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NEW APPLICATION

BEFORE THE ARIZONA CORPORATION COMMISSION

AZ CORP COMMISSION

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IN THE MATTER OF THE COMPETITION)
IN THE PROVISIONS OF ELECTRIC) DOCKET NO.________
SERVICES THROUGHOUT THE STATE)
OF ARIZONA) **NOTICE OF FILING**

Citizens Utilities Company hereby provides Notice of Filing its Stranded Cost Options and Implementation Plan, as required by the Commission's Order No. 60977. Citizens will file Appendices A, B, and C on Monday, August 24, 1998, as late filed Exhibits.

RESPECTFULLY SUBMITTED this 21st day of August, 1998.

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Citizens Utilities Company

Stranded Cost Options and Implementation Plan

August 21, 1998

EXECUTIVE SUMMARY

Citizens is pleased that the Commission has adopted an auction/divestiture approach to generation-related stranded cost valuation, an approach Citizens has supported since the inception of these proceedings. By taking this path, the Commission enables the restructured industry to move forward unencumbered by the past and in a way that can fairly allocate costs and benefits among the market participants. Citizens is firmly committed to remaining an active participant in the Arizona restructuring process as it unfolds.

Citizens believes that this docket is an opportunity to present innovative approaches and solutions to issues that must be resolved to effectively bring competition to the generation of electricity on Arizona. Citizens is aware that some of the proposals presented in this filing may present minor conflicts with the provision of the Emergency Rules, or may involve regulatory solutions that would not have been considered or even possible under traditional ratemaking. Citizens believes that forward-thinking approaches are necessary to successfully implement electric competition.

It is Citizens' understanding that provisions of the Electric Restructuring Rules are to be revisited in the "permanent' rulemaking that has been proposed for this fall. Citizens will also advocate the approaches set out in this filing in the formal rulemaking. However, the Commission will ultimately complete the formal rulemaking and the Company's final stranded-cost plan will, of course, comply with the final rules.

A. Citizens' Divestiture Plans

Citizens has developed two divestiture plans, a "Base Divestiture Plan" and an "Enhanced Divestiture Plan." Section I of this filing discusses the Base Divestiture Plan and Section II covers the Enhanced Divestiture Plan.

1. Citizens' Base Divestiture Plan

Citizens currently provides 100% of its power to its Arizona customers through a long-term term, power-supply contract with Arizona Public Service (the "APS Contract"). Under the Stranded-Cost Rule[1], the APS Contract is considered to be a generation asset.[2] Citizens' stranded costs derive mainly from the APS Contract. Because Citizens voluntarily divests all of its generation assets through an open auction to an unaffiliated third party, Citizens will be eligible for the opportunity to recover 100% of its stranded costs.[3] As recognized by the Commission, the major benefit of the auction and divestiture approach is that it allows the competitive market to directly value the amount of Citizens' generation-related stranded costs.

Citizens intends to solicit bids to assume the APS contract by December 31, 1999. Bids would be due by March 31, 2000, with the award to the winning bidder by April 30, 2000. Title would pass on December 31, 2000. Stranded-cost recovery would begin with a surcharge on service rendered on and after January 1, 2001.

From now until January 1, 2001, Citizens will attempt to mitigate the total amount of its stranded costs by commencing negotiations with APS to reduce the charges under the APS Contract and to restructure its terms to make it more attractive in the auction.

2. Citizens' Enhanced Divestiture Plan

Citizens' Base Divestiture Plan fully complies with the Commission's Stranded Cost Order and its Competitive Rules. Citizens also developed an Enhanced Divestiture Plan that would further enhance the Base Divestiture Plan. The Enhanced Divestiture Plan will (a) more quickly implement competition in Citizens' service territory, (b) bring more benefits to those customers that elect to continue to receive standard-offer service, and (c)

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[1] A.A.C. R14-2-1607

[2] A.A.C. R14-2-1601(39).

[3] Commission Decision No. 60977, at 10.

offset the amount of stranded-cost recovery for which Citizens' customers would otherwise be responsible.

The cornerstone of the Enhanced Divestiture Plan is Citizens' relinquishment and auctioning of the power-supply portion of its Certificate of Convenience and Necessity ("CC&N"). This is the right to provide power to Citizens' standard-offer customers through Citizens' transmission and distributions facilities. Citizens would retain its Transmission & Distribution ("T&D") CC&N and continue to provide regulated T&D service at rates bundled with the power-supply component.

A requirement for each bidder would be to guarantee a six-percent reduction in the power-supply component of the bundled rate for the first three years after the CC&N is split and the new power-supply CC&N is granted by the Commission. Standard-offer customers would then receive a two-part bill containing a regulated T&D charge for service provided by Citizens and a fixed standard-offer power-supply charge provided by the winning bidder.

The power-supply CC&N would be issued by the Commission for three years. Each three years, the certificate holder would have to offer the CC&N to other bidders, based solely on lowest, reliable delivered power costs. The incumbent provider would have the option of matching the winning bid and retaining the CC&N for another three years.

Each bidder in the initial supply round would bid an "acquisition fee" for the right to be the power supply provider. Citizens believes this may be substantial: the new entrant would gain a beachhead to the Arizona power market through overnight access to one of Arizona's fastest-growing power markets (Mohave County). This would provide a critical customer mass to justify creating marketing, education and customer-support functions. It could also provide a laboratory in which to work out the bugs in the transition to a competitive market. Also not to be overlooked would be the opportunity to earn potentially significant margins on the power sales, while still reducing the standard-offer customer's power-supply costs.

The Commission has ruled that if an Affected Utility is able to divest its generation assets at greater than book value, it can split the excess with its customers 50-50.[4] Consistent with this rule, Citizens would split the access fee 50-50 with its customers. The 50-percent customer share would be used to offset Citizens' stranded costs, dollar for dollar.

