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BEFORE THE ARIZONA CORPORATION COMMISSION

JIM IRVIN
Commissioner - Chairman
RENZ D. JENNINGS
Commissioner
CARL J. KUNASEK
Commissioner

IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. U-0000-94-165

NOTICE OF FILING OF TESTIMONY OF DIRK C. MINSON AND DAVID J. HEDBERG

Notice is given that Arizona Electric Power Cooperative, Inc. has filed the testimony of Dirk C. Minson and David J. Hedberg.

RESPECTFULLY submitted this 9th day of January, 1998.

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Arizona Corporation Commission
1200 West Washington
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Arizona Corporation Commission
DOCKETED

JAN 09 1998

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BEFORE THE ARIZONA CORPORATION COMMISSION

JIM IRVIN
COMMISSIONER - CHAIRMAN
RENZ D. JENNINGS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA	DOCKET NO. U-0000-94-165

TESTIMONY OF

DIRK C. MINSON

ON BEHALF OF

THE ARIZONA ELECTRIC POWER COOPERATIVE, INC.

JANUARY 9, 1998

TESTIMONY SUMMARY
OF DIRK C. MINSON
ON BEHALF OF
THE ARIZONA ELECTRIC POWER COOPERATIVE, INC. ("AEPCO")
DOCKET NO. U-0000-94-165

My testimony discusses AEPCO's position on the nine issues identified in the December 1, 1997 Procedural Order. AEPCO also recommends three amendments to the Electric Competition Rules concerning mitigation, recovery of stranded costs and prudence of prior investments.

AEPCO strongly supports the use of the "net revenues lost" calculation methodology. Coupled with a true-up mechanism, we believe this method is best suited to identify and assure proper recovery of Stranded Costs. There should not be any limitation on the timeframe over which AEPCO's Stranded Costs are calculated nor any generic limit on the recovery period. This issue should be left to utility specific stranded cost proceedings where a more informed decision can be made as to the correct recovery period.

AEPCO is a non-profit, generation and transmission cooperative which supplies the power needs of its five Arizona Class A member distribution cooperatives. AEPCO and its members supply electricity to about 300,000 people - most of them in rural Arizona. Over the past ten years, AEPCO has reduced rates to its members by more than 20%.

TESTIMONY OF
DIRK C. MINSON
ON BEHALF OF
THE ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. U-0000-94-165

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TESTIMONY OF
DIRK C. MINSON
ON BEHALF OF
THE ARIZONA ELECTRIC POWER COOPERATIVE, INC. ("AEPCO")
DOCKET NO. U-0000-94-165

Q: Please state your name, position and business address.

A: I am Dirk C. Minson, Assistant General Manager - Finance, for AEPCO. My business address is 1000 South Highway 80, Benson, Arizona 85602.

Q: Please state your relevant employment and educational background.

A: Currently, I am AEPCO's Assistant General Manager of Finance. I have held that position since May, 1990 and am responsible for the financial performance and integrity of AEPCO. In this capacity, I am one of seven assistant general managers that report directly to the Executive Vice President and General Manager of AEPCO. I graduated in 1975 with an undergraduate degree in Business Administration from Kansas State University. In 1982, I obtained a Masters of Business Administration from the University of Missouri. My work experience totals twenty-two years either working with or for rural generation and transmission electric cooperatives.

Q. Please describe AEPCO.

A. AEPCO is a non-profit generation and transmission cooperative which supplies all the power and energy needs of its five Arizona Class A Member distribution cooperatives. Pursuant to all requirements contracts with each of these members, they are obligated to purchase and AEPCO is obligated to supply all the electric needs in their respective certificated areas. These all requirements contracts currently extend through the year 2020.

Q. How does AEPCO meet the power needs of its members?

A. Primarily through 520 MW of coal and gas fired generation at our Apache Generating Station located near Wilcox, Arizona. However, AEPCO also has short and long-term purchase contracts with other utilities that it uses to meet these needs.

Q. What is AEPCO's position on the recovery of stranded costs?

A. AEPCO was formed to provide bulk generation and transmission service for its member distribution cooperatives. The Apache Station, along with a transmission system, was built to satisfy this need. Costs for these facilities were expended to ensure that the distribution cooperatives would have power at the lowest reasonable cost with high reliability. These costs have been approved by the ACC as prudently expended in prior rate hearings. AEPCO finances its generation and transmission facilities strictly through debt. Full recovery of "stranded costs" as a result of implementation of the electric competition rules in the state of Arizona is mandatory. Any significant losses as a result of unrecovered stranded cost may jeopardize AEPCO's debt and severely restrict AEPCO's ability to raise capital in the future.

