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IN THE MATTER OF THE STRANDED COST FILING AND REQUEST FOR A A WAIVER OF CERTAIN PORTIONS OF THE RULES FILED BY NAVOPACHE ELECTRIC COOPERATIVE, INC.) DOCKET NO. E-01787A-98-0465

IN THE MATTER OF THE STRANDED COST FILING AND REQUEST FOR A WAIVER OF A.A.C. R14-2-1607.D FILED BY TRICO ELECTRIC COOPERATIVE, INC.) DOCKET NO. E-01461A-98-0466

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STAFF'S COMMENTS REGARDING STRANDED COSTS PROPOSALS FILED BY THE AFFECTED UTILITIES

IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR APPROVAL OF ITS PLAN FOR STRANDED COST RECOVERY AND FOR RELATED APPROVALS, AUTHORIZATIONS AND WAIVERS.	DOCKET NO. E-01933A-98-0471
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IN THE MATTER OF THE STRANDED COST COMPLIANCE FILING OF ARIZONA PUBLIC SERVICE COMPANY	DOCKET NO. E-01345A-98-0473
IN THE MATTER OF THE FILING OF THE STRANDED COST OPTIONS AND IMPLEMENTATION PLAN OF CITIZENS UTILITIES COMPANY	DOCKET NO. E-01032C-98-0474

STAFF'S COMMENTS REGARDING STRANDED COSTS PROPOSALS FILED BY THE AFFECTED UTILITIES

I. INTRODUCTION.

Decision No. 60977 required the Affected Utilities to file their proposals for stranded cost recovery by August 21, 1998. Other interested parties are required to file their comments concerning the proposals by September 21, 1998. Staff of the Arizona Corporation Commission ("Staff") hereby files its comments concerning the proposals and also suggests an appropriate process for their review.

II. STAFF'S SUGGESTED PROCEDURE.

Staff suggests the following procedures in these matters. Staff will review the comments filed by the interested parties, in addition to continued its review of the Affected Utilities' stranded cost recovery proposals,. Staff will file its report concerning the stranded cost proposals and the comments by the other parties on or before November 13, 1998. The Staff Report will include Staff's own analysis, evaluation and recommendations concerning the proposals and comments filed by the other parties. Thereafter, hearings may be scheduled on the proposals in individual dockets, if necessary.

III. STAFF'S COMMENTS ON THE AFFECTED UTILITIES' STRANDED COST PROPOSALS.

A. Tucson Electric Power Company ("TEP")

Tucson Electric Power (TEP) has filed a divestiture plan and is requesting an interim Competitive Transition Charge (CTC) as well as a longer-term adjustment of the CTC. TEP is proposing to auction off all of its generating assets and contracts. The sale of the generating assets which TEP owns should be similar to other auctions. However, a large proportion of TEP's resources are no longer owned directly by TEP, but are owned by a subsidiary with which TEP has lease/buyback agreements and are also complicated by coal purchase agreements. The value of divestiture might be reduced by the lease/buyback agreements and by the Company's expectation that it may lose two-county financing.

Staff is investigating what the impact of the total divestiture will be on ratepayers. Staff notes that the 50% retention clause in Decision No. 60977 refers to a *net* benefit on *all* facilities divested. TEP should not expect to retain 50% of the gain on facilities sold at a price exceeding net book value. It is possible that a more limited divestiture may produce more benefits than a total divestiture. A minimum acceptable sales value for the total package should be developed to avoid the possibility of ratepayers being held responsible for greater stranded costs than would be incurred absent divestiture.

There are several issues regarding the calculation of an interim CTC. TEP is proposing an interim CTC which is based upon market futures prices as well as the Dow Jones Palo Verde Index. A more thorough review of this methodology and its implications should be made.

TEP's divestiture plan contains a provision that it would be allowed to reject any and all bids for an asset if deemed unacceptable as determined in the Company's sole discretion. This raises several concerns for Staff. It appears that TEP only will make this decision with no contemplation of Commission approval. The Company does not provide any explanation of the reasons or criteria it would use to reject bids on assets.

The Company discusses the issues surrounding divesting assets financed with Two-County Bonds but has not addressed any potential issues surrounding the divestiture of assets financed with pollution control bonds.

TEP has not proposed any methods or strategies to reduce the stranded costs that it will seek recovery of from its ratepayers. This is an explicit requirement in the stranded cost decision.

B. Arizona Public Service Company ("APS")

Arizona Public Service Company (APS) has not identified which option it is electing for stranded cost recovery as required by Decision No. 60977. APS' application does not include a divestiture/auction methodology. APS is proposing a stranded cost recovery plan which provides credits to existing rates for generation, while billing the Electric Service Provider (ESP) of competitive generation for the associated transmission, distribution and related billing, and metering and ancillary services. The approach taken by APS will produce results that are very favorable to the utility and are very disadvantageous to ratepayers.

