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**OFFICE OF THE**  
**AUDITOR GENERAL**

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June 18, 2003

Members of the Arizona Legislature

The Honorable Janet Napolitano, Governor

Mr. Marc Spitzer, Chairman  
Arizona Corporation Commission

Mr. James G. Jayne, Interim Executive Secretary  
Arizona Corporation Commission

Arizona Revised Statutes (A.R.S.) §40-202(O) directs the Auditor General to review A.R.S. §40-202(B)(4), a provision that confirms the Arizona Corporation Commission's authority to provide for electric metering, meter reading, and billing and collections on a competitive basis. This statute pertains only to those utilities and electric service providers regulated by the Arizona Corporation Commission (Commission).<sup>1</sup> Since the Commission's authority is derived from the Arizona Constitution, no change or repeal of this statute could affect the Commission's ability to authorize competitive electric services. Consequently, this review focused on the status of competition for these three electric services under commission rules. This review was conducted from January through March 2003.

## Summary

The Commission adopted administrative rules and developed procedures that allowed the offering of competitive electric services, including electric metering, meter reading, and billing and collections. Under these rules, competitive electric services are linked. Specifically, except for consumers served by electric cooperatives, consumers cannot choose a competitive metering company or meter-reading company without also changing their electricity generation provider.

Competition for electric generation and metering existed from December 1999 through March 2001, when multiple new companies were selling power in Arizona.

<sup>1</sup> The Arizona Corporation Commission, by authority of the Arizona Constitution, regulates electric service providers including public service corporations, investor-owned utilities, electric cooperatives, and competitive electric providers. The Legislature regulates public power entities, such as the Salt River Project, and municipalities, such as the City of Mesa, pursuant to A.R.S. §30-803.

However, economic conditions caused these new companies to leave the Arizona retail market and their absence effectively suspended competition for metering, meter reading, and billing and collections. During this time, consumer demand to switch electricity generation and metering service companies was also low. While industry professionals auditors interviewed suggested that metering may have the potential to be a viable competitive service, independent of competition in the retail power market, the Commission would need to revise its rules or use its rule waiver process to allow consumers the choice of competitive metering, regardless of whether they remain with their existing utility or choose a new electricity provider.

## Background

During the 1990s, many states adopted regulatory structures to allow or promote competition in electric services to consumers. Anticipated benefits included lower prices for consumers, increased technical innovations in electric generation and delivery, and increased consumer choices that might also spur the offering of more renewable power sources, such as wind or solar.

### Providers of Noncompetitive and Competitive Electric Services

#### Utility

- Provides noncompetitive services defined as either 1) the traditional package of electric service or 2) electricity transmission and distribution only
- Rates and territory regulated by the Commission

#### Electric Service Provider (ESP)

- Provides one or multiple competitive services at the retail level
- Can be a broker of competitive electric services by contracting with multiple companies, rather than providing direct services
- Rates and territory regulated by the Commission

Source: Auditor staff summary of Commission rules: R14-2-1601 and R14-2-1606.

In Arizona, the Commission and the Legislature promoted electric competition through rules and legislation.<sup>1</sup> Both regulatory structures allow a consumer to remain with the existing utility serving the geographic area or to choose competitive services, including electricity generation, metering, meter reading, and billing and collections. Competitive services are provided by one or more companies, referred to as Electric Service Providers (ESPs). The Commission issues a certificate to or certifies the ESPs, which deliver electric services to the

consumer either by providing or coordinating the three primary components of electric services:

- **Electricity generation**—Process by which fuel is transformed into electricity. Power plants typically use coal, natural gas, or nuclear reaction for fuel.
- **Transmission and distribution**—Moving electric power from the power generation source to the end user through a network of power lines. Transmission is the movement of higher voltages, which are then reduced to lower voltages for distribution to residences and businesses.

<sup>1</sup> Since the Arizona Corporation Commission does not regulate all utilities, the Legislature adopted similar statutes to allow competition for electric consumers served by public power entities.