Q: What is the purpose of your testimony?

A: The purpose of my testimony is to provide AEPCO's position on the nine issues concerning Stranded Costs which were set forth in the Procedural Order in this matter dated December 1, 1997. AEPCO is also offering the testimony of Mr. David Hedberg of the National Rural Utilities Cooperative Finance Corporation (CFC) in relation to several of these matters.

Q: Have you attempted to rank by order of importance the issues of most concern to AEPCO?

A: Yes. Consistent with the Hearing Officer's request, I will address first the issues of most importance to AEPCO. However, I would stress that all issues identified in the December 1, 1997 Procedural Order are of considerable importance to AEPCO. Therefore, I do not mean to minimize an issue's overall importance by discussing it later rather than earlier in my testimony.

CALCULATION METHODOLOGY

Q: The third issue identified in the Procedural Order is "What costs should be included as part of 'stranded costs' and how should those costs be calculated?" The Hearing Officer subsequently indicated that calculation methodology, market clearing price and SFAS 71 implications should be addressed in relation to this issue. Starting with calculation methodology, please state AEPCO's position.

A: AEPCO strongly supports the use of the "net revenues lost" methodology for calculation of stranded cost. This methodology was discussed at pages 20 - 22 and 27 - 28 of the Stranded Cost Working Group Report. This method has a number of advantages associated with it. With particular reference to AEPCO as a generation and transmission cooperative, AEPCO believes it is best suited to identify and allow recovery of stranded costs associated with our mortgage and the all requirements contracts we have with our Class A members. We do believe the Commission should amend its Competition Rules to state the filing requirements necessary to support a "net revenues lost" calculation filing.

Q. Please state AEPCO's view of Statement of Financial Accounting Standard (SFAS) No. 71, Accounting for the Effects of Certain Regulation, as it pertains to stranded cost recovery.

A. SFAS No. 71 allows for certain regulatory assets to be established by a utility if those amounts have been approved for recovery over a specified period of time by the utility's regulator. AEPCO uses this accounting standard for certain regulatory assets which have been approved for recovery by the Commission in prior rate hearings. Care must be taken by the Commission when addressing stranded cost recovery. Clear and precise language in any Stranded Cost Order will allow continued adherence to SFAS No. 71 standards by Arizona utilities and will avoid precipitous and unnecessary write-offs by utilities.

Q. Please state AEPCO's position on market clearing price matters.

A. Market clearing price is a very complicated subject and predicting it over even a short period of time is difficult. This reality is an additional argument in favor of a true-up mechanism which I'll discuss next. In general, AEPCO believes that the appropriate price by which to gauge stranded costs is the long-term marginal price. Although short and intermediate price estimates should also play a role in this determination, the long-term marginal price represents investment in an electrical system that was built under the concept of obligation to serve. A longer term price is not as subject to temporary market fluctuations and reflects the reality that in the future all power cannot and will not be sold at the short term marginal cost. Finally, use of a longer term price will (1) minimize stranded costs, (2) make full recovery more palatable and(3) avoid possible asset write-offs if stranded costs are overstated.

TRUE-UP MECHANISM

Q: Please state AEPCO's position on a true-up mechanism.

A: AEPCO believes a true-up mechanism would be appropriate. As a non-profit customer-owned generation and transmission cooperative, such a mechanism would help to ensure that stranded costs are neither over nor under recovered. We envision a true-up mechanism working much like a purchased power and fuel adjustment clause. Certain benchmarks would be established during the utility's specific stranded cost determination proceeding and regular filings would then be made to provide the Commission information as to stranded cost recovery in relation to those benchmarks. Every two years a true-up could be accomplished, if necessary. Finally, we recommend that any true-up procedure be streamlined. Ideally, unless there is some dispute concerning the utility's filing, the true-up could be accomplished by the Commission at Open Meeting without the necessity of a hearing.

LIMITATIONS

Q: The Procedural Order identified three issues (No's. 4, 5 and 8) requesting positions on various limitation suggestions. Let's begin with AEPCO's position on whether there should be a limitation on the timeframe over which "stranded costs" are calculated.