APS' original unbundled tariff filing calculated related billing, metering and customer information services credits by determining the avoided cost of providing these services, which is generally lower than the embedded cost of providing these services as was contemplated by the Rules. This approach would inhibit the development of competitive services by other providers in APS' service territory.

Another disadvantage to the approach that APS is proposing is that since the distribution rate is not defined, after January 1, 2001 when the utility becomes a distribution company, future ratemaking will require analysis of distribution-only revenue requirements. Without functional unbundling at this point in time, future ratemaking will be more difficult. This method will also allow parties to future proceedings to relitigate stranded cost amounts at that time.

The Company's stranded cost filing does not identify a CTC. Under the APS approach, the amount of stranded costs that will be collected over the six-year period is unknown. APS' filing takes a snapshot of its generating plants revenue requirements for a six (6) year period to quantify its estimated stranded costs. Staff has taken the position that stranded cost calculations must reflect the revenue stream to be achieved over the life of the generating station to capture future benefits when market revenues are greater than embedded costs. An administrative determination of stranded costs should attempt to determine what the sale of the generating unit would achieve. In an auction, the bidders estimate the total value they will collect over the life of the assets they are purchasing. The bid price is generally a net present value of that revenue stream. Because APS' interpretation of the financial viability model only addresses near-term revenue shortfalls, its stranded cost filing does not recognize that market prices will be higher than its units' costs in the future. Ratepayers are asked to pay for near-term shortfalls between embedded costs and market prices, but will never receive the benefits in the future when the units will be producing benefits (revenues greater than costs) for their owners.

APS has not proposed any mitigation strategies such as sales to its competitive affiliate, or other new wholesale sales as potential opportunities to reduce stranded costs. The Commission's decision explicitly requires some mitigation of stranded costs.

C. Citizens Utilities Company ("Citizens")

Citizens Utility Company (Citizens) filed its preliminary election of Option 1-Divestiture/Auction Methodology. Citizens filed a divestiture plan with a request for an initial (interim) Competitive Transition Charge (CTC) and a longer-term adjustment of the CTC over a 10-year period. Citizens is proposing to divest its generating resources, except for the Valencia units. This portfolio consists entirely of a long-term power supply contract with Arizona Public Service (APS) which also contemplated the construction of a combustion turbine facility by Citizens. Citizens is not proposing any stranded cost recovery before full competition begins on January 1, 2001. Mitigation efforts will materialize if Citizens is successful in negotiating with APS for reduced charges under the supply contract.

In addition, the Company is requesting inclusion in its CTC of a significant amount of estimated stranded metering and billing costs and "new functions required under competition". Staff would recommend against inclusion of any such estimates of non-generation related costs in the initial (interim) CTC.

Citizens is also proposing an "Enhanced Divestiture Plan" which appears to sell a portion of Citizens' Certificate of Convenience and Necessity (CC&N). The portion to be "sold" would be the power supply portion of the CC&N. This Enhanced Divestiture Plan appears to be

Citizens' future means of securing power for standard-offer customers. By requiring the payment of an acquisition fee for the right to supply power to standard offer customers, Citizens will attempt to retain 50% of the fee which might otherwise be reflected in the provision of service to the standard-offer customers without this proposed sale by Citizens. Citizens has not identified what happens to the CC&N which is sold as standard-offer customers exercise choice and select an alternate provider for generation.

Citizens has quantified regulatory assets of approximately $3 million. These relate to previously-deferred demand side management (DSM) program expenditures and DSM lost net revenues, which will be stranded by the implementation of competition. The Commission has authorized the deferral of the lost net revenues but has not approved the recovery of the deferrals to date.

When determining the appropriateness of the auction/divestiture proposal, Staff would recommend establishing a minimum level of revenues to be received as a benchmark for assessing the success or failure of the auction process. To establish this minimum level of revenues, stranded costs should be calculated.

Citizens also speculates that it may have stranded costs associated with their distribution system. Citizens refers to meter equipment and related billing and accounting systems that may be stranded if competition is introduced into its service territories. There are no specific stranded costs provided for distribution systems in Decision No. 60977.

It is Staff's position that at this point whether there are any distribution stranded costs is unknown, and it is premature to actually address alleged stranded costs related to distribution or potential transition costs that have not yet been incurred. Staff would note that if distribution-related stranded costs occur at some future date, Citizens could bring those matters to the Commission at that time. Staff also notes that just as with any other stranded cost, Citizens is under an obligation to mitigate those costs, if any.

