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MEMORANDUM

Arizona Corporation Commission

DOCKETED

OCT 25 2004

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TO: Docket Control
FROM: Ernest G. Johnson
Director
Utilities Division

DATE: October 25, 2004

RE: RESPONSIVE STAFF REPORT ON DISTRIBUTED GENERATION ISSUES
CONTAINED IN THE PROPOSED SETTLEMENT AGREEMENT OF ARIZONA
PUBLIC SERVICE COMPANY'S REQUEST FOR RATE ADJUSTMENT
(DOCKET NO. E-01345A-03-0437)

Attached is the Responsive Staff Report on Distributed Generation Issues contained in the proposed settlement agreement of Arizona Public Service Company's request for rate adjustment.

EGJ:BEK:rdp

Originator: Barbara Keene

Attachment: Original and thirteen copies

AZ CORP COMMISSION
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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

ARIZONA PUBLIC SERVICE COMPANY

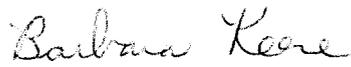
DOCKET NO. E-01345A-03-0437

**RESPONSIVE STAFF REPORT ON DISTRIBUTED GENERATION ISSUES
CONTAINED IN THE PROPOSED SETTLEMENT AGREEMENT**

OCTOBER 2004

STAFF ACKNOWLEDGMENT

The Responsive Staff Report on Distributed Generation Issues Contained in the Proposed Settlement Agreement of Arizona Public Service Company's Request for Rate Adjustment, Docket No. E-01345A-03-0437, was the responsibility of the Staff member listed below.



Barbara Keene
Public Utilities Analyst

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Introduction

The proposed settlement agreement in the Arizona Public Service ("APS") rate proceeding (Docket No. E-01345A-03-0437) contains provisions regarding distributed generation. On September 27, 2004, Staff filed a Staff Report on Demand-side Management, Renewables, and Distributed Generation Issues. On September 27, 2004, the Arizona Cogeneration Association filed direct testimony from three witnesses: Robert T. Baltes, William J. Murphy, and Peter F. Chamberlain. This Staff Report is a response to their testimony regarding distributed generation.

Response to the Arizona Cogeneration Association

In general terms, distributed generation ("DG") is small-scale power generation units strategically located near consumers and load centers. DG has the potential to provide benefits to customers and support the economic operation of the power distribution grid.

In 1999, Staff formed a working group to investigate issues related to DG. The final report recommended that further workshops be held to acquire additional information for several issues. The proposed settlement agreement provides for Staff to schedule workshops to consider outstanding issues concerning DG. The workshops may be followed by rulemaking.

The Arizona Cogeneration Association ("AzCA"), in its testimony, advocates for a standardized process for DG to interconnect with utility systems. Staff proposes to investigate this issue in the workshops to be held on DG that are mentioned in the proposed settlement agreement. Because developing interconnection standards would involve all electric utilities, this issue would best be addressed in a generic proceeding including all interested parties instead of a rate case proceeding for one utility.

The AzCA also wants pricing signals that encourage DG. Staff proposes to explore the issue of pricing for DG in the upcoming workshops. The Commission could adopt a policy or rules to encourage or require utilities to have specific types of tariffs that would encourage DG. This issue is best addressed in a generic proceeding.