A: There should not be any Rules' limitation on the timeframe over which stranded costs are calculated. In AEPCO's case, its "all requirements" contracts terminate in the year 2020. The estimated used and useful lives of most of its generating and transmission assets extend beyond this period. Keeping in mind that there is no AEPCO stockholder class nor any equity against which to bank or cushion unrecovered stranded costs, it is important to allow calculation of stranded costs, at a minimum, over the term of the all requirements contracts and, at a maximum, over the used and useful lives of the assets which were financed and constructed to support those obligations.

Q: What is AEPCO's position on a limitation on the recovery timeframe for stranded costs?

A: AEPCO does not believe that the Commission should establish any generic limit on the recovery timeframe for stranded costs. This issue should be left to utility specific stranded cost proceedings. The principle danger in adopting a fixed limit on recovery timeframe, i.e. seven or ten years, is that it will increase stranded cost recovery in the early years, correspondingly increasing rates which must be charged currently and perhaps creating artificial barriers to the competitive market.

Q: Finally, does AEPCO believe there should be price caps or a rate freeze imposed as part of the stranded cost recovery program?

A: No. Although I am not an attorney, I do not believe any legal basis exists for such a price cap or rate freeze. As an equitable matter, the Commission's Rules impose a continuing duty and obligation to serve any customer which either elects not to participate in the competitive market or does not have available competitive choices. Rates must be sufficient to support these and other ongoing service needs. Over the past ten years, AEPCO has decreased its Class A member rates by more than twenty percent. We hope to continue these rate reductions or at least maintain rate stability in the future. However, an arbitrary price cap or rate freeze would be just that and should not be imposed.

STRANDED COST FILING TIMING

Q: When does AEPCO feel it can make a stranded cost filing pursuant to R-14-2-1607?

A: At this time, I cannot answer that question because so many variables such as market clearing price and calculation methodology remain undefined by the Commission.

WHO SHOULD PAY

Q: Currently, the Competition Rules provide that stranded costs will be recovered only from customers participating in the competitive market. What is AEPCO's position on this issue?

A: All customers should pay stranded costs on a system by system basis. Apparently, the Commission has made a determination that competition will be in all customers', and the public's, best interest. Given that, all customers are beneficiaries of this public policy and therefore should bear the costs associated with it. Further, by spreading stranded costs over all customers on a system by system basis, the effect is to encourage competition and remove barriers to competition by reducing the amount of the charge to be recovered.

STRANDED COST MITIGATION FACTORS

Q: What factors does AEPCO believe should be considered for mitigation of stranded costs?

A: Obviously, mitigation opportunities and activities will vary on a utility by utility basis so it is difficult to state general guidelines. However, the Commission should take into consideration in AEPCO and other cooperatives' cases the fact that rural areas probably provide fewer mitigation opportunities. Also, because cooperatives have no stockholder class, no "venture capital" exists to fund mitigation activities. Finally, AEPCO believes firmly that mitigation offsets to stranded costs should be attributable only to traditional utility activities.

ELECTRIC COMPETITION RULES PROPOSED AMENDMENTS

Q: Does AEPCO believe there should be amendments to the existing electric competition rules?

A: Yes. In order to clarify mitigation duties and allowable profits and expenses, we recommend the following new language be substituted for the current R14-2-1607.A:

> A. The Affected Utilities shall undertake reasonable, cost effective measures to mitigate or offset Stranded Cost. However, neither revenues from nor expenses incurred in non-jurisdictional activities shall be considered in mitigation or calculation of Stranded Cost.

In order to allow stranded cost recovery from all customers, not just those competitively served, on a system by system basis, we recommend that all text after "from customers" be deleted in R14-2-1607.H and R14-2-1607.J be deleted in its entirety. Finally, to avoid relitigation of prior Commission decisions in Stranded Cost proceedings, we recommend the following sentence be added to R14-2-1607.I:

> The prudence of an Affected Utility's investment prior to the effective date of this Article shall not be at issue in the Stranded Cost determination.

After reviewing the other parties' testimony in this proceeding, AEPCO may have other recommendations or comments.

Q: Does this conclude your direct testimony?

A: Yes, it does.

0504740

DIRECT TESTIMONY

OF

DAVID J. HEDBERG

ON BEHALF OF
ARIZONA ELECTRIC POWER COOPERATIVE, INC.

IN THE MATTER OF THE COMPETITION
IN THE PROVISION OF ELECTRIC SERVICE
THROUGHOUT THE STATE OF ARIZONA
DOCKET NO. U-0000-94-165

JANUARY 9, 1998

Summary of David J. Hedberg's Testimony

Cooperatives, especially G&Ts like AEPCO, have been formed by its distribution members to provide power at the lowest long term cost. AEPCO does not have any incentive to charge its members more than is necessary to cover its long term costs but because of its low cost financial structure it has limited ability to absorb losses and this must be taken into consideration in the commissions' decisions.