D. Arizona Electric Power Cooperative, Inc. ("AEPCO")

AEPCO is electing Option 2-Transition Revenues Methodology stranded cost recovery. AEPCO is requesting a Regulatory Asset Surcharge of $.0033 per kilowatt-hour for five years and a Competitive Transition Charge of $.0125 per kilowatt-hour for five years or "so". Staff would note that AEPCO has provided very limited projections of operating income, debt service costs, or other financial information to demonstrate the need for transition revenues to maintain financial viability. For purposes of financial viability, AEPCO's application states that a debt service coverage of 1.0 is the minimum required to avoid default on its mortgage.

AEPCO has included estimated costs to decommission the Apache generating plant, a coal-fired generating station, in its calculation of stranded costs. For purposes of mitigation measures, AEPCO proposes to include the generation of revenues from other sources such as contract sales, other electric revenues and out-of-state Class A member sales. These revenues in 1999 were close to the AEPCO projected market price.

AEPCO's filing segregates its request for transition revenues into regulatory asset recovery and other stranded costs recovery. The following are classified by AEPCO, in its filing, as regulatory assets:

1) Debt-related regulatory assets;
2) Carbon Coal-related regulatory asset.

AEPCO proposes a five (5) year recovery period for these regulatory assets. The existing recovery period for the debt-related costs varies from 12 to 19 years, matching the maturity of the debt issue. The current recovery period for the deferred carbon coal costs is an eight (8) year period.

AEPCO is proposing a charge of $.0033/kwh for all unbundled and standard offer rates at the member distribution level to accelerate the recovery of these regulatory assets. AEPCO requests that the Commission authorize it to add the surcharge to its Class A-member distribution cooperatives' tariffs. Staff does not believe a distribution rate for member cooperatives is the appropriate vehicle for collection of this charge. AEPCO may receive authorization for an allocation to distribution cooperatives, but a per kilowatt-hour charge for distribution customers may not be an appropriate method to accomplish this.

In Decision No. 60977, the Commission found that stranded cost or other transition revenues authorized by the Commission should be collected over no longer than 10 years, although particular circumstances and objectives may dictate a shorter or longer period. (Decision at page 23) AEPCO is requesting a recovery period for regulatory assets that would accelerate the current recovery period into a much shorter transition period, which would increase the cost to all unbundled tariffs and standard offer rates.

Staff does not recommend condensing the recovery period of the regulatory assets in AEPCO's case because the amortization of the regulatory assets is designed to match the period over which the benefit of reductions in interest and fuel costs will be realized by the Company. To modify the amortization of the regulatory assets in this instance would cause a mismatch resulting in the loss of the future benefit of reduced costs for customers, and justification for this has not been demonstrated.

In addition, AEPCO proposes an initial Competitive Transition Charge (CTC) to be applied to all kilowatt-hours sold competitively within AEPCO's Class A-members' service territories. In addition, the CTC should be authorized in conjunction with a "true–up" procedure. AEPCO expects to need a CTC for a five (5) year period. AEPCO is projecting an initial CTC of $.0125/kwh based upon its 1999 revenue requirement calculation and an assumed market price of $.03/kwh. A true up would be computed and based on actual market price and would result in a new CTC in July of 2000. This process would repeat on an annual basis.

AEPCO is proposing a five (5) year transition period for application of a competitive transition charge. This proposal ignores the potential for future above-market revenues from AEPCO's generating asset. Ratepayers are asked to pay for near-term shortfalls between embedded costs and market prices, but will never receive the benefits in the future when the units will be producing benefits (revenues greater than costs) for the owner.

E. Distribution Cooperatives ("Coops")

Duncan Valley Electric Cooperative, Inc. ("Duncan Valley"), Graham County Electric Cooperative, Inc. ("Graham County"), Trico Electric Cooperative , Inc. ("Trico") and Sulphur Springs Valley Electric Cooperative, Inc. ("Sulphur Springs") collectively referred to as "Coops", have all filed similar requests for stranded cost recovery and waiver of the Commission Rules. The Coops have requested waiver of the application of A.A.C. R14-2-1607.D to allow the

Coops additional time to determine stranded costs, if any, and their alleged obligation to supplement Arizona Electric Power Cooperative, Inc.'s ("AEPCO") recovery for stranded cost allowed by the Commission. The waiver requests filed by the Coops indicate that they are unable to complete their filings at this time because of insufficient information to quantify any stranded costs. Staff does not oppose the request, with certain conditions as discussed below.

