consider the public interest in allowing full electric retail competition in Alaska.

The Pilot Program is consistent with the federal and state trend of allowing competition, direct access, and consumer choice within regulated industries. Throughout the nation, both federal and state regulators are allowing competitive forces to shape the marketplace of virtually every regulated industry including the natural gas industry, the telecommunications industry, the crude oil transportation industry, and both the wholesale and retail electrical power industry. In the wholesale and retail electrical power industry, this national trend has resulted in radical and long-lasting changes in the way consumers purchase their power.

Consistent with this national trend, the Commission has allowed or is considering retail competition within every industry it regulates. The Commission has allowed retail competition to varying degrees for natural gas transportation, telecommunications, crude oil transportation, and refuse. The Commission has approved several special contracts for the wholesale competitive sale of electric power throughout the Railbelt in Alaska. The Commission has also established a general regulatory docket for the purpose of considering the retail competitive sale of electric power within Alaska.

II. THE APPLICANT

Aurora is the largest, independent natural gas marketer in the Anchorage marketplace and has developed a great deal of direct experience in bringing the benefits of competitive choice to Alaskan consumers.¹ Aurora has already brought the benefits of competitive choice and reduced natural gas costs to a great many consumers including several agencies of the State of Alaska,

¹ Aurora does not own or operate any physical plant, pipeline, or system and is, therefore, not a public utility as defined in AS 42.05.990(4) and is not required to obtain a certificate of public convenience and necessity under AS 42.05.221(a).

municipalities, school districts, a university, major hospitals, and other governmental, nonprofit, and for-profit consumers. Aurora would be a qualified power marketer under the Pilot Program. Aurora has aggregated electric consumers representing approximately 25 MWs of electric power. In its capacity as a qualified power marketer, Aurora will purchase electric power under the terms of the Pilot Program for sale to its customers.

III. THE PILOT PROGRAM

A. Objectives of the Pilot Program

The Pilot Program is designed to achieve the following specific objectives:

- * Reduce electric rates to consumers;
- * Allow competitive choice for consumers;
- * Educate and prepare consumers for a competitive retail marketplace for electric generation and capacity;
- * Encourage development of a competitive retail marketplace for electric generation and capacity;
- * Test on a limited basis the effectiveness and readiness of the generation, transmission, and distribution systems for a competitive marketplace; and
- * Preserve and promote reliability, safety, and consumer protection.

In accomplishing these specific objectives, the Pilot Program will provide the Commission and other interested parties with the information and experience necessary to reshape the electric marketplace in Alaska from a marketplace based solely on monopoly regulation to a marketplace based, to the degree practical, on competitive choice.

Pilot programs have been used successfully in several other areas. Attached for the Commission's benefit as Exhibit A to this Application are the relevant portions of a survey

prepared by the Edison Electric Institute on the status of the various pilot programs throughout the nation. Aurora will supplement these portions with a complete copy of the survey as soon as it becomes available. In summarizing its observations on the benefits of a pilot program, Edison Electric Institute observed:

Pilots are Valuable. The fundamental finding from our review is that all the pilot utilities felt that the programs were worthwhile. . . . At least one utility representative said conducting retail programs was essential before the advent of full competition. Learning how to prepare for full competition is less disruptive when retail access is offered to only 3% of customers. Another utility said that, "every utility should do a pilot to learn."

Technical Implementation Issues are Important. Some of the interviewed utilities have indicated that the true value of pilots is the ability of the utility to understand, learn and develop procedures to accommodate customer choice, schedule customer meter readings, and process load profile estimates.

Participating Customers are Content With Pilots. Although there have been cases of customer confusion and dissatisfaction with levels of savings, customers are generally content with their decision to participate in the pilot. In most cases, their expectations have been met. One of the few pilot program surveys on customer choice and participation was conducted in New Hampshire, and it indicates strong customer satisfaction.

Aggregation Has Worked. Attempts to aggregate customer load were tried in most of the pilots. It was found to be successful and valuable especially when the pilots were focused on specific geographic areas.

Exhibit A at 16-17.

B. Description of the Pilot Program

1. Overview

The Pilot Program is designed to provide consumers with competitive choice. The Pilot Program will allow consumers located in the CEA and ML&P service areas to participate through any qualified power marketer. To qualify as a power marketer in the Pilot Program, a power marketer will have to (1) notify the Commission of its intention to participate at least 60 days prior to hearing, (2) demonstrate through prefiled testimony it has accumulated and subscribed an electric load of no less than 5 MWs nor more than 25 MWs from the CEA and ML&P service areas, and (3) fulfill any registration or bonding requirements which may be imposed by the Commission prior to participating in the Pilot Program. The Pilot Program will be limited to a maximum load of 35 MWs. The term of the Pilot Program will be two years. At no time during the Pilot Program will a consumer be charged (on average) more for electric power than that consumer would have otherwise paid under existing tariff rates. During the term of the Pilot Program, any qualified power marketer will be required to regularly provide the Commission with informational reports. These informational reports will be in whatever form and contain whatever information the Commission may deem most helpful.

2. Competitive Model Proposed Through the Pilot Program

The competitive model proposed through the Pilot Program may only be understood by considering the separate elements associated with providing electric service to the consumer. Essentially, electric service is comprised of five basic elements: (1) power generation; (2) power transmission; (3) power distribution; (4) consumer services; and (5) energy sales and marketing.

For any competitive model to work, CEA's and ML&P's electric services must be unbundled into separate service elements. Following is a brief description of each of these elements as well as a description of the impact of the Pilot Program on each element.

a. **Power Generation:** Power generation is the process and related services associated with producing electrical power. Under the Pilot Program, qualified power marketers would be allowed to collectively purchase up to 35 MWs--roughly 10 percent of the 350 MWs of total retail electric load in the CEA and ML&P service areas. These purchases would be on a competitive basis from any power supplier. Essentially, the Pilot Program allows competition among power suppliers for approximately 10 percent of the total electric load in the CEA and ML&P service areas.

b. **Power Transmission:** Power transmission is the process and related services associated with moving large amounts of electricity from the generator site to the general location where it will be consumed. Under the Pilot Program, there will be limited transmission of bulk electric energy between the CEA and ML&P service areas. This transmission will be on the existing facilities owned by CEA and ML&P. The qualified power marketer will be responsible for arranging this limited transmission of bulk electric energy. The Commission will need to continue to regulate rates to be charged by the electric utility for transmission.

c. **Power Distribution:** Power distribution is the process and related services associated with moving electric power from the bulk transmission lines to the consumers' location. Under the Pilot Program, power will be delivered to selected points of delivery on the

transmission/distribution facilities of either CEA or ML&P. The qualified power marketer will be responsible for arranging the distribution of electric power with the electric utility, either CEA or ML&P, which owns the distribution system used by the participating consumer. The Commission will need to continue to regulate rates to be charged by the electric utility for distribution.

d. **Customer Services:** Customer services are the services associated with the activities that are needed by customers in order to receive electric power. These services include adding and terminating service, meter reading, billing, collection, and emergency service restoration. Under the Pilot Program, CEA or ML&P will continue to be responsible for the emergency service restoration in their own service areas and the qualified power marketer will be responsible for arranging or providing all other customer services. The rates for all customer services except for emergency service restoration (the costs of emergency service restoration are included within the cost of transmission or distribution) will be fully competitive.

e. **Energy Sales and Marketing:** Energy sales and marketing are the services associated with marketing electric power to the participating consumer. These services include marketing, sales, and education directed at the participating consumer. Under the Pilot Program, energy sales and marketing will be performed by the qualified power marketer. The rates for these services will be fully competitive.

3. Subscription in Pilot Program

To allow power marketers an opportunity to qualify for participation in the Pilot Program, each power marketer will have until the date set by the Commission for prefiled testimony in which to aggregate and subscribe retail electric consumers for the Pilot Program. In the event the Pilot Program is oversubscribed, each qualified power marketer will be allowed to sell a prorated share of the 35 MWs of total retail electric load available to the Pilot Program. The prorated share will be based on each qualified power marketer's subscribed retail electric load, which may be no less than 5 MWs nor more than 25 MWs.

4. Rates for Electric Power

As noted above, under the Pilot Program, any power supplier may provide electric power to qualified power marketers. To compliment these power sales, the Commission should require power suppliers to file a wholesale bulk power tariff under which any qualified power marketer may purchase electric power and related services at wholesale bulk power rates. The Commission should also allow power suppliers and qualified power marketers to enter into special contracts under which power suppliers may sell qualified power marketers electric power and ancillary services at wholesale bulk power rates.

5. Rates for Transmission and Distribution

As noted above, under the Pilot Program, CEA's and ML&P's services will need to be unbundled to allow a competitive marketplace to develop. Thus, the Commission will have to continue to establish rates for those unbundled services for which there continues to be a natural

monopoly while at the same time allowing the marketplace to establish rates for those unbundled services for which there is no natural monopoly.

For the purposes of the Pilot Program, rates for power generation, customer support services, and energy sales and marketing will be competitively determined. Competition between CEA, ML&P, and other power suppliers may be trusted to establish more competitive rates for power generation. Likewise, competition may be trusted to establish competitive rates for support services and energy sales and marketing services.

Competition, however, may not be trusted to establish competitive rates for transmission and distribution. These services require the use of the existing transmission and distribution systems for CEA and ML&P. Just and reasonable rates for transmission and distribution services have already been determined in operating agreements, participants' agreements, and cost-of-service studies. For the purposes of the Pilot Program, the Commission should set unbundled rates for transmission and distribution based on these existing agreements and cost-of-service studies.

IV. CONSUMER IMPACTS

A. Consumer Benefits

The Pilot Program will result in both immediate benefits to participating consumers and long-term benefits to all consumers. Participating consumers should realize cost savings of approximately 10 percent as compared to what they would have paid absent the Pilot Program. In addition, the introduction of competitive forces into the electric marketplace may be expected to result in the more efficient utilization of power generation and lower costs for all consumers

over time. These benefits may be expected to be shared by a broad range of consumers. Currently, Aurora has residential, small commercial, and large commercial consumers under contract who are willing to participate in the Pilot Program.

B. Consumer Protection

The Pilot Program will allow any participating consumer to terminate participation on 30-days' notice. If a participating consumer elects to terminate participation or if the qualified power marketer fails to arrange or provide service for the consumer, the consumer will simply return to his original electric provider. The Pilot Program will also provide that a participating consumer may not be charged any more than he would otherwise have been obligated to pay absent participation in the Pilot Program. Finally, the Commission may also require registration and consumer bonding from qualified power marketers who wish to participate in the Pilot Program.

V. UTILITY IMPACTS

The Pilot Program is geographically restricted to the CEA and ML&P service areas and quantitatively restricted to 35 MWs or 10 percent of the total electric retail market of approximately 350 MWs. As the result, the Pilot Program will not impact utilities nearly as much as allowing full retail competition. The Pilot Program will, however, do a good job of foretelling and defining the issues both CEA and ML&P will have to confront if the Commission determines that full retail competition is in the public interest.

CEA and ML&P will be impacted in a similar manner relative to the services they provide. For both, the primary risk is that their customers will have a choice which may be

exercised to the customers' own economic benefit and to the utilities' economic disadvantage. This risk may be expected to result in greater efficiency for CEA and ML&P and lower costs for their consumers.

