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BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED
AZ CORP COMMISSION

JAN 21 11 56 AM '98

IN THE MATTER OF THE COMPETITION IN,) DOCKET NO. RE-00000C-94-0165
 THE PROVISION OF ELECTRIC SERVICES,) (formerly U-0000-94-165)
 THROUGHOUT THE STATE OF ARIZONA,)
)
) NOTICE OF FILING OF TESTIMONY OF
) KENNETH R. SALINE
)

Notice is given that Arizona Transmission Dependent Utility Group has filed the testimony of Kenneth R. Saline.

RESPECTFULLY submitted this 21st day of January, 1998.

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Original and ten copies of the foregoing filed this 21st day of January, 1998, with:

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Arizona Corporation Commission
DOCKETED

JAN 21 1998

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SUMMARY OF TESTIMONY OF KENNETH R. SALINE

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1. The Rules should be changed to clarify the standard of proof for stranded costs.
2. Costs incurred or obligated prior to December 26, 1996 should be included in stranded costs.
3. Direct proof of a stranded asset should be required.
4. Stranded costs should be calculated over a period of regulatory upset, but not beyond 2006.
5. Stranded cost recovery periods should be flexible.
6. Customers availing themselves of retail competition should pay stranded costs.
7. No true-up mechanism is necessary if direct assignment of costs is used.
8. There should be no price caps on rate freezes.
9. All utility activities should be usable for mitigation.

1 BEFORE THE ARIZONA CORPORATION COMMISSION

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5 IN THE MATTER OF THE COMPETITION) DOCKET NO. RE-00000C-94-0165
IN, THE PROVISION OF ELECTRIC) (formerly U-0000-94-165)
7 SERVICES, THROUGHOUT THE STATE OF)
ARIZONA)
9)
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TESTIMONY OF KENNETH R. SALINE

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On Behalf of

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ARIZONA TRANSMISSION DEPENDENT UTILITY GROUP

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January 21, 1998

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1
3 DIRECT TESTIMONY

5 OF

7 KENNETH R. SALINE

9 (Docket No. RE-00000C-94-0165; formerly U-0000-94-165)

11 I. INTRODUCTION

13 Q. PLEASE STATE YOUR NAME, EMPLOYMENT AND BUSINESS ADDRESS.

15 A. My name is Kenneth R. Saline, and my business address is 160
17 North Pasadena, Suite 101, Mesa, Arizona 85201-6764. I am a
19 Partner of K. R. Saline & Associates, a consulting engineering
21 firm which advises members of the Arizona Transmission Dependent
23 Utility Group¹ ("TDU Group") on electrical power supply and
25 delivery matters.

27 Q. WHAT ARE YOUR QUALIFICATIONS TO TESTIFY AS AN EXPERT WITNESS?

29 A. My educational, professional qualifications and experience are
31 set forth in Attachment 1, which is attached to my testimony.
33

35 Q. HAVE YOU RECENTLY PARTICIPATED IN ANY RATE PROCEEDINGS INVOLVING
37 ANY OF THE AFFECTED UTILITIES?

39
41
43
45 ¹Aguila Irrigation District, Ak-Chin Indian Community, Buckeye Water
47 Conservation and Drainage District, Central Arizona Water Conservation
49 District, Electrical District No. 3, Electrical District No. 4, Electrical
District No. 5, Electrical District No. 7, Electrical District No. 8,
Harquahala Valley Power District, Maricopa County Municipal Water District
No. 1, McMullen Valley Water Conservation and Drainage District, Roosevelt
Irrigation District, City of Safford, Tonopah Irrigation District, Wellton-
Mohawk Irrigation and Drainage District

1 A. Yes. I have been participating as a consulting engineer and
3 witness in proceedings before the Federal Energy Regulatory
5 Commission involving the Open Access Tariff filings by Arizona
7 Public Service Company.