- **Meter-related functions—**
  - ◆ Metering includes installing and programming the electric meter and may also include energy management services.
  - ◆ Meter reading involves extracting the electric usage data and transmitting it to one or more entities needing the information for billing or energy management purposes.
  - ◆ Billing and collections includes providing the customer a bill for electricity usage applying appropriate rate schedules, and collecting fees for services provided.

## Regulatory framework links metering and electricity competition

The electric competition regulatory framework, consisting of administrative rules and procedures, was developed to make electric competition possible. This framework provides consumers two options for electric services: traditional services or competitive services. Traditional services, the historical delivery model, involve a single regulated utility within a specific geographic territory providing all three components of electric service. Competitive services, as defined and described by Arizona Administrative Code R14-2-1601, 1605, and 1606, involve one or more private companies providing the electricity and other services such as metering, and billing and collections, while the incumbent utility provides only transmission and distribution.

However, commission rules do not allow certain electric service structures for some customers. Specifically, most consumers cannot choose a competitive metering company without also choosing a new electricity provider. Likewise, larger electric consumers cannot stay with their existing utility for metering and billing if they choose a new ESP.<sup>1</sup> For example, beginning in December 1999, when new ESPs offered services, a consumer could stay with Arizona Public Service or choose a new electric service provider that either offered the metering services in its packaged offer or allowed the consumer a choice of metering companies. However, unless served by an electric cooperative, a consumer could not choose competitive metering without also choosing a new electric service provider. It is unclear why the Commission did not provide for competitive metering separate from choosing a new electric service provider, and current commission officials declined to comment about the considerations of this issue that preceded adoption of these rules.

<sup>1</sup> In accordance with commission administrative rules, the incumbent utility may continue to serve as the metering and meter-reading provider for residential customers who typically have peak electric loads of 5 to 6 kilowatts, even if they have chosen a new ESP. Through a commission rule waiver, small commercial customers (peak electric loads of 20 kilowatts or less) can also retain the utility for metering. Consumers served by electric cooperatives are also able to use this structure through a rule exemption.

## Status of competition for metering services

While Arizona developed a workable framework for electric competition, companies offering alternate electricity generation were in the Arizona market for only a short time. Between 1998 and 2001, the Commission certified 20 new companies as ESPs. Of the 20 ESPs, 11 provided electricity generation and contracted for the provision of metering and meter reading. Eight companies provided metering and/or meter reading, but not electricity generation, and the remaining company was certified as a broker and aggregator of services. From December 1999 through March 2001, approximately 340 consumers, mostly medium- to large-sized businesses, switched to competitive services, including electricity generation, metering, meter reading, and billing and collections.

While the framework allowing for competitive electric services is still in place, changes within the Arizona electric services market have effectively suspended competition. Specifically, by the end of 2000, the competitive market in Arizona was affected by several factors, including the California deregulation experience that resulted in power blackouts and dramatic price fluctuations for both consumers and wholesale energy purchasers in California. According to utility and commission officials, by March 2001, the small number of Arizona customers who switched to competitive services were returned to their regulated utilities because the new providers were leaving the Arizona market due to market conditions, including weaknesses in both supply and demand. The number of competitive retail electricity providers decreased due to low profit margins as well as the uncertainty of wholesale energy prices. As of March 2003, none of the 11 ESPs that were certified to provide electricity generation were serving Arizona customers. Consumer demand to switch companies was also low. In fact, only approximately 340 of the over 1.25 million customers eligible for electric competition switched from their traditional service.

The absence of competitive electricity providers in Arizona's retail market combined with low consumer demand has effectively eliminated competitive services for metering. As explained earlier, the structure of the commission rules prevents most consumers from choosing a private company for metering services while retaining the traditional utility for electric generation. Consequently, with the loss of competitive retail electric generation, metering companies have a very limited ability to market their products and services in Arizona.

## Competitive metering independent of electricity choice

Some industry professionals auditors interviewed, including representatives of the metering industry, large electric consumers, and competitive electric service provider representatives, suggested that commission rules could allow metering companies

to compete apart from the choice of competitive electricity generation. Two metering industry representatives auditors spoke with expressed the potential value to Arizona of allowing certified competitive metering providers the ability to offer services to consumers who remain energy customers of their existing utility. Several of these industry representatives believe that some larger business customers may benefit from competitively provided state-of-the-art metering that allows the customer more effective energy management. For example, according to an official with one large electric consumer who changed meters in 1999, this consumer realized electric cost savings of over \$600,000 per year with the use of “real time” information, which management uses to make hour-to-hour decisions affecting electricity consumption.