VI. QUALIFIED POWER MARKETERS

To qualify as a power marketer under the Pilot Program, a power marketer will have to

- (1) notify the Commission of its intention to participate at least 60 days prior to hearing,
- (2) demonstrate through prefiled testimony it has accumulated and subscribed an electric load of no less than 5 MWs nor more than 25 MWs from the CEA and ML&P service areas, and
- (3) fulfill any registration or bonding requirements which may be imposed by the Commission prior to participating in the Pilot Program.

Establishing a minimum electric load for qualification as a power marketer under the Pilot Program is also an important requirement for the Pilot Program to be successful. A 5 MW minimum load will avoid the regulatory burden associated with monitoring an unlimited number of power marketers with no substantial load in so limited a Pilot Program.

In addition, the Commission may see fit to require qualified power marketers to register with the Commission and provide consumer bonding to ensure the public's trust and confidence in the Pilot Program.

VII. AFFILIATE RULES

Existing power suppliers who provide electric power and services to affiliated, qualified power marketers should be allowed to do so under a set of affiliate rules which prevent existing power suppliers from taking unfair advantage of their position as a power generator to gain or maintain market share as a qualified power marketer. The affiliate rules should ensure a level playing field between affiliated, qualified power marketers and independent, qualified power marketers. Among other broad-based affiliate rules, the Commission should provide that any affiliated, qualified power marketer must purchase electric power and services from its affiliated power supplier under the same wholesale bulk power tariff which is available to independent, qualified power marketers.

VIII. IMPLEMENTATION OF THE PILOT PROGRAM

A. Commission Authority

The Commission has full regulatory authority to approve and implement the Pilot Program. AS 42.05.141(a), (a)(1), (a)(2), and (a)(3) grant the Commission full regulatory authority to regulate every public utility to the extent not preempted by federal law. Moreover, AS 42.05.151(a) grants the Commission the authority to adopt regulations which are not inconsistent with the law. AS 42.05.221(d) contains the only restriction to the Commission's authority to allow competition and provides that the Commission may act to disallow competition only when that competition is found to be not in the public interest. Clearly, the Commission may act to approve and implement a limited pilot program to allow participating consumers, representing only 10 percent of the total electric market, a choice.

B. Request for Expedited Consideration

Aurora respectfully requests the Commission to expedite its consideration of the Pilot Program and not to allow the broader issues associated with the complete restructuring of the electric industry to allow full retail wheeling in Alaska to bog down its consideration of the Pilot Program. By its nature, the Pilot Program is designed to provide an efficient opportunity from which to further consider full retail wheeling in Alaska. If the Commission allows the broader issues associated with full retail wheeling to be considered at the same time, the efficiencies of the Pilot Program will be diminished. For its part, Aurora believes the limited approach advanced in the Pilot Program has merit and will more efficiently focus the Commission's future consideration of full retail wheeling.

C. Commission Action Necessary to Implement Pilot Program

To approve and implement the Pilot Program, the Commission should (1) open a "U" docket to consider this Application, (2) establish an expedited procedural schedule, (3) require and approve wholesale bulk power tariffs, (4) set unbundled rates for the transmission and distribution of electric power within the CEA and ML&P service areas based on their existing cost studies and contracts, and (5) approve the terms and conditions of the Pilot Program.

IX. CONCLUSION

The Pilot Program is a reasoned and measured approach to the introduction of competitive forces into the electric marketplace in Alaska. The Pilot Program will provide participating consumers the benefits of competitive choice and reduced electric costs and will provide the Commission and the stakeholders in the existing electric market place with the

knowledge and experience necessary to fully consider the public's interest in full electric retail competition in Alaska.

Dated: _____

BRENA, BELL & CLARKSON
Attorneys for Aurora Power Resources, Inc.

By _____
Robin O. Brena
Kevin G. Clarkson
310 K Street, Suite 601
Anchorage, Alaska 99501
(907) 258-2000

VERIFICATION

I, Robin Brena, being first duly sworn upon my oath, state as follows:

I am an attorney for Aurora Power Resources, Inc. in the above-referenced matter. I have read the foregoing document and know the contents thereof to be true and accurate to the best of my knowledge and belief.

DATED this _____ day of June, 1998.

Robin O. Brena

SUBSCRIBED AND SWORN TO OR AFFIRMED before me this _____ day of June, 1998.

Notary Public in and for Alaska
My Commission Expires: _____

Testimony of Robert A. Wilkinson
Before the Joint Legislative Committee on
Electric Utility Industry Restructuring
August 6, 1998

My name is Robert A. Wilkinson, and I am the General Manager of Copper Valley Electric Association, Inc.

Thank you Senator Sharp, Representative Rokeberg, and members of the Committee for allowing me the opportunity to testify before you today.

I am here today as a representative of the Purchasing Utilities of the Four Dam Pool. Prior to making specific remarks pertaining to Four Dam Pool concerns about restructuring, I would offer some brief general comments on behalf of the Four Dam Pool utilities.

Restructuring of the electric utility industry in Alaska is an enormous undertaking with far reaching and potentially serious consequences. While this industry sees possible benefits from competition, and in fact, many Alaska utilities are already delivering economic and improved service benefits to customers in preparation for industry change we also see many unanswered questions. We believe the following basic principles should be kept firmly in mind as you weigh the benefits and impacts of restructuring.

- ◆ All customers should be treated equitably.
 - ◆ All potential power suppliers should be held to the same standard of reliability and safety, as are utilities.
 - ◆ Suppliers of last resort, in the event of shortages, should be clearly determined.
- And finally,
- ◆ Stranded costs must be fairly addressed.

The information accumulated on this subject is voluminous. The U.S. Congress, and virtually every state, either through the legislative process or through their public utility commission, is dealing with this issue. The one thing we know for certain is that the more we as utilities learn about electric industry restructuring, the more questions we have. Four Dam Pool utilities say, what's the rush? Numerous studies and pilot programs are under way nationwide. We urge this Committee to conduct deliberate, scientific, and thorough study prior to coming to any conclusions, and we suggest the appropriate strategy is to watch what others are doing so that we may learn from their experiences.

You have no doubt heard countless times that Alaska is unique, which brings me to a subject, which is truly a one of a kind - The Four Dam Pool. The Four Dam Pool is comprised of four state-owned hydroelectric projects operated by five utilities that serve Petersburg, Wrangell, Ketchikan, Kodiak Island, Valdez, and the Copper River Basin. These utilities, together with the Alaska Energy Authority, entered into a 45-year Power Sales Agreement in 1985. Effectively, the utilities pool the costs to operate the four projects and then sell energy at a postage stamp rate back to the individual utilities.

Ratemaking in the electric utility industry, in its most simplistic terms, involves dividing the operation, maintenance, and debt-service costs by energy sales to produce a retail rate.

This is a very capital-intensive business, and the fixed costs of operations generally represent a very large percentage of any utility's operating costs.

We are all familiar with the term "stranded investment." While each Four Dam Pool utility is concerned with their own stranded cost in a competitive environment, we are collectively concerned that the Long Term Power Sales Agreement represents additional stranded investment to the utilities and the State as well. Under the energy program for Alaska, the State invested many hundreds of millions of dollars in the Four Dam Pool, in part, in exchange for the Long Term Power Sales Agreement, which provides a revenue stream of 4¢ kwh on sales from the four hydro projects. In the face of retail competition, utilities could lose energy sales to competing providers, which could reduce sales from the Four Dam Pool projects. Should this occur, not only will the State lose the 4-cents-debt-service revenue, but with a declining denominator in the rate equation, the cost of Four Dam Pool power to the utilities will rise as well, and ultimately, so will the rates of those utilities who under the Long Term Power Sales Agreement are required to purchase all output these projects can generate.

Finally, I mentioned earlier many utilities are looking inwardly for ways to improve service and reduce the price of electricity in anticipation of the new competitive environment, and I want to share some of those activities with you by Four Dam Pool members.

Ketchikan is trying to put together the Southeast Intertie project which will electrically connect the Tyee and Swan Lake hydro projects allowing the Four Dam Pool utilities, as well as the State, to benefit from the underutilized Tyee project.

Kodiak is currently developing a steam-turbine-cogeneration project with the United States Coast Guard aimed at saving the government and Kodiak customers' money.

Copper Valley is developing a combustion-turbine-cogeneration project with a Valdez refinery aimed at reducing the cost of power for all 3,300 CVEA customers.

The Four Dam Pool is currently conducting a study for more efficient economic dispatch of the two Southeast hydros.

The point I would like to drive home here is that utilities are proactively working on developing competitive solutions to the problem of high-cost energy in coastal Alaska.

In closing, Alaska cooperatives and municipal utilities have done business as regulated monopolies for over 50 years. Transition to a competitive environment may or may not be good for Alaskan ratepayers. We urge this Committee to carefully and deliberately evaluate this extraordinarily complex issue. The Four Dam Pool utilities stand ready to participate in this process, and we pledge our assistance to the effort. Thank you for the opportunity to speak to you today on this very important issue.

