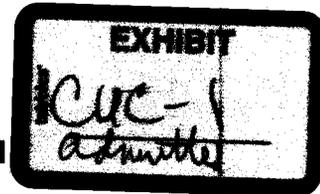




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JIM IRVIN
COMMISSIONER-CHAIRMAN
TONY WEST
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF THE COMPETITION
IN THE PROVISIONS OF ELECTRIC
SERVICES THROUGHOUT THE STATE OF
ARIZONA.

DOCKET NO. RE-00000C-94-0165

NOTICE OF FILING

Citizens Utilities Company hereby provides Notice of Filing Direct Testimony
in regard to Stranded Cost Issues for Sean R. Breen in the above-referenced
docket.

RESPECTFULLY SUBMITTED this 19th day of March, 1999.

Craig A Marks

Craig A. Marks
Associate General Counsel
Citizens Utilities Company
2901 N. Central Avenue, Suite 1660
Phoenix, Arizona 85012

Original and ten copies filed this
19th day of March, 1999, with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

1 Copies of the foregoing mailed/delivered
2 this 19th day of March, 1999, to:

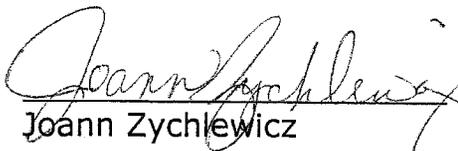
3 Jerry Rudibaugh
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15 All parties indicated on service list.

16 By:


17 Joann Zychlewicz

18 G:\CRAIGDOC\NOF Stranded Cost Testimony~Breen~3~99.doc

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1 Q. Please state your name and business address.

2 A. My name is Sean R. Breen. I am employed as a Project Manager by
3 Citizens Utilities Company, 1300 South Yale Street, Flagstaff, Arizona.

4
5 Q. Are you the same Sean R. Breen who testified previously in this docket.

6 A. Yes, I am. My relevant experience and qualifications have been set forth in
7 testimony filed January 9, 1998, in this docket.

8

9 Q. What is the purpose of your testimony?

10 A. My testimony addresses Citizens Utilities Company's ("Citizens") stranded
11 costs attributable to the introduction of competition to the electric industry
12 in Arizona and Citizens' unbundled rates created to enable electric
13 competition to begin in its service area. My testimony updates Citizens'
14 stranded costs and unbundled rates filings made August 21, 1998, and
15 December 31, 1997, respectively.

16

17 Q. How is your testimony organized?

18 A. My testimony is comprised of two main sections. The first section deals
19 with stranded costs and addresses the key subject areas of: stranded cost
20 mitigation; generation-related stranded costs; regulatory assets; metering
21 and billing-related stranded costs; transition costs; and the design of
22 Citizens' stranded cost recovery mechanism, or so-called competitive
23 transition charge ("CTC"). The second section of my testimony describes
24 Citizens' unbundled rates and the terms of a settlement previously reached
25 with Staff and RUCO on the implementation of these rates.

26

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1 Q. Please summarize your testimony.

2 A. My testimony first describes the results of Citizens' stranded cost mitigation
3 efforts, which have reduced projected generation-related stranded costs by
4 nearly \$29 million. As a result of these efforts, Citizens estimates that total
5 stranded costs have been reduced from \$57 million to \$28 million, a
6 51%reduction.

- 7
- 8 1. Concerning generation-related stranded costs, I describe a proposal
9 by Citizens to delay the divestiture of its APS power supply contract
10 for approximately six months, implement a net lost revenues
11 recovery mechanism for stranded costs in the interim, and make a
12 filing with the Commission in mid-2000 for a final determination of
13 whether divestiture is the best option for Citizens.
 - 14 2. Concerning other components of stranded cost (regulatory assets,
15 metering and billing, and transition costs), Citizens' estimates have
16 not changed from its August 1998 filing. Citizens does propose,
17 however, to establish two deferral accounts to capture and track
18 transition costs and stranded costs associated with opening metering
19 and billing to competition.
 - 20 3. My testimony also describes proposals for slight modifications to the
21 recovery mechanism proposed in Citizens' August 1998 filing to
22 accommodate subsequent changes in the Competition Rules and the
23 proposed changes in handling APS-contract stranded costs.
 - 24 4. Finally, my testimony requests that the Commission approve the
25 implementation of Citizens' unbundled rates consistent with the
26 settlement previously reached with Staff and RUCO.
- 27
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1 **STRANDED COSTS**

2 **Mitigation**

3 Q. Has Citizens undertaken efforts to mitigate its potential stranded costs?

4 A. Yes, it has. During much of 1998 and continuing into 1999, Citizens has
5 focused extensively on mitigating the key components of its stranded cost,
6 mainly in the areas of electric generation.

7
8 Q. Have these efforts been successful?

9 A. Yes, they have. In its August 1998 filing, Citizens identified and estimated
10 \$47.4 million of generation-related stranded costs associated with its power
11 service contract with Arizona Public Service Company ("APS"), and its
12 planned combustion turbine and transmission facilities in Mohave County.
13 As a result of Citizens' mitigation efforts, these potentially stranded costs
14 have been reduced by over 60%, a decrease of approximately \$29 million.

15
16 Q. Please describe how and to what degree Citizens has mitigated stranded
17 costs associated with the APS contract.

18 A. Citizens has recently negotiated substantial reductions to its long-term
19 wholesale power supply agreement with APS. These reductions have
20 reduced the estimated stranded cost potential of this agreement from
21 \$43.2 million to \$18.3 million, a 57% reduction. In addition, the results of
22 the negotiation translate into immediate reductions in generation costs of
23 approximately 6% for existing (Standard Offer) customers. Moreover, such
24 customers will see additional generation cost reductions in 2000 and 2001
25 respectively, as a result of modifications to the APS agreement. In total
26 between now and April 30, 2002, Citizens' generation customers will realize
27 nearly \$13 million of savings.

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Q. Was the negotiation process a costly undertaking?

A. No. Citizens has successfully re-negotiated this agreement without resorting to a costly and time-consuming filing with the Federal Energy Regulatory Commission ("FERC"). Citizens previously estimated the cost of a FERC filing, for outside services alone, to be \$175,000. While a final accounting has not been completed, Citizens believes the total costs to renegotiate the contract, including all internal expenses, to have been less than \$100,000.

Q. Why is a 57% reduction a reasonable level of mitigation of the stranded costs associated with the APS contract?

A. Citizens believes that the final result of the negotiation process reflects, on balance, the highest level of concessions in contract price and terms that could reasonably be expected under the circumstances. During the negotiation process, Citizens estimated, from publicly available information and data provided by APS, the embedded cost of the wholesale power services provided under Service Schedule A, that portion of the APS contract under negotiation. After extensive negotiations spanning a 10-month period, APS agreed to lower its rates under Schedule A to a level very close to Citizens' embedded cost estimate, and to do so retroactively back to November 1998. If Citizens had pursued a filing with FERC on this matter and received a favorable ruling, it does not believe that a result lower than APS' embedded costs could have been achieved for Schedule A rates. Furthermore, the retroactivity of the final rates would have applied only to a period beginning two months after the FERC filing was made - an estimated eight months beyond the negotiated retroactive date. Taking

1 into account the avoided litigation costs, uncertainty, and time
2 requirements of a FERC proceeding, Citizens regards this as a very
3 favorable outcome.
4

5 Q. Did the negotiation process result in any other important concessions for
6 Citizens?

7 A. Yes, there are two additional important concessions resulting from the
8 negotiation process. First, APS agreed to modify the contract to make it
9 fully assignable to a third party by January 1, 2001, the date when full
10 competition in generation is slated to begin. This is important because it
11 makes the contract clearly marketable and removes any uncertainty
12 surrounding Citizens' ability to divest itself of the contract as part of its
13 proposed stranded cost valuation and recovery process. Second, APS
14 agreed to maintain the current contract pricing under Service Schedule B, a
15 significant intermediate electric resource provided under the APS contract.
16 This is an important concession because, under current contract terms, the
17 cancellation of the Mohave CT (a matter I address below) would have
18 caused the demand rate under Schedule B to increase by \$2/kW-Month.
19 Such an increase would have immediately raised power supply costs by
20 over \$1.2 million per year. Due to this concession, such increase will not
21 occur.
22

23 Q. In what other way has Citizens mitigated its stranded costs?

24 A. Citizens has successfully eliminated the stranded cost exposure that would
25 have resulted by canceling the 75-MW Mohave Combustion Turbine project
26 ("Mohave CT"). Citizens and APS had contracted for APS to build this
27 project and sell its output to Citizens. In its August 1998 filing, Citizens
28
29

1 proposed to terminate the Mohave CT project to reduce its stranded cost
2 exposure. By doing so, an estimated \$1.85 million of cancellation costs and
3 \$2.1 million of expenditures for planning, permitting, and right-of-way costs
4 associated with transmission facilities would have become stranded.

5
6 In the fall of 1998, Citizens entered a sales agreement with the developers
7 of the Griffith Energy project, a 650 MW generation facility and related
8 transmission improvements in Mohave County, in which Citizens transferred
9 rights-of-way and environmental permits associated with a portion of the
10 planned transmission corridor for a payment which significantly offset
11 Citizens' stranded cost. Citizens retained its interest in the remainder of
12 the corridor, which it plans to use for future transmission projects to meet
13 the energy delivery needs of its customers.

14
15 Recently, APS elected to retain the combustion turbine for its own use
16 thereby waiving any cancellation costs. Together, these events have
17 effectively mitigated all potential stranded costs associated with the Mohave
18 CT, for a total reduction in stranded costs of approximately \$4 million.

19
20 **Generation-Related Stranded Costs**

21 Q. Please summarize the components of Citizens' generation-related stranded
22 costs.

23 A. As set forth in its August 1998 filing, Citizens' generation-related stranded
24 costs were comprised of two key components: the APS contract and the
25 Mohave CT and associated transmission. As described above, the Mohave
26 CT stranded costs have been reduced to zero and the APS contract
27 stranded costs reduced to an estimated \$18.3 million.

1 Q. Does Citizens continue to support divestiture of the APS contract as the
2 means to value and recover its associated stranded costs?

3 A. Yes. However, Citizens is now proposing a slightly different approach to the
4 divestiture process than set forth in its August 1998 filing.
5

6 Q. Please explain.

7 A. Citizens' August 1998 filing described a divestiture scenario that
8 commenced a bid process at the beginning of the year 2000, with an
9 ultimate assignment of the contract rights to the winning bidder by
10 December 31, 2000. While Citizens continues to believe the end of the
11 year 2000 as the most appropriate time for potential assignment of the
12 contract, it now proposes to move the bidding into the second-half of 2000
13 to allow time to seek final approval from the Commission before proceeding
14 with the bid process. Before accepting bids, Citizens would make a filing (in
15 early to mid 2000) that seeks direction and approval on whether the
16 Commission believes the Company should divest the contract or continue to
17 hold it as a power source for meeting the load requirements of Standard
18 Offer customers. This approach would provide the Commission with better
19 information than that which exists today in order to judge whether Citizens'
20 contract is sufficiently above market price to justify both the expense of
21 divestiture as well as the risk that such divestiture could conceivably lead to
22 even higher stranded costs.
23

24 Q. Why is this proposal being made now and not when Citizens made its
25 original August 1998 filing?

26 A. Before knowing the results of its contract re-negotiations that made
27 substantial reductions in the rates charged, Citizens did not have a
28
29

1 reasonable basis for determining whether the APS contract would be within
2 proximity of market price for many years. Now that contract rates are
3 lower and the prospect exists that it may not create significant stranded
4 costs, Citizens believes it is sensible to delay the decision to divest the
5 contract for as long as practical. This way, the Commission will be in a
6 better position to make a fair determination on the best course of action for
7 Citizens.

8
9 Q. If Citizens maintained the APS contract to serve Standard Offer load, would
10 that in fact be contrary to the provision currently in the Competition Rules
11 that Affected Utilities acquire power to serve Standard Offer customers
12 through an open bid process?

13 A. Yes, technically it would. However, Citizens believes, under the
14 circumstances described, that the Commission may want to consider
15 granting Citizens a waiver of that requirement.

16
17 Q. Why is that so?

18 A. If the determination is made in mid-2000 that the APS contract does not
19 appear to present significant stranded cost potential, it may be prudent to
20 allow Citizens to continue holding the contract, rather than having its
21 customers incur the cost and risk of divestiture.

22
23 Q. Does Citizens continue to support its Enhanced Divestiture proposal?

24 A. Yes, it does. However, since this option also involves divestiture of the APS
25 contract, Citizens proposes that, if approved, this be addressed using this
26 modified approach, where final Commission approval is sought before
27 proceeding.

1 Q. Are there any other changes with regard to the handling of the APS
2 contract that Citizens proposes to make?

3 A. Yes. Citizens' August 1998 filing proposed that the Company notify APS as
4 of January 1, 1999 of its intent to cancel Schedules B and C power
5 deliveries (intermediate and peaking electric resources, respectively) by
6 January 1, 2001. Given the uncertainty surrounding the timing of
7 implementation of electric competition, Citizens did not exercise that
8 option. In view of Citizens' current proposal here to possibly extend the
9 contract beyond 2001, cancellation of Schedules B and C is not warranted
10 at this time.

11
12 Q. Does extension of Schedules B and C of the APS contract beyond 2001
13 increase Citizens' stranded costs?

14 A. No. Schedules B and C are load-following schedules and therefore the
15 associated costs are not likely to become stranded as Citizens' customers
16 opt to take competitive power.

17
18 Q. Does Citizens propose any different treatment for its Valencia generation
19 facilities than set forth in its August 1998 stranded cost filing?

20 A. No. Citizens continues to believe that the best interests of its customers
21 are served by retaining the Valencia facilities as Must-Run generation and
22 recovering their costs through unbundled Transmission service charges, as
23 reflected in Citizens' unbundled rates filing.

24
25 Q. Are there any additional generation-related stranded costs?

26 A. Yes, there are two additional items. First, Citizens estimated its cost of
27 divestiture of the APS contract to be \$100,000 for consulting assistance.

28

29

1 Citizens continues to believe this to be a reasonable estimate. Second,
2 Citizens included in its previous filing a "placeholder" estimate for the
3 effects on stranded costs of dissolving its Purchased Power and Fuel
4 Adjustment Clause ("PPFAC"), should that occur. Due to the substantial
5 uncertainty surrounding this matter, Citizens has removed this item (which
6 had a \$1 million downward effect on the total) from its present stranded
7 cost estimate.

8
9 **Regulatory Assets**

10 Q. Please summarize Citizens' stranded costs associated with Regulatory
11 Assets.

12 A. In its August 1998 filing, Citizens reported approximately \$3.0 million of
13 regulatory assets that would become stranded by the implementation of
14 competition. This amount represents the then-current balance of
15 previously-deferred and unrecovered DSM and DSM lost revenues.

16
17 Q. Is Citizens proposing to change or update these stranded costs?