The Commission would need to address certain issues raised by utility officials to allow Arizona consumers the choice of competitive metering, regardless of whether they remain with their existing utility or switch providers. First, the meter serves as the cash register for energy consumption, and the energy provider is at financial risk for errors in recording and transmitting meter data. Second, installing a meter is a safety and liability risk because faulty installation can cause fire or explosion. Metering company representatives auditors interviewed agreed that procedures are needed to address these issues. However, according to a commission engineer and the metering company representatives, these issues can be procedurally addressed, and there are no technical reasons that prevent the existence of competitive metering in conjunction with retaining the incumbent utility for electricity generation and distribution. According to commission officials, the Commission has not been approached by consumers or metering providers to allow such a structure; however, it would review and consider a waiver or change to its rules if approached. In fact, in January 2001, the Commission approved a rule waiver to allow small commercial customers (those with peak electric loads of 20 kilowatts or less) to retain the incumbent utility’s meter when choosing a new electricity provider.

Although auditors’ review of national literature did not identify information that details whether other states allow competitive metering independent of competition for electricity generation, auditors reviewed the regulatory structures of two Western states that have active retail competition for electricity, California and Texas.<sup>1</sup> Similar to Arizona’s, California’s structure links competitive metering services to a customer’s choice of a competitive electricity provider. In Texas, rules for metering are under consideration. Texas is mandated to introduce competition in metering services by 2004. Auditors spoke with two industry professionals in Texas, one from the regulatory commission and the other from a competitive energy company, who both believed that metering would eventually operate independently of the ESP choice. However, both parties said that they anticipated the transition would occur in phases and it might be several years after 2004 when competition for metering services would be completely independent.

<sup>1</sup> California suspended competition in October 2001 and new customers cannot choose competition. However, those consumers who had chosen a new ESP prior to the suspension were allowed to retain the competitive company. Approximately 5 percent of California’s electricity used during peak electric consumption is supplied by the competitive market.

## Meter-reading services

While commission rules define meter reading as a competitive service, fewer companies entered the Arizona market to provide this service than to provide metering or electricity generation. Until more companies have the necessary technology and more consumers have metering that allows for remote meter reading, increased competition for this service is unlikely. Meter reading done by traditional means involves a person who physically travels to the meter location to determine the customer's energy usage. The incumbent utilities have almost full penetration of a geographic service territory and, therefore, can realize cost efficiencies, particularly among residential populations, in performing this service. In contrast, it is significantly more costly for the competitors, who have sparsely and unevenly distributed service areas, to maintain a cost-effective reading function. While technology exists to read meters remotely, it requires the additional expense of replacing the metering or adapting it to remote capability. For high-use customers, the overall impact of this change can be relatively negligible, while the opposite is often true for low-use customers.

## Billing and collections

Billing and collections, also defined as a competitive service in commission rules, has received little attention from consumers or electric service providers as an independent electric service business market. Commission staff interpreted the rules to exempt billing and collections companies from commission certification because companies offering this service operate in a variety of industries and the function is not specific to electric service. However, according to commission and electric industry representatives interviewed during this review, no companies entered the market specifically to provide billing and collections services.

Additionally, to prepare for competition, commission rules directed changes to the content of customer electric bills. Specifically, to provide the consumer with the information to make cost comparisons in shopping for electric services, the electric bill was “unbundled” to show separate charges for services, including:

- electric generation
- transmission and distribution
- competitive transition charge
- metering

- meter reading
- billing and collection

We have discussed the results of this review with the Arizona Corporation Commission, and their response is enclosed. My staff and I will be pleased to discuss or clarify items in this letter.