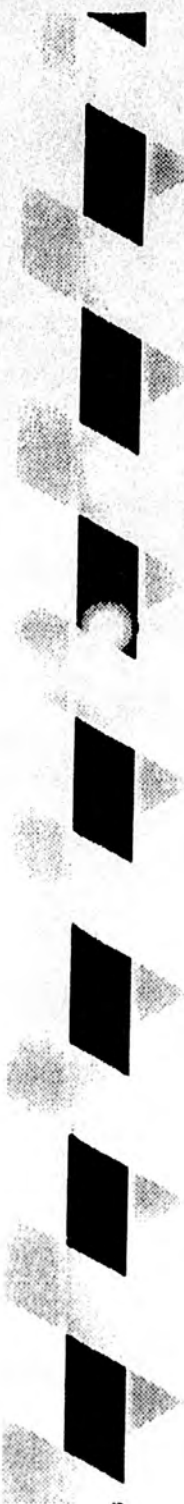


Electric Industry Restructuring

ARECA REPORT, August 6, 1998

ARECA Topic

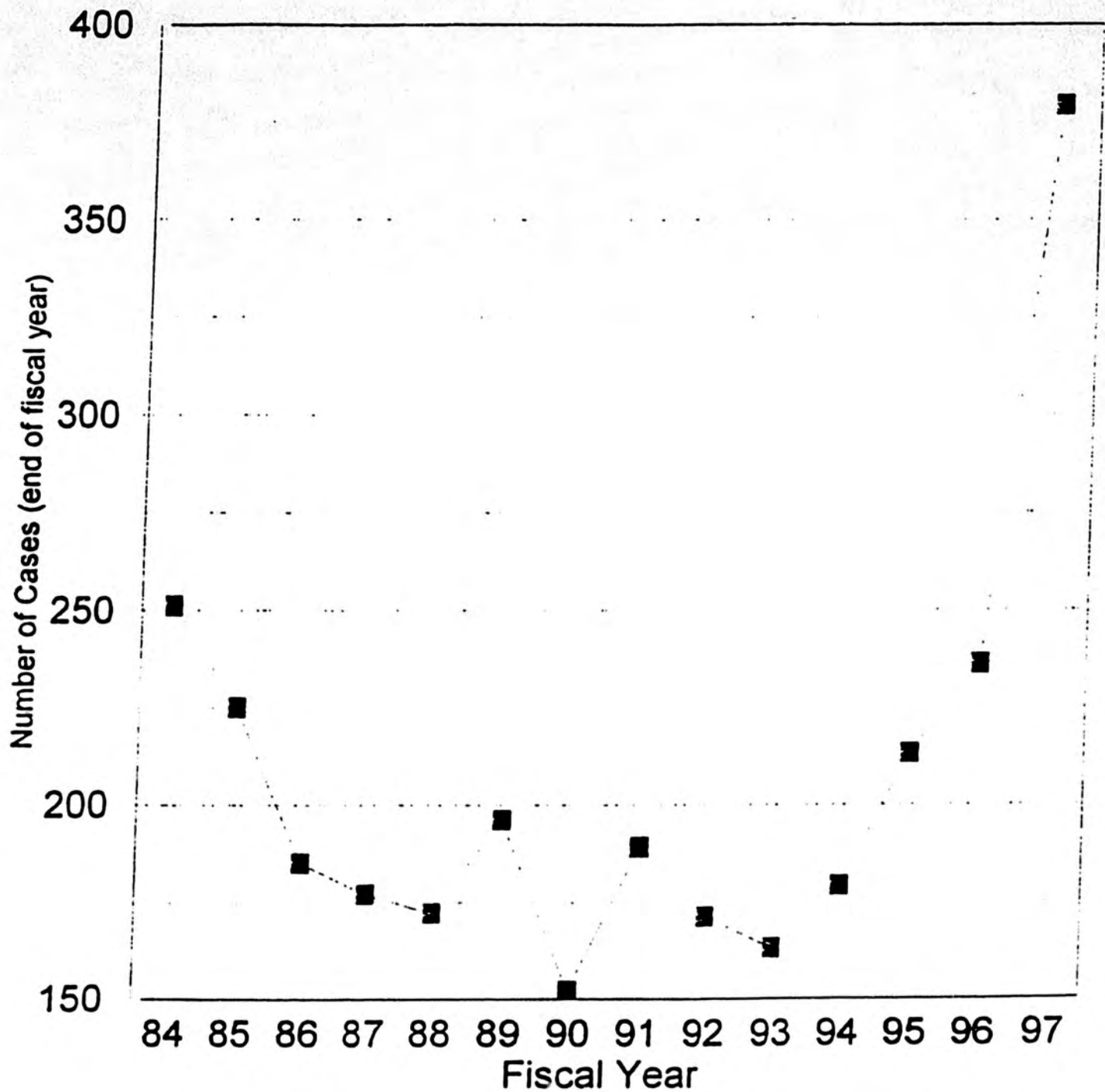
- State and Federal Activity on Utility Deregulation
- The Electric Utility industry in the State of Alaska
- Important Issues for the State of Alaska
- Standards for the State of Alaska
- Summary



Electric Utility Deregulation

- **Deregulation**
 - **Reregulation**
 - **Retail Wheeling**
 - **Restructuring**
 - **Customer Choice**
 - **Retail Competition**
 - **Unbundling**
- 

APUC Formal Caseload



Deregulation

National

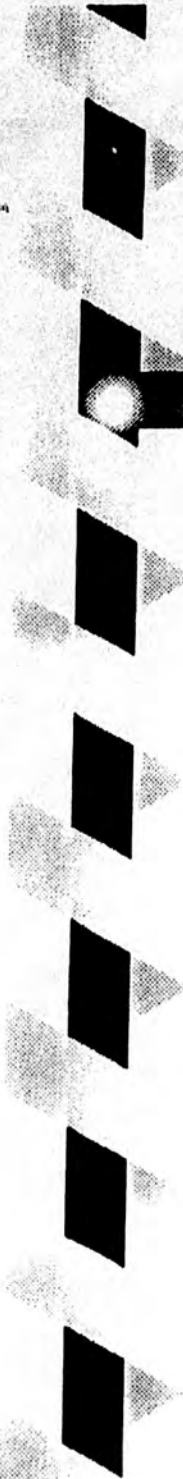
- **Gas pipelines**
- **Communications**
 - **Airlines**
- **Electric Utilities (???)**

State



Federal Legislation Pending

- **HR 1119 & S 936**
 - **HR 655 Dan Schaefer**
 - **S 237 Dale Bumpers**
 - **S 1401 Slade Gorton**
 - **S 487 Frank Murkowski**
 - **S 687 Jim Jeffords**
 - **S 1276 Jeff Bingaman**
 - **S 1230 Tom DeLay**
 - **HR 1359 Peter DeFazio**
 - **S 722 Craig Thomas**
 - **HR 1960 Edward Markey**
 - **Murkowski Hearings**
- 



State Activity – Retail Wheeling

- **14 States enacted restructuring legislation**
- **6 State PUC's issued orders**
- **26 States studying**
- **5 States – No Action**

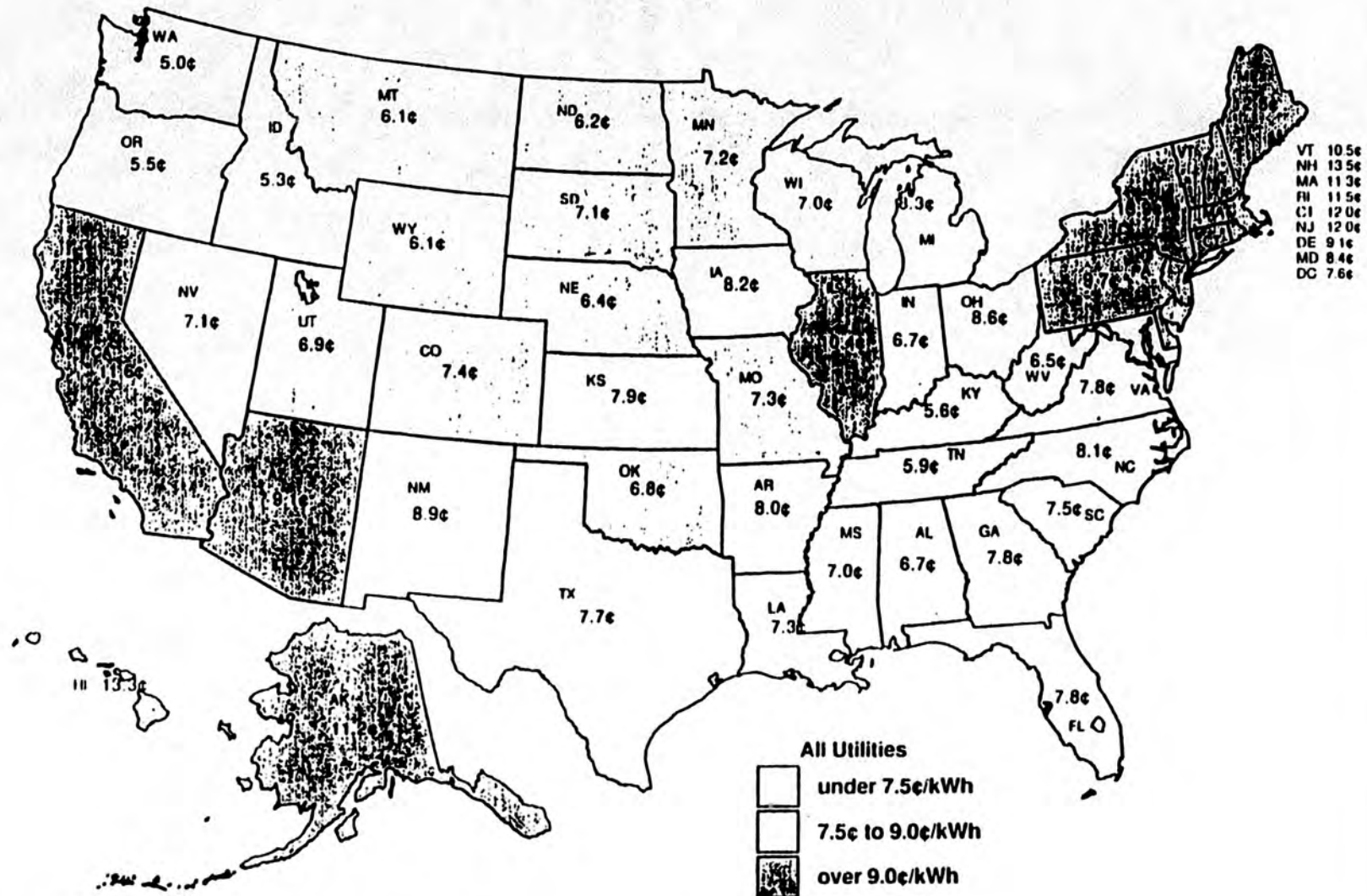


State of Alaska Efforts to Restructure

- **SB 54 Service Area Protection**
- **HB 235 Cautious Deregulation**
- **HB 287 Anchorage Area Deregulation**
- **HCR 34 Legislative Subcommittee**
- **SB 355 Anchorage Area Deregulation**
- **Regulatory-APUC Docket R-97-10**
- **Regulatory- Various Open Dockets**



cents per kWh

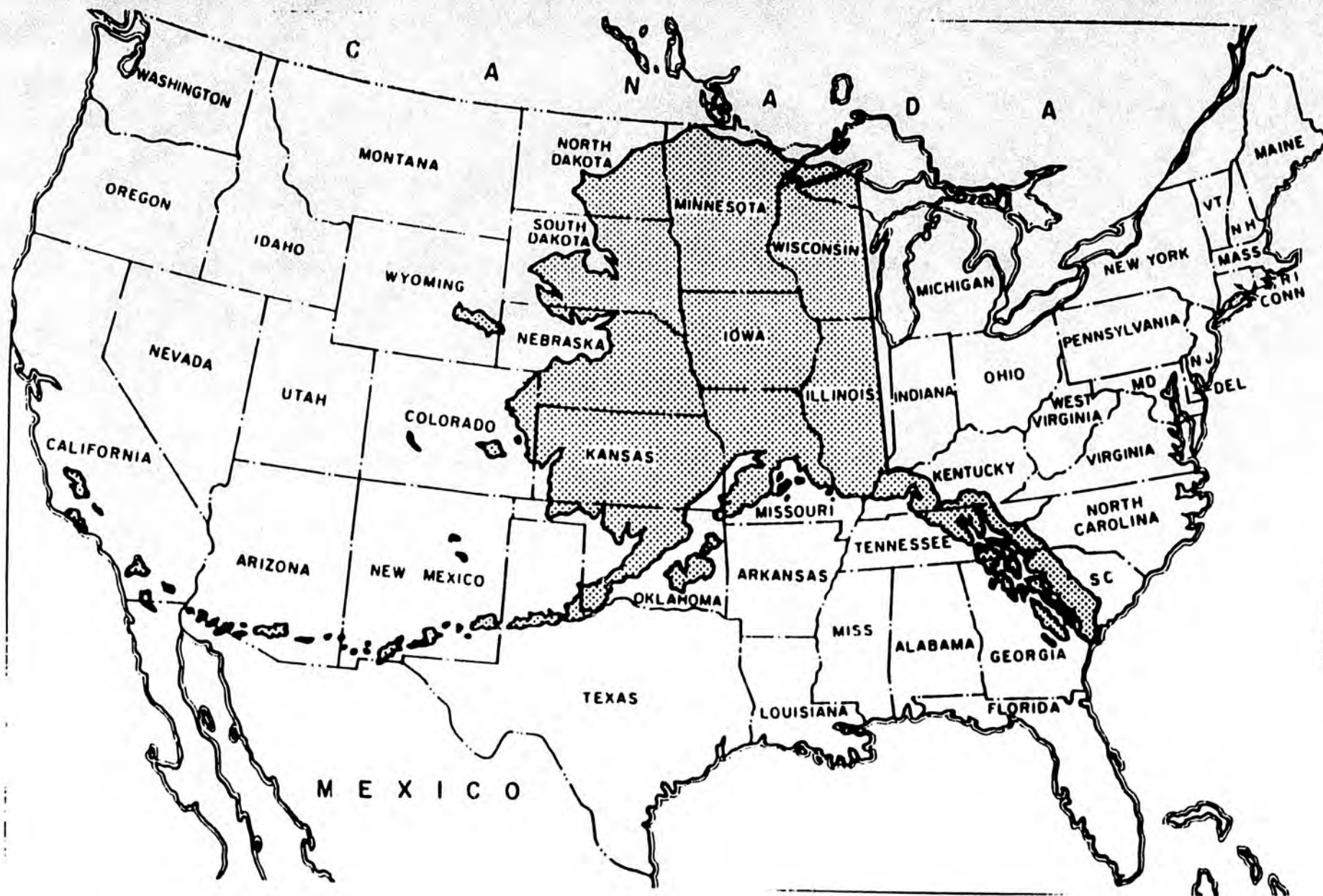


67% of co-ops have higher rates than IOUs they compete with.