18 A. No, not at this time. However, at the time of its compliance filing in this
19 proceeding, Citizens proposes that it update the balance of these regulatory
20 assets to properly reflect carrying charges and the effect of related deferred
21 income taxes on previous expenditures.

22
23 **Metering and Billing**

24 Q. Please summarize Citizens' metering and billing stranded costs.

25 A. In its August 1998 filing, Citizens estimated stranded costs of \$1.1 million
26 (net present value over 10 years) associated with metering and billing
27 functions, based on a net-revenues-lost approach.

1 Q. Is Citizens proposing to change or update its metering and billing stranded
2 cost estimate?

3 A. Conceptually, Citizens continues to support the method for determining
4 metering and billing stranded cost presented in its August 1998 filing. My
5 testimony provides greater specificity with respect to how Citizens proposes
6 to calculate stranded metering and billing costs.

7
8 Q. Please describe Citizens' proposed method for calculating stranded
9 metering and billing costs.

10 A. The introduction of competition for metering and billing creates stranded
11 costs because certain costs associated with these functions (such as
12 allocated Administrative and General costs) are not immediately reduced
13 when customers take competitive services. As noted in Citizens' August
14 1998 filing, stranded costs associated with the metering and meter reading
15 functions are relatively small since a majority of costs are variable and the
16 meters, once removed, can technically be re-used to serve new customers.
17 However, in the case of billing and collections, the majority of associated
18 costs are fixed, and therefore, will not decline when customers opt for
19 alternative service providers. Therefore, most of billing and collections
20 costs are in fact strandable.

21
22 Q. How does Citizens propose to calculate these stranded costs?

23 A. The stranded costs for metering and billing would be calculated as the
24 difference between lost revenues and the variable costs for customers who
25 opt to take service from competitive providers. Lost revenues for the
26 relevant services are calculated using the unbundled rate charges in
27 Citizens' then-current tariffs. These charges are the average costs for
28

1 these services, as determined in Citizens' most recent rate case, and
2 include both fixed and variable components. Citizens proposes that the
3 variable component be calculated as:

- 4 • all fully loaded labor costs;
- 5 • all per-unit priced subcontracted services such as meter reading;
- 6 • transportation costs; and
- 7 • meter investments (including property taxes, depreciation,
8 return, and income taxes).

9 The remaining costs are fixed and therefore stranded when customers take
10 competitive service.

11
12 Q. What accounting mechanism does Citizens propose for stranded metering
13 and billing costs?

14 A. Citizens proposes to establish a Metering and Billing Deferral Account
15 ("MBDA") for each of its rate classes to provide a mechanism for proper
16 accumulation, tracking, as well as future analysis of the associated stranded
17 costs for cost recovery evaluation purposes.

18
19 Q. How will accounting entries into the MBDA s be determined?

20 A. Citizens proposes that accounting entries into the MBDA s be made quarterly
21 to allow an adequate period for calculating representative average costs.
22 The calculation procedure would follow the following 6 steps for each
23 quarter:

- 24 1. Calculate the total variable cost separately for metering (labor only),
25 meter reading, and billing/collections using the above cost categories
26 for each function.

1 Q. For how long does Citizens propose it be allowed to continue recovery of
2 metering and billing stranded costs?

3 A. Citizens proposes to continue recovery of these stranded costs for a ten-
4 year transition period.

5

6 **Transition Costs**

7 Q. Does Citizens anticipate transition costs associated with electric
8 competition?

9 A. Yes. Citizens' August 1998 filing describes substantial expected transition
10 costs under the heading "New Functions Under Competition." Such
11 transition costs fall into the areas of: energy supply and demand
12 transactions; new operational processes; regulation; and customer
13 communication and education.

14

15 Q. Is Citizens proposing to update or change its filing relative to transition
16 costs?

17 A. Citizens does not propose to update the basic structure of its proposal with
18 regard to such transition costs, which is to establish a deferral account for
19 future regulatory analysis and cost recovery purposes. Citizens would,
20 however, like to incorporate its October 21, 1998, amendment to its August
21 1998 stranded cost filing that requested issuance of an accounting order.

22 The October amendment asked that Citizens be allowed to:

- 23 1. establish a Competitive Transition Deferral Account ("CTDA") to
24 accumulate the "New-Function Costs" described in its Stranded Cost
25 filing;
26 2. make retroactive adjustments to its books to transfer legitimate
27 transition costs incurred in 1998 and 1999 to the CTDA;

28

29

- 1 3. accumulate interest expense based on the unamortized balance in the
2 CTDA using Citizens' currently-approved AFUDC rate; and
3 4. amortize the deferred costs in the CTDA, subject to the Commission
4 approval of the process set forth in Citizens' August 1998 filing,
5 through the Citizens' CTC to be established in this docket.
6

7 Q. Is Citizens proposing that the process described above to treat transition
8 costs continue indefinitely?

9 A. No. The above process would apply only during the initial stages of electric
10 competition. Once a more stable process for the functions to support open
11 access has been established, it is reasonable to include the incremental
12 costs for these activities as a part of Citizens' basic service rates. It would
13 therefore be Citizens' intent to reflect the on-going level of these costs in
14 the cost-of-service in the Company's next general rate case.
15

16 Q. Does Citizens have an updated estimate for its transition costs?

17 A. No. Citizens continues to believe the estimates included in its August 1998
18 filing to be reasonable. In that filing, Citizens estimated transition costs to
19 include approximately \$1.8 million of one-time costs and an on-going,
20 average annual cost level of approximately \$600,000.
21

22 Q. Is Citizens seeking approval for recovery of those amounts in this
23 proceeding?

24 A. No. Citizens seeks only to establish the CTDA to accumulate prudent
25 transition expenditures and to define the procedures for their subsequent
26 recovery.
27
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1 **Stranded Cost Recovery Mechanism**

2 Q. Please summarize Citizens' proposed stranded cost recovery mechanism
3 from its August 1998 filing.

4 A. Citizens proposed a four-step stranded cost recovery process:

- 5 1. The Commission approves stranded cost amounts and/or calculation
6 and accounting procedures for stranded costs expected to be incurred
7 in future periods;
- 8 2. A CTC is established for each rate class based on an initial forecast of
9 costs and the number of billing units that are expected to convert to
10 open access;
- 11 3. Moving forward into competition, actual costs, billing units, and CTC
12 revenues are tracked;
- 13 4. Periodically, in a proceeding before the Commission, these quantities
14 are reconciled against the forecasted values and a new CTC is
15 established based on historical actuals and updated forecasts.

16 This process would be applied to the four categories of stranded costs
17 identified by Citizens: generation; regulatory assets; metering and billing;
18 and transition costs.

19
20 Q. Is Citizens proposing any changes to this process?

21 A. Citizens is modifying its original proposal to accommodate two factors: 1)
22 changes made to the Competition Rules that affect the CTC calculation; and
23 2) the proposed changes in handling of the stranded costs associated with
24 the APS contract, including an interim CTC for the period from the initiation
25 of competition until the disposition of the APS contract is determined
26 (presumably in late 2000). In Citizens' original proposal, stranded costs for
27 the APS contract would have been determined with finality through
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29

1 divestiture and subsequently amortized over a ten-year period. Since
 2 divestiture is uncertain under the current proposal, Citizens would establish
 3 a net-revenues-lost recovery mechanism at the start of competition and
 4 transition to its originally proposed recovery process if divestiture was
 5 determined by the Commission to be the best alternative.

6
 7 Q. What contemplated changes to the Competition Rules would affect Citizens'
 8 stranded cost recovery mechanism?

9 A. The Competition Rules in place at the time of Citizens' August 1998 filing
 10 limited recovery of stranded costs to customers taking competitive service.
 11 Under the current draft of the Rules, stranded costs may be recovered from
 12 all customers taking distribution service. While this change would not
 13 require conceptual change in Citizens' proposed mechanism, it does change
 14 the calculation methodology. Where appropriate, Citizens would base
 15 calculations on total sales rather than competitive sales in computing CTC
 16 values.

17
 18 Q. Can you be more specific about the handling of each of the four
 19 components of stranded costs?

20 A. The components of Citizens' stranded costs have both one-time and on-
 21 going elements. The table below illustrates the breakdown based on
 22 current estimates:

Stranded Cost Component	One-Time Costs	On-Going Costs
APS Contract	\$18.4 million (if divested).	Lost Rev. minus Avoided Cost. (Interim CTC)
Regulatory Assets	\$3.0 million	None.
Metering & Billing	None.	Lost Rev. minus Avoided Cost
Transition Costs	\$1.8 million	Incremental Costs (~\$600k/yr)

1 For calculation of the CTC, Citizens proposes that one-time costs be
2 amortized over a ten-year period while annual on-going costs be recovered
3 ratably throughout the year.

4
5 Q. Please explain the proposed methodology to calculate the CTC.

6 A. Citizens proposes the calculation of the CTC be made using the following
7 steps:

- 8 1. Forecast revenue requirements for Commission-approved one-time
9 costs (amortized over 10 years) and on-going costs for the up-
10 coming period;
- 11 2. Allocate stranded cost revenue requirements to rate classes in a
12 manner that reflects cost allocations underlying current rates;
- 13 3. Forecast total customer billing units for the up-coming period for each
14 rate class;
- 15 4. Determine the CTC for each rate class as the quotient of the allocated
16 revenue requirements and the total billing units for the period.

17
18 Q. Does Citizens propose to update the CTC periodically?

19 A. Yes. As explained in Citizens' August 1998 filing, the Company proposes
20 that its CTC be updated annually during the initial years of competition and
21 once every two years thereafter, as determined by the Commission.
22 Through this process actual stranded costs and CTC revenues would be
23 compared for the prior period and updated forecasts would be made for the
24 upcoming period. A new CTC would then be calculated based on the
25 needed true-ups from the prior period and the updated forecasts. It is
26 anticipated that these calculations would be reviewed in a proceeding
27 before the Commission.

1 Q. Does Citizens continue to support its proposals in its August 1998 filing
2 relative to the rate design of the CTC?

3 A. Yes, it does. Citizens continues to firmly believe that stranded recovery
4 charges, a function of past industry decisions and structures, should be
5 based on historical usage levels and not be tied to future electricity
6 consumption. Citizens continues to support a CTC rate design that employs
7 flat monthly fees rather than volumetric-based charges.

8
9 Q. How would the interim CTC be calculated relative to the APS contract, the
10 largest component of Citizens' stranded costs?

11 A. Stranded costs under the APS contract can be calculated as the difference
12 between the change in revenue and the change in power supply cost that
13 occurs when customers leave the Citizens' system. When a customer's load
14 is lost to alternative power suppliers, generation revenues are decreased at
15 a rate approximately equal to Citizens' average power supply costs. At the
16 same time, Citizens' power supply costs are reduced at a rate equal to its
17 short-run decremental (or avoided) cost. Since Citizens' avoided supply
18 costs are lower than its average power costs, each kWh lost creates lost net
19 revenue or stranded cost.

20
21 Q. What is the magnitude of these stranded costs?

22 A. While the actual amount of stranded cost depends on the load
23 characteristics and existing rate class of the customers leaving the system,
24 Citizens expects these costs to range between \$.01 - \$.02/kWh for
25 departing commercial customers and be approximately \$.02/kWh for
26 departing residential customers.

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1 Q. Does this mean that rates for residential customers taking competitive
2 service, for instance, will be the equivalent of \$.02/kWh higher to pay for
3 Citizens' stranded costs?

4 A. No, this would not be the case assuming the current provision in the
5 competition rules is retained that allows all distribution customers to pay a
6 competitive transition charge. With this provision retained, stranded costs
7 would be spread across all customers resulting in a stranded generation
8 charge would be some fraction of the amounts cited, based on the
9 percentage of sales that are from alternative sources.

10
11 Q. Why isn't the market price for power factored into Citizens' stranded cost
12 calculation?

13 A. If Citizens were in a position to re-sell the power resources freed up when
14 customers take competitive service, the market price would be a factor in
15 stranded cost calculations. However, Citizens is not in this position since its
16 APS contract applies only to power consumed by Citizens' customers; no
17 provision is available to Citizens to sell any power outside its service area.

18
19 Q. Would the other components: regulatory assets, metering and billing, and
20 transition costs also be included in the interim CTC?

21 A. Yes. Citizens refers to this mechanism as "interim," in that it would
22 precede the final decision on the disposition of the APS contract, the single
23 largest component of stranded costs.

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1 Q. What approvals does Citizens seek from the Commission in this filing
2 relative to stranded costs?

3 A. Citizens seeks approval for:

- 4 1. the recovery of APS contract stranded costs using, in the interim, the
5 net-revenues-lost method for calculation described here;
- 6 2. the recovery of the Regulatory Assets of approximately \$3.0 million
7 comprised of previously deferred DSM costs and lost net revenues;
- 8 3. the establishment of Metering and Billing Deferral Accounts for
9 recovery of related stranded costs;
- 10 4. the establishment of a Competitive Transition Deferral Account for
11 recovery of transition costs for enabling competition in Citizens'
12 service area including the ability to make retroactive adjustments to
13 its books to transfer legitimate transition costs incurred in 1998 and
14 1999;
- 15 5. the establishment of and calculation methodology for the proposed
16 CTC mechanism, including flow-through accounting and Commission-
17 approval procedures summarized in my testimony; and
- 18 6. Citizens' proposal to delay APS contract divestiture with final
19 determination on the ultimate disposition of the contract made on the
20 basis of a mid-year 2000 filing by Citizens.

21
22 Q. How would Citizens likely proceed if given the above approvals?

23 A. Following approval of these matters by the Commission, Citizens would:
24 establish the approved deferral accounts; prepare and file a final accounting
25 of its previously-incurred expenditures; and file a proposed initial CTC
26 based on the approved stranded costs and calculation methodology.

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1 **UNBUNDLED RATES**

2 Q. Did Citizens negotiate a settlement of its unbundled rates filing with Staff
3 and RUCO?

4 A. Yes, it did. A document summarizing this settlement, the December 22,
5 1998 Commission Staff's transmittal memorandum and proposed order on
6 Citizens' unbundled and standard offer service tariffs filing (Docket No. E-
7 01032C-97-0774), is attached to my testimony as Exhibit A.

8
9 Q. Please summarize the elements of the settlement.

10 A. Under the settlement, Citizens would initially implement standard offer and
11 unbundled rates that are essentially revenue-neutral. Later this year,
12 Citizens would file a rate design proposal for consideration by the
13 Commission that is based on more current load and usage data and
14 incorporates a number of principles set forth in the settlement document.

15
16 Q. Does Citizens continue to support the rate settlement?

17 A. Yes, it does. The settlement was based on lengthy discussions between the
18 parties in 1998 and is a reasoned resolution of the issues and a sound basis
19 for the establishment of Citizens' rates for supporting electric competition.

20
21 Q. What does Citizens propose that the Commission do with respect to the
22 settlement?

23 A. Citizens respectfully requests that the Commission approve the settlement
24 in its present form.

25
26 Q. Does this conclude your testimony?