Sincerely,

Debbie Davenport  
Auditor General

Enclosure





# AGENCY RESPONSE



**COMMISSIONERS**  
MARC SPITZER - Chairman  
JIM IRVIN  
WILLIAM A. MUNDELL  
JEFF HATCH-MILLER  
MIKE GLEASON



**JAMES G. JAYNE**  
Interim Executive Secretary

**ARIZONA CORPORATION COMMISSION**

June 11, 2003

Debbie Davenport, Auditor General  
Office of the Auditor General  
2910 North 44<sup>th</sup> Street, Suite 410  
Phoenix, Arizona 85018

Re: Sunset Review of A.R.S. § 40-202(B)(4)

Dear Ms. Davenport:

With your June 4, 2003, letters to Arizona Corporation Commission (ACC) Chairman Marc Spitzer and Interim Executive Secretary James G. Jayne, you supplied a revised preliminary draft of the report which your staff prepared pursuant to A.R.S. § 40-202(O) and indicated that the revision reflects your understanding of changes agreed to in ACC's meeting with your staff on May 14, 2003. You also asked that the ACC provide written comments on the revised draft by Wednesday, June 11, 2003.

Accordingly, you will find ACC's comments on the revised draft enclosed. At your suggestion, I am also sending an electronic copy of the comments and this letter to you by e-mail so that they may be included in any electronic dissemination of the report.

Sincerely,

Kenneth C. Rozen  
Executive Consultant for Government Affairs

c: Chairman Spitzer  
James Jayne, Interim Executive Secretary  
Ernest Johnson, Utilities Division Director

Enclosure

Arizona Corporation Commission  
Comments on the June 4 revised preliminary draft report by the Office of the Auditor General  
Pursuant to A.R.S. § 40-202, Subsection O.  
June 11, 2003

The Arizona Corporation Commission acknowledges and appreciates the many changes that the Office of the Auditor General made to the draft in response to the Commission's May 13, 2003, written comments on the preliminary draft dated May 1, 2003. The Commission also appreciates this opportunity to offer a final written response, and would like to take advantage of it by reiterating and elaborating on the Commission's previous comments concerning the focus of the review.

The introductory paragraph correctly notes that A.R.S. § 40-202(O) authorizes the Auditor General to review A.R.S. § 40-202(B)(4), which in turn, confirms the Commission's authority to require an electric distribution utility under Commission jurisdiction to provide a) billing and collection services, b) metering, and c) meter reading on a competitive basis. However, the introduction does not mention that A.R.S. § 40-202(O) expressly authorizes the Auditor General to perform a sunset review of the specified statutory provisions<sup>1</sup>, and instead, indicates that the review focused on the status of competition for the three subject services under Commission rules. Implicit justification for reviewing the status of competition under Commission rules, rather than performing a sunset review of the provisions of A.R.S. § 40-202(B)(4), appears to be offered in the statement "Since the Commission's authority is derived from the Arizona Constitution, no change or repeal of the statute could affect the Commission's ability to authorize competitive electric services."

The Commission understands that the wording of A.R.S. § 40-202(O) is unusual because agencies and programs, rather than statutory provisions, are conventionally the subjects of sunset reviews. Nonetheless, that the Commission's authority to regulate public service corporations rests apart from the legislature does not appear to constitute a relevant rationale for focusing the review on the status of competition under Commission rules, rather than on the extent to which the statutory provisions requiring that the three services be offered on a competitive basis remain appropriate and effective five years after they were enacted (Laws 1998, Chapter 209). However important the current status of electric competition would be to the context in which the specified provisions could be evaluated, the appropriateness and utility of the statutory provisions themselves, rather than the status of competition in the three services as affected by Commission rules, might as well have been the subject of the review.

To conclude, the Commission would recommend that the provisions of A.R.S. § 40-202(B)(4) remain as they are to serve as useful direction if competition, which is essentially nonexistent at present, develops in the future. Should that occur, the marketplace would provide a concrete context in which to evaluate the rules based on their practical application. If experience were to show that rule changes are warranted, such changes could be effected through the Commission's rule making process.

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<sup>1</sup> A.R.S. § 40-202(O) states "The provisions of subsection B, paragraph 4 of this section are subject to *sunset* review by the auditor general in 2003." (emphasis added)