Co-ops do not typically provide service in relatively high rate states, eg Calif. and New England.

Source: 1995 EIA data

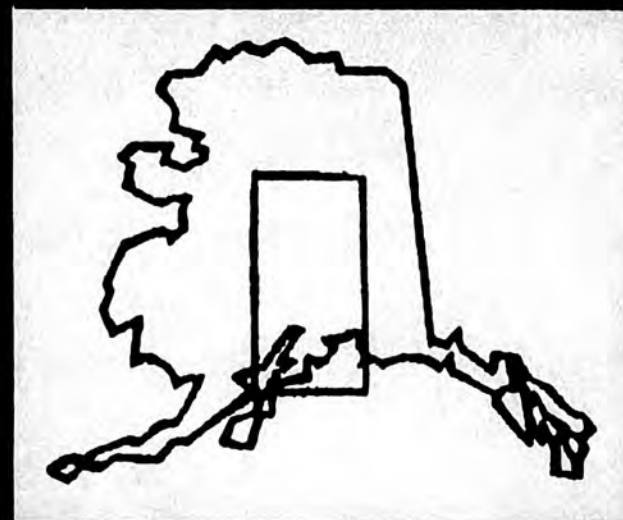
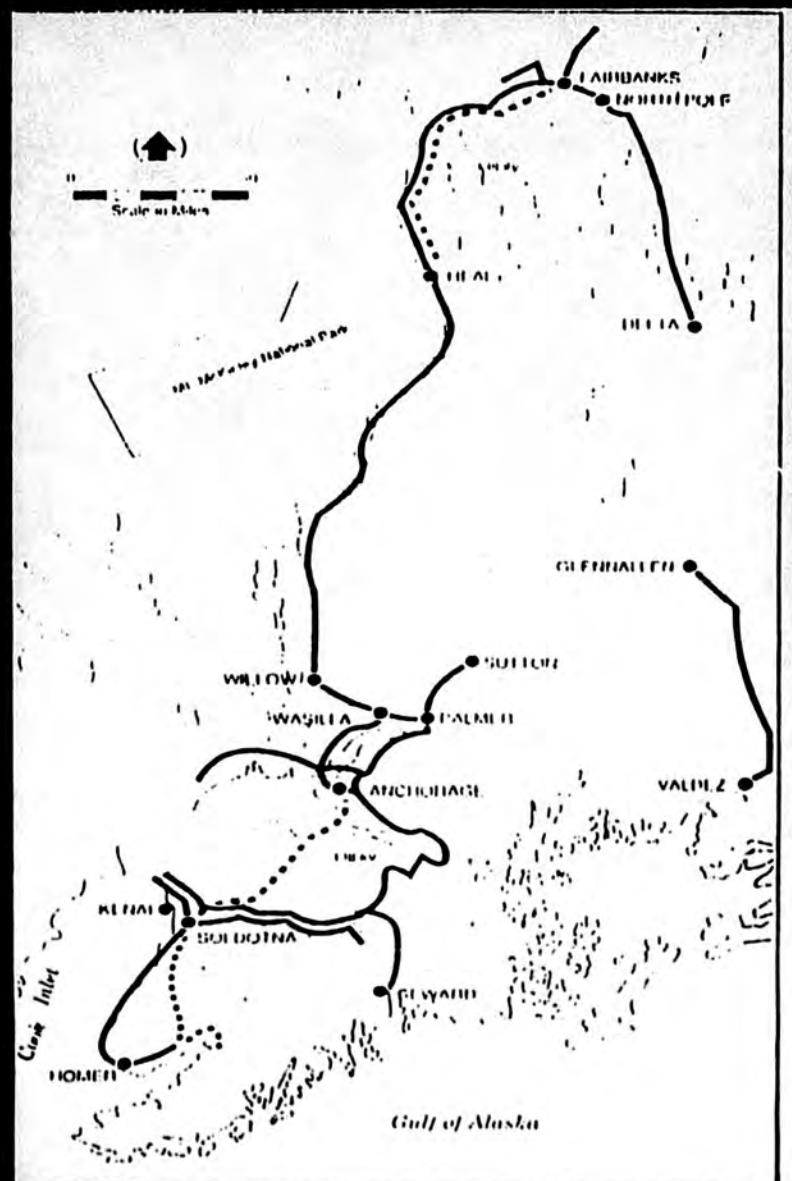
U.S. Avg. 8.4¢/kWh



Electric Utility Rates

	<u>Residential</u> ¢ /KWH	<u>All Class</u> ¢ /KWH
<u>U.S. Average</u>	8.4	7.6
<u>Alaska</u>	11.2	10.1
CEA	9.5	8.4
ML&P	9.8	8.3
GVEA	9.8	8.8
Rural	>40.0	

Minimal Transmission Grid



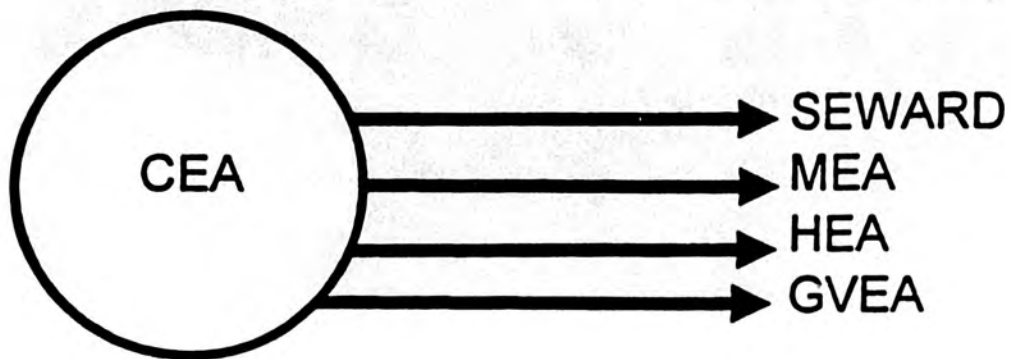
Railbelt Area

- Existing Transmission Lines
- Bradley Lake Transmission Lines
- - - Proposed Northern and Southern Transmission Lines