Recovery of full stranded costs is critical for AEPCO. The stranded cost process should be based on a lost revenue approach with a true up mechanism and be applied to all customers classes including any who may leave the system. This can best be accomplished by a company by company basis.

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Direct Testimony of David J. Hedberg

DIRECT TESTIMONY OF DAVID J. HEDBERG
ON BEHALF OF
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
<u>IN DOCKET NO. U-0000-94-165</u>

Q1: PLEASE STATE YOUR NAME AND ADDRESS.

A1: My name is David J. Hedberg, and my business address is Woodland Park, 2201 Cooperative Way, Herndon, Virginia 22071-3025.

Q2: WHAT IS YOUR PRESENT OCCUPATION?

A2: I am employed as the Senior Vice President of Strategic Services at the National Rural Utilities Cooperative Finance Corporation (CFC).

Q3: WHAT ARE YOUR DUTIES WITH CFC?

A3: My duties with CFC involve many areas, but include providing assistance to member cooperatives in the areas of rate of return, rates, acquisitions and mergers. This assistance includes appearing as an expert witness on behalf of the cooperatives in rate case proceedings and providing any other rate or regulatory support as needed. In addition, I am actively involved in CFC's efforts to determine the future changes in the industry, the best way to adapt to these changes and meet the competitive standards of our ultimate consumers. Finally, I am in charge of CFC's workout efforts that involve determining valuations, market prices and what are hopefully creative solutions to maximizing the repayment of debt.

Q4: PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL QUALIFICATIONS.

A4: I graduated from Kent State University with a Bachelor of Business Administration Degree in 1972 with a major in Economics and a minor in Finance. In 1976 I received a Master of Arts Degree in Economics. From 1974 to 1976 I worked as an Economic Planner for the government of Botswana in Southern Africa while with the Peace Corps. I was employed by the Federal Energy Regulatory Commission (FERC) from February 1977 until December 1981 when I joined CFC. My responsibilities with FERC included the review and preparation of cost of service and rate design studies of electric utilities involved in rate proceedings before FERC. I have also attended many conferences and courses concerning income taxes, rate design, rate of return, marketing power and energy, and cost of service. These included the National Association of Regulatory Utility Commissioners Annual Regulatory Studies Program at the Graduate School of Business Administration, Michigan State University, East Lansing, Michigan. In addition, I have prepared several papers on a variety of financial subjects concerning the electric utility industry.

Q5: HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE REGULATORY BODIES?

A5: Yes, I have submitted testimony before FERC in the following proceedings:

Commonwealth Edison Company, Docket No. E-9002; Indiana & Michigan Electric Co. Docket Nos. ER78-379, ER78-103, ER76-176; Ohio Edison Co. Docket Nos. ER77-530, ER78-490; Central Illinois Public Service Co., Docket Nos. ER78-80, ER77-89; Ohio Power Co., Docket No. ER80-673; Utah Power and Light Co., Docket No. ER79-121; Kansas City Power and Light Co. Docket Nos. ER80-315, ER80-450; Public Service Co. of New Mexico, Docket Nos. ER80-313, ER81-187; Wisconsin Electric Power Company, Docket No. ER80-567.

In addition, I either supervised or participated in approximately 50 rate cases before FERC that resulted in a settlement of issues so that a hearing was not required.

Q6: HAVE YOU TESTIFIED BEFORE STATE COMMISSIONS PRIOR TO THIS CASE?

A6: Yes, since being employed by CFC, I have testified in about 100 rate cases before approximately 25 state commissions including several before this commission.

Q7: WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A7: The purpose of my testimony is to provide a national perspective as to rural electric cooperatives, their regulation and how they differ from investor owned utilities in several important respects. I will also discuss several issues outlined in the 12/2/97 procedural order in this docket including how to determine stranded costs, true up mechanisms, timeframes, price caps/rate freezes, who should pay and stranded cost mitigation factors.

Q8: WHAT ARE THE SECTIONS OF YOUR TESTIMONY?

A8: I will briefly explain CFC and how it operates some of the unique financial and operating characteristics of electric cooperatives and the issues mentioned above specific to this proceeding.

Q9: PLEASE EXPLAIN THE PURPOSE OF CFC.