The Enhanced Divestiture Plan can only be offered with Commission approval. Citizens sees no downside; the worst-case would simply be that no marketer would bid for Citizens' power-supply CC&N. In that case, the Enhance Divestiture Plan would simply default to the Base Divestiture Plan and Citizens would retain the full CC&N. Citizens urges the Commission to approve both plans.

B. Classification of Valencia Power Station as Transmission

Because of their operation solely for local reliability purposes, Citizens should retain its Valencia generation facilities, located in Nogales, Arizona, as part of its regulated operations. The associated Valencia cost of service would be included in charges for transmission service. This is discussed in greater detail in Section III of this filing.

C. Citizens' Stranded Cost Estimate

Citizens was required to estimate its stranded costs for this filing. Citizens emphasizes that this estimate is preliminary; actual stranded costs associated with generation will be determined by the auction and divestiture procedure. Section IV of this filing (together with Appendix A and Appendix B) details these estimates. These costs include one-time, as well as on-going costs over a twelve-year period, from January 1, 1999 to December 31, 2010.

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[4] Decision No. 60977 at 12

In total, the revenue requirement to recover these costs over ten years (01/01/01 – 12/31/10) is estimated to be approximately $57 million dollars in present-value terms.

1. Generation Assets

Citizens' generation-related stranded costs, totaling an estimated $46.5 million, are associated with the APS Contract and its planned construction of a combustion turbine and associated transmission facilities in Mohave County. Background information and a brief description of how stranded cost estimates were developed for these elements follows:

APS Contract – The APS Contract includes three power supply schedules one of which, Schedule A, contains provisions for 100 megawatts (MW) of take-or-pay baseload capacity that Citizens is obligated to purchase through 2011. As described in Section V of this filing, Citizens forecasted the market price of electricity over the term of the contract and compared these prices with the cost of deliveries under Schedule A to assess the degree of stranded costs. The net present value difference in these values over the term of Schedule A is approximately $43 million in stranded costs, assuming the contract is divested as of December 31, 2000.

In addition to these costs, Citizens has included in the stranded generation estimates its cost estimates: (i) to conduct the contract bid process ($100,000); (ii) to pursue re-negotiation efforts for contract mitigation ($175,000); and (iii) to terminate the Company's Purchased Power and Fuel Adjustment Clause, which would reduce stranded cost by approximately $1 million.

Mohave Combustion Turbine and Transmission Facilities – As set forth in its 1992 and 1996 Integrated Resource Plans, Citizens has pursued the development of a combustion turbine power plant and associated transmission facilities as a least-cost solution to meeting load requirements in Mohave County, the fastest growing area of Citizens' Arizona electric service areas. With the advent of electric competition, Citizens will be unable to recover the costs of these facilities.

The combustion turbine facility was to be constructed and operated for Citizens on the basis of a long-term power purchase agreement with APS ("APS PPA"). As described in Section V, the costs to cancel the APS PPA are an estimated $1.9 million. In addition, Citizens has completed preliminary engineering, permitting, and right-of-way acquisition for the transmission facilities needed to deliver power from the turbine to load centers in Mohave County. Section V provides the background information on the costs stranded as a result of abandoning this transmission project, an estimated $2.1 million.

2. Regulatory Assets

Citizens' main regulatory assets that would be stranded by the implementation of competition are its previously-deferred DSM expenditures and DSM lost net revenues.[5] These total approximately $3.0 million. Part B of Section V (together with Appendix B) summarizes Citizens' DSM efforts and expenditures; reviews the load impacts caused by DSM programs; assesses DSM lost net revenues; and evaluates, from both societal and utility perspectives, the cost-effectiveness of the programs. In total, this evaluation shows that Citizens' DSM programs have provided over $2 million in net economic benefits to Citizens' customers.

3. Metering and Billing

The opening of metering and billing functions to competition exposes Citizens to additional strandable costs. As customers select competitive suppliers for metering, meter reading, and/or billing and collections functions, Citizens will realize immediate reductions in revenue and certain variable costs. However, certain costs associated with these functions, which are fixed over the short term, such as administrative & general ("A&G") costs, will not be immediately reduced when customers take competitive services. To estimate these stranded costs, Citizens has first estimated the decremental variable costs associated with metering and billing functions. The difference between the unbundled service charges and the decremental variable costs for these functions represents Citizens' estimate of stranded costs. Citizens estimates these costs to be approximately $1.1 million in present value over the ten-year stranded cost recovery period.[6]

4. New Functions Required Under Competition

The introduction of competition into the electric industry brings with it new costs and requirements for regulated Utility Distribution Companies (UDC). In its Unbundled Rates filing, Citizens identified four broad areas for these new functions: energy supply and demand transactions; operational processes; regulation; and customer communication and education. In total Citizens estimates these costs to include a one-time development cost of $1.8 million and on-going support costs of $4.1 million[7] in present value terms over ten years. A description of each of these new functions is provided below:

Energy Supply and Demand Transactions – The new functions in this area include: load profiling for residential and small commercial loads; schedule coordination for standard-offer and competitive transmission; Citizens' costs to support the Independent System Administrator; and the requirements for standard offer information disclosure per the Commission competition rules.

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[5] In preparing this preliminary estimate, Citizens has not evaluated the effect of related deferred income taxes on previous expenditures.

[6] It is not clear whether these costs are properly recovered as part of Citizens' CTC or its T&D charges. For purposes of this filing, they are presented as stranded costs.

[7] *Id.*

Operational Processes – The new operational functions include: management of multiple providers; development and operation of new information and accounting systems; and handling increased customer service activities.