27 A. Yes, it does.
28
29

EXHIBIT A

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



JACK ROSE
EXECUTIVE SECRETARY

ARIZONA CORPORATION COMMISSION

December 22, 1998

RECEIVED
DEC 29 1998
PHOENIX ADM. OFFICE

Mr. Craig A. Marks
Associate General Counsel
Citizens Utilities Company
2901 North Central Avenue, Suite 1660
Phoenix, Arizona 85012

Dear Mr. Marks:

Enclosed are the Commission Staff's transmittal memorandum and proposed order on the Citizens Utilities Company's unbundled and standard offer service tariffs filing (Docket No. E-01032C-97-0774). This is only a Staff recommendation to the Commission; it has not yet become an order of the Commission. The Commission can decide to accept, amend or reject Staff's proposed order.

This matter is scheduled for Commission deliberation at its Working Session on December 30, 1998, at 10:00 a.m., and for a Commission decision at either its Working Session on December 30, 1998, at 10:00 a.m., or at its regular Open Meeting on December 31, 1998, at 10:00 a.m.

If you have any questions about this matter, please contact John Wallace of our Staff at (602) 542-0865, or me, at (602) 542-0748.

Sincerely,

Ray T. Williamson
Acting Director
Utilities Division

RTW:JVW:djg/PAB

Enclosure

12/30/98 10:45 AM FAX 602 255 8710

CITIZENS UTILITIES COMPANY

MEMORANDUM

TO: THE COMMISSION

FROM: Utilities Division

DATE: December 22, 1998

RE: IN THE MATTER OF THE FILING BY CITIZENS UTILITIES COMPANY OF UNBUNDLED AND STANDARD OFFER SERVICE TARIFFS PURSUANT TO A.A.C. R14-2-1606 (DOCKET NO. E-01032C-97-0774)

On December 31, 1997, Citizens Utilities Company (Citizens, CUC or Company) filed its unbundled and standard offer service tariffs pursuant to A.A.C. R14-2-1606. In this filing, the Company priced electric service elements such as transmission and distribution. The Company filed standard offer tariffs, which increase, decrease, and change rates for various customer classes (residential, small general, etc.). CUC also submitted information and requested a system benefits charge.

Effective December 26, 1996, the Arizona Corporation Commission (Commission) adopted rules governing the parameters of retail electric competition. Pursuant to A.A.C. R14-2-1606(D), each incumbent utility must file Unbundled Service Tariffs to provide the following services to all eligible purchasers on a nondiscriminatory basis: Distribution service; Meter and meter reading service; Billing and collection service; Open access transmission service; Ancillary services; Information services; and Other ancillary services necessary for safe and reliable system operation. Pursuant to A.A.C. R14-2-1606(C), each incumbent utility may also file proposed tariffs to provide standard offer bundled service.

Decision No. 60575, dated January 14, 1998, suspended this filing until May 29, 1998. Decision No. 60910, dated May 22, 1998, suspended this filing until November 25, 1998. In a letter dated November 13, 1998, the Company agreed to delay the implementation of its Unbundled Services Tariffs and System Benefits Charge, which were filed on December 31, 1997 until December 10, 1998.

Staff's concern with the Company's unbundled tariffs as filed on December 31, 1997 was that they would result in step increases and decreases for certain standard offer customers and customers who choose competitive suppliers. These increases and decreases were primarily the result of higher fixed charges in the unbundled and standard offer tariffs than are in the Company's current tariffs.

THE COMMISSION

December 22, 1998

Page 2

As a result of discussions with Staff the Company and Staff have developed a Summary of Settlement Terms (Settlement Terms) dated November 30, 1998. The major provisions of those Settlement Terms are detailed below.

For 1999, Citizens' unbundled and standard offer rates shall be designed so that they are essentially revenue neutral; that is, there will be no re-allocation of revenue responsibility between rate classes nor adoption of the rate design changes proposed in Citizens' original Unbundled Rates filing, with the following exceptions:

- a. the Dusk-to-Dawn Lighting Service rate design will be modified to better reflect actual lighting energy usage by fixture type;
- b. the demand ratchet for the Large Power Service Rates will be lowered to 80 percent.

The basis for the unbundled and standard offer rates shall be the cost of service presented in response to Staff data request BA-73.

The costs of Citizens' Valencia facilities shall be reflected in the revenue requirements underlying the rates for distribution service. If the Valencia facilities are no longer needed to support local transmission reliability, or other significant operating changes occur, Citizens will meet with Staff to determine if and how its rates should be revised to account for the changes that have occurred.

Citizens may file a revenue-neutral rate design proposal in 1999 based on more current customer load and usage data which reflects the following principles of cost allocation:

- a. generation capacity costs will be allocated using the four (4) Coincident Peak (CP) and average method;
- b. most distribution capacity costs will be allocated using class Non-Coincident Peaks (NCP);
- c. load data will conform to the criteria described in the attached Appendix A.

Citizens' 1999 rate filing will also include the following principles:

- a. a redistribution of costs among rate classes to achieve a movement of at least 50 percent of the way toward equalized rates of return;

THE COMMISSION

December 22, 1998

Page 3

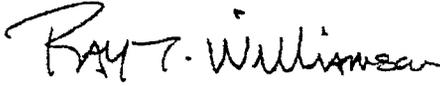
- b. the use of a rate phase-in process for all customer classes with annual rate changes over a multi-year period, if necessary, to insure that no customer (including zero-use) will experience a rate increase of more than 7 percent in any year;
- c. the adoption of two-tier pricing for transmission and distribution services for Residential and Small General Service rates with a Customer Charge, Head Block and Tail Block.
- d. an Unbundled Interruptible Service Rate based on removal of production demand, transmission, and sub-transmission-related costs from firm LGS rates;
- e. a revenue-neutral re-design of the Large Power Service rate that allows recovery of lost revenue from known and expected conversions to 69 kV service; and
- f. the equalization of Residential rates between Mohave and Santa Cruz counties.
- g. the equalization of Small Commercial rates between Mohave and Santa Cruz counties.

Staff will accept the results of the cost of service study for rate design purposes, and the other rate principles above, if the study adheres to the above criteria. The load data should conform to the criteria described in the Appendix A attached to the Settlement Terms. (See attachment).

In conclusion, Staff believes the Settlement Terms are in the public interest and should be approved because the Company has agreed to unbundle its current tariffs and file a revenue neutral rate case with updated load data before proposing increases and decreases to certain rates and charges. On December 22, 1998, Residential Utility Consumer Office filed a letter stating that it would not object to the proposed tariffs based upon the functionalization of the Valencia generating facilities to either distribution or transmission service. The Company revised its tariffs in accordance with the Settlement Terms on December 8, 1998. Staff recommends that the December 8, 1998 tariff filing be approved to be used only as a customer information tariff. Staff further recommends that the effective date for the Company's unbundled tariffs be suspended until such time that the Commission has made a determination in the Company's stranded cost case (Docket No. E-1032C-98-0474). The proposed tariffs contain a provision for a Competitive Transition Charge (CTC) which is subject to a determination by the Commission. Staff further recommends that Citizens revise its December 8, 1998 filing at such time that the Commission issues a decision in Citizens' stranded cost filing.

THE COMMISSION
December 22, 1998
Page 4

Staff further recommends the Company's proposed System Benefits Charge with its request to include the CARE low income program expenditures as a part of its revenue neutral filing in 1999 be approved.



Ray T. Williamson
Acting Director
Utilities Division

RTW:JVW:djg/PAB

ORIGINATOR: John V. Wallace

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE FILING BY)
CITIZENS UTILITIES COMPANY)
OF UNBUNDLED AND STANDARD)
OFFER SERVICE TARIFFS)
PURSUANT TO A.A.C. R14-2-1606)

DOCKET NO. E-01032C-97-0774

DECISION NO. _____

ORDER

Open Meeting
December 30 and 31, 1998
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Citizens Utilities Company (Citizens, CUC or Company) is certified to provide electric service as a public service corporation in the State of Arizona.
2. On December 31, 1997, Citizens Utilities Company filed its unbundled and standard offer service tariffs pursuant to A.A.C. R14-2-1606. In this filing, the Company priced electric service elements such as transmission and distribution. The Company also filed standard offer tariffs which increase, decrease and change rates for various customer classes (residential, small general, etc.). CUC also submitted information and requested a system benefits charge.
3. Effective December 26, 1996, the Arizona Corporation Commission (Commission) adopted rules governing the parameters of retail electric competition. Pursuant to A.A.C. R14-2-1606(D), each incumbent utility must file Unbundled Service Tariffs to provide the following services to all eligible purchasers on a nondiscriminatory basis: Distribution service; Meter and meter reading service; Billing and collection service; Open access transmission service; Ancillary services; Information services; and Other ancillary services necessary for safe and reliable system operation. Pursuant to A.A.C. R14-2-1606(C), each incumbent utility may also file proposed tariffs to provide standard offer bundled service.

1 4. Decision No. 60575, dated January 14, 1998, suspended this filing until May 29,
2 1998. Decision No. 60910, dated May 22, 1998, suspended this filing until November 25, 1998.
3 In a letter dated November 13, 1998, the Company agreed to delay the implementation of its
4 Unbundled Services Tariffs and System Benefits Charge, which were filed on December 31,
5 1997 until December 10, 1998.

6 5. Staff's concern with the Company's unbundled tariffs as filed on December 31,
7 1997 was that they would result in step increases and decreases for certain standard offer
8 customers and customers who choose competitive suppliers. These increases and decreases were
9 primarily the result of higher fixed charges in the unbundled and standard offer tariffs than are in
10 the Company's current tariffs.

11 6. As a result of discussions with Staff, the Company and Staff developed a
12 Summary of Settlement Terms (Settlement Terms) dated November 30, 1998.

13 7. According to the Settlement Terms, for 1999, the Citizens' unbundled and
14 standard offer rates shall be designed so that they are essentially revenue neutral; that is, there
15 will be no re-allocation of revenue responsibility between rate classes nor adoption of the rate
16 design changes proposed in Citizens' original Unbundled Rates filing, with the following
17 exceptions:

- 18 a. the Dusk-to-Dawn Lighting Service rate design will be modified to
19 better reflect actual lighting energy usage by fixture type;
20 b. the demand ratchet for the Large Power Service Rates will be
21 lowered to 80 percent.

22 8. The Settlement Terms specify the basis for the unbundled and standard offer rates
23 shall be the cost of service presented in response to Staff data request BA-73.

24 9. According to the Settlement Terms, the costs of Citizens' Valencia facilities shall
25 be reflected in revenue requirements underlying the rates for distribution service. If the Valencia
26 facilities are no longer needed to support local transmission reliability, or other significant
27 operating changes occur, Citizens will meet with Staff to determine if and how its rates should be
28 revised to account for the changes that have occurred.

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10: The Settlement Terms state that Citizens may file a revenue-neutral rate design proposal in 1999 based on more current customer load and usage data which reflects the following principles of cost allocation:

- a. generation capacity costs will be allocated using the four (4) Coincident Peak (CP) and average method;
- b. most distribution capacity costs will be allocated using class Non-Coincident Peaks (NCP);
- c. load data will conform to the criteria described in the attached Appendix A.

11. According to the Settlement Terms, Citizens' 1999 rate filing will also include the following principles:

- a. a redistribution of costs among rate classes to achieve a movement of at least 50 percent of the way toward equalized rates of return;
- b. the use of a rate phase-in process for all customer classes with annual rate changes over an appropriate multi-year period, if necessary, to insure that no customer (including zero-use) will experience a rate increase of more than 7 percent in any year;
- c. the adoption of two-tier pricing for transmission and distribution services for Residential and Small General Service rates with a Customer Charge, Head Block and Tail Block.
- d. an Unbundled Interruptible Service Rate based on removal of production demand, transmission, and sub-transmission-related costs from firm LGS rates;

- 1 e. a revenue-neutral re-design of the Large Power Service rate
2 that allows recovery of lost revenue from known and
3 expected conversions to 69 kV service; and
4 f. the equalization of Residential rates between Mohave and
5 Santa Cruz counties.
6 g. the equalization of Small Commercial rates between
7 Mohave and Santa Cruz counties.

8 12. Staff will accept the results of the cost of service study for rate design purposes,
9 and the other rate principles above, if the study adheres to the above criteria. The load data
10 should conform to the criteria described in the Appendix A attached to the Settlement Terms.

11 13. Staff believes the Settlement Terms are in the public interest and should be
12 approved because the Company has agreed to unbundle its current tariffs and file a revenue
13 neutral rate case with updated load data before proposing increases and decreases to certain rates
14 and charges. The Company revised its tariffs in accordance with the Settlement Terms on
15 December 8, 1998.

16 14. On December 22, 1998, Residential Utility Consumer Office filed a letter stating
17 that it would not object to the proposed tariffs based upon the functionalization of the Valencia
18 generating facilities to either distribution or transmission service.

19 15. Staff recommends that the December 8, 1998 tariff filing be approved to be used
20 only as a customer information tariff.

21 16. Staff further recommends that the effective date for the Company's unbundled
22 tariffs be suspended until such time that the Commission has made a determination in the
23 Company's stranded cost case (Docket No. E-1032C-98-0474). The proposed tariffs contain a
24 provision for a Competitive Transition Charge (CTC) which is subject to a determination by the
25 Commission.

26 17. Staff further recommends that Citizens revise its December 8, 1998 filing at such
27 time that the Commission issues a decision in Citizens' stranded cost filing.

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18. Staff further recommends the Company's proposed System Benefits Charge with its request to include the CARE low income program expenditures be approved.

CONCLUSIONS OF LAW

1. CUC is an Arizona public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution.

2. The Commission has jurisdiction over CUC and over the subject matter of the application.

3. The Commission, having reviewed the Summary of Settlement Terms developed by Staff and CUC, the revised tariff pages in accordance with the Settlement Terms and Staff's Memorandum dated December 22, 1998, concludes that the Settlement Terms and revised tariffs are reasonable and equitable and are therefore in the public interest.

ORDER

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THEREFORE, IT IS ORDERED that the Settlement Terms and revised tariffs to be used only for customer information be and hereby are approved.

IT IS FURTHER ORDERED that the effective date for the Company's unbundled tariffs be suspended until such time that the Commission has made a determination in the Company's stranded cost case (Docket No. E-1032C-98-0474).

IT IS FURTHER ORDERED that Citizen's revise its December 8, 1998 filing at such time that the Commission issues a decision in Citizen's stranded cost filing (Docket No. E-1032C-98-0474).

IT IS FURTHER ORDERED that CUC's current tariffs shall be used as the standard offer tariffs.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

COMMISSIONER - CHAIRMAN

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, JACK ROSE, Executive Secretary of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this ____ day of _____ 1998.

