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WILLIAM A. MUNDELL
CHAIRMAN
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IN THE MATTER OF THE APPLICATION OF NAVOPACHE ELECTRIC COOPERATIVE, INC., AN ARIZONA NON-PROFIT CORPORATION FOR A FINDING OF FAIR VALUE OF ITS PROPERTIES AND A FAIR RATE OF RETURN THEREON, AND FOR APPROVAL OF RATES AND CHARGES, AND FOR APPROVAL OF CHANGES TO ITS POLICY MANUAL	**DOCKET NO. E-01787A-01-0063** NAVOPACHE ELECTRIC COOPERATIVE, INC.'S NOTICE OF FILING SUMMARY OF PRE-FILED TESTIMONY

Navopache Electric Cooperative, Inc. ("Navopache"), pursuant to the March 9, 2001 Procedural Order, hereby files Summaries of Pre-Filed Testimony of Wayne A. Retzlaff and Kent Rhoton of Navopache, David W. Hedrick and Judy K. Lambert of C.H. Guernsey & Company, and William K. Edwards of National Rural Utilities Cooperative Finance Corporation.

Respectfully submitted this 26th day of October, 2001.

MARTINEZ & CURTIS, P.C.

Arizona Corporation Commission
DOCKETED
OCT 26 2001
DOCKETED BY

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PROOF OF SERVICE AND CERTIFICATE OF MAILING

I hereby certify that on this 26th day of October, 2001, I caused the foregoing document to be served on the Arizona Corporation Commission by hand-delivering the original and ten (10) copies of said document to:

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109/-29-15-7/pleadings/notice of filing testimony summary.1020.01

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SUMMARY OF PRE-FILED TESTIMONY
WAYNE A. RETZLAFF
DOCKET NO. E-01787A-01-0063

A. STRUCTURE OF NAVOPACHE

Wayne A. Retzlaff, General Manager for Navopache Electric Cooperative, Inc. ("Navopache") testifies that Cooperatives are structured differently than the Investor Owned Utilities ("IOUs"). He explains that Navopache is a not-for-profit corporation; that there are no "stockholders"; that Navopache's customers are its members; that every member is allocated a proportionate share of Navopache's positive margins as capital credits, which are returned to the members on a twenty year rotation cycle; and that retirement of capital credits must be suspended when Navopache is in financial distress. He also explains Navopache's Mission Statement and Management Code of Ethics and that the purpose of Navopache is to make electric service available at the lowest possible cost, consistent with good management practices, for the mutual benefit of all of Navopache's member-customers.

B. NATURE OF NAVOPACHE'S SERVICE AREA

Mr. Retzlaff testifies that Navopache provides electric service to a rural area encompassing 10,000 square miles in parts of Greenlee, Gila, Navajo and Apache Counties in Arizona and Catron County in New Mexico, but has less than 30,000 member-customers. To serve these member-customers, Navopache must maintain over 2,855 miles of distribution and transmission lines. Mr. Retzlaff also explains that Navopache is experiencing robust growth within its service area requiring many new line extensions and distribution upgrades.

C. NAVOPACHE'S FUNDING NEEDS

Mr. Retzlaff testifies to Navopache's funding needs and associated minimum OTIER requirements by Navopache's lenders, RUS and CFC, explaining Navopache's adjusted Test Year 0.21 OTIER is far below the minimum default requirements required by RUS and CFC. He explains Navopache's operating funds come from rates and charges approved by the Commission and that construction funds come primarily from line extension agreements and loans from RUS and CFC. He further explains that Navopache currently has over $32,000,000 in principal outstanding in long-term loans from RUS and CFC, a $10,000,000 line of credit (bridge loan) from CFC, and that the Cooperative has a pending application to approve an additional $ 24,572,000 loan from RUS to fund the new construction and upgrades outlined in its current 4-year work plan. A summary of Navopache's 4-year work plan is included as part of Attachment 1 to his direct testimony.