Regulation – The introduction of competition has required Citizens to undertake significant new activities to support filing requirements for unbundled rates and stranded cost valuation and recovery. Additionally, the electric competition rules specify increased regulatory reporting requirements.

Customer Communication and Education – All parties to the Arizona electric competition docket agree that there is a need for extensive customer communication and education. The Commission working group on this issue has developed a set of recommendations for the type and level of communications and educational activities needed, which form the basis of our estimates.

5. Total Estimated Stranded Costs

The one-time costs and 10-year present value of on-going costs for each of the four stranded cost categories are:

	One-time Costs	On-going Costs
Generation	$46.5 Million	
Regulatory Assets	$3.0 Million	
Metering and Billing		$1.1 Million
New Functions	$1.8 Million	$4.1 Million

I. BASE DIVESTITURE PLAN

Citizens generation-related strandable costs are associated with three key elements:

1. A portion of its APS Contract with long-term obligations to buy power that Citizens estimates is priced above-market;

2. The APS PPA associated with a peaking generation facility (yet to be built), which contains long-term payment obligations which are unrecoverable by Citizens as a regulated distribution company; and

3. Investments in transmission facilities to bring power from the peaking facility to load centers in Citizens' Mohave County service area.

The APS Contract will be divested under Citizens' Base Divestiture Plan. The APS Contract contains three power delivery schedules, Schedules A, B and C. Schedules B and C are tied to Citizens' load levels and existing Valencia generation capacity and consequently can not be practically divested. These will instead be cancelled. Schedule A, however, which includes power delivery rights to 100 MW of firm capacity and energy at 100% load factor, can be sold to a third party. As demonstrated in Section IV, the price of the 100 MW of power is higher than Citizens' forecast of the market price for a majority of the years remaining in the term of the contract.

Citizens' Base Divestiture Plan would be carried out in the following manner:

1. **By January 1, 1999**. Notify APS of Citizens' intent to terminate Schedules B and C power deliveries by 1/1/2001.

2. **By December 31, 1999**. Put the power delivery rights to the Schedule A 100 MW block out to open bid to pre-qualified bidders, with bids due by 3/31/00. Bids could be negative or positive. If a bidder believes that the APS Contract is above market, it would submit a negative bid equal to the amount it would take for it to assume the contract. If the bidder believes that the APS Contract was of positive value, it would make a positive bid. APS would be

allowed to bid by submitting a contract buyout bid, positive or negative, which, if accepted, would allow APS to cancel the contract and keep the power.

3. **By March 31, 2000**. Bids received by Citizens.

4. **By April 30, 2000**. Winning bid awarded. This would also establish Citizens' stranded costs (positive or negative) associated with the APS Contract.

5. **By December 31, 2000**. APS Contract assigned.

6. **On January 1, 2001**. Stranded cost recovery begins. If stranded costs are negative, refunds to customers would begin.

During this time period, it is expected that construction will begin on one of the two planned Mohave County generating facilities. Because each of these projects would exceed 500 MW of capacity, either would obviate the need for Citizens to purchase power from the planned APS 75 MW peaking facility set forth in the APS PPA. Citizens also believes that its planned Mohave County transmission project would then be unnecessary. Accordingly, Citizens would cancel both projects.

Citizens entered the Agreement and pursued construction of the transmission project through the Commission's Integrated Resource Planning ("IRP") process and as a part of the obligation to serve under its regulated franchise. Only the introduction of competition would make them unnecessary. All costs associated with their cancellation would legitimately be recoverable as stranded costs.

II. ENHANCED DIVESTITURE PLAN

Citizens' Base Divestiture Plan complies with the Commission's Stranded Cost Order and its Competitive Rules. Citizens has also developed an Enhanced Divestiture Plan that would further enhance the Base Divestiture Plan. If approved, the Enhanced Divestiture Plan will (a) more quickly implement competition in its service territory, (b) bring more benefits to those customers that elect to continue to receive standard-offer service, and (c) offset the amount of stranded-cost recovery for which Citizens' customers would otherwise be responsible.

The cornerstone of the Enhanced Divestiture Plan is Citizens' relinquishment and auctioning of the power-supply portion of its Certificate of Convenience and Necessity. This is the right to provide power to Citizens' standard-offer customers through Citizens' transmission and distributions facilities. Citizens would retain its T&D CC&N and continue to provide regulated T&D service at rates bundled with the power-supply component.

The Enhanced Divestiture Plan does somewhat limit Citizens' future role in the Arizona power industry. However, in addition to the many benefits it could bring to Citizens' customer, it would further Citizens long-run strategic plans. Citizens' core competency is constructing and operating local utility distribution systems. Citizens presently offers local gas, electric, telephone, water or wastewater utility service in approximately 20 states. The Enhanced Divestiture Plan would allow Citizens to focus on serving Arizona electric customers with regulated distribution services and allow a qualified national energy supply company to procure power supplies.

A requirement for each bidder would be to guarantee a six-percent reduction in the power-supply component of the bundled rate for the first three years after the CC&N was split and the new power-supply CC&N was granted by the Commission. Standard-offer customers would then receive a two-part bill containing a regulated T&D charge for service provided by Citizens and a fixed standard-offer power-supply charge provided by the winning bidder. Each three years, the power-supply component would have to be re-bid for the next three years. The incumbent provider would have the option of matching any winning bid and retaining the CC&N for another three years.

Each bidder in the initial supply round would bid an "acquisition fee" for the right to be the power supply provider. Citizens believes this may be substantial: the new entrant would gain a beachhead to the Arizona power market through overnight access to one of Arizona's fastest-growing power markets (Mohave County). This would provide a critical customer mass to justify creating marketing, education and customer-support functions. It could also provide a laboratory in which to work out the bugs in the transition to a competitive market. Also not to be overlooked would be the opportunity to earn potentially significant margins on the power sales, while still reducing the standard-offer customer's power-supply costs.