RAILBELT GENERATION

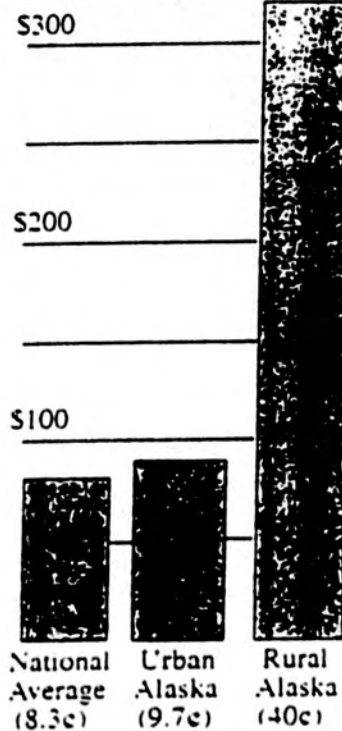
Self
Generation

Wholesale
Generation



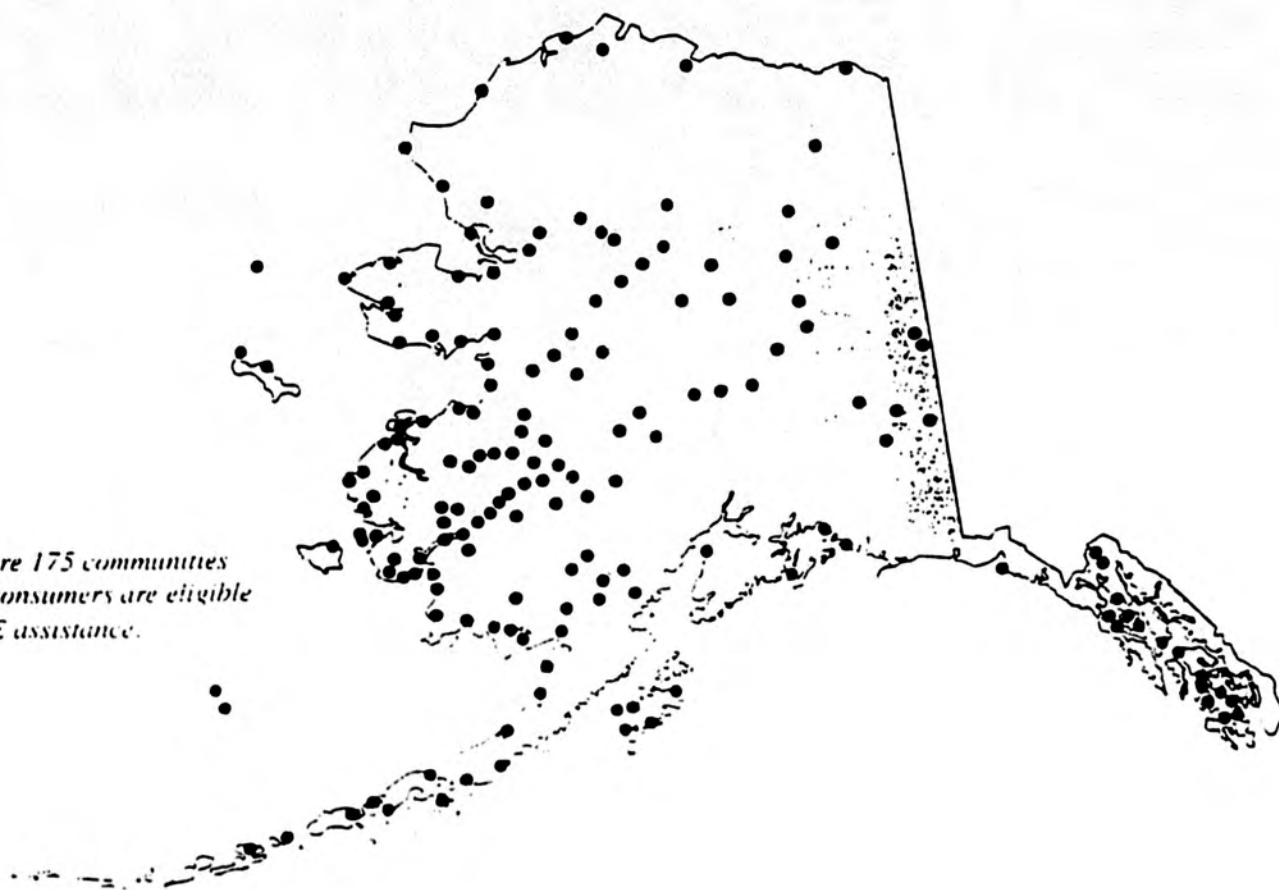
Electricity Costs

Dollars Per Month

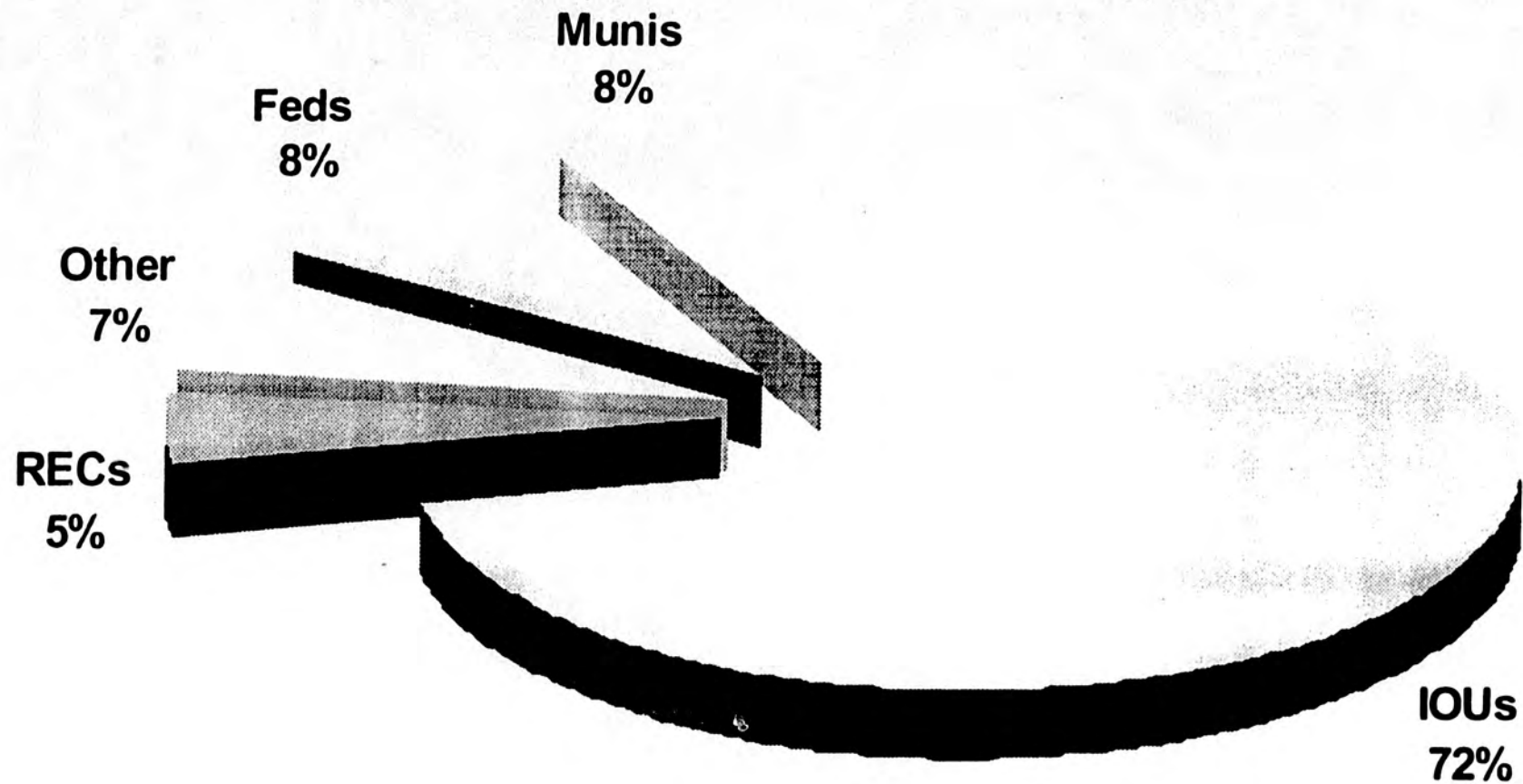


1995 Cost per Kilowatt-Hour
Based on National Average
822 Kilowatt-Hours Per Month

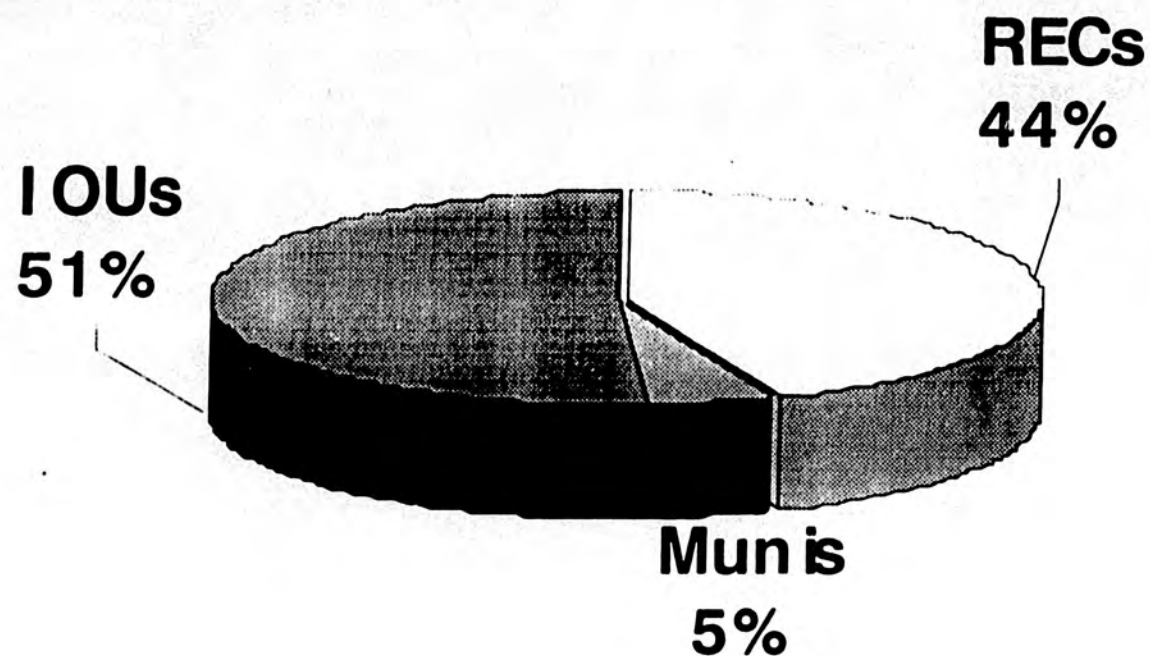
*There are 175 communities
where consumers are eligible
for PCE assistance.*