JACK ROSE
Executive Secretary

DISSENT _____

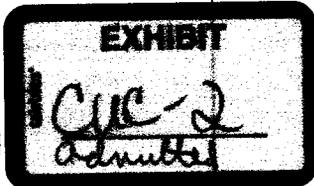
RTW:JVW:djg/PAB

Appendix A

Guidelines For Updating Load Research

Since it is not possible for Citizens to update its load research program in a timely fashion, the Company needs to correct the deficiencies in its filed allocated cost of service study using surrogate load research data from other sources. The Company should use the alternate load research data in order to check the accuracy of its own data, and supplement it where appropriate. At a minimum, the Company should incorporate the following in its unbundled rate design:

1. The Company should prepare a statement on the applicability of the alternate load research data by comparing the load characteristics of the target classes, for instance, similar average customer size, similar climate (for classes with weather sensitive end uses such as air conditioning), and similar time of the system peak. The Company should also describe the load research accuracy and methods employed by the utility(ies) which developed the load research data.
2. The Company should begin with its own billing data (kWh, kW or kVA where applicable) and adjust the data if necessary to the time frame of the alternate data. The Company should adjust its billing data as appropriate, given its knowledge of the timing of its meter reading and billing. The Company should also explain how it estimated the consumption of non-metered classes, e.g. hours of darkness for street lighting classes.
3. The Company should apply the coincidence factors of the alternate load research data, or a ratio analysis, to develop estimates of class peak (NCP), system peak (CP) and maximum customer demands (MCD) at the customer level. The Company should adjust the coincidence factors or ratios as it deems appropriate based on billing data and on the older load research data, where class definitions have not changed.
4. The Company should adjust the CP, NCP and MCD for each class to the generator level by applying loss factors. The Company should state the source of the loss factors it utilizes. Next, the sum of the CP's should be compared to the actual system monthly peaks, and adjusted if necessary on a reasonable basis (excluding deterministic loads such as hourly metered classes and street lighting classes.)
5. The Company should then compare the resulting class allocations to those in its initial filing. The Company should state for which classes it will use the allocators based on the surrogate data.



BEFORE THE ARIZONA CORPORATION COMMISSION

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CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

1999 JUL 28 P 4: 39

AZ CORP COMMISSION
DOCUMENT CONTROL

IN THE MATTER OF THE APPLICATION OF
CITIZENS UTILITIES COMPANY FOR
APPROVAL OF ITS PLAN FOR STRANDED
COST RECOVERY.

DOCKET NO. E-01032C-98-0474

IN THE MATTER OF THE FILING BY
CITIZENS UTILITIES COMPANY OF
UNBUNDLED AND STANDARD OFFER
SERVICE TARIFFS PURSUANT TO A.A.C.
R14-2-1606.

DOCKET NO. E-01032C-97-0774

IN THE MATTER OF COMPETITION IN
THE PROVISIONS OF ELECTRIC
SERVICES THROUGHOUT THE STATE OF
ARIZONA.

DOCKET NO. RE-0000C-94-0165

**CITIZENS UTILITIES
COMPANY'S STANDARD OFFER
AND UNBUNDLED SERVICE
TARIFFS**

Citizens Utilities Company hereby provides Notice of Filing Rebuttal
Testimony in regards to Unbundled and Standard Offer Service Tariffs for Sean R.
Breen in the above-referenced docket.

RESPECTFULLY SUBMITTED on July 28, 1999.

Craig A. Marks
Associate General Counsel
Citizens Utilities Company
2901 N. Central Avenue, Suite 1660
Phoenix, Arizona 85012

1 Original and ten copies filed on
2 July 28, 1999, with:
3
4 Docket Control
5 Arizona Corporation Commission
6 1200 West Washington
7 Phoenix, Arizona 85007
8
9 Copies of the foregoing mailed/delivered
10 on July 28, 1999, to:

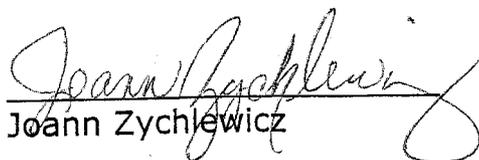
11 Jerry Rudibaugh
12 Arizona Corporation Commission
13 1200 West Washington
14 Phoenix, Arizona 85007

15 Paul Bullis
16 Arizona Corporation Commission
17 1200 West Washington
18 Phoenix, Arizona 85007

19 Ray Williamson
20 Arizona Corporation Commission
21 1200 West Washington
22 Phoenix, Arizona 85007

23 Service List for RE-00000C-94-0165
24
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27
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29

By:


Joann Zychlewicz

G:\Craig~docs\Electric Restructuring Matters\Notice of Filing~July 28 Rebuttal Testimony~Unbundled.doc

1 **INTRODUCTION**

2 Q. Please state your name and business address.

3 A. My name is Sean R. Breen. My business address is Citizens Utilities
4 Company, 1300 South Yale Street, Flagstaff, Arizona.

5
6 Q. Are you the same Sean R. Breen who testified previously in this case?

7 A. Yes, I am.

8
9 Q. What is the purpose of your rebuttal testimony?

10 A. My rebuttal testimony responds to testimony addressing Citizens' positions
11 submitted by Richard La Capra, on behalf of the Arizona Corporation
12 Commission Staff; Richard Rosen, on behalf of the Residential Utility
13 Consumer Office; and Betty Pruitt, on behalf of the Arizona Community
14 Action Association.

15
16 **TESTIMONY OF RICHARD LA CAPRA**

17
18 Q. Please summarize Mr. La Capra's testimony as it relates to Citizens'
19 proposals for electric competition.

20 A. Mr. La Capra set forth a number of principles that Staff believes are
21 necessary to foster the development of a competitive electric services
22 market and provides his assessment of whether Citizens' proposals are
23 consistent with these principles. He also addresses a number of "other
24 issues" raised by my direct testimony.

25
26 Q. Does Mr. La Capra conclude that certain aspects of Citizens' proposals are
27 consistent with Staff's electric competition principles.

1 A. Yes, he does. In summary, he concludes that Citizens' proposals ensure
2 that:

- 3 ▪ All potential suppliers have access to customers;
- 4 ▪ Citizens will not have any incentive to attempt to hinder supplier
5 or customer access to the wires;
- 6 ▪ Customers have the opportunity to purchase electric services
7 from a supplier of their choice;
- 8 ▪ Customers are informed of what they pay for each (non-CTC)
9 functional component of rates so they can compare different
10 providers;
- 11 ▪ There is little opportunity or motivation for Citizens to shift costs
12 from unregulated to regulated functions;
- 13 ▪ Stranded costs have been significantly reduced; and
- 14 ▪ Existing ratepayers will (apparently) receive significant savings
15 as a result of Citizens' stranded cost mitigation efforts.

16
17 Q. Are there aspects of Citizens' proposals that Mr. La Capra believes are at
18 odds with the Staff's electric competition principles?

19 A. Yes, there are three areas where Mr. La Capra expresses concern about
20 Citizens' proposals:

- 21 ▪ Generation market power relative to Citizens' must-run Valencia
22 facilities;
- 23 ▪ The ability of customers to know in advance how much bills will
24 be reduced if alternative suppliers are chosen; and
- 25 ▪ Citizens' "Enhanced Divestiture" proposal.

1 Q. Does Citizens really have the potential to exert generation market power?

2 A. No. Mr. La Capra asserts that the pricing or availability of Citizens'
3 generation may disadvantage alternative suppliers. As explained in various
4 of our filings, the Valencia facilities (Citizens' only generation) are operated
5 solely for backup and voltage support to the single radial transmission line
6 serving Citizens' Santa Cruz County territory and are currently the only
7 backup source in the area. Further, their annual operation is strictly limited
8 by the terms of their air quality permit. The Valencia facilities pose no
9 threat to competition.

10

11 Q. Hasn't Staff previously addressed the issue of the Valencia generation?

12 A. Yes. Staff recognized the critical need for the Valencia facilities to support
13 distribution reliability. Staff's December 22, 1998, proposed order on
14 Citizens' unbundled and standard offer tariffs, stated:

15 "The costs of Citizens' Valencia facilities shall be reflected
16 in the revenue requirements underlying the rates for
17 distribution service. If the Valencia facilities are no longer
18 needed to support local transmission reliability, or other
19 significant operating changes occur, Citizens will meet with
20 Staff to determine if and how its rates should be revised to
21 account for the changes that have occurred."

22 Nothing has changed to affect that conclusion.

23

24 Q. Should Mr. La Capra be concerned about the ability of customers to know in
25 advance how much bills will be reduced if alternative suppliers are chosen?

26 A. No. Mr. La Capra's concern centers on the fact that Citizens' CTC has not
27 yet been defined. Citizens' filed unbundled and standard offer tariffs list the
28 charges under its CTC as "to be determined" because of the uncertainty
29 about the manner in which the Commission would approve its proposed

1 stranded cost recovery mechanisms. Once a definitive order has been
2 issued, the CTC charges will be determined and itemized in Citizens' tariffs.
3 (Under Citizens' proposed standard offer tariffs, both the charge for
4 generation and the CTC are itemized.) Citizens' unbundled tariff charges
5 are identical to its standard offer charges, except there is no charge for
6 generation. Customer savings will be clearly revealed.
7

8 Q. Is Mr. La Capra correct in characterizing Citizens' "Enhanced Divestiture"
9 proposal as simply "responding to basic Commission directives."

10 A. Not at all. Citizens' Enhanced Divestiture proposal is an innovative
11 alternative, where the Company would not only divest its generation assets
12 to value its stranded costs, but would also voluntarily put out to bid the
13 generation-related, obligation-to-serve components of its Certificate of
14 Convenience and Necessity. Nowhere in the competition rules or any of its
15 orders has the Commission suggested that the implementation of electric
16 competition require utilities to relinquish their rights and obligations to
17 serve standard-offer generation customers. Citizens made this offer as a
18 means to mitigate the total level of its stranded cost, recognizing that the
19 ability to gain a significant foothold in the Arizona electric market may in
20 fact be an attractive prospect to potential bidders. Citizens proposed that
21 the proceeds from the voluntary sale be treated in a manner similar to
22 long-standing precedent concerning sales of rate-based utility assets,
23 where the above-book-value proceeds are split evenly between ratepayers
24 and stockholders. Citizens continues to support its Enhanced Divestiture
25 proposal.
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1 Q. What are the "other issues" Mr. La Capra raises about Citizens' proposals?

2 A. Mr. La Capra takes exception with six other areas of Citizens' proposals:

- 3 ▪ The Metering and Billing Deferral Account;
- 4 ▪ The Competitive Transition Deferral Account;
- 5 ▪ Citizens' proposal to defer divestiture of the APS contract;
- 6 ▪ The effect of APS contract renegotiations;
- 7 ▪ The proposed interim CTC; and
- 8 ▪ The interaction between the Purchased Power and Fuel
- 9 Adjustment Clause ("PPFAC") and the CTC.

10
11 Q. Why does Mr. La Capra oppose Citizens' proposal to establish a Metering
12 and Billing Deferral Account to track costs stranded by competition?

13 A. Mr. La Capra presents a host of reasons for not allowing recovery of
14 Metering and Billing stranded costs. These reasons could just as easily
15 serve to thwart recovery of stranded generation costs, a proposition
16 already rejected by the Commission. Although La Capra supports
17 resolution of "disputes over stranded costs" as a requisite to effective
18 electric competition, he now appears, when it comes to non-generation
19 assets, to reject stranded recovery outright. The introduction of
20 competition to metering and billing services, that have previously been
21 provided through a price-regulated monopoly, potentially strands costs in
22 exactly the same way as does the introduction of competition to generation.
23 The very same arguments for recovery of stranded costs for generation
24 apply equally to other utility activities opened to competition. The
25 Commission has ruled unambiguously that utilities should be allowed a
26 reasonable opportunity to recover prudently incurred stranded costs; no
27 exception should be made for metering and billing.

28
29

1 Q. What are Mr. La Capra's issues with Citizens' proposed Competitive
2 Transition Deferral Account ("CTDA")?

3 A. While Mr. La Capra supports allowing Citizens to establish the CTDA, he
4 opposes "automatic" collection of additional transition costs through the
5 CTC.

6
7 Q. Does Citizens propose "automatic" cost recovery for its CTDA?

8 A. No. Recovery would occur only after review of incurred or projected costs,
9 and costs would not be flowed through the CTC until approved by the
10 Commission.

11
12 Q. In what situations would additional transition costs be covered by existing
13 revenue streams as Mr. La Capra suggests?

14 A. By definition, this will never occur. The costs included in my testimony are
15 incremental costs for new functions that are not now performed and which
16 will require new investment and expense to undertake.

17
18 Q. Could Citizens earn more than its authorized rate of return if it recovered
19 transition costs?

20 A. Mr. La Capra suggests that this could result from offsetting changes in costs
21 or revenues in other areas, which could allow Citizens to earn more than an
22 appropriate rate of return. Alternatively, he suggests that if the Company
23 didn't earn its authorized return it could always file a rate case. Mr. La
24 Capra has taken a classic "Heads I win, tails you lose" position. He is in
25 essence suggesting that the Commission today establish rates below the
26 cost of service because there might be some offsetting changes in costs or
27 revenues in the future. Further, he suggests that Citizens just "file a rate

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29

1 case" if it finds itself under-earning, knowing full well that the impacts of
2 stranded metering/billing and transition costs would likely never rise to the
3 level of justifying a full rate case. Further, the prohibition against
4 retroactive ratemaking would prohibit recovery of past unrecovered
5 transition costs. Mr. La Capra's suggestion would ignore lawful principles of
6 rate-making.

7
8 Q. With regard to the APS contract negotiations, is it true, as Mr. La Capra
9 suggests, that Citizens' PPFAC will not return the negotiated retroactive rate
10 reductions to customers?

11 A. No. All retroactive refunds will flow through Citizens' PPFAC bank and
12 accrue fully to the benefit of customers.

13
14 Q. Is it true that Citizens has not provided information as to how much
15 generation costs have been reduced?

16 A. No. Both in my direct testimony and in response to data requests from
17 Staff, Citizens has quantified the cost reductions it expects from the APS
18 contract renegotiations. Citizens expects to file in the near future an
19 adjustor mechanism to its PPFAC that will pass these savings directly to
20 customers.

21
22 Q. Is it true that Citizens needs to return to customers the "significant
23 payment" made by Griffith Energy?

24 A. No. The payment from Griffith Energy is a partial offset to capital
25 expenditures incurred since the conclusion of Citizens' last rate case. These
26 expenditures were never included in rate base, therefore, the underlying
27

1 net investments are not reflected in current rates. No payment need be
2 returned.

3
4 Q. Does Mr. La Capra oppose spreading the collection of stranded costs across
5 all customers?

6 A. Yes, he does.

7
8 Q. Why is Citizens making a proposal to do so?

9 A. Citizens proposed to collect stranded costs from all customers because the
10 current version of the competition rules states (R14-2-1607(F)): "A
11 Competition Transition Charge may be assessed on all retail customers
12 based on the amount of generation purchased from any supplier."

13
14 Q. Is it true that, under Citizens' proposed CTC mechanism, standard offer
15 customers would pay both over-market embedded generation costs and the
16 net revenue lost from departing customers taking competitive power?