The Commission has ruled that if an Affected Utility is able to divest its generation assets at greater than book value, it can split the excess with its customers 50-50.[8] Consistent with this rule, Citizens would split the acquisition fee 50-50 with its customers. The 50-percent customer share would be used to offset Citizens' stranded costs, dollar for dollar.

The Enhanced Divestiture Plan can only be offered with Commission approval. Citizens sees no downside; the worst-case would simply be that no marketer would bid for Citizens' power-supply CC&N. In that case, the Enhanced Divestiture Plan would simply default to the Base Divestiture Plan. Citizens urges the Commission to approve the Enhanced Divestiture Plan.

III. VALENCIA POWER STATION

As described in Citizens' Unbundled Rates filing of December 31, 1997, the Valencia plant consists of combustion turbine and diesel generating units with a nominal rating of approximately 55 MW. As a peaking power facility designed solely to maintain reliability in the local area, these units have relatively high running costs and are seldom dispatched for energy supply purposes. The Valencia units are operated only during critical conditions, including when:

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[8] Decision No. 60977 at 12.

1. There is a failure in the single, 70-mile Western Area Power Administration ("WAPA") 115 kV transmission line running from the Del Bac substation to the Apache substation;

2. WAPA is experiencing difficulty in maintaining nominal voltage levels on its transmission system; or

3. Citizens experiences difficulty with its 55-mile long 115 kV radial transmission line running from the Nogales tap on WAPA's line to the Valencia plant.

Because of the critical reliability support provided by the Valencia generation and the Commission's emphasis on reliability preservation throughout the industry restructuring process, Citizens requests that the Commission accept its proposal to retain the facilities and recover their costs through its regulated transmission rates. There are at least two key reasons for the Commission should accept this proposal.

First, if these facilities were divested through a normal sales process, the new owner would be free to move the facilities to a new location. If this were done, and WAPA (or Citizens) were to experience a significant transmission outage (caused, for example, by an act of nature) on the single line serving Santa Cruz County, there would be no way to provide backup power and much of the County could be left without power until repairs were completed. This would clearly be unacceptable. Without the Valencia facilities in place, either new generation facilities or a new transmission source would need to be constructed to provide the needed backup power. Citizens believes that either of these projects would cost an amount greater than the approximate $9 million net book value of the Valencia plant.

An alternative to the above scenario is to divest the facilities with the understanding that they would have to remain in place to provide reliability service. However, since all of the electrical capacity of the units is needed to maintain local reliability, such a divestiture would accomplish nothing but to increase costs to Citizens' customers who would then have to pay the new owner a higher unregulated rate of return on the facilities for the identical service they are now receiving from Citizens. For these reasons, and because the standby power and voltage support functions provided by the plant are required to support and back-up the existing transmission system for all customers regardless of their source of electrical energy, Citizens urges the Commission to allow the Company to retain the Valencia facilities and recover their costs through unbundled transmission service charges, as currently reflected in Citizens' Unbundled Rates filing.

IV. STRANDED COST CALCULATION

Citizens has categorized its stranded costs into four areas. These include stranded costs associated with:

- Electric Generation
- Regulatory Assets
- Metering and Billing
- New Functions Under Competition

Stranded costs associated with electric generation are those broadly addressed in Section III and consist mainly of costs stranded by the APS Contract. Citizens' stranded regulatory assets consist mainly of previously-deferred Demand-Side Management ("DSM") expenditures and lost net revenue. The opening of metering and billing functions to competition also creates stranded costs in the form of costs that are fixed in the short-term and therefore not eliminated when customers elect to take service from competitive metering and billing suppliers. Finally, electric competition brings with it the need for the Company to implement new systems and functions within its regulated operations to enable and adequately support customer access to the competitive electricity market.

Each of these four main elements of stranded costs are described and estimated in subsections that follow. Citizens does not present these estimates as a firm and final cost recovery proposal. Rather they are presented to assist the Commission in gaining a full understanding of the general magnitude of the costs stranded by the introduction of competition. The Company recognizes that its estimates are imperfect and that further cost mitigation strategies may become possible in the future. Therefore, Citizens presents a proposal for a stranded cost recovery mechanism that will help insure that only legitimate and verifiable stranded costs are recovered from customers.

A. Electric Generation

Citizens' generation-related stranded costs, totaling an estimated $46.5 million, are associated with the APA Contract and its planned construction of a combustion turbine and associated transmission facilities in Mohave County. Background information and a brief description of how stranded cost estimates were developed for these elements follows:

APS Contract – Citizens' Power Service Agreement with APS includes three power supply schedules one of which, Schedule A, contains provisions for 100 megawatts (MW) of take-or-pay baseload capacity that Citizens is obligated to purchase through 2011. As described in Appendix A to this filing, Citizens forecasted the market price of electricity over the term of the contract and compared these prices with the cost of deliveries under Schedule A to assess the degree of stranded costs. The net present value difference in these values over the term of Schedule A is approximately $43 million, assuming the contract is divested as of December 31, 2000.

In addition to these costs, Citizens has included in the stranded generation estimates its estimates: (i) to conduct the contract bid process ($100,000); (ii) to pursue re-negotiation efforts for contract mitigation ($175,000); and (iii) to terminate the Company's Purchased Power and Fuel Adjustment Clause, a reduction to stranded cost of approximately $1 million.

Mohave Combustion Turbine and Transmission Facilities – As set forth in its 1992 and 1996 Integrated Resource Plans, Citizens has pursued the development of a combustion turbine power plant and associated transmission facilities as a least-cost solution to meeting load requirements in Mohave County, the fastest growing area of Citizens' Arizona electric service areas. With the advent of electric competition, Citizens will be unable to recover the costs of these facilities.