U.S. Generation



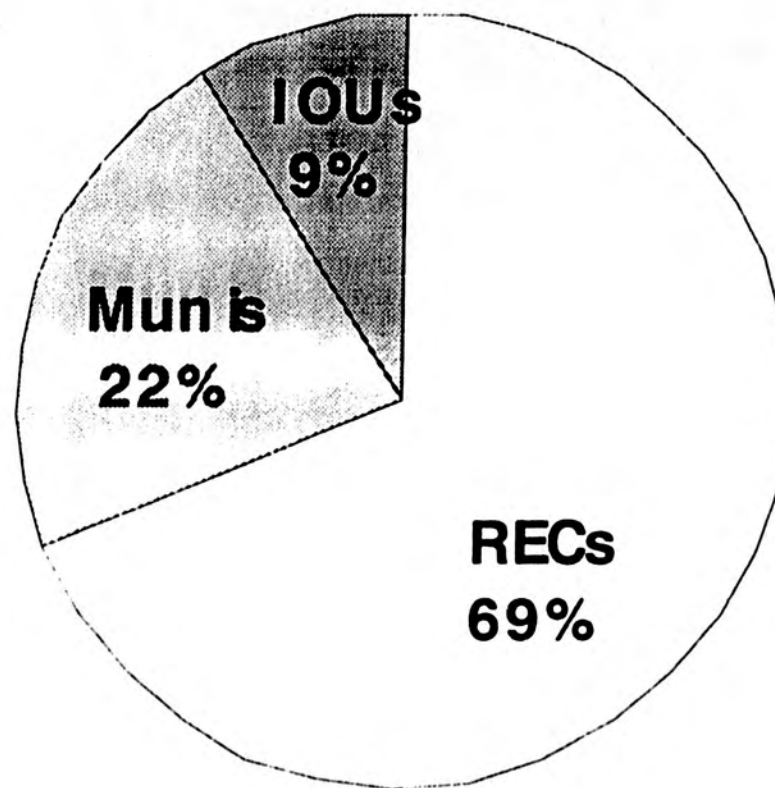
U.S. Distribution Line Miles



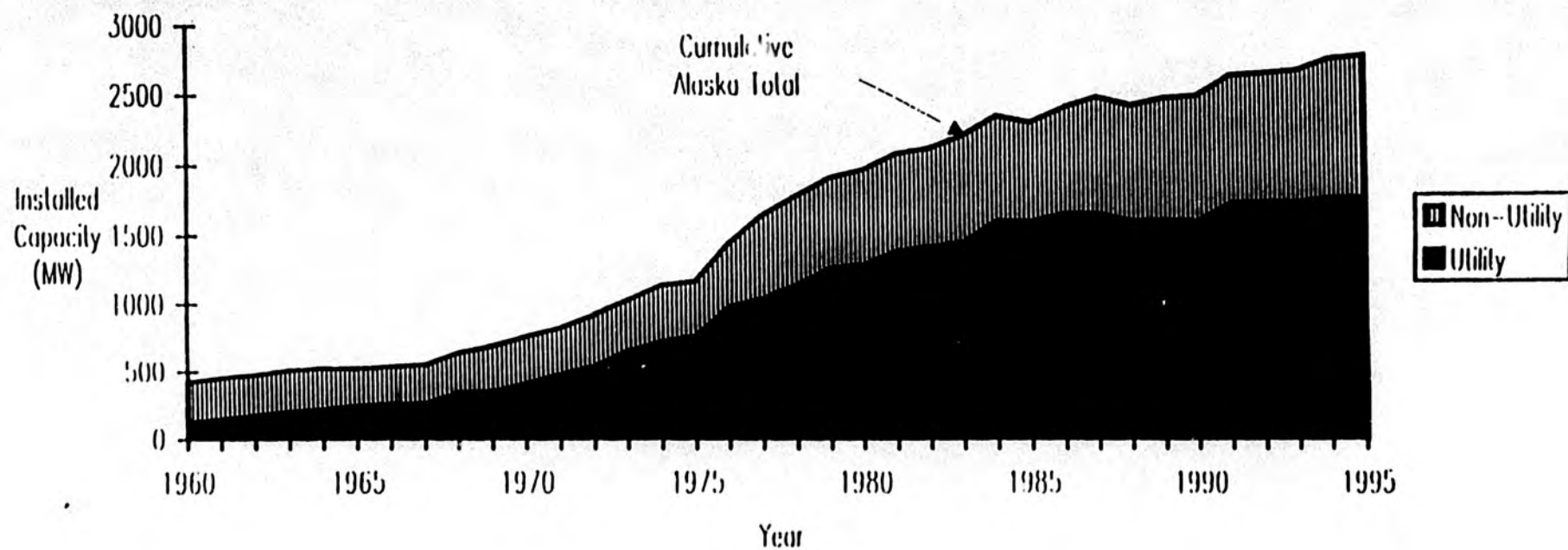
U.S. Total 4.7 Million Miles

Alaska Electric Utilities

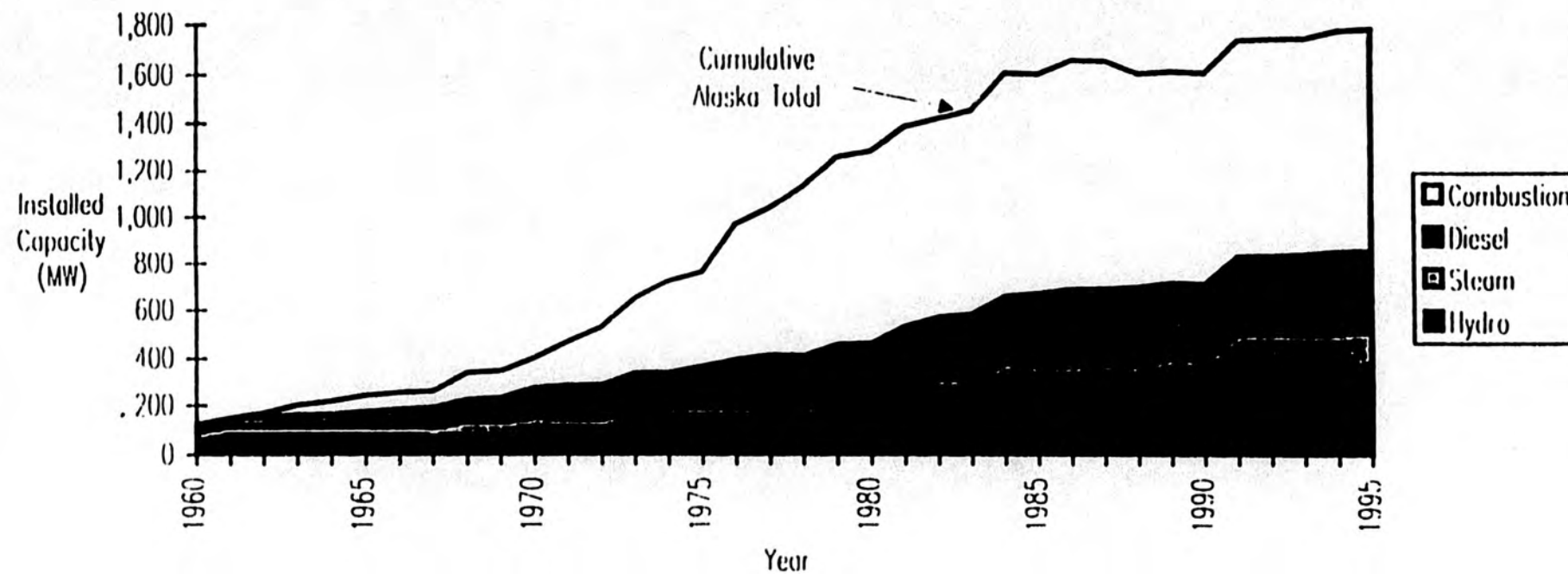
Residential Customers Served



Alaska Installed Capacity
Historical Summary
Utility and Non-Utility
(1960 - 1995)

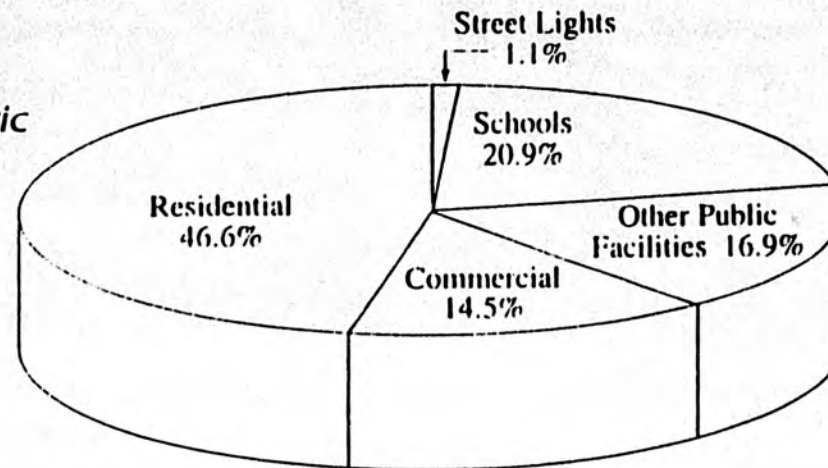


Alaska Utility Installed Capacity
by Prime Mover
(1960 1995)

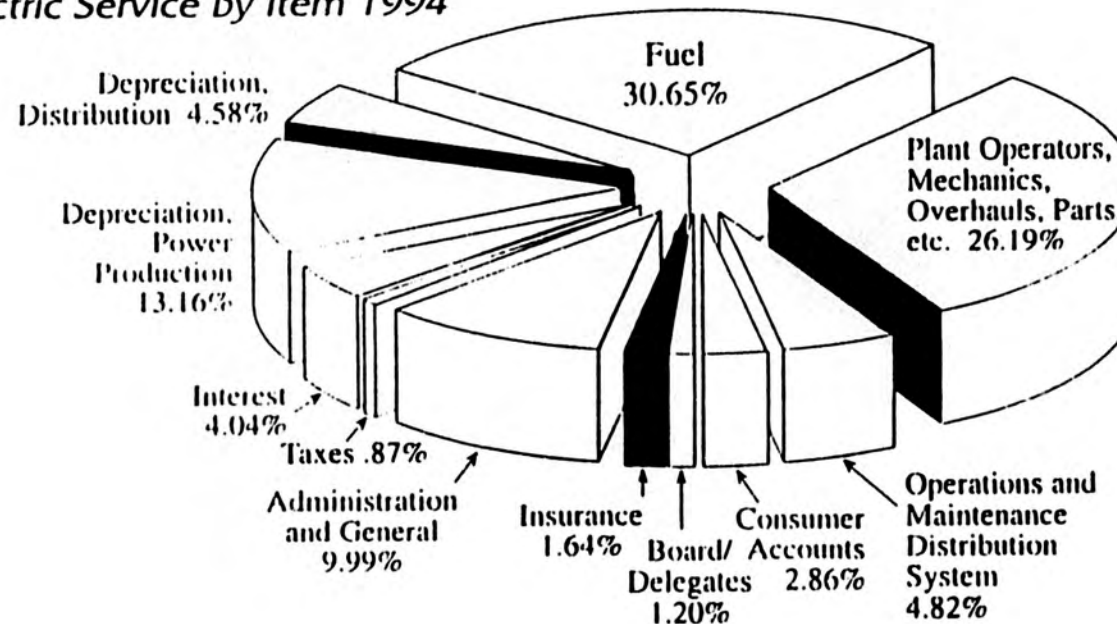


The Cost of Power

**Alaska Village Electric
Cooperative (AVEC)
Source of Electric
Revenue 1994**



**AVEC Total Cost of
Electric Service by Item 1994**

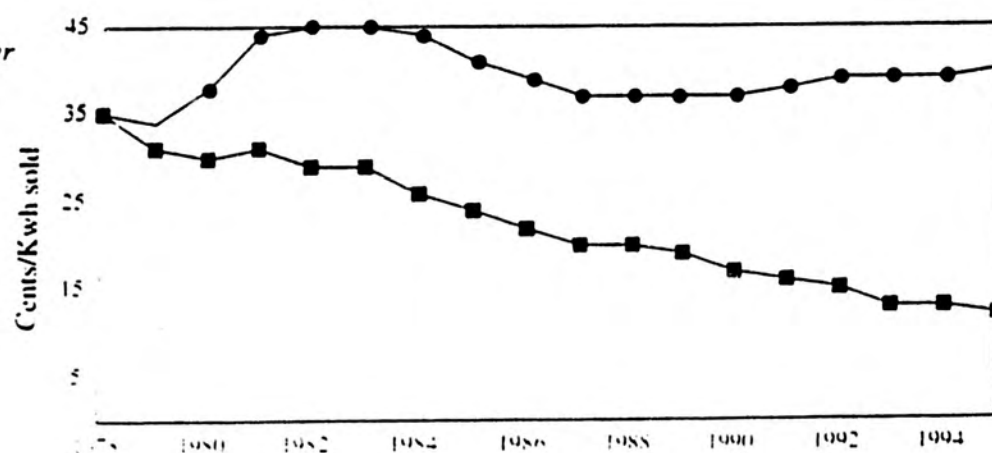


In 1978, the Alaska Village Electric Cooperative sold electricity for about 35¢ per kwh. The rate was 40¢ per kwh in 1995 — but only 12¢ per kwh in 1978 dollars.

- Actual cost
- Costs adjusted for inflation using the Consumer Price Index

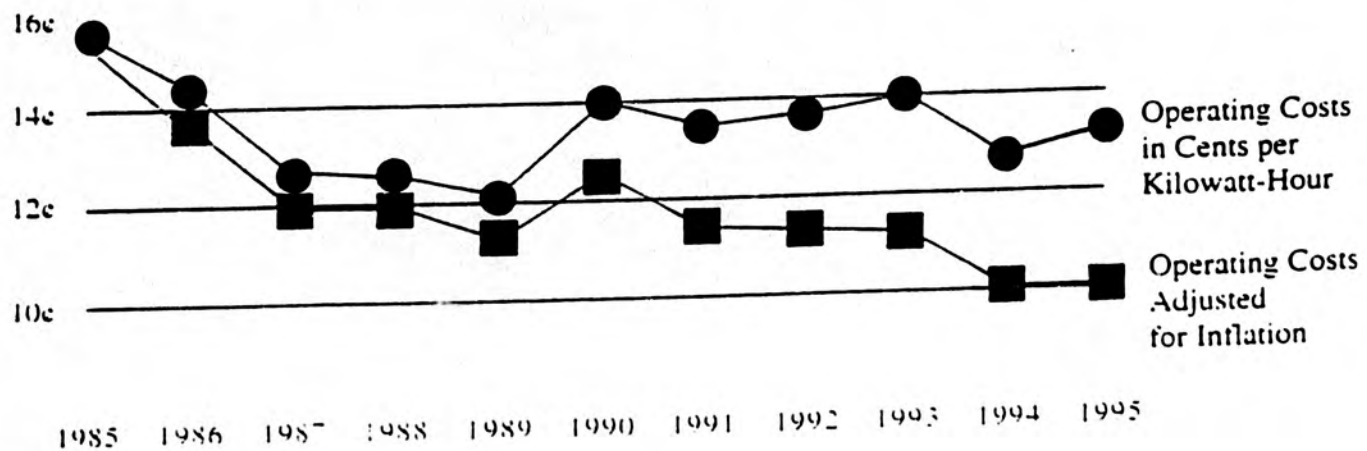
AVEC Average Revenue Per Kwh Sold

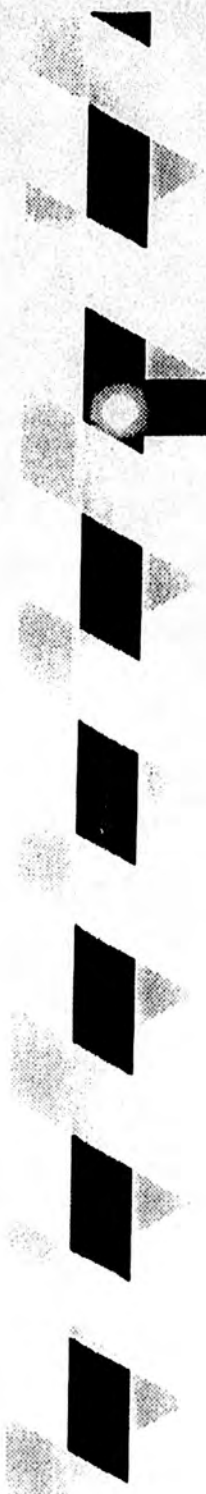
AVEC has reduced the real cost of power to consumers.