E. NAVOPACHE'S RATE INCREASE IS REASONABLE

Mr. Retzlaff testifies Navopache has proactively reduced and controlled its operating expenses, including securing a new power supply agreement from Public Service Company of New Mexico ("PNM") thereby reducing Navopache's adjusted Test Year power costs by $3,170,963 or 18%. Mr. Retzlaff explains that it has been eight years [now 9 years] since Navopache's last rate increase; that the requested revenue increase of $3,260,399 will be only a slight increase over Navopache's revenues, prior to the automatic reduction of revenues due to the pass through of the $3,170,960 savings in power costs; that Navopache's members have been receiving the benefits of reduced power costs since July 1, 2000; and, even after reducing Navopache's revenues to reflect the pass through of the power cost savings, the proposed rate increase reflects an annual compound growth rate of only 1.51 percent per year since 1992, well below the average annual inflation rate of 2.65 percent for this same period. Mr. Retzlaff also testifies that Navopache is experiencing deficit operating margins, an eroding equity and an adjusted Test Year OTIER that is below the minimum levels required by RUS and CFC.

F. ALLOWANCE OF LOBBYING EXPENSES

Mr. Retzlaff supports the inclusion of $13,093 in expenses paid as part of the annual fees to the Grand Canyon State Electric Cooperative Association and the National Rural Electric Cooperative Association and used by the Associations to fund lobbying activities on behalf of all their member-cooperatives. He explains that while it may be reasonable to disallow lobbying expenses for an IOU where the efforts benefit stockholders, the lobbying efforts on behalf of cooperatives are undertaken on behalf of the ratepayer-members and should be allowed.

G. PROPOSED RATE DESIGN AND COST OF SERVICE STUDY

Mr. Retzlaff explains how electric restructuring affects Navopache and how Navopache's rate design tracks its costs of service in order to meet the realities of a new competitive environment, where Navopache's primary function is that of a Utility Distribution Company ("UDC"). In rebuttal, Mr. Retzlaff expresses satisfaction with Staff's acceptance of Navopache's cost of service study and rate design.

H. TREATMENT OF PLAINS' GAIN FROM SALE OF ASSETS

Mr. Retzlaff testifies that both RUS (Attachment 3 to his direct testimony) and Navopache's auditors have advised that the $860,670 distribution from Plains should be treated as return of patronage capital, i.e., the positive margins allocated by Plains to Navopache based upon the rates paid to Plains over the 20 years Plains was Navopache's supplier of wholesale power. In other words, these funds were paid by and are the property of Navopache. Mr. Retzlaff explains that if treated as patronage capital, Navopache's members/ratepayers would receive the benefit through allocation and rotation of their capital credits (earned through payment of rates to Navopache). The cost of terminating the Plains Wholesale Agreement was negotiated without knowledge of, and irrespective of, any return of patronage capital from Plains. In rebuttal and rejoinder testimony, Mr. Retzlaff opposes Mr. Carlson's recommendation to use these funds, including interest earned thereon, to reduce the CTC charge. Mr. Retzlaff also testifies Staff's recommendation is based on a misreading of Navopache's Stranded Cost Settlement Agreement and Commission Decision, which merely deferred examination of the issue until this rate case.

I. PROPOSED CHANGES TO POLICY MANUAL AND STANDARD OFFER TARIFFS

Mr. Retzlaff testifies to proposed changes to Navopache's Policy Manual to reflect Navopache's current operating procedures and the new competitive environment. In rebuttal and rejoinder testimony, Mr. Retzlaff expresses Navopache's agreement with the proposed language changes to the Policy Manual and Tariff Schedule No. 4 recommended by Mr. Carlson, but disagrees with Mr. Carlson regarding Tariff Schedule No. 7 (Cogeneration).

SUMMARY OF PRE-FILED TESTIMONY
KENT RHOTON
DOCKET NO. E-01787A-01-0063

A. APPROPRIATE TREATMENT OF TEST-YEAR CWIP

Mr. Kent Rhoton, Manger of Engineering Services for Navopache Electric Cooperative, Inc. ("Navopache"), provides rejoinder testimony responding to surrebuttal testimony provided by Darron Carlson of Staff regarding whether the $3,972,405 of test-year CWIP, now in service, should be excluded from rate base. Mr. Rhoton testifies that he supervises all work orders and fieldwork and personally records the plant-in-service date when each work order is completed and the plant comes into service. Mr. Rhoton reviewed the work orders identified in Data Requests and Ms. Lambert's testimony and testifies that based on this review, he is certain that $3,639,315.87 of the $3,972,405 of test-year CWIP is in service. Mr. Rhoton testifies that the remaining $333,889.44 includes additions to general plant, which he does not directly oversee.