17 A. Yes. However, it is also true that the magnitude of the portion of the CTC
18 associated with lost net generation revenues, when spread over all
19 customers, is likely to be small in the early stages of competition. Citizens
20 believes that the effect of generation cost reductions in the APS contract
21 will largely, if not completely, offset bill increases due to the generation
22 CTC.

23
24 Q. Why is this so?

25 A. The first year of APS contract rate reductions will reduce generation costs
26 by approximately \$3 million. Citizens' current energy sales volume is
27 approximately 1,000,000 MWh. Consequently the contract savings are
28

1 approximately \$3/MWh. The high estimate of the difference between
2 generation revenues and the marginal cost of generation is \$20/MWh.
3 Thus, under Citizens' proposal, first-year sales loss would have to exceed
4 15% ($\$3/\20) for generation CTC charges to exceed contract savings – a
5 very unlikely event.
6

7 Q. Is there a method of CTC recovery that would avoid the need for standard
8 offer customers to pay both above-market generation costs and the net
9 revenues lost when customers depart Citizens' system?

10 A. Yes, there is. Citizens could adopt a "shopping credit" approach, as now
11 proposed in the APS and Tucson Electric Power settlements, where the
12 departing customers are given a generation credit reflective of the
13 competitive retail market price for power. Under this approach stranded
14 costs (the difference between Citizens' average generation cost and market
15 price) are the same for all load.
16

17 Q. Why did Citizens not adopt this approach in its filing?

18 A. Citizens did not adopt a shopping-credit approach because its interpretation
19 of the competition rules is that the Commission is seeking: 1) to unbundle
20 rates in a manner that provides "credit" to customers taking competitive
21 services for the full embedded cost of generation; and 2) a CTC that
22 reflects only those costs that are actually stranded by competition.
23

24 Q. What do you mean by "costs that are actually stranded by competition?"

25 A. By "actually stranded" I am referring to the fact that, until some customer
26 leaves the system, technically there are no stranded costs.
27
28
29

1 Q. Is it true, as Mr. La Capra states, that for a utility that does not own
2 generation, stranded costs are the "difference between embedded revenues
3 requirements associated with their contracts and the market value of the
4 same amount of power."

5 A. No, not in a practical sense. Mr. La Capra's definition of stranded costs
6 here implies that the power in question could in fact be sold on the open
7 market. In Citizens' case, its contract with APS does not allow for re-sale of
8 power "freed up" by customers purchasing electricity competitively.
9 Therefore, what becomes "stranded" by competitive sales loss is not so
10 much related to what the power could be sold for competitively, as it is to
11 what costs are left unrecoverable as a result of the loss of sales. In
12 Citizens' case, the amount "actually stranded" is equal to the difference
13 between the average cost of generation embedded in the rates it would
14 have been paid and its avoided costs from not having to serve the sales.
15 Citizens' filing seeks approval from the Commission to recover the costs
16 that are actually stranded and to spread these across all customers. Any
17 similarity between this amount and the amount consistent with Mr. La
18 Capra's definition would be purely coincidental.

19
20 Q. Would Citizens oppose adoption of a "shopping credit" approach to stranded
21 cost recovery?

22 A. No, not as long as the CTC mechanism ensured full recovery of costs
23 actually stranded by competition.

24
25 Q. How could this be accomplished?

26 A. To ensure full stranded cost recovery, there would have to be a
27 reconciliation process put in place that periodically calculated the difference
28

1 between Citizens' CTC recoveries and the amounts actually stranded, as I
2 have defined them, and the ability to adjust the forward-going CTC to
3 account for these differences.
4

5 Q. Is Mr. La Capra correct in stating that there may be interactions between
6 Citizens' CTC mechanism as proposed and the Company's PPFAC?

7 A. Yes. The calculation of PPFAC bank adjustments must explicitly account for
8 CTC recoveries in order to accurately reflect only the differences between
9 fuel/purchased power costs and the base charges embedded in rates.
10

11 Q. Do you believe it is necessary for Citizens to re-file its tariffs to better
12 define the energy adjustment and the CTC?

13 A. No. However, Citizens does not oppose filing a detailed explanation of its
14 calculation methods in its compliance filing in these proceedings.
15

16 **TESTIMONY OF RICHARD ROSEN**
17

18 Q. Are Citizens and RUCO engaged in settlement discussions on the points
19 covered in Dr. Rosen's testimony?

20 A. Yes, RUCO invited us to join with them to discuss and hopefully resolve,
21 open issues. I share Dr. Rosen's optimism that these discussions will lead a
22 settlement. We would hope for similar discussions and results with Staff.
23

24 Q. What is the purpose of your rebuttal in relation to the concerns about
25 Citizens' stranded cost recovery plans raised in Dr. Rosen's testimony?
26
27
28
29

1 A. The purpose of my rebuttal testimony is to make Citizens' current positions
2 on these issues a matter of record for use in the event settlement
3 discussions break down.
4

5 Q. Do you share Dr. Rosen's concern that take-or-pay provisions of Schedule A
6 of the APS contract, together with the inability to re-sell power, could
7 significantly add to stranded costs?

8 A. Yes and no. This is because the take-or-pay provisions of Schedule A only
9 apply to the first 100 MW of Citizens' power requirements, and Citizens
10 peak load requirements exceed 250 MW. Therefore, significant load
11 reductions must occur before these impacts on stranded costs become
12 material. Citizens has proposed that the Commission consider delaying
13 divestiture of its contracts, at least until it is clear that the costs and risks
14 of divestiture are justified. The impacts referred to here by Dr. Rosen
15 would only become a real concern after significant levels of sales loss.
16 Further, any impacts would likely be small compared to price reductions
17 resulting from the APS contract renegotiation.
18

19 Q. Would re-negotiation of the APS contract to allow re-sale of power freed-up
20 by competition alleviate this problem, as Dr. Rosen states?

21 A. Yes, it would. Citizens has and will continue to discuss alternatives in this
22 regard with APS.
23

24 Q. Does Citizens support Dr. Rosen's proposal to separately calculate stranded
25 costs for each rate class, reflecting the amount of participation in direct
26 access by class.
27
28
29

1 A. Yes, it does. However, implementation would require a waiver of the
2 competition rules that specify that stranded costs are to be recovered "in a
3 manner consistent with the specific company's current rate treatment of the
4 stranded asset." For Citizens, this translates to a stranded cost allocation
5 generally consistent with the allocation of generation costs in current rates.
6 Citizens agrees that it is likely that commercial and industrial customers will
7 be the dominant participants in direct access. Therefore, the allocation of
8 stranded costs in proportion to direct access participation would likely result
9 in greater allocations of stranded costs to these customer classes than if
10 Citizens were to allocate these costs in the same manner as generation.

11
12 Q. Does Citizens continue to support stranded cost recovery based on each
13 customer's historical use of electricity?

14 A. Yes. Citizens continues to believe this is the proper manner to allocate
15 stranded costs to customers, because stranded costs result from historical
16 decisions about generation investments, which in turn were based on load
17 forecasts under historical (now incorrect) assumptions. If stranded cost
18 recovery is based on prospective usage, future consumption decisions will
19 be influenced by relics from the past. Consequently, the marginal price of
20 power to customers will not reflect the true marginal cost.

21
22 Q. Does Citizens continue to support flat monthly fees for stranded cost
23 recovery.

24 A. Yes. Again, the cause of stranded costs are decisions made under historical
25 assumptions. Future decisions about consumption should not be unduly
26 influenced by past decisions. Implementing flat fees for stranded cost
27 recovery is a sound way to avoid such influence.

1 Q. Would implementation of a stranded recovery mechanism that was based
2 on volumetric charges and future consumption unduly impact Citizens'
3 ability to recover its stranded costs?

4 A. No. Citizens has proposed the historical usage/flat fee approach not for
5 reasons of assuring cost recovery, but because it believes this approach will
6 result in less economic distortion to future electricity purchase decisions.
7

8 Q. What has Dr. Rosen proposed relative to recovery of Citizens' deferred DSM
9 costs?

10 A. He has proposed continued deferral of these costs on the grounds that the
11 ACC has approved carrying charges for these costs.
12

13 Q. What is wrong with this suggestion?

14 A. Dr. Rosen's suggestions appears to ignore the larger picture of what is
15 occurring as the industry transitions from a regulatory environment to a
16 market environment. Regulatory assets, like Citizens' deferred DSM costs,
17 are relics of the fully-regulated industry. Without clear evidence of the
18 regulatory intent to recovery, the ability for utilities to continue to carry
19 these assets on their books, under generally-accepted accounting
20 principles, would become highly questionable after the transition to
21 competition. Understanding this, the Commission, in Decision No. 60977
22 (6/28/98) in this docket, provided for assured recovery of regulatory
23 assets. Dr. Rosen is wrong when he states that "it seems inappropriate to
24 include purported DSM cost amounts at this time."
25
26
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1 Q. Does Dr. Rosen express concern about Citizens' proposed recovery of
2 stranded costs associated with billing and metering?

3 A. Yes. He suggests that competition should be structured in a way that
4 avoids stranded billing and metering, by for instance, offering billing and
5 metering services to ESPs.

6
7 Q. Could Citizens offer billing and metering services to ESPs under the current
8 competition rules?

9 A. No. Citizens' current business plans do not include establishing a
10 competitive affiliate to offer and compete for metering and billing services,
11 or any competitive electric services, for that matter. Rule section R14-2-
12 1615(B) unambiguously states: "Beginning January 1, 2001, an Affected
13 Utility or Utility Distribution Company shall not provide Competitive
14 Services as defined in R14-2-1601." Since "Competitive Services" include
15 billing and metering, the current rules effectively preclude Citizens from
16 offering billing and metering services to ESPs. Citizens is thus faced with
17 the need to recover costs stranded by opening billing and metering to
18 competition and has set forth a sound and reasonable means for doing so.
19 Again, the Commission should disregard Dr. Rosen's testimony on this
20 matter.

21
22 Q. Does Dr. Rosen comment on Citizens' proposal for recovering electric
23 competition transition costs?

24 A. Yes, he does. He suggests that transition costs are not stranded costs
25 because they are not generation-related, and therefore should not be
26 recovered as such.

1 Q. Is Dr. Rosen correct that "transition costs" are not stranded costs?
2 A. No. Referring once again to the competition rules, the definition of
3 "Stranded Costs" in R-14-2-1601 includes: "Other transition and
4 restructuring costs as approved by the Commission as part of the Affected
5 Utility's Stranded Cost determination pursuant to R14-2-1607." Consistent
6 with this direction, Citizens has included its transition costs and a proposed
7 mechanism for their recovery in its filing. Clearly, there costs would not be
8 incurred but for the introduction of competition. Once again, the
9 Commission should disregard Dr. Rosen's testimony on this subject.

10
11 Q. Dr. Rosen states that Citizens' current estimate of stranded costs seems to
12 involve two flaws. Do you agree with his assessment?

13 A. I do not disagree in concept with Dr. Rosen, however, most likely the
14 "flaws" are not material. First, I have not seen the results of the updated
15 Stone & Webster analysis of the regional electricity prices, particularly for
16 delivery into Citizens' service areas. If those results are made available to
17 Citizens, we will review them for possible inclusion in our stranded cost
18 calculations. Second, Dr. Rosen also opines that Citizens did not include
19 the last year of the APS-Citizens contract in our analysis, and that it would
20 have a downward effect on our estimate. Citizens did not in fact include
21 the last year of the APS Schedule A contract in the analysis, primarily
22 because the contract expires in mid-year. However, it was also recognized
23 that the discounted present value of a part-year impact twelve years into
24 the future would not have a material effect on the calculation.

1 Q. Do you disagree with Dr. Rosen that the retail shopping credit for
2 residential customers should be based on the expected retail market
3 generation price?

4 A. No. In the event that the Commission determines that the "shopping
5 credit" approach for stranded recovery is appropriate for Citizens, it does
6 not object to having the residential credit so based.
7

7

8 **TESTIMONY OF BETTY PRUITT**

9

10 Q. Are the rate design changes alluded to in Ms. Pruitt's testimony a part of
11 Citizens' proposed unbundled rates now before the Commission?

12 A. No. The matters Ms. Pruitt refers to are elements of the December 1998
13 Stipulation with Staff. As part of that stipulation, Citizens would make a
14 separate filing with the Commission to implement the proposed rate design
15 changes. Citizens has not made that filing and, therefore, will not address
16 Ms. Pruitt's concerns in this proceeding.
17

17

18 Q. Does this conclude your testimony?

19 A. Yes.
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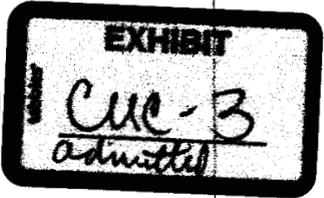
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6
7 IN THE MATTER OF THE APPLICATION OF
8 CITIZENS UTILITIES COMPANY FOR
9 APPROVAL OF ITS PLAN FOR STRANDED
COST RECOVERY.

DOCKET NO. E-01032C-98-0474

10 IN THE MATTER OF THE FILING BY
11 CITIZENS UTILITIES COMPANY OF
12 UNBUNDLED AND STANDARD OFFER
SERVICE TARIFFS PURSUANT TO A.A.C.
R14-2-1606.

DOCKET NO. E-01032C-97-0774

13 IN THE MATTER OF COMPETITION IN
14 THE PROVISIONS OF ELECTRIC
15 SERVICES THROUGHOUT THE STATE OF
16 ARIZONA.

DOCKET NO. RE-0000C-94-0165

17 Citizens Utilities Company hereby provides Notice of Filing Direct Testimony
18 in regard to Stranded Cost Recovery and Unbundled and Standard Offer Service
19 for Sean R. Breen in the above-referenced docket.

20 RESPECTFULLY SUBMITTED on May 22, 2000.

21
22
23

24
25 Craig A. Marks
26 Associate General Counsel
27 Citizens Utilities Company
28 2901 N. Central Avenue, Suite 1660
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1 Original and ten copies filed on
2 May 22, 2000, with:

3 Docket Control
4 Arizona Corporation Commission
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7 Copies of the foregoing mailed/delivered
8 on May 22, 2000, to:

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11 Arizona Corporation Commission
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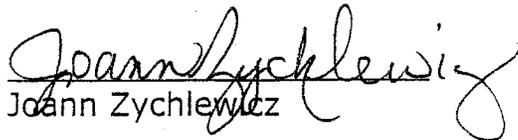
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29 Service List for RE-00000C-94-0165

By:


Joann Zychlewicz

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1 Q. Please state your name and business address.

2 A. My name is Sean R. Breen. I am employed as Director of Energy Services
3 for Citizens Utilities Company ("Citizens"), 1300 South Yale Street,
4 Flagstaff, Arizona.

5
6 Q. Are you the same Sean R. Breen who has testified previously in these
7 dockets.

8 A. Yes, I am. My relevant experience and qualifications were set forth in my
9 testimony in Docket No. RE-00000C-94-0165, submitted January 9, 1998.