9 Q. **WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

11 A. The purpose of this testimony is to respond to the nine questions
13 put forward by the Arizona Corporation Commission concerning the
15 Commission rules on recovery of stranded costs.
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1 II. SUMMARY

3 Q. WOULD YOU SUMMARIZE THE TDU GROUP'S INTEREST IN THE ISSUES
5 IDENTIFIED IN THE DECEMBER PROCEDURAL ORDERS?

7 A Yes. The TDU Group represents utilities which are public
9 utilities created among other things to provide electrical
11 service to their loads and resale customers. The standard
13 typically adopted for serving their consumers is to provide
15 service to their consumers at the lowest possible cost consistent
17 with sound business principles. These utilities are wholesale
19 utilities and are not Affected Utilities as defined in A.A.C.
21 R14-2-1601. However, the issues related to Stranded costs may
23 impact the TDU Group utilities and their customers if stranded
25 costs are not directly quantified and assigned to the departing
27 consumer (i.e., directly assigned).

29 Socialization of stranded power costs through broader-based
31 charges such as facility charges, distribution wheeling rates,
33 ancillary service rates, meter charges, or across other related
35 services will result in cost shifting to the non-departing
37 consumers, other utilities or consumers of other utilities.
39 Since the TDU Group members also wheel power across the
41 integrated transmission and distribution systems of Affected
43 Utilities, collection of stranded power supply costs through wire
45 service charges or connection fees will shift stranded costs to
47 consumers who have their own power cost responsibilities and are
49 not responsible for creating a stranded power cost to the

1 Affected Utility. Consumers may also depart from a TDU Group
3 utility to another supplier which may strand a power supply cost
5 of the respective TDU Group utility.

7 Because of the potential for cost-shifting and causation by the
9 departing customer, I recommend the Commission require specific
11 quantification of Stranded Costs for each departing customer on a
13 direct assignment basis. Consistent with FERC Order 888, if a
15 customer uses retail access to reach a new supplier, the utility
17 should be entitled to recover legitimate, prudent and verifiable
19 costs that it incurred. Direct assignment of stranded costs to
21 the departing consumer is preferable because the stranded costs
23 are caused by the departing customer.

25 From an end-use customer standpoint, stranded costs will have to
27 be weighed against the savings realized by accelerated access to
29 market suppliers. Due to the economics and unresolved technical
31 factors, like the independent transmission system operator, the
33 larger customers have the greatest potential for justifying
35 paying stranded costs, and should be allowed to do so. Metering,
37 accounting, billing, and resource administration services must
39 still be resolved on a large scale, without creating an
41 independent source of costs which outweighs potential power
43 supply savings. If market prices go up between now and 2003, the
45 potential for stranded costs will be reduced. If market prices
47 go down, customers may be able to afford to pay their stranded
49 costs and save money. If a consumer cannot economically justify

1 leaving their power supplier, then that supplier must be the
3 lowest cost provider to that customer and the Commission Rules
5 should not create a stranded cost for that consumer or increase
7 costs to that consumer.

9 **III. RESPONSE TO EACH OF THE ISSUES IDENTIFIED IN THE DECEMBER**
11 **PROCEDURAL ORDERS?**

13 **Issue No. 1 - Should the Electric Competition Rules be modified**
15 **regarding stranded costs? If so, how?**

17
19 A. Yes.

21 Q. Do you have any specific recommendations?

23 A. I believe the Rules should be modified with regard to stranded
25 costs. Specifically, I would propose that the term "verifiable"
27 in the definition found in R14-2-1601(a) be further clarified by
29 the following addition:

31 "Verifiable means proven by the Affected Utility by clear and
33 convincing evidence".

35 Recovery of stranded costs is an extraordinary activity. The
37 Affected Utility claiming such recovery should bear a significant
39 burden of proving that these costs are actually stranded. While
41 I am not an attorney, I am advised that the "clear and convincing
43 evidence" standard is a stringent one and appropriate for this
45 type of inquiry since the stranded costs will be paid.

47
49 Q. Do you have any comment about any other suggested changes to this
definition that have been included in other testimony?

1 A. Yes, I believe it was appropriate for the Commission to terminate
3 the acquisition of costs which are included in stranded costs as
5 of the date of the Rules being ordered into effect, December 26,
7 1996. Utilities had substantial notice before then of the Rules
9 being developed and implemented. Investments made after the
11 effective date of the Rules should be considered business risks.
13 Additionally, I believe the use of the term "value" in the
15 "before" test is valid. Certainly, assets that have previously
17 been scrutinized and allowed by the Commission need no further
19 scrutiny. But assets and obligations incurred between the
21 utility's last rate case and the effective date of the Rules
23 should be subject to question.