The combustion turbine facility was to be constructed and operated for Citizens on the basis of a long-term power purchase agreement with APS. As described in Appendix A in this filing, the costs to cancel that agreement are an estimated $1.9 million. In addition, Citizens has completed preliminary engineering, permitting, and right-of-way acquisition for the transmission facilities needed to deliver power from the turbine to load centers in Mohave County. Appendix A provides the background information on the costs stranded as a result of abandoning this transmission project, an estimated $2.1 million.

B. Regulatory Assets

Citizens' main regulatory assets that would be stranded by the implementation of competition are its previously-deferred DSM expenditures and DSM lost net revenues. These total approximately $3.0 million. Appendix B summarizes Citizens' DSM efforts and expenditures; reviews the load impacts caused by DSM programs; assesses DSM lost net revenues; and evaluates, from both societal and utility perspectives, the cost-effectiveness of the programs. In total this evaluation shows that Citizens' DSM programs have provided over $2 million in net economic benefits to Citizens' customers.

C. Metering and Billing

The introduction of competition in the provision of metering, meter reading, and billing and collection, and customer information functions leads to the creation of stranded costs. This is because certain costs associated with these functions (such as administrative and general costs allocated to these functions) are not immediately reduced when customers take competitive services. To prepare an estimate of these stranded costs for this filing, Citizens has relied upon the cost studies included in its December 1997 Unbundled Rates filing. A preliminary assessment of the revenue requirements for the relevant functional components of rates was done to identify variable costs, which would be reduced when customers took service from alternative service providers, versus fixed costs that would not. Because the metering and billing functions represent the dominant costs, Citizens based its assessment on these functions. The following discussion presents the results of this preliminary assessment.

Because the magnitude of these stranded costs depends on the number of customers who elect competitive services, the starting point for the analysis was to prepare a forecast of the customer impacts. The results of this forecast are presented in tabular form in Table IV-1. Forecasting customer participation in the competitive market is fraught with uncertainty. Citizens presents this forecast, not as an attempt to accurately predict future customer behavior, but rather, for purposes of preparing a preliminary estimate. Citizens' proposed mechanism for stranded cost recovery is based on recovering actual, measurable costs as they occur, not forecasted costs.

	Table IV-1 Forecast of Number of Customers Taking Open Access									
Customer Class	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Residential	688	1788	2888	4950	7425	9281	11602	14502	18127	22659
Commercial	120	190	240	270	300	320	340	360	380	400
Industrial	6	8	9	9	10	10	11	11	12	12
TOTAL	814	1986	3137	5229	7735	9611	11953	14873	18519	23071

Citizens' preliminary review of functional revenue requirements for metering and billing indicated that the stranded costs for the metering and meter reading functions are a relatively small fraction of the total costs, since a majority of costs are variable and the meters, once removed can technically be re-used for new customer additions. Citizens' estimate is that 12% of revenue requirements for metering and meter reading are strandable when customers take competitive services. However, in the case of billing and collections, the majority of revenue requirements are associated with fixed costs that will not be reduced when customers depart from Citizens. Furthermore, the information needs for each customer under open access will increase significantly, and costs for this function will increase, not decrease when customers take competitive services. Consequently, for purposes of this estimate, it is assumed that all of Citizens' costs associated with billing and collections are stranded when customers elect competitive providers for these functions.

A simplifying assumption was made in this analysis that no rate or cost changes would occur over the 10-year analysis period. It is not Citizens' position that this is a likely outcome, but the precision level of this preliminary assessment simply does not warrant making this detailed level of an adjustment to the inputs.

Using the unit revenues by rate class for the metering and billing functions as filed in Citizens' Unbundled Rates filing (fully phased-in – Step 4), the above stranded percentages, and forecast of customers taking open access results in the following estimate of stranded costs.

Table IV-2 Forecast of Stranded Costs from Loss of Metering and Billing Revenues

Customer Class	1999	2000	2001	2002	2003	
Residential	$ 14,000	$ 36,000	$ 59,000	$101,000	$151,000	
Commercial	$ 4,000	$ 7,000	$ 8,000	$ 10,000	$ 11,000	
Industrial	$ 5,000	$ 6,000	$ 7,000	$ 7,000	$ 7,000	
TOTAL	**$ 23,000**	**$ 49,000**	**$ 74,000**	**$118,000**	**$169,000**	
Customer Class	**2004**	**2005**	**2006**	2007	**2008**	**TOTAL**
Residential	$189,000	$236,000	$296,000	$369,000	$461,000	**$1,912,000**
Commercial	$ 11,000	$ 12,000	$ 12,000	$ 13,000	$ 14,000	**$ 102,000**
Industrial	$ 7,000	$ 8,000	$ 8,000	$ 9,000	$ 9,000	**$ 73,000**
TOTAL	**$207,000**	**$256,000**	**$316,000**	**$391,000**	**$484,000**	**$2,087,000**

In net present value terms, the above stream of total stranded costs is approximately $1.1 million.

D. New Functions Under Competition

The introduction of competition into the electric industry brings with it new costs and requirements for regulated Utility Distribution Companies. In its Unbundled Rates filing, Citizens identified four broad areas for these new functions: energy supply and demand transactions; operational processes; regulation; and customer communication and education. A brief description of the each of these new functions follows:

Energy Supply and Demand Transactions – The new functions in this area include: load profiling for residential and small commercial loads; schedule coordination for standard offer and competitive transmission; Citizens' costs to support the Independent System Administrator; and the requirements for standard offer information disclosure per the Commission competition rules.

Operational Processes – The new operational functions are in the areas of: management of multiple providers; development and operation of new information and accounting systems; and handling increased in-office and field customer service activities.