10

11 Q. What is the purpose of your testimony?

12 A. The purpose of my testimony is to present the background and status of
13 activities undertaken by Citizens in support of the introduction of retail
14 electric competition for its Arizona Electric Division.

15

16 Q. Please summarize your testimony.

17 A. My testimony describes Citizens' participation in the Arizona electric
18 competition proceedings and updates Citizens' proposals on its Stranded
19 Costs and Unbundled and Standard Offer rates from its March 1999 filing.

20

21 Q. Does Citizens support the concept of introducing retail electric competition?

22 A. Yes, it does. Citizens believes that introducing competition for electric
23 services has the potential for increasing service options available to
24 customers and lowering electric power costs. For these reasons, Citizens
25 has actively supported the electric restructuring process since the 1994
26 inception of the Arizona proceedings.

27

28

29

1 Q. Do Citizens' shareholders stand to gain from the introduction of
2 competition?

3 A. No, they do not. Under the approved Electric Competition Rules ("Rules"),
4 Citizens has no opportunity to increase earnings beyond what they would
5 be absent the introduction of retail competition. Of course, it is equally
6 important, that earning reductions should not occur.

7
8 Q. Why can't Citizens increase earnings?

9 A. Early in the process Citizens made the decision to focus its business
10 resources on its core capabilities as an electric distribution, or "Wires,"
11 company." Citizens has no plans to enter the electric business segments
12 made competitive under the Rules. The introduction of electric competition
13 therefore offers Citizens no direct upside potential for increased business
14 volumes or earnings for its Arizona Electric operations.

15
16 Q. Does electric competition present downside potential for Citizens?

17 A. Yes, it does. Electric competition presents increased cost recovery risk.
18 Without orders from the Commission, which clearly authorize Citizens to
19 recover the costs stranded by the loss of sales to competition and the
20 incremental costs for implementing retail direct access, Citizens faces the
21 risk of financial loss. Moreover, delays in the recovery of costs of service,
22 beyond what exists under the existing regulatory framework, will increase
23 Citizens' business and financial risks.

24
25 Q. If there is no potential for gain, and only a risk of financial loss, why has
26 Citizens continued to support electric competition?

27
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1 A. Citizens supports the introduction of retail electric competition because our
2 customers have clearly indicated their desire for choice. Moreover, Citizens
3 supports the introduction of competition because of the potential benefit to
4 customers in the form of improved economic conditions. Citizens'
5 shareholders benefit indirectly when Citizens promotes the economic vitality
6 of its service areas. Introducing competition for electric services may
7 indeed help in this regard.

8

9 Q. What has Citizens done to support the introduction of electric competition in
10 Arizona?

11 A. Citizens has committed substantial human and financial resources to the
12 restructuring of the Arizona electric industry in the areas of rulemaking,
13 implementation planning and development, and ratemaking/regulatory
14 activities.

15

16 Q. In what ways has Citizens contributed to the rulemaking process?

17 A. The participants in the Arizona electric restructuring process have worked
18 diligently to identify and address the broad range of issues arising with the
19 introduction of electric competition. Since 1994, Citizens has actively
20 participated with the Commission Staff and other stakeholders to develop
21 guiding principles, create the competition rules, and establish the structures
22 and processes through which the transition to a competitive electric
23 industry can occur in a timely, equitable and efficient manner. For more
24 than six years, Citizens representatives have actively participated in the
25 numerous groups (working groups, subcommittees, task forces, etc.) that
26 have been created to identify and resolve the myriad issues. Throughout
27 the process, Citizens has maintained a proactive stance, seeking to find

28

29

1 solutions to the complex and contentious issues as an agent for effective
2 change. Citizens continues to actively today to support the on-going efforts
3 in the development of standardized processes and market structures for
4 electric competition.

5
6 Q. Why are implementation planning, and development activities important to
7 retail direct access.

8 A. Without substantially modifying the existing operating practices and
9 structure of utility distribution companies ("UDC"), efficient implementation
10 of retail direct access would be most difficult to achieve. Beginning in the
11 fourth quarter 1998, following the Commission's approval of the emergency
12 competition rules, and continuing again in late 1999 and 2000 (following
13 the stay in the competition rules in early 1999 and the subsequent approval
14 of the final competition rules in September 1999), Citizens has undertaken
15 a significant effort to prepare its operational systems, employees and
16 customers for the introduction of electric competition. Implementation of
17 retail direct access impacts virtually every aspect of UDC operations. The
18 existing systems, processes, and procedures for maintaining the traditional
19 operations of energy procurement, metering, meter reading, billing,
20 customer information, customer and cost accounting all must be
21 significantly modified to accommodate retail direct access. In addition,
22 major new processes for establishing electronic communications with
23 multiple service providers; processing direct access service requests;
24 managing transactions among multiple market participants; and forming
25 and managing new business relationships with competitive providers are all
26 necessary to support electric competition.

1 Q. What has Citizens done to prepare its operations for retail direct access?

2 A. Citizens has established a Direct Access Implementation Team ("DAIT")
3 whose exclusive focus is preparing operations, employees, and customers
4 for electric competition. The DAIT is charged with: 1) designing the
5 required new business processes and existing process modifications; 2)
6 developing and testing new work plans and processes; 3) implementing
7 those processes; and 4) providing the necessary employee training and
8 customer education to allow for an effective rollout of retail direct access in
9 Citizens' service areas. To date, the DAIT has achieved the greatest
10 progress in steps 1 & 2 – the design and planning for direct access
11 implementation. This design and planning work has focused upon the
12 requirements under the Rules, and the preliminary findings of the
13 Commission's Process Standardization Working Group ("PSWG"). The DAIT
14 will undertake the significant amount of additional work remaining, the bulk
15 of which can not realistically proceed until Citizens has received an order
16 from the Commission in this proceeding. Citizens estimates that four
17 months of additional effort will be required after a Commission order in this
18 matter to complete its preparations for retail direct access.

19
20 Q. What ratemaking/regulatory activities has Citizens undertaken in support of
21 electric competition?

22 A. Citizens has undertaken significant activities in support of its unbundled
23 electric rates, the recovery of strandable costs, and the settlement with key
24 parties of the principles guiding retail direct access implementation.

25
26 Q. Please provide the background and status of Citizens' unbundled electric
27 rates.

28
29

1 A. Citizens submitted a timely filing of its unbundled electric tariffs in
2 December 1997 in compliance with the then-current electric competition
3 rules. The revenue-requirement and sales levels implicit in the unbundled
4 rates mirrored the bases of the tariffs put into effect in January 1997 as a
5 result of Citizens' last rate case. The unbundled rates reflected a number of
6 rate design proposals by Citizens to make them more cost reflective, a
7 significant consideration with the introduction of retail competition.
8 Following extensive negotiations with the parties during 1998, a settlement
9 was reached in which Citizens agreed to unbundle its electric tariffs "as is,"
10 that is, maintaining the cost allocation methodologies and factors among
11 customer classes and relationships between customer, energy, and demand
12 charges implicit in the existing electric tariffs. Unbundled tariffs consistent
13 with this agreement were filed with the Commission in December 1998 (but
14 not subsequently approved) and once again, with slight modifications, in
15 July 1999, to comply with the competition rules. In December 1999,
16 Citizens filed a revised set of bundled electric tariffs (which were
17 subsequently approved by the Commission in Decision No. 62082) to
18 correct certain errors recently discovered that had been made in developing
19 the rates approved in its last rate case. Citizens intends to file an updated
20 set of unbundled electric rates in this proceeding that reflect the revised
21 tariffs, the changes needed to comport with the current Rules, and the
22 specific terms of a Commission order in this case.

23
24 Q. Please provide the a narrative description of events relating to Citizens'
25 requested recovery of costs stranded by the introduction of retail electric
26 competition.

1 A. Following the Commission hearing process conducted in early 1998,
2 Citizens submitted a timely filing in August 1998 of an estimate of its
3 potential stranded costs and a proposed recovery mechanism. In March
4 1999, in compliance with the Rules, Citizens filed an update to its initial
5 stranded cost estimate that described the results of Citizens' mitigation
6 efforts. These efforts led to a 60% reduction of potentially stranded costs
7 from an original estimate of approximately \$47 million to a revised total of
8 \$18 million. A significant portion of this reduction resulted from a re-
9 negotiation of Citizens' power supply agreement with Arizona Public Service
10 Company ("APS"). In December 1999, in connection with its Purchased
11 Power and Fuel Adjustment ("PPFA") mechanism, Citizens implemented a
12 bill-credit adjustment factor that is currently passing the power cost savings
13 from the APS contract re-negotiation directly to customers.

14
15 Q. Has Citizens further re-negotiated any other terms under the APS power
16 supply agreement, since its March 1999 filing, that affect its stranded costs
17 or the implementation of open access?

18 A. Yes, it has. Citizens and APS have recently reached conceptual agreement
19 to modify the existing power supply contract in two key ways that will both
20 reduce Citizens' stranded costs and facilitate open access implementation.
21 Although, a final agreement has not yet been executed, Citizens hopes to
22 complete this effort by the scheduled hearings in this case.

23
24 Q. Please explain the contract modifications that reduce stranded costs.

25 A. Under the existing agreement, which has been in place for many years,
26 Citizens is under a long-term obligation to purchase a 100 MW block of
27 baseload capacity regardless of the level of customer loads on its system.

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1 While this power supply arrangement has been appropriate and beneficial
2 to customers as Citizens remained the sole electrical supplier for the
3 growing load requirements of all its customers, it is problematic under
4 competition where Citizens faces the prospect of losing a substantial portion
5 of its load to competitive suppliers. Citizens has negotiated with APS to
6 attempt to mitigate this potential problem. As part of an overall settlement
7 of issues, APS and Citizens now agree that, beginning in May 2002, Citizens
8 may reduce the amount of baseload capacity it purchases from APS
9 consistent with the net loss of load resulting from competition.
10

11 Q. How does this reduce stranded costs?

12 A. Under the existing agreement, the obligation to purchase the 100 MW of
13 capacity is a fixed cost, that is, a cost that does not change with sales
14 volume. Consequently, as load is lost to competition, the same fixed costs
15 are spread over a lower sales volume, and average unit costs tend to rise.
16 Another way to view this concept is to consider Citizens' generation
17 revenues versus costs under competition. Since generation rates are based
18 on total average cost, the revenue associated with each kWh sold recovers
19 a portion of the fixed capacity costs in the APS contract. When sales are
20 lost to competition, Citizens no longer recovers the associated generation
21 revenues, however, the fixed costs are not reduced. With the ability to
22 reduce the amount of baseload capacity Citizens purchases, the upward
23 push on unit costs, and the revenue-cost discrepancies, are virtually
24 eliminated. Consequently, Citizens' generation-related stranded costs are
25 dramatically reduced.
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1 Q. Do you have an estimate of the amount of reduction of stranded costs
2 resulting from this change?

3 A. I have not quantified the impact at this time, however, in general terms this
4 change in the contract all but eliminates unrecoverable generation costs
5 caused by the introduction of competition. The total exposure of the
6 potentially unrecoverable generation costs can be demonstrated by
7 considering their magnitude relative to total generation costs. In 1999, the
8 baseload capacity payments under the APS contract and total retail sales
9 were approximately \$19.3 million and 1.1 million megawatt-hours,
10 respectively. This translates to an average cost of approximately 1.75
11 cents per kilowatt-hour ("kWh") of sales. Total 1999 average generation
12 costs for Citizens are in the area of 4.5 cents per kWh. Thus the total
13 exposure of potentially unrecoverable fixed generation costs is equivalent
14 to about 40% of current total generation costs. With the changes in the
15 APS contract, the prospect of these costs becoming stranded by
16 competition is virtually eliminated.

17
18 Q. Why is this important relative to establishing Citizens' Competitive
19 Transition Charge ("CTC")?

20 A. Ratepayer equity dictates that, when customers depart their host utility
21 generation service to take advantage of competitively-price electricity, they
22 do not leave the remaining customers with the burden of paying for
23 unrecoverable fixed generation costs. If this were to occur, departing
24 customers would enjoy lower rates at the expense of increased rates for
25 Standard Offer customers. To prevent this from occurring, a CTC would
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1 need to be set so that departing customers continue to pay their share of
2 fixed generation costs. As a result of the negotiated APS contract changes,
3 this portion of the CTC is virtually eliminated.

4
5 Q. You state that these costs are "virtually" eliminated. Why are they not
6 totally eliminated?

7 A. There are two reasons why these costs are not totally eliminated. First, the
8 contract changes do not take effect until May 2002. In the meantime,
9 Citizens anticipates that its system will be open to direct access much
10 sooner, within the next several months. Consequently, there may be some
11 fixed generation transition costs that are potentially stranded in the interim.
12 Second, the terms of the contract amendments dictate that the reductions
13 in baseload contract demand are determined in advance for the coming
14 year, based on verifiable net load loss. Projecting this value will involve
15 certain assumptions about near-term future events, and therefore will be
16 subject to some degree of uncertainty. Undoubtedly there will be some
17 variance between actual and anticipated outcomes that will require
18 subsequent correcting adjustments over time. These factors will need to be
19 reflected in the design of Citizens' CTC in order to fully recover costs
20 stranded by the introduction of competition.

21
22 Q. Please explain the recent APS contract changes that facilitate open access
23 implementation in Citizens' service areas.

24 A. In its current form, billing under the APS contract is based on the total
25 electrical usage metered at a number of input points into Citizens' system.
26 The amount of power flowing across these metering points will not change
27 just because of competition, however, Citizens will actually be selling only a
28

1 portion of the total load – the difference represents power sold by
2 competitive providers to their customers. Under the conceptual agreement
3 reached with APS, the companies will restructure the relevant provisions in
4 the contract so that Citizens pays only for the power actually consumed by
5 its Standard Offer customers.

6
7 Q. What are Citizens' current proposals on recovery of stranded costs?

8 A. In general, Citizens continues to support the stranded cost recovery
9 proposals set forth in testimony filed March 1999.

10
11 Q. Please summarize those proposals.

12 A. My March 1999 testimony addressed five broad areas relating to stranded
13 costs: generation-related costs; regulatory assets; metering and billing
14 costs; transition costs; and the stranded cost recovery mechanism.

15
16 Q. Please address generation-related stranded costs.

17 A. My March 1999 testimony recommended that Citizens delay the proposed
18 divestiture of the APS contract (Citizens' proposal from its August 1998
19 stranded cost filing) in light of the negotiated reductions in the contract
20 pricing. Such a delay, it was suggested, would provide the Commission
21 with better information than was currently available to judge whether
22 Citizens' contract was sufficiently above market price to justify costs and
23 risks of divestiture. Citizens now believes that because of the recent
24 agreement with APS allowing the company to reduce its baseload capacity
25 purchases consistent with net competitive load loss, it is not necessary for
26 Citizens to divest the APS contract.

1 Q. Why is that so?

2 A. As I have described previously, the new provisions allowing reductions of
3 baseload capacity purchases effectively eliminate the potentially
4 unrecoverable fixed generation costs under the contract. While a portion of
5 Citizens' generation costs may continue to be above-market, the departure
6 of customers seeking competitive power supplies no longer impacts the
7 costs for serving the remaining Standard Offer customers.