25 Q. Do you have any other suggestions with regard to changes in the
27 Rules?

29 A. Yes. Concerning the collection of stranded costs, I believe that
31 the Commission should retain the use of the term "feasible" in
33 R14-2-1607 and not accept the suggestions that have been made
35 about changing that term to "reasonable". The existing term is
37 an action-forcing mechanism. Changing to some reasonableness
39 standard only provides a wider range of excuses not to do
41 something. I believe that mitigation should apply to all
43 activities of an Affected Utility that can provide a source of
45 revenue, even if such activities are unregulated. Furthermore,
47 as unbundled rates become the norm, some activities currently
49 undertaken under bundled rates, such as metering and billing, may
end up being unregulated activities. I think utilities should

1 have the opportunity to mitigate costs by any legitimate means at
3 their disposal without reaching into the activities of holding
5 companies or sister corporations under such holding companies.

7 In addition, it is obvious that paragraphs C., D., E., and F.
9 will need to be stricken at some point in time because they
11 define tasks that have been accomplished. I would recommend that
13 a new paragraph C. be added to state a burden of proof as to
15 mitigation as follows:

17 "The Affected Utility shall be required to show by clear and
19 convincing evidence that all feasible, cost-effective
21 mitigation measures have been employed".

23
25 Q. Do you have any other suggestions about these Rules?

27 A Yes. The more testimony I read and the more debate we have over
29 stranded costs, the messier the subject becomes. The larger
31 Affected Utilities appear to believe that they can adjust to the
33 new economic conditions within the next five to seven years.
35 Utilities are already underway to restructuring services and
37 costs to their larger customers. Wouldn't the Commission,
39 utility customers and indeed the companies themselves be better
41 off if the Commission allocated more time to make business
43 decisions, and resolve technical issues and just not deal with
45 this subject? We have already seen major reaction by the biggest
47 of these utilities in Arizona to the upcoming competition without
49 these rules on stranded costs. What would happen if we allowed
the largest electric consumers in Arizona to go first? Aren't

1 they the most sophisticated and don't they have the greatest
3 potential to pay stranded costs? We could then let the next
5 largest group follow and finally get to the homeowners. Wouldn't
7 the companies have more time to make business judgments, inform
9 consumers and spend less time talking to lawyers this way? We
11 might even be able to keep the same tight time table in the Rule
13 (R14-2-1604).

15 **Issue No. 2 - When should "Affected Utilities" be required to make a**
17 **"stranded cost" filing pursuant to ACC R14-2-1607?**

19 Q. Do you have an opinion with regard to the above question?

21 A The Commission needs to set a timetable for stranded cost filings
23 that will allow it to make its determinations about stranded
25 costs being "verifiable" and "unmitigated" before such costs are
27 collected. The amount of time the Commission needs to do this
29 should be the lead time necessary for the filing.

31 **Issue No. 3 (pursuant to Procedure Order dated 12/1/97) - What costs**
33 **should be included as part of "stranded costs" and how should those**
35 **costs be calculated?**

37 **Issue No. 3 (pursuant to First Amended Procedural Order) - The**
39 **recommended calculation methodology and assumptions made**
41 **including any determination of the market clearing price.**

43 Q. What costs should be included as part of stranded costs?

45 A. Generation costs should be included as long as the assets were
47 acquired or the obligations incurred before the effective date of
49 these Rules. Any financial obligations after that should be

1 consigned to business risk. Generation costs already allowed in
3 the rate base need not be reexamined but costs and obligations
5 incurred in the interim between the utility's last rate case and
7 the effective date of these Rules should be subject to scrutiny.