Regulation – The introduction of competition has required Citizens to undertake significant new activities to support filing requirements for unbundled rates and stranded cost valuation and recovery. Additionally, the electric competition rules specify increased regulatory reporting requirements.

Customer Communication and Education – All parties to the Arizona electric competition docket agree that there is a need for extensive customer communication and education. The Commission working group on this issue has developed a set of recommendations for the type and level of communications and educational activities needed. Citizens' filing includes its estimate of costs to support the incremental communications costs.

As an initial step in estimating the costs to support these new functions, Citizens first projected the number of new personnel needed to carry them out and the associated additional salary requirements. The five new position types and a brief description of their duties follows:

- **Customer Communication and Education –** Outreach to customer groups (e.g. low-income, elderly); manage mass communications activities; handle in-depth customer inquiries and manage customer service communications; and manage the residential phase-in process.

- **Competitive Provider Liaison –** Develop, execute, and monitor energy service provider (ESP) contracts; manage relationships with meter reading service providers (MRSP) and billing agents (BA); standard offer load scheduling and settlement; scheduling and settlement of WAPA transmission.

- **Senior Information System ("IS") Analyst –** implementation and administration of new rate structures and DASR process; maintenance of EDI systems; new hardware and software acquisition, set-up and testing; employee IS training.

- **Customer Service-Field** – Meter removals/change-outs; monitoring of installs by meter service providers

- **Customer Service-Office –** ESP usage history requests; DASR processing; handle increased level of inquiries and complaints; records management associated with ESP interactions; MRSP and BA interactions.

Table IV-3 below summarizes the anticipated new Full-Time-Equivalent (FTE) personnel additions need and an estimate of the incremental salary and overhead costs.

Table IV-3 Incremental Salary and Overheads For New Functions Under Competition

Year	Additional FTE	Add'l Salary and Overhead
1998	4	$105,000
1999	7.5	$759,000
2000	7.0	$725,000
2001	6.8	$720,000
2002	4.5	$485,000
After	3	$167,000

In addition to on-going salary and overhead costs, Citizens anticipates significant one-time costs for development and set-up of systems and on-going non-salary expense to support the new functions. For each of the functional areas, these costs are estimated to be as shown in Table IV-4. An overview of the bases of costs estimates within each functional area follows the table.

Table IV-4 Non-Salary Costs for New Functions		
New Competitive Function	**One-Time Cost**	**On-Going Expense**
1. Supply and Demand Transactions		
A. Load Profiling		
Telemeter Installations (340)	$150,000	
IS Development/Set-up	$250,000	
Outside services and expenses		$150,000
B. Scheduling & Settlement		
IS Development/Set-up	$100,000	
C. ISA Development (CUC share)	$55,000	
2. Operational Processes		
A. New IS Systems-Billing/CIS		
Interim System (1999-2001)	$160,000	$140,000
Permanent System	$550,000	
B. Additional O&M Expense		$100,000
3. Regulation		
A. Regulatory Filings		
Unbundled Rates (Outside Services).	$75,000	
Stranded Costs (Outside Service)	$50,000	
Internal Staffing – (1.5 FTE)	$225,000	
B. Incremental Filing Req'mts.		
Reporting Filings		$25,000
Disclosure Label Req'mts		$150,000
4. Communications and Education		
A. Comm. Mat'ls Dev'mt	$150,000	$10,000
B. Media costs (1999-2001)		$200,000
C. Operating Expense		$50,000
TOTAL NEW FUNCTIONS COST	**$1,765,000**	**$775,000**

1. Energy Supply and Demand Transactions

The principal cost in this area is for development and operation of a load profiling system to enable participation in competitive generation markets by low-use customers. The load settlement process of electric open access requires as an input customer load data on an hourly (or other short interval) basis. Due to the relatively high cost of interval metering for residential and small commercial customer, any significant participation by these customers (less than 20 kW) will require some means of estimating the time distribution of their loads. Load profiling is a statistical sampling technique for estimating standard customer usage patterns that can be balanced to actual meter readings and used as proxies for actual load shapes.

Citizens has been a leading proponent within the competition working group process for establishing a centralized, statewide dynamic load profile segmentation system in Arizona to provide and maintain a single set of segment load profiles for use across the entire state. Such a system could very likely be put in place at a much lower cost than the development of separate systems by each utility. As of this writing, resolution has not been reached on how a statewide system may be established or what the cost of such a system might be.

Consequently, Citizens has an estimate for a stand-alone load profiling system within its service area for purposes of this filing. For planning purposes, Citizens has assumed it would contract with an outside firm to develop and maintain its load profiling system. The costs contained in Table IV-4 are based on a system employing 200 residential and 140 commercial sampling meters and the associated telecommunications and computer systems to enable monthly downloading and processing of load data.

Load scheduling and settlement are additional activities that Citizens will have to undertake with the introduction of electric open access. There are two key areas that require scheduling and settlement: Citizens' Standard Offer load and transmission services. Currently load scheduling and settlement services are performed on Citizens' behalf for its aggregate load by APS under the Power Service Agreement. Under open access, scheduling and settlement for Citizens' Standard Offer load will be far more complex given the need to account for the individual schedules and actual loads of many customers buying power competitively. Citizens anticipates that undertaking these functions will require extensive new information and communications systems.

Transmission services for competitive suppliers will also require scheduling and settlement due to the nature of the WAPA transmission system supplying Citizens' Mohave County service areas and Citizens' transmission service agreement with WAPA. Currently, there is no additional capacity available on the WAPA transmission systems supplying Mohave County electric loads. Consequently, any competitive supplier serving customers in this area can do so only by utilizing transmission capacity now reserved by Citizens.