Operating Costs for Utilities Receiving PCE, 1985 to 1995 (does not include fuel costs)

Rural utilities are winning the battle against inflation. Through efficiency improvements and other means, PCE utilities have reduced operating costs by about one-third since 1985.





Deregulation Issues

- **Monopolization (Market Presence)**
- **Cherry Picking**
- **Stranded Cost**
- **Obligation to Serve**
- **Universal Service (PCE)**
- **Reliability**
- **Tax-exempt status**

Principals adopted by
National Association of Regulatory Commissioners

1. Assign states the responsibility for determining "the extent of and pace for expanding choice for customers under their regulatory oversight."
2. Maintain universal service at reasonable rates, as well as the safety, reliability, quality and sustainability of electric service.
3. Protect customers from anti-competitive behavior and other malfeasance.
4. Preserve or improve the quality of the environment.
5. Stranded investment that result from existing regulatory and legal requirements should be addressed in a fair and reasonable manner by the states.

Power and Generation Committee (G)

ELECTRIC INDUSTRY RESTRUCTURING — The National Rural Electric Cooperative Association should protect the interests of consumer-owners and their cooperatives by participating in congressional legislative actions to ensure inclusion of essential provisions. These provisions would protect and advance the interests of the consumers, while doing no harm to cooperatives or other rural electric systems in any state.

- All consumers must be treated equitably.
- If stranded costs are to be recovered, they should be recovered in a competitively neutral manner, without placing an undue burden on residential and small business customers.
- All energy providers – not just utilities – must be subject to the same standards as utilities.
- All consumers must have universal access to affordable electric service.
- Reliability and safety must not be jeopardized.
- Exclusive distribution service areas must be maintained to avoid duplication of electrical facilities.
- There must be a transition and educational period before full consumer choice is implemented.

As consumer-owned utilities, we are concerned by efforts on both the state and national levels to restructure the electric utility industry without providing appropriate safeguards for all consumers. Without such safeguards, these efforts may result in degradation of system reliability, negatively affect long-range planning and the ability to provide reliable service to remaining ratepayers at reasonable cost. Such efforts, whether on a state or national level, threaten to damage both consumers and their cooperatives. (98-G-1)

Restructuring
Concepts and Principals for Alaska

- Recognize Unique features of Alaska's system
- Vast sections of the State are not interconnected
- Uniform standards for all energy providers
- Maintain Exclusive distribution service areas
- Universal access to affordable electric service
- Role of "supplier of last resort" must be clearly defined
- Stranded costs must be addressed
- The issue of wholesale contracts must be addressed
- Any proposed pilot program must be carefully planned

Conclusions

- Adopt uniform standards
- Protect all consumers
- Consider no restructuring for Rural Utilities
- Conduct a third party economic assessment aimed at creating a template for restructuring the industry
- Be objective enough to conclude that restructuring may not be appropriate for Alaska yet

Elizabeth A. Moler, Chair

Federal Energy Regulatory Commission

March 20, 1997 before Senate Energy Committee

Moler said Congress should promote choice at the retail level. "Direct the states to establish consumer choice programs, but with the opportunity to opt out if a state determines that retail competition is contrary to its own needs and interests."

Doug Lattner, Utility Consultant with Deloitte & Touche

Dow Jones article on deregulation of electric utilities.

March 25, 1997

“I foresee a market containing only about 10 major power generators in 10 years’ time – much like the six or seven major airlines that exist now.”

August 6, 1998

**Testimony to the Joint Committee on Electric Utility Restructuring
from Bruce D. Scott, CREC, Director of Member and Public Relations
Matanuska Electric Association, Inc.**

Senators, Representatives, and members of the audience, I thank you for this opportunity to offer a few comments on the subject of utility restructuring to the Joint Committee on Electric Utility Restructuring. My name is Bruce D. Scott and I'm the director of member and public relations for Matanuska Electric Association, Inc., called MEA by its members.

Incorporated in 1941, MEA is a nonprofit electric cooperative that serves more than 29,000 members in Southcentral Alaska. Our service area is 3,360 square miles, nearly the same size as the 2.2-million-acre Yellowstone National Park, twice the size of Delaware and three-fifths the size of Connecticut.

We have nearly 35,000 active accounts and more than 2,966 miles of line. Last year, we built 56 miles of new line and 1,248 new services, or hookups, and look forward to continued growth this year and for the foreseeable future.

Matanuska Electric Association has not yet taken a position on whether retail competition is good, bad or indifferent to the interests of our consumer-members. Our major reason for such a stance is that we think one needs to build the cart, and make sure the wheels work, before hooking up the horse. In this instance, the "cart," if you will, is competition on the wholesale side of the electric utility market. I'll come back to this point in a few minutes.

The argument for deregulation of the electric utility industry could be stated as follows: The consumer should have the right to choose from whom he buys the product we sell, electricity.

By virtue of having that choice, the argument goes, consumers will pay less for the product. The argument, simply stated, is that where two merchants are offering the same item for sale, the two will compete to have the lowest cost item for sale. This is why the Sam's Clubs and Costcos and Wal-Marts of the nation thrive, the argument goes.

Now, I realize I'm simplifying here – there are time constraints to my testimony – but these stores owe much of their power to compete to the trucks, barges and airplanes that bring them their products – along highways, oceans and the atmosphere – from the Lower 48 and other countries, where several companies manufacture each of the products they sell in their warehouse stores.

Testimony by Bruce D. Scott, CREC
for Matanuska Electric Association, Inc.
Page 2
August 6, 1998

In the electrical utility industry, our product is transported via electrical interconnections. In the Lower 48, these interconnections span the nation, creating electrical highways from state to state. Unfortunately, the interconnections in Alaska – unlike in the Lower 48 or the aforementioned highways, oceans and atmosphere – cannot link up across interstate or international lines.

Wal-Mart may be able to buy the T-shirts it sells you from New York, Los Angeles, or Hong Kong. Their computer paper could come from Canada or an East Coast paper mill.

Electric utilities in the Lower 48 may be able to buy the electricity they sell you from Florida, Georgia or New Jersey on the East Coast, or from California, Nevada or New Mexico on the West Coast. Theoretically, at least, they could buy electrical energy from New York and sell it to you in San Diego, California.

In Alaska, the electricity our industry buys comes from Alaska, Alaska ... or Alaska. As Alaskans, our power suppliers are both insulated and isolated from the rest of the electric utility world: Insulated in that there are no electrical interconnections with the outside world; isolated in that Alaska's power suppliers have historically planned their respective power supply and transmission systems independently.

In the Lower 48, the choices are first and foremost choices between wholesale power suppliers. Where retail competition is being attempted, it is only after the retail supplier has the option to choose its own wholesale supplier, or a mix of wholesale suppliers.

And this right of "retail choice," if you will, is not being extended unilaterally. California is a state with 30 million people and is frequently considered to be "on the cutting edge" of electric utility deregulation. In California, electric cooperatives are exempted from the California Public Utility Commission regulations that mandate head-to-head competition among utilities, as directed by A.B. 1890, the California restructuring legislation.

There are no investor-owned utilities in the Railbelt, where the overwhelming majority of the state's electricity consumers reside. Statewide, most residents receive their electricity from cooperatives, with municipal utilities ranking second and IOUs a very distant third.

As I have stated in past testimony to other bodies – none as august as this one, of course – we are a "captive" market for one of our most likely competitors, should retail competition be allowed. All of MEA's electricity is purchased under contract from Chugach Electric Association. This contract, and others similar to it, was negotiated and signed in a day when electric utilities were guaranteed an exclusive service territory. Since these contracts account for more than 50 percent of our costs, we have a hard time envisioning any sort of level playing field for competition if those contracts are allowed to stand.

To refer back to my Wal-Mart example, this is as if Wal-Mart was the only T-shirt manufacturer in business, and manufactured the T-shirts it sold to both Wal-Mart and Costco, its competitor. Guess which T-shirt would cost less? And although the shirt on your back may be important, electricity is more of a necessity.

If one is to have competition, it must first come at the wholesale level. One should set up the mechanism to allow for competitively priced wholesale electricity, then see that competition works at that level, before going on to retail competition. First the cart, then the horse. It is for this very reason that the APUC is currently in the final stages of a comprehensive study examining the issue of pooling generation resources in the Railbelt. That study, by the national consulting firm of Black & Veatch, is due out later this year.

We understand this committee is charged with two tasks: First, determining whether competition is good for electric utility consumers in Alaska; and second, if it is, how to implement electric utility restructuring.

As you wrestle with these issues, we would like to consider the seven points made by the Power and Generation Committee of the National Rural Electric Cooperative Association. NRECA is a national association representing MEA and approximately 1,000 other electric cooperatives.

1. All consumers must be treated equitably.
2. If stranded costs are to be recovered, they should be recovered in a competitively neutral manner, without placing an undue burden on residential and small business customers.
3. All energy providers – not just utilities – must be subject to the same standards as utilities.
4. All consumers must have access to affordable electric service.
5. Reliability and safety must not be jeopardized.
6. Exclusive distribution service areas must be maintained to avoid duplication of electrical facilities.
7. There must be a transitional and educational period before full consumer choice is implemented.

With these points in mind, I wish to emphasize my earlier statement that MEA has not yet taken a position on whether retail competition is good, bad or indifferent to the interests of our consumer-members. However, we do hold one position firmly: that our membership should be protected against unfair, unscrupulous actions masquerading as "competition."

In the Lower 48, large commercial power users – customers – are the driving force for competition in the electric industry. In Alaska, the prime forces clamoring for competition are not customers, but a large electric utility that wishes to take customers

Testimony by Bruce D. Scott, CREC
for Matanuska Electric Association, Inc.
Page 4
August 6, 1998

and revenues from other, smaller utilities, and power brokers who want to take revenues from everybody.

Like its sister cooperatives, MEA is obligated to provide service to anyone in our service territory that requests it. If these boundaries were to be opened to competitors, in all likelihood they would attempt to serve our high-margin, low-cost customers, the larger businesses, the urban population centers. They would not battle us for the low-margin, high-cost customers, the ones who pose a credit risk or those who are just plain inconvenient to serve for factors of density and distance.

Because we are a member-owned cooperative, our rates are designed so that each customer pays his or her "fair share" of our total costs -- no more, no less. If we lose a customer to the sort of predatory "cherry-picking" described above, we can expect two things to happen.

First, although we no longer will have to purchase wholesale power for that customer, the price we pay for the wholesale power we sell to our remaining customers will go up. This is because we pay our supplier their overall average cost, and less sales do not translate into corresponding cost reductions at the power plants.

Second, MEA's direct costs -- such as O&M, general and administrative and depreciation -- stay the same. This means that these remaining costs must now be recovered through fewer units of sales, fewer kilowatt-hours, which also translates into higher rates for our remaining customers.

Losing high-margin, low-cost customers will have the effect of driving up MEA's costs to serve low-margin, high-cost customers.

There is, of course, the possibility that MEA could acquire additional revenue by serving other utilities' high-margin, low-cost customers. But, to refer back to the T-shirt analogy, as a captive customer at the wholesale level, how could we possibly compete under the existing contractual framework?