8

9 Q. What does Citizens now propose?

10 A. Citizens proposes that it be allowed to retain the APS contract for service to
11 Standard Offer customers and to continue passing generation revenues and
12 costs through its PPFA mechanism. Moreover, since the restructured
13 contract no longer poses the threat of competition-driven generation rate
14 increases, Citizens asks that the Commission waive the requirement for
15 Citizens to acquire a portion of the power to serve Standard Offer customer
16 through an open bid process.

17

18 Q. Why is this open-bid power supply issue important?

19 A. Citizens has been, and continues to be, essentially an all-requirements
20 customer of APS, at least with respect to its Standard Offer customer load.
21 If Citizens were required to secure Standard Offer power supply from
22 alternative sources, it could do so only by either abrogating the APS
23 contract or paying twice for the same power (once to APS, once to the
24 winning open-market bidder). In addition to the rate equity reasons cited
25 above, allowing Citizens to retain the contract avoids the necessity to
26 consider, as well as the costs and risks, of contract divestiture.

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1 Q. Why can't Citizens simply sell on the open market the APS contract power
2 freed-up by competition?

3 A. Citizens does not have the rights under the APS contract to any more
4 power than is metered for service to Standard Offer customers.
5

6 Q. How should generation-related stranded costs be calculated?

7 A. As described in my March 1999 testimony, Citizens should be permitted to
8 establish a net-revenues-lost procedure that accumulates the difference
9 between generation revenues lost to competition and the change in
10 generation costs associated with the lost sales.
11

12 Q. Should Citizens' Standard Offer tariffs include a generation shopping credit?

13 A. Yes, they should. Citizens believes that generation shopping credits
14 commensurate with those established for APS should be implemented
15 within Citizens' tariffs.
16

17 Q. Why is this so?

18 A. First, Citizens' power supply resources are essentially a subset of the APS
19 resource portfolio. This observation suggests that symmetry in treatment
20 between the two companies is appropriate. Moreover, recognizing that the
21 Commission-approved APS generation shopping credits have been designed
22 to reflect the market price of power, there is no reason to assert that the
23 market price of an electric power commodity should be different for
24 Citizens' customers in Arizona than for APS' customers. Finally, it is in the
25 best interest of Arizona, and the success of the competitive electric
26 industry, to avoid establishing of a patchwork of generation shopping
27 credits across the State. Non-uniform credits will result in unequal
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1 emphasis in marketing by competitive providers and therefore promote an
2 unequal opportunity for Arizona electric customers to glean the benefits of
3 electric competition. Citizens can see no reason why the Commission
4 should promote such an outcome.

5
6 Q. How does this recommendation comport with the fact that the Commission
7 has already approved generation shopping credits that are not uniform
8 across utilities.

9 A. Citizens understands that Tucson Electric Power, for instance, has a
10 different generation shopping credit than APS. However, Citizens does not
11 believe that this fact makes the benefits of greater uniformity across
12 Arizona any less desirable. APS is the State's largest electric utility and
13 serves a broad area of Arizona. Setting Citizens' generation shopping
14 credits equal to APS' credits will add Mohave and Santa Cruz Counties and
15 nearly 70,000 more customers to the portion of the State under a uniform
16 credit.

17
18 Q. Does Citizens continue to support its proposal to recover costs of its
19 Valencia generation facilities through unbundled transmission charges?

20 A. Yes it does, for reasons cited in Citizens' August 1998 stranded cost filing
21 and my March 1999 testimony.

22
23 Q. Please address Citizens' stranded costs associated with regulatory assets.

24 A. As set forth in Citizens' August 1998 stranded cost filing, and affirmed in
25 my March 1999 testimony, Citizens proposes that it be allowed to recover
26 the regulatory assets consisting of previously-deferred and unrecovered
27 DSM and DSM lost revenues as part of its stranded costs. The current
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1 balance of these costs is estimated to be roughly \$3.5 million. At the time
2 of a compliance filing in this proceeding, Citizens proposes that it be
3 allowed to update the balance of these regulatory assets to properly reflect
4 carrying charges and the effect of related deferred income taxes, and to
5 include recovery of these costs in its System Benefits Charge
6

7 Q. Please address stranded costs associated with metering and billing.

8 A. Citizens continues to support its proposals for recovering metering and
9 billing costs stranded by the introduction of retail competition as set forth in
10 my March 1999 testimony. In summary, Citizens proposes to recover net
11 lost revenues calculated as the difference between metering and billing
12 revenues lost to competition and the reduction in variable costs associated
13 with departing customers who are no longer taking these services from
14 Citizens. The basic procedure for how this calculation would be done,
15 including the establishment of a metering and billing deferral account for
16 tracking these costs, is provided in my March 1999 testimony.
17

18 Q. Please address transition costs.

19 A. As described in Citizens' August 1998 stranded cost filing, and again in my
20 March 1999 testimony, Citizens anticipates substantial "transition costs" to
21 effect the implementation of retail direct access. Such costs would likely
22 not otherwise arise. Citizens continues to support the proposals for
23 accounting and recovery of transition costs described in my March 1999
24 testimony. In summary, Citizens proposes to:

- 25 • establish a Competitive Transition Deferral Account ("CTDA") for
26 accumulating legitimate incremental costs for implementing direct
27 access;

- 1 • accumulate carrying charges on the unamortized balance in the
- 2 CTDA;
- 3 • amortize deferred costs in the CTDA, subject to Commission approval,
- 4 through the CTC to be established in this proceeding; and
- 5 • continue deferral and CTC amortization of costs during the initial
- 6 stages of electric competition, until a more stable process is
- 7 established, and thereafter, include the incremental costs of direct
- 8 access implementation in basic service rates, as a component of
- 9 Citizens' next general rate case.

10
11 Q. Does Citizens have an updated estimate for its transition costs?

12 A. No, not at this time. However, I believe the estimates included in its
13 August 1998 filing and affirmed in my March 1999 testimony continue to be
14 reasonable.

15
16 Q. Please address Citizens' proposed stranded cost recovery mechanism.

17 A. Citizens proposes a stranded cost recovery mechanism that:

- 18 1. establishes the CTC for each rate class based on the difference
- 19 between total average generation costs and the generation shopping
- 20 credit;
- 21 2. periodically (annually in initial stages, perhaps bi-annually thereafter),
- 22 in a proceeding before the Commission, reconciles actual stranded
- 23 costs and CTC revenues and considers establishment of a new CTC for
- 24 the next period based in true-ups from the prior period and updated
- 25 forecasts. The extent of adjustment of the CTC for any particular
- 26 reconciliation would consider the impact of the adjustment on the
- 27 shopping credit, recognizing that changes in the CTC necessarily
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- 1 change the magnitude of the generation shopping credits;
2 3. during the transition period (consistent with the term of the APS
3 contract (2011)), allows for consideration of alternative
4 recovery/refund mechanisms to the extent the absolute value of
5 balance in the CTC account grows large (e.g. greater than
6 \$1,000,000);
7 4. at the end of the transition period, establishes a surcharge that
8 recovers or refunds the balance in the CTC account.
9

10 Q. What is Citizens' ultimate goal in its proposal for a stranded cost recovery
11 mechanism?

12 A. Citizens' ultimate goal in this proposal is to avoid increasing its business
13 and financial risk, while allowing for a fair and efficient recovery process.
14 Citizens would consider alternative mechanisms that support an efficient
15 open market process, as long as Citizens is made whole for the costs
16 stranded by competition and not put at risk by a lengthy delay in cost
17 recovery.
18

19 Q. Does Citizens continue to support a CTC rate design that employs a flat
20 monthly fee based on historical usage levels.

21 A. No, it does not. Given that dramatic reductions in strandable costs that will
22 result from the recent conceptual agreement with APS, the underlying
23 reasons for its support of CTC rate design are no longer valid. Instead,
24 Citizens supports a CTC rate design based on a per-kWh and/or per-kW
25 charge applicable to current consumption.
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1 Q. Does Citizens have proposals relative to its Unbundled and Standard Offer
2 tariffs?

3 A. Yes, it does. Citizens continues to generally support the tariffs it filed with
4 the Commission July 1, 1999, but proposes that it be allowed to make three
5 substantive adjustments to: 1) implement generation shopping credits for
6 each tariff generally as I have described earlier in my testimony; 2) modify
7 its System Benefits Charge to include DSM and DSM lost net revenue
8 recovery; and 3) to remove Western Area Power Administration ("WAPA")
9 transmission costs from the generation charge and include them instead
10 within the non-bypassable unbundled transmission charge.

11
12 Q. Why should the Commission allow these changes?

13 A. The reasons for implementing generation shopping credits and allowing
14 DSM/DSM lost net revenue recovery have been addressed earlier in my
15 testimony. The reason for allowing Citizens to unbundle its WAPA
16 transmission costs from generation relates to changes in the Commission's
17 Electric Competition Rules.

18
19 Q. Please explain.

20 A. The final Rules approved by the Commission in September 1999 include the
21 provision that "Utility Distribution Companies shall retain the obligation to
22 assure that adequate transmission import capability is available to meet the
23 load requirements of all distribution customers within their service areas."
24 (R14-2-1609B). In Citizens' case, transmission import capability is
25 provided largely through its transmission service contract with WAPA.
26 Since transmission import capability must be maintained for all customers,
27 regardless of whether they are taking competitive or Standard Offer

1 services, it follows that all customers should pay the costs of these
2 transmission services through a wires charge. Citizens proposes to ensure
3 this occurs by including WAPA costs within the Transmission charge in its
4 tariffs and making that portion of its transmission charge subject to
5 adjustment to reflect increases or decreases in the cost of these services,
6 as is now the case through Citizens' current PPFA mechanism.

7
8 Q. Does this conclude your testimony?

9 A. Yes, it does.

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Schmidt

BEFORE THE ARIZONA CORPORATION COMMISSION

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF
CITIZENS UTILITIES COMPANY FOR
APPROVAL OF ITS PLAN FOR STRANDED
COST RECOVERY.

DOCKET NO. E-01032C-98-0474

IN THE MATTER OF THE FILING BY
CITIZENS UTILITIES COMPANY OF
UNBUNDLED AND STANDARD OFFER
SERVICE TARIFFS PURSUANT TO A.A.C.
R14-2-1606.

DOCKET NO. E-01032C-97-0774

IN THE MATTER OF COMPETITION IN
THE PROVISIONS OF ELECTRIC
SERVICES THROUGHOUT THE STATE OF
ARIZONA.

DOCKET NO. RE-0000C-94-0165
**SETTLEMENT AGREEMENT
BETWEEN COMMISSION STAFF,
RESIDENTIAL UTILITY
CONSUMER OFFICE, AND
CITIZENS COMMUNICATIONS
COMPANY**

The Arizona Corporation Commission Staff ("Staff"), the Residential Utility Consumer Office, ("RUCO") and the Arizona Electric Division (AED) of Citizens Communications Company¹ ("Citizens") have engaged in settlement discussions concerning the above-referenced dockets. These discussions have led to the following points of agreement that are intended to resolve all issues between Staff, RUCO and Citizens in these dockets:

1. Except as specifically stated otherwise in the following paragraphs,

¹ Citizens Utilities Company changed its name to Citizens Communications Company, effective May 18, 2000.

1 Citizens' proposed unbundled and standard offer service tariffs, and plan for
2 stranded cost recovery, as discussed in the prefiled testimony of Sean R. Breen in
3 Docket No. E-01032C-98-0474, are acceptable.

4 **RETAIL ACCESS IMPLEMENTATION**

5 2. If a final Commission order in this matter is issued on or before
6 August 1, 2000, Citizens' AED distribution system will open for retail direct access
7 on December 1, 2000, in general accordance with the current form of Electric
8 Competition Rules (with exceptions as specified below). Should Commission
9 approval occur after August 1, 2000, Citizens will endeavor to implement retail
10 access within four calendar months of the final order. Citizens may withdraw from
11 this agreement if the Commission does not issue a final order by September 30,
12 2000.

13 3. Citizens will make retail access immediately available to all customers
14 without phase-in limitations on the date it opens its service area to competition.
15 Citizens' Residential Phase-In Program ("RPIP") filed with the Commission (and
16 amended) in 1998, is no longer applicable; however, Citizens will report on the
17 relevant data required under R14-2-1604.B.5.

18 4. Citizens' will take all reasonable measures to finalize satisfactory
19 changes to Citizens' existing Power Service Agreement with Arizona Public
20 Service Company ("APS") to allow for scheduling of competitive loads into
21 Citizens' service areas.

22 5. Citizens has no current plans for establishing a competitive electric
23 affiliate for providing Competitive Services. Until or unless Citizens does seek to
24 offer Competitive Services, Citizens is not required to structurally or functionally
25 separate any of the present functions of its electric operations or to propose or
26 adopt a Code of Conduct under R14-2-1616. Nothing in this provision prevents
27 any successor organization to Citizens from engaging in competitive electric
28 activities under the Commission Rules applicable at the time.

29

1 **RATE MATTERS**

2 6. The Parties acknowledge that Citizens has recently received approval
3 to implement a bill-credit adjustment factor under its Purchased Power and Fuel
4 Adjustment Clause (PPFAC) to pass onto customers substantial reductions in
5 power costs recently negotiated by Citizens. Further, Citizens is currently
6 completing negotiations with APS that will provide further customer benefits and
7 significantly reduce Citizens' stranded cost liabilities. These reductions satisfy the
8 requirements of R14-2-1604.C. for "possible mechanisms" for rate reductions for
9 Standard Offer customers.

10 7. No later than 30 days after an order is issued approving this
11 Settlement Agreement , Citizens will file a new set of Standard Offer and
12 Unbundled Tariffs that include (in part) the following features:

- 13 a) an annually updated Competitive Transition Charge (CTC) for each rate
14 tariff established, on a prospective basis, for recovery of annual
15 Generation Transition Costs (GTC). GTCs are defined as the positive
16 difference between generation rate revenues that would have been paid
17 during the next year by customers expected to depart and the costs
18 that will be avoided as a result of this load loss. The CTCs for each
19 customer class will be calculated as follows:

20
$$[(\text{current generation rates for that class}) * (\text{projected lost sales}$$

21 for the class) - (an estimate of generation costs that will be

22 avoided in the upcoming year for that class attributed to the

23 projected class electric sales to be supplied by competitive

24 generation providers)] / (the projected amount of lost sales for

25 the class).