A9: CFC is a self-help, independent financing institution, organized as a cooperative and operated on a non-profit basis. As a cooperative organization, CFC is member-owned and controlled. The purpose of the organization, as stated in its Articles of Incorporation, is "to provide, secure, and arrange financing for its members and patrons... for the primary and mutual benefit of the patrons of the Associations and their patrons, as ultimate consumers." CFC's equity was originally provided by the member rural electric systems through the purchase of Capital Term Certificates (CTCs). Equity is also provided when borrowers purchase additional CTCs, if required with long-term loans, and through CFC's margins, 70% of which are currently returned to our member-systems as capital credit payments in the year they are allocated, and the other 30% retained for 15 years before being returned to our member-systems.

Q10: HOW DOES CFC FUNCTION IN RELATION TO ITS MEMBERS AND THE CAPITAL MARKET?

A10: CFC functions both as a borrower and a lender. As a lender, CFC makes short and long-term loans to its member-systems. As security for its long-term loans, CFC normally receives a first mortgage on a borrower's facilities. These mortgages and related mortgage notes are used as security to support CFC's collateral trust bonds issued in the public capital market. Through the sale of such bonds, and through the sale of commercial paper and various types of notes, CFC obtains capital to meet the financing requirements of its members. In this role, CFC acts as a borrower from investors.

Q11: WHAT TYPES OF LOANS DOES CFC MAKE?

A11: For both G&T and distribution systems, CFC offers long term secured loans and guarantees that have a wide variety of maturity and repricing options. In addition, CFC provides a variety of short term loans including lines of credit.

Q12: WHY DO THE VAST MAJORITY OF COOPERATIVES DEPEND UPON CFC FOR SUPPLEMENTAL FINANCING, INSTEAD OF EACH INDIVIDUAL COOPERATIVE HANDLING ITS OWN NEEDS?

A12: There are a number of sound reasons for cooperatives to obtain their capital through CFC. By pooling resources and approaching the private capital markets collectively, the systems develop economies of scale and bring a diversified loan portfolio for CFC to offer investors. In addition, CFC brings to the market about

$1.5 billion in equity, a loan loss reserve and other financial advantages that benefit its members. These financial strengths have earned CFC an AA bond rating.

Q13: WOULD YOU EXPLAIN THE RELATIONSHIP BETWEEN RURAL UTILITIES SERVICES (FORMERLY REA) AND CFC AS IT RELATES TO THE FINANCING OF ELECTRIC COOPERATIVES?

A13: Rural Utilities Services (RUS) is the federal agency that has been responsible for financing the rural electric program for more than 50 years. CFC is the private organization responsible for meeting the capital gap that has developed between demand for funds and funds available from RUS. As RUS' role has declined in the last few years, CFC's role has increased. Under current legislation, cooperatives have had the right to buy out their government debt, and to date, approximately 150 have either done so or started the process.

Q14: WHAT IS THE SIZE OF THE ELECTRIC COOPERATIVE PROGRAM?

A14: Size can obviously be described in many ways. In numbers there are approximately 1,000 electric cooperatives operating in 46 states and servicing about 70% of the land area of the continental U.S. Total assets of this group is in excess of $60 billion and they serve about 15 million customers representing over 30 million people.

Q15: HOW DO GENERATION AND TRANSMISSION (G&T) ELECTRIC COOPERATIVES DIFFER FINANCIALLY FROM INVESTOR OWNED UTILITIES (IOUS) THAT WOULD BE OF RELEVANCE TO STRANDED INVESTMENT DECISIONS?

A15: G&Ts like AEPCO have traditionally been funded almost entirely with debt as opposed to IOUs who have traditionally used a combination of debt and equity of roughly equal proportions. These differences usually mean the G&T can operate with a lower rate of return but have very little ability to absorb losses such as disallowed stranded costs. Any significant losses may mean the debt is in jeopardy and so a G&Ts ability to raise capital in the future could be severely restricted. This is particularly true in AEPCO's case. As of 12/31/96, it had more than $35 million in total membership capital deficiency or negative equity. While AEPCO has made significant progress over the past 10 years in improving its negative equity situation, it obviously can ill afford any reversal in that positive trend.

Another important difference between G&Ts and IOUs is the type of customers they serve. AEPCO was formed to serve its six distribution members who control the G&T through the board of directors, who in turn serve their retail customers (members). As Mr. Minson discussed in his testimony, they are bound together by an "all requirements" contract that terminates in 2020. IOUs on the other hand directly serve most of their customers at the retail level with no contracts although many IOUs do serve some customers at wholesale and some large customers under contract.