Under its transmission service agreement with WAPA, Citizens is permitted to assign transmission rights to third parties, however, the Company remains liable for payments to WAPA for all capacity reserved. Consequently, to enable open access in Mohave County, competitive suppliers will have to enter agreements with Citizens for rights to WAPA transmission capacity. Proper allocation of costs among competitive suppliers will be based on a load scheduling and settlement process which will be a requirement under the transmission agreement with Citizens. For planning purposes, Citizens has assumed that internal personnel would perform these functions, and the additional salary and overhead costs are included in Table IV-3. Citizens estimates that the information and communications systems needed for Standard Offer and transmission service load scheduling and settlement activities will cost an additional $100,000.

The final area associated with energy supply and demand transactions under open access is the costs to develop the Independent System Administrator (ISA) addressed in the Commission's electric competition rules. The working group addressing the development of the ISA has estimated a total cost of approximately $2.5 Million to establish the ISA operations, with Citizens share of those costs being approximately $55,000. This amount has been included as a one-time transition cost in this filing.

2. Operational Processes

The introduction of unbundled rates and the handling of extensive new information-flows under open access bring the need for comprehensive upgrades to Citizens' customer information, billing and accounting systems. Citizens anticipates that the "rules of engagement" for open access transactions will be under a nearly constant state of flux during the initial implementation period (e.g. 1999 – 2000). Consequently, Citizens preliminary plans call for implementing small-scale, highly flexible, and relatively low cost interim information systems to handle the initial information, billing and accounting requirements. Ultimately, when open access requirements have been established as relatively firm, permanent modifications to Citizens systems are planned. The costs included in Table IV-4 reflect the estimates for one-time and on-going costs to implement the above strategy.

3. Regulation

Citizens has included in this filing its estimates for the additional costs for complying with the regulatory requirements of electric open access. These include the estimated costs for outside services and internal staffing resources for preparing, filing, and processing unbundled rates and stranded cost filings required by the commission, as well as for participating in the regulatory proceedings associated with introducing electric competition. The on-going regulatory reporting and disclosure requirements of open access will also bring new costs. Table IV-4 reflects the component costs Citizens has estimated for these one-time and on-going regulatory costs.

4. Communications and Education

Table IV-4 also summarizes Citizens' estimates for communication and education activities to support open access. Citizens current plans anticipate the addition of a full-time position to manage these activities, and the additional salary and overhead expense for this new position are reflected in

Table IV-3. Citizens further anticipates significant communications development costs and on-going media and other operating costs in support of these customer education activities, as set forth in Table IV-4.

V. SUMMARY OF STRANDED COST ESTIMATES

Appendix C summarizes the estimates of stranded costs described above and, for illustrative purposes, computes the year-by-year Citizens' revenue requirements that would be needed to support these costs. In making these computations, a number of key assumptions are made:

- **Timing** – For purposes of developing this estimate, it is assumed that all one-time costs are made in 1999. While this in fact would not likely be the case, this assumption was used to yield a conservative estimate with somewhat higher revenue requirements than if these costs were spread over the first few years of open access, as would be expected.

- **Amortization Period** – A ten-year amoritization period for all one-time costs is assumed based on the Commission's Stranded Cost Order.

- **Capital Costs** – It is assumed that one-time costs are financed under the Company's existing capital structure.

Under these assumptions, nominal revenue requirements would range approximately from a high of $10.6 million in the first year to a low of $6.8 million in year ten. On a levelized basis, the annual revenue requirement would be approximately $8.8 million per year for ten years to recover this level of estimated stranded costs

VI. IMPLEMENTATION PLAN

This section summarizes the Citizens' action items for moving forward with its stranded cost valuation process and also addresses a proposed mechanism for recovering stranded costs from customers electing to take competitive power.

A. Preliminary Action Plan

As described above and in Appendix A, Citizens has requested Commission's approval of several items that will dictate the manner and schedule of Citizens' stranded cost valuation and recovery process. These include:

1. Acknowledgement by the Commission that retention by Citizens, as part of its regulated operations, of the Valencia generation facilities as "must run" units needed for critical transmission reliability support is acceptable.

2. Approval of the Base and Enhanced Divestiture Plans.

3. Approval of Citizens' conditional course of action on cancellation of the Mohave CT and abandonment of its Mohave transmission corridor tied to the certainty of construction of a combined-cycle power plant and adequate transmission facilities.

Citizens requests that the Commission provide its direction on these items at the earliest possible time in order to expedite the overall schedule and form of its auction/divestiture process.

Once the Commission has provided its approval, the key action items for moving forward the stranded valuation and recovery process are:

1. **Mitigation** – In addition to the mitigation alternatives set forth in this filing, Citizens is also pursuing contract renegotiation, possible asset sales, and other options as potential measures for mitigating its stranded costs. These activities will continue with the highest priority.

2. **Bid Process** – Citizens intends to retain the services of a qualified firm to develop bid documents, execute the bidding process, and evaluate bids. Given Commission direction on the above, Citizens would proceed directly to initiate this process.

3. **APS Contract** – Citizens intends to renegotiate the APS Contract to reduce stranded costs and to improve its marketability.

B. Recovery Mechanism

Citizens believes that recovery of stranded costs from customers taking competitive services should be structured to ensure that any Competitive Transition Charge (CTC) should reflect only verified costs. Citizens further believes that an appropriate mechanism to accomplish this is a surcharge mechanism that passes approved actual costs to customers as they occur over time. To accomplish these goals, the basic structure of Citizens proposed recovery mechanism is comprised of the following four basic steps:

1. Commission approves stranded cost amounts and/or calculation and accounting procedures for stranded costs expected to be incurred in future periods.

2. CTC is established for each rate class based on an initial forecast of costs and the number of billing units (e.g. kWh., kW, or customers) that are expected to convert to open access.