In conclusion, if it is determined that electric utility restructuring is good for Alaska, then we believe this committee should analyze the benefits, risks and the impact on the organizations and the ratepayers of any proposed restructuring. If at the end of the day, there are sufficient benefits to justify the risks, then you will see MEA standing up to go forward.

Matanuska Electric Association, Inc.
163 E. Industrial Way
Palmer, Alaska 99645
(907) 745-3231

Competitive "We Believes" for GVEA -July, 1998
Mike Kelly, President and CEO

We believe that competition in the electric industry in Alaska will generally provide lower cost and better service to the consumer in the long-term.

We believe that GVEA maintains very competitive rates and service when compared to any electric utility in the state. We believe that we must become globally competitive and that doing so will involve exciting challenges and painful change.

We believe that when a consumer announces that he or she can get lower cost service from another source, we should be interested enough to roll up our sleeves and see if we can help.

We believe that any adjustment to the competitive and regulatory environment in Alaska should be approached with the consumers' long range preferences in mind. It will be a challenge to faithfully represent the consumer in this matter - particularly when the preference of one consumer class may cause a negative impact on another and when a particular benefit for the consumer may appear to have negative consequences for the utility or its directors and employees.

We believe that Alaska is comprised of several economic sectors containing markets that range from relatively mature to very immature. A single competitive solution may not work for all.

We believe we can learn to thrive across the complete spectrum, from total service area protection to total deregulation (including no APUC), using only our elected co-op Board for regulation.

We believe that new business ventures are critical to GVEA's becoming the energy and services provider of choice for our present

and future consumers. Regulation may be a clumsy surrogate for competition in these ventures.

We believe there are benefits to be gained from Alaska watching and learning from electric utility deregulation successes and failures as they unfold in the lower 48. We believe GVEA's member-owners will be advantaged by a slow and careful approach to deregulation.

We believe that if electric service territory protection is to be abandoned in Alaska, that the order of preference is as follows:

- 1. Southcentral**
- 2. Railbelt**
- 3. Bush**

We believe our members are very satisfied with the status quo. Our acquisition of FMUS and our service and rate competitiveness have generally stopped the clamor for service territory elimination in our area. However, we believe our member-owners will not be so satisfied five years from now if we do not change our utility significantly. We are excited and confident concerning our future.

0 11/1/98
Bjornstad
CEA

The Legislature Sets Policy

I would like to begin by reading a quote by a Railbelt Electric Utility Manager on October 21, 1996, "One thing is certain and that is that the customer can't lose as a result of competition." This was not Chugach speaking although we believe it to be true.

Another quote is equally enlightening "The transition to competition holds an enormous challenge and opportunity for electric utilities. Like any new development change can be profitable if you're positioned to take advantage of it. ML&P is!" (1996 Annual Report - Published 1997)

You are here to investigate and make written recommendation on two burning questions.

1. Whether to implement electric utility restructuring in Alaska.
2. How to implement electric utility restructuring in Alaska

Chugach believes the answer to the first question is intuitively obvious. Restructuring implies allowing competition. Competition is a cornerstone of American business. Competition makes for new ideas, better customer service, innovation, efficiency, reduction in costly regulatory oversight, and added value to customers and shareholders.

The consequence of elimination or restriction of competition is an important issue of public policy.

We all know that one of the most important functions of the legislature is to set the **broad policy** of the state. It takes nothing away from the important work of regulators and technicians to say that their job is to implement the broad policy decisions of the legislature.

We will be suggesting that today's discussion will be most productive if it is kept at a high level of broad policy. The issue for you should not be how to implement competition or restructuring. The legislature sets policy, the APUC implements it.

The question is very timely because we have a recent order from our regulators, the APUC, which interprets the policy you, the legislature, has set for them to follow.

In your notebook under the tab entitled "APUC Authority" you can see the comparison of Legislation Policy Guidance and the PUC interpretation of its authority. It is apparent that the PUC understands that the legislature intended to displace competition and delegated to the PUC the policy making of when to eliminate or implement competition.

Legislative Policy Guidance

The only statutory reference to competition is in A.S. 42.05.221 (d) which says:

"In an area where the commission determines that two or more public utilities are competing to furnish identical utility service and that this competition is not in the public interest, the commission shall take appropriate action to eliminate the competition and any undesirable duplication of facilities."

The statute goes on to describe some of the measures the APUC can employ, including creating service area boundaries and eliminating duplication of plant.

PUC Interpretation of its Authority

In the recent APUC proceeding Chugach asked the APUC to conclude that service territories are not exclusive except when the APUC acts to limit competition pursuant to A.S. 42.05.221(d). The APUC liberally construed its authority stating:

"There is no Alaska statute that specifically addresses the issue of retail competition . . . The Commission's authority to decide these matters derives from its general power to regulate utilities . . . require certificates . . . and to eliminate competition that it finds is not in the public interest."

...

The Commission concludes that the Alaska Legislature has evidenced its intent to displace competition in the utility industry by creating a comprehensive regulatory structure, which the Commission administers, and furthermore delegating to the Commission the power to determine when to eliminate or implement competition in the public interest pursuant to A.S. 42.05.221(d)."

I want to be very clear. We are not here to reargue the issue with the APUC or to take them to task. We appreciate that we have a legitimate disagreement with them and we recognize that they are performing their jobs in the true spirit of public service. We also appreciate that they made their decision in advance of this hearing so that we know where they stand on this issue.

Nevertheless, in light of the APUC's view that the legislature intended to preclude competition except in unusual circumstances, the issue is ripe for a public policy decision first by this joint committee and next winter by the legislature.

Here is the circumstance we are in right now. The current **status quo is that restructuring and/or competition is not allowed**. Unless policy makers' step up to the issue, customers cannot choose from now until that status quo is changed, customers cannot receive the benefits of choice.

It's Simple

I. **First**, I want to impress upon you that **your work here can be simple**. What the customers need is primarily a broad policy statement that competition is allowed as the general rule. The message needs to be clear: suppliers don't have to get special permission unless if they want to be exempted from competition. We think that's what the law already says but we believe that the legislature needs to clarify it. If you do that -- if you are willing to step that far, you will have satisfied the charge of HCR 34.

II. **Second**, even though you do not need to get into the detail of implementation, the **actual implementation of customer choice in Anchorage could be pretty simple**.

Here's how it could work:

A **customer** in Chugach's or ML&P's distribution service territory **asks for service** from another supplier. The supplier pays a **fair rate set by the PUC** for access over the other system.

If it's a **large customer**, equipment is installed, which communicates with the suppliers' computers and generators to follow this load. If it's a **small customer** the supplier uses load research data, determines an estimate of the customer's usage and operate its generators to match that expected load. At the end of the month, the differences if any are **trued up**. This is what we've been doing for over a decade since the ML&P and Chugach systems were interconnected. It is that simple.

III. **Third**, choice by consumers for goods and services from suppliers happens every minute of the day it is not complex. You know it, your constituents know it and all of the utilities represented in the room today know it. But you will hear that allowing competition in the electric utility industry is going to be very difficult and complex. I daresay you will hear words to that effect again today.

Confusion and complexity = delay. And, delay is the prime objective.

The strategy of the opponents of competition is achieving delay. Delay is fully as effective at preventing customer choice as a policy statement by the legislature to prevent competition. Those who proclaim that the sky will fall in if the customers are allowed to chose will raise many questions and make it seem as complex as possible. By the end of the day you can expect to see a long list of questions and concerns.

Is competition really a good idea in Alaska?

The starting point for this discussion must be with basic human behavior. The argument over whether the competitive or the collectivist model is the better way of organizing productive enterprises must be classed as one of the great debates of our century. History shows the outcome: Western competitive capitalism: One, Soviet collectivism: ZERO.

Competition works because it is more in synch with the way humans behave. Competition encourages efficient behavior in business enterprises.

So the burden of proof on this one ought to be on those who want to prevent competition to prove why it cannot work here and why the forces of the state government ought to continue to be used to prevent it.

We think the opponents of competition have a tough row to hoe because competition is already working here.

Lets talk about competition, here are some examples:

- 1994 ML&P offers lower rates to MEA,
- 1994 ML&P offers economy energy to Fairbanks,
- 1995 ML&P attempts to get CVEA in a joint venture,
- 1996 ML&P attempts to get Seward as a customer,
- 1997 ML&P signs contract to sell energy to GVEA.

A review of competition for sales to Fairbanks will show benefits enjoyed by the customers in Fairbanks as well as the millions of dollars of rate reductions that have been passed on to Southcentral customers resulting from the additional revenues from sales to Fairbanks. Now the opponents of competition will tell you with great confidence (maybe even today) that you can't have competition that works where there is only one buyer and 2 sellers. But, that situation (two sellers and one buyer) is exactly the situation, which has brought millions of dollars in savings to the railbelt for over a decade. It reminds me of the joke about the economist who would not pick up the \$5 bill he saw lying on the side walk offering the explanation (with great confidence I might add) that if the \$5 bill were real someone would already have picked it up.

Second, look at all the efforts that just the fear of competition has brought. MEA again recently cut prices to its customers. The MEA bill for this month proudly announces that small commercial rates are lower than Chugach's. ML&P in 1997 proudly announced that their rates are lower than Chugach's. GVEA's message to its customers at their annual meeting is "Our rates are competitive." Chugach in 1997 did not pass on to its customers both wholesale and retail \$3.5 million in fuel costs. Copper Valley Electric proudly announces a joint project with one of its major customers to jointly develop a cogeneration project. Ask yourselves did these events just happen? HEA, and ML&P are attempting to sign up existing customers with special contract considerations. Aurora Power is signing five-year contracts promising to represent an electrical customer as a Power Pool Administrator and charge 20% of the customer's monthly savings as a fee. These are just a few examples of what happens when businesses try to satisfy their customers.

So the question is not really properly stated as: "Will it work?" because it 's already working. There is every reason to believe that it will work even better when policy makers actually allow it.

Customer choice is the key to competition.

Customer choice is the key to why competition works. It is not just "what happens" when there is competition. It's the key to why it works. It works because the customer chooses. Not the legislature, not the regulators, not the Municipal assembly, and not the utility managers or their boards of directors. Competition works because you let the customer choose. You let the customer make all the choices they are used to making when they decide to buy something. They get to decide when, from whom, how much they buy and how much they will pay. The blessings of competition flow from the system of incentives and how they operate to get people to do what you want: provide good value to the customers.

It is because you let them choose that it works. It's the reason it works not just a pleasant consequence.

It follows then - the flip side of this is - the more you or the regulators make choices for the customer, the less choice you leave them - and the less they will benefit. This certainly is what the Brookings Institution study says. This is why it is so important to just let the customers choose and not get carried away trying to create elaborate perfect structures where all the various "stakeholders" get something. And it is why we wince when people - even the well meaning people - talk about "leveling the playing field." What criterion does one use to "level the playing field?" Because one person's leveling is another person's unfair tilting. Leveling the playing field can move dangerously toward picking winners and losers. Leave that to the customers and we will all be better off.

This is why less is more.

When you set up a system where the parties compete to please the customers, customers win because the customer gets to choose. The winner is the one the customer decides to buy from.

If you keep more of the decision-making with the regulators or the legislators, then the utilities will be directed at winning your approval. The customer's interests will take a back seat to winning regulatory or legislative approval for each entity's favorite scheme. It will work better if you leave more choice with the customer. The more you try to build the perfect system of checks in the marketplace to protect this or that interest group, the less customers will benefit.