Q16: WHY ARE THESE DIFFERENCES BETWEEN G&TS AND IOUS IMPORTANT WITH REGARD TO STRANDED INVESTMENT ISSUES?

A16: These differences are very important because AEPCO's ability to mitigate costs, tolerate rate freezes, absorb unrecovered or delayed recovery of stranded costs is very limited and may be very different from other utilities in the state. If this is not properly recognized in commission stranded cost decisions, it could have a very adverse impact on AEPCO, its distribution members and their retail customers.

Q17: HAVE YOU READ THE REPORT SUBMITTED BY THE STRANDED COST WORKING GROUP CONCERNING STRANDED COSTS?

A17: Yes I have.

Q18: DO YOU AGREE WITH THE DEFINITION OF "STRANDED COST" OR DO YOU HAVE A PREFERABLE DEFINITION?

A18: I understand the intent of the definition but determining the difference between the value of all prudent jurisdictional assets and the market value directly attributable to the introduction of competition will be a very cumbersome undertaking and subject to many interpretations.

I believe a much better approach and what I have used successfully is the "revenue lost" approach. As I have used this approach, it is quite simple. As market prices are determined, a competitive revenue requirements for a utility will be determined by the competitive market place and this will replace the traditional cost based revenue requirements. The difference or the lost revenue (its possible to have gained revenue) can be used to determine the plant and related costs that cannot be supported by the competitive revenue requirement and are thus stranded.

Q19: WON'T THE MARKET PRICES CHANGE OVER TIME AND RESULT IN OVER OR UNDER COLLECTIONS OF STRANDED COSTS AND IF SO HOW CAN THIS BE ADDRESSED?

A19: Yes, over time prices will adjust but will move to the cost of incremental capacity. As prices move, an adjustment mechanism such as fuel adjustment clauses can be used to true up stranded investment recoveries on an annual or bi-annual basis. Trying to predict market prices especially in the early years of competition will be very difficult so an adjustment mechanism is essential to ensure fair treatment of all the parties.

Q20: WHAT IS A REASONABLE TIME FRAME FOR RECOVERY OF STRANDED COSTS?

A20: Time frames adopted to date seem to be varying widely from 5 to more than 10 years. There is no magic in the right time frame and I believe the magnitude of the stranded investment must first be determined. Then the time frame can be more objectively evaluated when the rate impact from different recovery periods can be determined. In some cases, it may require rate increases if a short period is chosen and for this reason longer time periods may be necessary.

Q21: DON'T MANY STATES CONTEMPLATE RATE REDUCTIONS, PRICE CAPS OR RATE FREEZES?

A21: Yes, several states including California and Pennsylvania expect rate reductions but this is in part due to expected securitization savings that will occur because of the refinancing of stranded costs by securitization bonds. A cooperative like AEPCO, which already uses relatively low cost debt, would be unlikely to experience any significant savings from refinancing and would likely have to pay prepayment penalties to RUS if this was done. Obviously the proceeds from any securitization would have to be used to pay down debt which would correspond to the assets that would be written off or reduced.

As pointed out earlier, a cooperative like AEPCO has very limited cost mitigation potential beyond the steps it is already taking so required rate reductions or rate freezes may actually harm its member retail customers if not done in a prudent manner.

Q22: WHO SHOULD PAY FOR STRANDED COSTS?

A22: Because the state of Arizona has decided to move toward competition at the generation level, there is a presumption that benefits will result. If there are significant benefits to competition, they should clearly be netted by the costs to achieve those benefits. It is hard to imagine that the public interest is served if classes of customers that leave the utility and thus may benefit from competition should not pay their fair share of a system that was built for their benefit. As a result of this, I believe all classes should pay for stranded costs.

Q23: COULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?

A23: Cooperatives, especially G&Ts like AEPCO, have been formed by its distribution members to provide power at the lowest long term cost. AEPCO does not have any incentive to charge its members more than is necessary to cover its long term costs but because of its low cost financial structure it has limited ability to absorb losses and this must be taken into consideration in the commissions' decisions.

Recovery of full stranded costs is critical for AEPCO. The stranded cost process should be based on a lost revenue approach with a true up mechanism and be applied to all customers classes including any who may leave the system. This can best be accomplished by a company by company basis.

Q24: DOES THIS CONCLUDE YOUR TESTIMONY?

A24: Yes it does.