3. Moving forward into competition, actual costs, billing units, and CTC revenues are tracked.

4. Periodically, in a proceeding before the Commission, these quantities are reconciled against the forecasted values and a new CTC is established based on historical actuals and updated forecasts.

This process would continue for ten years or until all stranded costs are recovered, whichever occurs first.

The following discussion provides background on each of these steps and describes Citizens' proposal for rate design of CTCs.

1. Stranded Cost Approval

Citizens envisions a stranded cost approval process that considers the Company's stranded costs in the four categories identified: generation; regulatory assets; metering and billing; and new functions under competition. The Company does not expect a final determination on the actual amount of Citizens' recoverable stranded costs to be made on the basis of this filing alone for at least two key reasons. First, Citizens will continue to aggressively pursue mitigation opportunities that may lead to reductions in stranded costs as filed here. Second, this filing, particularly as it relates to the largest category of its stranded costs – generation – is based on the Company's projections of market prices and other values that can greatly affect the magnitude of stranded costs depending on actual outcomes. Consequently, with the exception of regulatory assets, which are based on historical costs, Citizens proposes that the Commission make a ruling in this filing relative to Citizens' proposed general principals, methods and accounting procedures to be utilized in the calculation of its generation, metering and billing, and new function-related stranded costs. For regulatory assets, Citizens proposes that the Commission approve the actual amount and manner of recovery.

2. Establishment of Competitive Transition Charge

To allow for an orderly and timely implementation of open access beginning January 1, 1999, the CTC will need to be established before all actual stranded costs are known. Further, the actual number and type of customer loads electing competitive service will not be known at the initiation of open access. Consequently, the initial CTC will by necessity need to be based on forecasts of costs and competitive loads. Citizens proposes that the establishment of the CTC use the following steps:

a) Use the Commission-approved amounts and methods from Step 1 above to forecast revenue requirements for the ten-year transition period.

b) Allocate stranded cost revenue requirements to rate classes in a manner that reflects cost allocations in current rates (per R14-2-1608 (G)).

c) Forecast a ten-year stream of expected billing units that will take competitive service by rate class.

d) Determine an average CTC for each rate class using the numerical sum of the ten-year forecast of allocated revenue requirements in the numerator and the sum of billing units in the denominator.

The allocation of stranded cost calculations will employ eleven different allocators. Each will be developed using the same methods employed in Citizens's last rate case and in its unbundling cost of service study. However, the allocators will not employ the billing determinants for the total system. Instead the allocators will be based on the demand, energy and customer counts of those customers anticipated to take unbundled service. The table below summarizes the allocators to be employed.

Number	Stranded Cost	Description of Allocator
1	Production Demand	4CP
2	Production Energy	Loss adjusted sales
3	Demand Side Management	Rate case DSM
4	Metering and Billing	Meter investment and meter reading expense
5	Billing and Collection	Customer billing and collections expense
6	Energy Transactions	Loss adjusted sales
7	Operational Processes	Subtotal of metering, billing, and collections
8	Regulatory costs	Revenue requirements
9	Customer Comm. & Educ.	Customer count
10	Return	Computed investor capital required
11	Taxes	Computed taxes to generate return on equity

3. Tracking Actual Costs and Revenues

Using Commission-approved accounting and calculation procedures, Citizens will track actual stranded costs as they are incurred, allocating them to rate classes in the same manner as described above. Actual CTC revenues will be tracked by rate class.

4. Updating the Competitive Transition Charge

Citizens proposes that its CTC be updated periodically over the ten-year stranded recovery term in proceedings before the Commission. Due to the initially high degree of uncertainty, Citizens proposes that annual updates be done for the period 1999 – 2001. Thereafter, bi-annual updates may be adequate. Updating the Competitive Service Charge will involve the following five steps:

a) Actual costs incurred will be compared to original forecast values as the basis for an update to the stranded cost forecast for the remainder of the cost recovery period.

b) An updated stream of ten-year revenue requirements will be established based on prior actual costs and new forecasted values using the calculation methods approved by the Commission.

c) Any over- or under-recovery of stranded costs from the prior period will be amortized over the remaining recovery term with revenue requirements adjusted accordingly.

d) An updated forecast of competitive market participation and billing units will be prepared based on earlier experience.

e) A new CTC will be established based on the above updated forecasts.

5. Rate Design for Competitive Transition Charge

Throughout the electric competition workshop process, Citizens has supported use of stranded cost charges that minimize price distortions and do not cause uneconomic consumption decisions. Stranded costs are a function of past industry decisions and structures. An important goal for the Arizona electric industry as it moves into competition should be to minimize the impacts of these past decisions on future decision-making. For these reasons Citizens firmly believes that stranded recovery charges should be based on historical usage levels and not be tied to future electricity consumption. In this vein, Citizens proposes that stranded recovery charges be designed for its respective major rate classifications as described below (for existing customer accounts):

Residential and Small General Service – CTC is a flat monthly fee calculated for four blocks of consumption across the full range of normalized 12-month usage history by rate class. Allocation of revenue burden among the four blocks would be based on the average energy consumption within each block.

Large General Service, Interruptible Power Service, and Large Power Service – CTC is a calculated fixed monthly fee based on the sum of historical billing demands for the twelve months prior to customer election of open access and a predetermined $/kW stranded cost charge.

For new customers or customers with insufficient usage history, fee calculation will initially be based on projections that are subject to update after sufficient history is obtained. CTCs would of course be subject to change based on periodic updated CTC calculations as approved by the Commission.

VII. CONCLUSION

Based on the above discussions, Citizens requests that the Commission approve Citizens' Base Divestiture Plan and Enhanced Divestiture Plan.

RESPECTFULLY SUBMITTED this 21st day of August, 1998.

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