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SUMMARY OF PRE-FILED TESTIMONY
DAVID W. HEDRICK
DOCKET NO. E-01787A-01-0063

A. COST OF SERVICE STUDY

David W. Hedrick of C.H. Guernsey & Company sponsors Navopache's cost of service study (Schedules F through N), to which Staff Witness Darron W. Carlson took "no exception." A primary goal in the allocation of the revenue requirement to each class was the movement toward the elimination of interclass subsidies. The proposed revenue requirement for each class brings the class closer to providing revenue sufficient to cover its cost of service. The cost of service study indicated that the Residential and Irrigation classes required the greatest increases and Small Commercial and Large Power classes the smallest increases.

B. RATE DESIGN

Mr. Hedrick testifies that the rates proposed by Navopache better track the costs of providing service, as reflected in the cost of service study, and prepare Navopache for Commission mandated deregulation. Mr. Hedrick explains (1) under deregulation it is more important than ever to send the appropriate cost signals so people will be making competitive decisions on true costs; (2) the rural character and low densities of Navopache increase its fixed costs of providing service; (3) the rate design proposed by the White Mountain Apache Tribe for the residential class, overprices energy and thereby causes large kWh users to subsidize low kWh users and encourages people to shift to other power suppliers and sources for the wrong reason; and (4) the Tribe owns and operates a propane business and chooses to install propane appliances in buildings on the reservation, including residential housing, thereby ensuring Tribe members electric energy consumption will be low, regardless of their income level.

Mr. Hedrick's cost of service study demonstrates that, regardless of energy usage, it costs Navopache \$18.97 per month for each non-time-of-use residential customer connected to its system, and \$28.20 per month for each time-of-use residential customer connected to its system. Under deregulation, the Commission requires each utility "unbundled" rate to show the various costs it is charging its customers for services now open to competition, including Metering, Meter Reading, Customer Billing and Distribution Access. Mr. Hedrick's proposes a customer charge of \$18.75 (Metering - \$3.13, Meter Reading - \$0.80, Customer Billing - \$4.12 and Distribution Access \$10.70) for its non-time-of-day residential customer and a customer charge of \$25.85 (Metering - \$7.82, Meter Reading - \$3.21, Customer Billing - \$4.12 and Distribution Access \$10.70) for its time-of-day residential customers.

Mr. Hedrick's testimony demonstrates the increased customer charge more fairly recovers the cost of providing service and assists in addressing the costs associated with seasonal customers and customers with low electric usage due to significant reliance on gas. These customers require Navopache to build the same backbone system to serve their residence and remain connected throughout the year, but only occupy the residence for a few months or use small amounts of electric energy.

C. TIME OF USE RATES

Mr. Hedrick also supports: (1) a slight modification of the on-peak and off-peak hours to better coincide with Navopache's new power supplier's peak periods while at the same time providing some flexibility to Navopache's membership; and (2) the redesign of the interruptible service rate to reflect the new power supply with PNM.

D. MISCELLANEOUS CHANGES TO FEES AND CHARGES AND POLICY MANUAL

As reflected in Schedule N-5 to the testimony, Mr. Hedrick also supports numerous changes to Navopache's miscellaneous fees and charges, including increasing: (1) the Establishment fee from $10 to $25; (2) the Re-Establishment fee from $70 to $90; (3) the Reconnect fee from $50 to $70; (4) the Temporary to Permanent Service fee from $65 to $75; (5) the Returned Check fee from $12.50 to $25; (6) the Field Collection fee from $10 to $25; and (7) the Meter Test fee from $15 to $35. The Tampering fee would remain at $100 for the first violation, increasing to $150 for the second violation. The Late Payment fee would remain at 1.5% of the delinquent balance.

E. ENVIRONMENTAL PORTFOLIO STANDARD

Mr. Hedrick also supports inclusion of a provision for the recovery of the Environmental Portfolio Standard ("EPS") as established by the Commission. Subsequent to Navopache's filing this rate application, the Commission formalized the EPS, which is now codified under A.A.C. R14-2-1618 and approved a specific EPS Surcharge Tariff for Navopache. In rejoinder testimony, Mr. Hedrick supports amending Navopache's Tariffs to incorporate the EPS Surcharge Tariff for reference and reinserts the Demand Side Management ("DSM") Adder, including a provision that continues the collection of the Adder amount if the DSM program is terminated, but applies the funds toward EPS uses as required under A.A.C. R14-2-1618(A)(2).