9 Q. Do you have a recommendation with regard to the methodology for
11 calculating stranded costs?

13 A I am concerned about the testimony I have read about use of lost
15 revenues approach. Comparing revenues in a regulated environment
17 to revenues in an unregulated environment will be difficult. In
19 the former, there is a regulatory decision allowing a rate of
21 return on assets whose value has been determined and approved for
23 inclusion in a rate base. In the unregulated market, business
25 practice and competition will determine rates of return or profit
27 margins. The new margins may be more or less than such rates of
29 return in a regulated environment. The industry itself will set
31 these practices based on competition. At least in the interim,
33 resource margins are likely to become much tighter. Thus, the
35 utility should have to demonstrate that it has an asset that it
37 is not able to use or a cost that is not recoverable. This would
39 avoid the situation where the utility decides to lower prices and
41 therefore net revenues for competitive purposes and then turns
43 around and claims stranded costs because of such deliberately
45 lowered rates.

47 Issue No. 3 (pursuant to First Amended Procedure Order) - The
49 implications of the Statement of Financial Accounting Standards

1 No. 71 resulting from the recommended stranded cost calculation
3 and recovery methodology.

5 Q. Do you have an opinion about the implications of Statement of
7 Financial Accounting Standards No. 71?

9 A. No. I am not an accountant.

11 **Issue No. 4 - Should there be a limitation on the time frame over**
13 **which "stranded costs" are calculated?**

15
17 Q. Do you have a suggestion for a time limitation on the stranded
19 cost calculation methodology?

21 A. Yes. The purpose of retail access is to transform the regulated
23 power supplies to unregulated power supplies. Therefore, any
25 protracted stranded costs recovery will only delay the ultimate
27 transition to unregulated supplies, and create excessive
29 administrative costs. Either through payment of stranded cost
31 for a departing customer, or expiration of the period for
33 accessing stranded costs, stranded costs must have finality. The
35 stranded cost methodology should be used to provide a transition
37 and not to provide security for utility assets through the
39 remainder of their useful life. I believe that the time frame
41 should be set to cover a period of "regulatory upset". At the
43 very latest, that period should end at the end of 2006. Economic
45 adjustments after the fixed date should be a matter of business
47 risk. Otherwise the utility will take profits in good years and
49 cover losses through stranded costs in bad years, getting the
best of the regulated monopoly and unregulated worlds, but not

1 leaving much for the consumer.

3 Issue No. 5 - Should there be a limitation on the recovery time frame
5 for "stranded costs"?

7 Q. What time limitation on stranded cost recovery do you recommend?

9
11 A. I believe the amortization period for each customer to pay their
13 stranded cost should be dependent upon the utility and customer.
15 Flexibility will be necessary for the various utilities to
17 recover stranded costs from departing customers. For example, a
19 TDU Group utility may recover stranded costs through increased
21 water payments like a transmission owner is permitted to recover
23 wholesale stranded costs through a transmission surcharge.
25 Flexibility in the amortization period will enhance the
27 opportunity for customer choice by giving customers financing
29 options for stranded cost payments.

31 Issue No. 6 - How and who should pay for "stranded costs" and who, if
33 anyone, should be excluded from paying for stranded costs?

35 Q. Who should pay for stranded costs?

37 A. Customers departing to access the competitive marketplace should
39 pay for that advantage, if stranded costs are to be collected.
41 Broad base charges or surcharges on all customers, even those
43 remaining behind with bundled service from the utility, would
45 amount to nothing more than a tax.

47 Q. How should stranded costs be collected?

49 A. I believe that exiting customers should pay a predetermined

1 stranded cost fee based on a net profit formula calculated over a
3 four to seven year period as determined by the Commission. The
5 proceeds would be deposited in a fund with interest and paid to
7 the Affected Utility upon successful proof that it had incurred
9 stranded costs under these Rules. The stranded cost fee would be
11 charged only the first time a customer transferred from current
13 regulatory service to competitive service. Collection of the
15 stranded cost fee could be staged over a longer collection
17 period as long as the customer remained in Arizona and received
19 service from an Affected Utility.

21 **Issue No. 7** - Should there be a true-up mechanism and, if so, how
23 would it operate?

25 Q. Do you recommend the establishment of a true-up mechanism?

27 A. I don't believe a continuous true-up mechanism would be necessary
29 if a direct assignment method and refund is employed. The
31 Commission would set a formula that determined a fixed amount of
33 money as a one-time amount or staged fee for entering
35 competition. The money could be collected into a fund subject to
37 refund to the customer if the utility failed to demonstrate that
39 it incurs its claimed stranded costs. Since real money would be
41 involved in real dollar decisions, no "true-up" would be
43 necessary once the cost is proven. The proof requirements of
45 the utility would take care of that.