1. Conditions for approval of the waivers.

Staff recommends that if the Commission grants the Coops' requests for a waiver of A.A.C. R14-2-1607.D, that the waiver be granted for a time certain, such as through March 31, 2002, with reporting requirements that demonstrate that the Coops are actually in the process of determining any alleged stranded costs. During the period of the waiver, the Coops should also be required to demonstrate through timely reporting, their attempts to lower the costs of the power they purchase. For example, power costs may be lowered through negotiations with AEPCO and the RUS, and also, through their attempts to purchase lower-cost power in the competitive market. Although the Coops have alleged in their filings that they have obligations to purchase their power from AEPCO, the Coops, like all Affected Utilities, are required to mitigate any alleged stranded costs under the Rules. None of the filings by the Coops indicate specific mitigation attempts to either renegotiate their contracts with AEPCO (or AEPCO's renegotiation of contracts with RUS) to lower the costs of power. Further as indicated above, the filings do not indicate any attempt to obtain lower costs for power in the competitive wholesale market.

2. Distribution stranded costs.

In addition to their waiver requests, the coops also speculate that they will have stranded costs associated with their distribution systems. The filings refer to meter equipment and related billing and accounting systems that may be stranded if competition is introduced into their service territories. There are no specific stranded costs provided for distribution systems. The Coops indicate that once competition is implemented in their service territories that they will know the nature of the alleged distribution stranded costs.

It is Staff's position that at this point whether there are any distribution stranded costs is unknown, and it is premature to actually address alleged stranded costs related to distribution. If such stranded costs occur at some future date, the Coops can bring those matters to the Commission at that time. Staff does note, just as with any other stranded cost, the Coops are under an obligation to mitigate these costs, if any. No discussion is provided in the filings concerning mitigation of any alleged distribution costs. If a waiver is granted to the Coops, the waiver should specifically require that the Coops identify potential alternatives for mitigation for distribution stranded costs, if they intend to claim the same in the future.

3. Generation stranded costs.

The Coops also indicate that a favorable outcome of AEPCO's request for stranded cost recovery is sought by the Coops. The favorable outcome they seek is that AEPCO would be awarded stranded cost recovery as set forth in AEPCO's application filed on August 21, 1998. Apparently, the Coops believe that a favorable result in these matters is to have AEPCO pass on its stranded costs to the Coops, which in turn will pass these costs on to their member customers. From the Coops' customers' point of view, it would seem that just the opposite would be true. The less stranded costs awarded to AEPCO (lowered either through mitigation or otherwise), the more favorable the outcome for the member customers who may have to pay them. That is why Staff has suggested herein that the Coops be required to seek renegotiation of their contracts with AEPCO and/or AEPCO with RUS during the period of the waiver to reduce any alleged stranded costs that might be passed on to the Coops' member customers.

It is also interesting to note that the Coops indicate that they are reserving their right to make filings as necessary to supplement the recoveries that the Commission allows AEPCO, in order to pass on these supplements to AEPCO's cost recovery to the Coops' customers. Apparently the Coops believe that if the Commission does not award AEPCO all of its stranded costs, this would result in an inadequate allowance for AEPCO, which they would seek to supplement. It is difficult to understand why the Coops' customers would seek to supplement AEPCO's stranded cost recovery in a competitive market. Mitigation of these costs through obtaining low cost power would seem to be a more optimum result. In light of this, Staff recommends that if waivers are granted, the Coops be required to demonstrate attempts to renegotiate their contracts to reduce stranded costs. They should also be required to demonstrate any specific attempts and successes to obtain lower cost wholesale power in the competitive environment mandated by the Commission's rules.

F. Mohave Electric Cooperative, Inc. ("Mohave") and Navopache Electric Cooperative, Inc. ("Navopache")

Two other cooperatives have also filed for waivers, Mohave Electric Cooperative, Inc. ("Mohave") and Navopache Electric Cooperative, Inc. ("Navopache"). Mohave and Navopache indicated that they have insufficient information at the present time to determine if they have any stranded cost and to determine the amount of such cost.

Mohave also refers to its contractual relationship with AEPCO as a reason why it cannot determine its stranded cost until AEPCO's recovery for unmitigated stranded cost is acted upon by the Commission. Navopache refers to its contractual relationship with Plains Electric Cooperative, Inc. as a basis for waiver due to the uncertainty of Plains' status related to stranded cost in other jurisdictions. If waivers are granted to the other Coops, similar waivers with the recommended conditions identified above, should also be granted to Mohave and Navopache.

IV. CONCLUSION.

Staff requests that a procedural order reflecting Staff's suggested date for filing its Staff Report be issued. If hearings are necessary in individual dockets, Staff requests that these hearings be scheduled subsequent to the filing of its Staff Report on November 13, 1998.

RESPECTFULLY SUBMITTED this 21st day of Sept., 1998

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