SUMMARY OF PRE-FILED TESTIMONY
JUDY K. LAMBERT
DOCKET NO. E-01787A-01-0063

A. TEST YEAR RATE BASE, REVENUES AND EXPENSES

Judy K. Lambert of C.H. Guernsey & Company analyzed revenues and expenses for Navopache for the adjusted test year rate base, ending October 31, 1999. Ms. Lambert and Commission Staff generally agree except for: (1) differences arising from the inclusion of $3,972,405 end of test year CWIP that has been reclassified to transmission, distribution plant, and general plant accounts, as plant in service; and (2) inclusion of lobbying expenses. Ms. Lambert testifies Navopache has an Original Cost Less Depreciation and Fair Value Rate Base of $41,304,582; Adjusted Test Year Revenues of $25,842,232; Operating Expenses of $25,278,384; a deficit Operating Margin (after Interest and other Deduction) of $1,414,846. (See, JKL Rebuttal Schedule 4.)

B. NAVOPACHE'S PROPOSED REVENUE REQUIREMENTS

Ms. Lambert's analysis (including changes to operating expenses based on Staff's recommendations), shows that Navopache's current rates are wholly inadequate. Based upon a review of Navopache's current and projected financial condition using a Five-Year Planning Horizon Study (Schedule E), Ms. Lambert strongly recommends rates designed to achieve a 2.0 OTIER. In order to achieve a 2.0 OTIER, Navopache's total revenue requirement is $29,102,722, which is an increase of $3,260,399 above adjusted test year revenues of $25,842,323. This is an increase of 12.62 percent, however, this is only $90,917 (or .0031%) more than the $29,011,805 in operating revenues actually received by Navopache from its members during the test year (i.e., prior to reducing revenues for lower PPAM collection due to lower power costs). With adjusted operating expenses of $25,278,384, the return is $3,824,338, for a rate of return of approximately 9.26 percent on a rate base of $41,304,582. This return is calculated before considering the $1,978,785 in interest and other deductions, or the $1,027,400 in principal payments, paid by Navopache.

C. 2.0 VS. 1.5 OTIER

In response to Staff's recommendation, Ms. Lambert prepared a Five-Year Planning Horizon Study using the 1.5 OTIER recommended by Mr. Carlson. (See, JKL Rebuttal Schedules 7-9.) The planning horizon studies prepared using a fixed return represented by Staff's 1.50 TIER show Navopache's equity and OTIER continuing to erode. In fact, by 10/31/2003, Navopache would be below loan default levels again.

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SUMMARY OF PRE-FILED TESTIMONY
WILLIAM K. EDWARDS
DOCKET NO. E-01787A-01-0063

A. CFC RECOMMENDS AT LEAST A 2.0 OTIER FOR NAVOPACHE

Mr. William K. Edwards, Director of Regulatory Affairs, for the National Rural Utilities Cooperative Finance Corporation ("CFC") testifies that CFC's purpose is to lend money to rural electric cooperatives, such as Navopache, to supplement the loan programs of the Rural Utilities Service ("RUS"), or to lend 100% of loan requirement for those electric cooperatives electing not to borrow funds from RUS. Mr. Edwards testifies that Navopache is a member of CFC and has long-term loans with CFC totaling $7,757,552 as of December 31, 2000. As a lender to Navopache, CFC has a vital interest in Navopache maintaining an appropriate OTIER. He testified that if many cooperatives were allowed to operate close to the minimum default requirements, CFC would not have the ability to raise new capital in the financial markets.

Mr. Edwards testifies that, based on CFC's analysis of Navopache's rate case application, the optimal OTIER for Navopache should be at least a 2.5. CFC, however, believes that the minimum 2.0 OTIER, as requested by Navopache's Board of Directors, strikes an appropriate balance between the financial viability of the Cooperative and financial burden on its members.

B. CFC DOES NOT BELIEVE THAT STAFF'S 1.5 OTIER IS ADEQUATE

Mr. Edwards provides significant independent analysis of Navopache's financial condition and concludes Navopache is a financially distressed utility and its OTIER and DSC ratios are among the lowest in the country. During the test year, Navopache's equity ratio was approximately 26 percent. By contrast, distribution cooperatives as an industry had a median equity ratio of about 48.32 percent. In his opinion, a 1.5 OTIER is inadequate and the 2.0 TIER requested by Navopache is a minimum OTIER.

C. OTHER STATE PUCS ARE ALLOWING OTIERs OF BETWEEN 2.0 AND 2.5

Mr. Edwards provides decisions from other state PUCs finding OTIERs between 2.0 and 2.5 to be appropriate.

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