1 Issue No. 8 - Should there be price caps or a rate freeze imposed as
3 part of the development of a stranded costs recovery program, and if
5 so, how should it be calculated?

7 Q. Do you recommend price caps or a rate freeze?

9 A. No. The idea is to deregulate prices and market forces should be
11 allowed to work.

13 Issue No. 9 - What factors should be considered for "mitigation" of
15 stranded costs?

17 Q. What limits should the Commission make to mitigation activities?

19 A. The Commission should not limit any Affected Utility in efforts
21 it might make to mitigate stranded costs. These would include
23 both regulated and unregulated activities that the utility may
25 undertake under State law. Since some bundled activities may end
27 up unregulated when unbundled, the concept of "traditional"
29 utility activities may have little relevance in the future.

31 Q. **HAVE YOU PRIORITIZED THE ISSUES ADDRESSED IN YOUR TESTIMONY AS
33 REQUESTED BY THE DECEMBER PROCEDURAL ORDERS?**

35 A. No, I have followed the order of the questions. Because of the
37 interdependence of the subjects covered, relative priority is
39 difficult to assess. Since the purpose of this process is to
41 consider Rules amendments, that is obviously the first priority.

43 Q. **DO YOU HAVE ANY OTHER OBSERVATIONS ABOUT THESE RULES RELATED TO
45 STRANDED COSTS?**

47 A. Yes. Without finality, stranded costs will be headed toward a
49

1 process that could be more complicated and time-consuming than
3 current rate cases. We would then be merely substituting one
5 form of regulation and costs for another, not deregulating the
7 sale of electricity or decreasing the price of electricity at
9 retail in Arizona. There ought to be a better way of doing this.

11 Q. DOES THAT CONCLUDE YOUR TESTIMONY?

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15 A. Yes. It does.
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STATEMENT OF QUALIFICATIONS

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Mesa, Arizona 85201-6764

(602) 610-8741

Kenneth R. Saline is the principal partner in K.R. Saline & Associates, a consulting engineering firm located in Arizona. Mr. Saline provides electrical power consulting services to numerous irrigation districts, electrical districts, federal, state and municipal utilities located in Arizona, New Mexico and Nevada. Mr. Saline is a registered professional electrical engineer in the State of Arizona.

Mr. Saline graduated from New Mexico State University in 1980 with a Bachelor of Science degree in Electrical Engineering with power system emphasis. Mr. Saline worked for four years at San Antonio Public Service Company, a municipal electric and gas utility, as a transmission planning engineer. At San Antonio, Mr. Saline performed planning studies of the city's transmission systems including interconnected EHV transmission and stability studies in various Electric Reliability Counsel of Texas (ERCOT) committees. Mr. Saline represented the city in the ERCOT Engineering Subcommittee, Loadflow Task Force, EHV Task Force, Power Transfer Task Force and Transient Stability Task Force. During this period, these ERCOT task forces established the wholesale power brokerage system, Megawatt-mile transmission wheeling methodology, and the first transient stability analysis of the interconnected ERCOT EHV system.

Following San Antonio, Mr. Saline worked for R.W. Beck and Associates for seven years as an engineering consultant. At R. W. Beck, Mr. Saline assisted public utilities in applying for allocations of Hoover power, Salt Lake City Integrated Projects power, and Parker-Davis Project power. He participated in the preparation of Consulting Engineer's Reports used in Official Statements issued for revenue bond financing and assisted in the start-up of five new municipal utilities who were established to utilize Hoover power entitlements in Arizona. He assisted these utilities in wholesale power supply and wheeling contract negotiations, power supply planning and development of customer policies, rates and regulations for service to their customers.

Currently Mr. Saline provides ongoing consulting engineering services and management consulting to various public utility clients within Arizona with regard to their long-term and short-term electric operations. In this capacity he is responsible for power scheduling, economic studies, power supply studies, transmission studies, rate analyses, contract negotiations and customer service policies. His representation of these entities includes recommendations to federal and state agencies and he negotiates necessary programs, contracts and policies on their behalf.