26 With the CTC established in this manner, the migration of customers to
27 competitive providers will not cause an increase in Standard Offer
28 generation rates, because the class-specific CTC will be recovered from
29

1 all customers in that class whether on Standard Offer rates, or not. The
2 initial CTCs will be based on an estimated 10% sales migration for all
3 rate classes;

- 4 b) an annual procedure that includes a reconciliation of CTC revenues with
5 the GTC for the current year, and adjusts the CTC as computed in a)
6 above for any over/under recovery of GTC in the current year, subject
7 to a 2 mill/kWh per year limit on any CTC rate increase.
- 8 c) an allowance for carrying charges to be accrued on the balance of the
9 CTC reconciliation account computed using a rate indicative of the
10 Company's incremental borrowing cost;
- 11 d) a generation shopping credit for each rate class, that equals the
12 difference between the class generation rate and the respective class
13 CTC, and which shall be adjusted once per year on the anniversary of
14 the start of retail competition;
- 15 e) shopping credits for metering, meter reading, and billing based on the
16 full unbundled charge within each tariff;
- 17 f) included in the System Benefits charge for each rate class (in addition
18 to costs previously reflected in Citizens' July 1, 1999 Unbundled Rates
19 filing) will be the applicable portion of previously-deferred, Commission-
20 approved DSM expenditures, less the \$1.5 million refund from APS
21 resulting from the new contract renegotiation (including allowed accrued
22 carrying charges) over the transition period, recognizing the amounts
23 currently allowed in rates for this purpose;
- 24 g) a provision that, should any under-recovered balance in the CTC
25 reconciliation account exceed \$3,000,000 and be expected to continue
26 growing at a significant rate, the parties are in agreement that it is
27 appropriate for Citizens to seek accelerated recovery of the CTC
28 balance;.

- 1 h) a provision that, if the CTC reconciliation account reflects an over- or
2 under-recovered balance at the end of the competitive transition
3 period, Citizens' CTC surcharge or surcredit, as appropriate, will
4 continue until any balance is fully recovered or refunded;
- 5 i) a per-kWh and/or per-kW (as relevant) generation CTC levied on actual
6 customer usage/demand for the billing period;
- 7 j) a new section of Citizens' Rules and Regulations ("Terms and Conditions
8 for Direct Access") that sets forth the rules and regulations for
9 implementation of direct access in Citizens' service area, including direct
10 access service fees.
- 11 k) an unbundled transmission charge that includes the costs of
12 transmission services provided by the Western Area Power
13 Administration (WAPA) after that charge has been removed from
14 generation rates, and is subject to adjustment to reflect any increase or
15 decrease in the cost of WAPA transmission services; and
- 16 l) a modified Purchased Power and Fuel Adjustment Clause (PPFAC)
17 mechanism applicable to Standard Offer generation, which will function
18 in the same manner as the current mechanism, except for: 1) the
19 appropriate allocation of CTC revenues and GTC to the CTC account so
20 that Standard Offer generation rates will not be increased as a result of
21 competitive sales migration; and 2) the use of a separate adjustment
22 calculation and account for WAPA transmission costs. In addition, the
23 existing \$2.6 million threshold initiating changes to the PPFAC rate
24 adjustment factor will be eliminated, and the PPFAC adjustment to rates
25 will occur simultaneously and consistently with the annual adjustment to
26 the CTC. This provision shall not prevent Citizens from filing for an
27 adjustment to the PPFAC at some other time, in the event of i)
28 conditions or circumstances that constitute an emergency, or ii)
29

1 material changes in the cost of purchased power or fuel as a result of
2 federal, tribal, state or local laws; regulatory requirements; or judicial
3 decisions, actions or orders.;

4 m) a competitive transition period consistent with the duration of Schedule
5 A of the APS Power Service Agreement (currently 2011), if the current
6 APS contract is kept. If the current APS contract is divested, then the
7 transition period ends as of the date of divestiture.

8 8. Revenue requirements applicable to Citizens' Valencia generation
9 facilities will be recovered in rates for distribution service. If the Valencia
10 facilities are no longer needed to support local transmission reliability, or other
11 significant operating changes occur, Citizens will make a filing with the
12 Commission to determine if and how rates should be revised to account for the
13 changes that have occurred.

14 **REGULATORY ASSETS AND TRANSITION COSTS**

15 9. Citizens shall utilize the projected refund from APS to reduce its
16 current balance of previously-deferred DSM expenditures of approximately \$2.5
17 million. The balance, including carrying charges computed at Citizens' approved
18 AFUDC rate, may be recovered through the System Benefits Charge for each rate
19 class using the allocation method for these costs now reflected in Citizens' rates,
20 at the amortization rate allowed for deferred DSM recovery in Citizens' last rate
21 case. Citizens will file with the Commission for a change in its Systems Benefit
22 Charge when the deferred DSM balance is fully amortized, which should occur in
23 less than seven years.

24 10. Citizens will continue to defer DSM lost net revenues as provided for
25 in Decision No. 59951. Citizens may seek recovery for this item in a future rate
26 case, but Staff takes no position at this time on whether recovery should be
27 allowed.

28 11. A Competitive Transition Deferral Account ("CTDA") will be set up for
29

1 deferral of prudently-incurred, incremental transition costs directly related to and
2 resulting from the implementation of electric competition. The parties to this
3 agreement will support Citizens' recovery of legitimate, prudently-incurred
4 transition costs. This settlement agreement is intended to provide Citizens'
5 reasonable assurance that these transition costs will be recovered in future rates.
6 Amounts to be deferred will be calculated in accordance with the procedure set
7 forth in Appendix A. Incremental transition costs may include, but are not limited
8 to, costs for:

- 9 • the systems and processes for enabling retail access transactions,
10 including costs associated with establishing scheduling coordinator
11 services, accounting systems(s) to separate competitive service
12 customer's load from Standard offer customer load, and the costs to
13 implement Electronic Data Interchange systems and protocols;
- 14 • stranded costs associated with competitive provision of metering and
15 billing services;
- 16 • consumer education;
- 17 • divestiture of the APS Power Service Agreement if deemed
18 appropriate based on further discussion with the parties to this
19 agreement;
- 20 • participation in the establishment and operation of the Arizona
21 Independent System Administrator (and any successor entity);
- 22 • regulatory matters directly associated with electric competition; and
- 23 • carrying charges accrued at Citizens' AFUDC rate computed on the
24 rate-of-return tested balance in the CTDA.

25 12. The Parties understand that, due to certain provisions under Schedule
26 A of the APS contract, competitive sales loss may have the effect of increasing
27 the Competitive Transition Charge. It is further understood that proceeding with
28 divestiture of the APS agreement to value stranded costs involves additional
29

1 costs, which should only be incurred if the level of actual competitive sales loss
2 creates undue impact on the CTC. Consequently, Citizens should only proceed
3 with divestiture of the APS Power Service Agreement if actual competitive sales
4 loss has a significant impact on the CTC. If this occurs, Citizens will apply to the
5 Commission for authority to proceed with divestiture of the APS contract through
6 an open bid process with the goal of transferring the rights and obligations under
7 the contract to a third party within approximately six months of the time from
8 when the decision to divest was made.

9 13. The Commission should waive R14-2-1606.B, requiring competitive
10 market purchase of Standard Offer generation, during the period Citizens retains
11 the APS contract. Should Citizens proceed with divestiture of its power supply
12 contract, stranded generation costs will be determined by the difference between
13 the proceeds from the sale and the future obligations under the contract. In
14 either case, Citizens may recover 100% of these stranded costs over the
15 transition period. If Citizens does divest the APS contract and incurs unrecovered
16 stranded costs, then Citizens may recover carrying charges on the unrecovered
17 balance calculated at Citizens' approved AFUDC rate.

18 14. If large customers choose competitive suppliers and then desire to
19 return to Citizens' service, the cost to supply returning customers may be higher
20 than for other Standard Offer customers. Citizens shall have the right to file a
21 Default Service rate for returning large customers that reflects the incremental
22 cost of providing such service. For these purposes, a large customer shall be
23 defined as any customer with a total load of 1 megawatt or greater.

24 **SUPPORT OF SETTLEMENT AGREEMENT**

25 15. The parties will support this Agreement in these dockets through
26 testimony and other appropriate means, as necessary.

27 16. This Agreement represents a compromise and settlement of disputed issues
28 and resolves all outstanding issues in these proceedings. If this Agreement is not
29

1 accepted by the Commission, none of the Parties compromises or otherwise
2 waives any position it has taken or may take on these issues.

3 17. The provisions of this Agreement are not severable and are effective only
4 after the Commission enters an order approving this Agreement without
5 modification. If this Agreement is not approved by the Commission in the form
6 submitted, it is deemed withdrawn, and its stipulations are void.

7 18. The Parties urge the Commission to approve this Agreement.

8
9 DATED June __, 2000

10 Staff of the Arizona Corporation Commission

11
12 By: Barbara W. Teske
13 Title: Assistant Director
14

15 Residential Utility Consumer Office

16
17 By: Brian Townsend
18 Title: Deputy Director
19

20 Citizens Utilities Company

21
22 By: Cecil W. Anderson
23 Title: Vice President
24

Appendix A

Formula for Computing the Allowed Deferral of Incremental Transition Costs

Purpose

The purpose of this calculation is to make periodic determination of the amount of prudently-incurred, incremental transition costs that Citizens may defer in its Competitive Transition Deferral Account.

Frequency of Calculation

This calculation will be done annually based on the calendar-year financial performance of Citizens. Citizens will endeavor to submit the results of this calculation to Staff on or before March 31 of the following year or as soon as actual financial results are available.

Base Year

The results of the calculation will be compared to the reported financial results of a base year of the twelve-month period ending March 31, 1995, adjusted for the granted increases in Citizens' last rate case. Should the Commission determine that either a rate increase or decrease is justified, the base year for comparison will become the reported financial results for the new test-year underlying such rate adjustment.

Method

The extent of allowed deferral of transition costs will depend on the relationship between the Per Books Rate-of-Return (PBROR) for the period compared to the PBROR for the base year, as follows:

- If the PBROR for the period, without inclusion of the transition costs, is lower than the base-year PBROR, then Citizens may defer 100% of the transition costs;
- If the PBROR for the period, after inclusion of the transition costs, is higher than the base-year PBROR, then none of the transition costs

1 incurred in the period may be deferred.

- 2 • If inclusion of transition costs causes the PBROR for the period to
3 decrease from a level higher to a level lower than the base-year PBROR,
4 then Citizens may defer only the portion of transition costs that causes
5 the PBROR to fall below the base-year level.

6 PBROR = Net Operating Income/Net Rate Base, where:

7 Net Operation Income = Operating Revenue - Operations &
8 Maintenance Expense - Depreciation - Interest on Customer
9 Deposits - Taxes; and

10 Net Rate Base = Plant in Service - Accumulated Depreciation +
11 Materials and Supplies - Contributions in Aid of Construction -
12 + Accumulated Amortization of CIAC - Advances for
13 Construction - Customer Deposits - Accumulated Deferred
14 Taxes.

15 The PBROR for the base year is as follows:

	T.Y. Ending 3/31/95	Granted Adjustments	Adj. Per Books Test-Year
16 Operating Revenue	\$84,297,834	\$ 474,428	\$84,772,262
18			
19 Operating Expenses:			
20 Operation & Main.	\$59,487,665		
21 Depreciation	\$ 6,637,086		
22 Int.-Cust. Dep[a]	\$ 126,520		
23 Other Taxes	\$ 9,109,784		
24 <u>Income Taxes[b]</u>	<u>\$ 2,369,609</u>	<u>\$ 186,355</u>	<u>\$ 2,555,964</u>
25 Total	\$77,730,664	\$ 186,355	\$77,917,019
26			
27 Net Operating	\$6,567,170	\$ 288,073	\$ 6,855,243
28 Income			

1 **Rate Base:**

2	Plant in Service	\$172,286,035
3	Accum. Depreciation	\$(55,499,124)
4	Material & Supplies	\$ 1,822,277
5	CIAC[c]	\$ (4,606,311)
6	Accum. Amort. of CIAC[c]	\$ 636,554
7	Advances for Cons.	\$(15,047,932)
8	Customer Deposits	\$ (2,108,667)
9	<u>Accum. Deferred Taxes</u>	<u>\$ (4,101,165)</u>

10 **Net Rate Base** **\$93,381,667**

11

12 [a] Computed at the statutory rate of interest - currently 6%

13 [b] Computed at 39.28% of NOIBIT less synchronized interest

14 [c] Reported as part of PIS and Accum. Depr. in book numbers

15

16 **Base Year PBROR=Net Operating Income/Net Rate**

17 **Base=\$6,855,243/\$93,381,667=7.34%**

18

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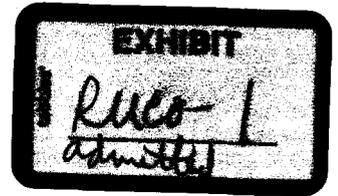
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CITIZENS UTILITIES COMPANY

DOCKET NO. E-01032C-98-0474

DOCKET NO. E-01032C-97-0774

DIRECT TESTIMONY
OF
MARYLEE DIAZ CORTEZ

ON BEHALF OF
THE
RESIDENTIAL UTILITY CONSUMER OFFICE

JUNE 20, 2000

1 Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

2 A. My name is Marylee Diaz Cortez. I am a Certified Public Accountant. I am the
3 Utilities Audit Manager for the Residential Utility Consumer Office located at 2828
4 North Central, Suite 1200 Phoenix, Arizona.

5
6 Q. PLEASE SUMMARIZE YOUR EXPERIENCE AND QUALIFICATIONS.

7 A. Appendix I, which is attached to this testimony, describes my educational
8 background and includes a list of the rate case and regulatory matters in which I
9 have participated.

10
11 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

12 A. The purpose of my testimony is to support the Settlement Agreement between
13 Commission Staff, Residential Utility Consumer Office (RUCO), and Citizens
14 Communications Company.

15
16 Q. PLEASE SUMMARIZE THE TERMS OF THE SETTLEMENT AGREEMENT.

17 A. There are ten main terms of the Settlement Agreement, which I believe on
18 balance render the Agreement in the public interest. The most important terms
19 are as follows:

- 20 1. The Agreement allows for retail access to begin as early as December
21 1, 2000 for all customers.

- 1 2. It establishes a procedure for dealing with any stranded generation
2 costs associated with Citizens' current all requirements purchased
3 power contract with Arizona Public Service Company (APS). This
4 procedure helps to ensure that ratepayers will not over-pay for
5 stranded costs, because it includes an annual true-up mechanism. It
6 also limits the rate of increase of the CTC from one year to the next to
7 2 mills per kWh, thus protecting ratepayers from sudden rate
8 increases.
- 9 3. It establishes a methodology for setting the generation rate for Citizens'
10 standard offer customers once retail access begins, and only allows
11 that rate to be changed once per year through the end of the transition
12 period in 2011.
- 13 4. It approves a previous unbundling of Citizens' electric rates. It also
14 shifts some Western Area Power Administration (WAPA) related
15 transmission costs and some Valencia-related system reliability costs
16 out of generation rates and into transmission and distribution rates.
- 17 5. It allows Citizens to use the significant cost reductions that have been
18 negotiated previously with APS with regard to the current purchased
19 power contract to satisfy the requirements of R14-2-1604.C as a rate
20 reduction for standard offer customers.

1 6. It establishes a procedure for Citizens to recover certain existing DSM
2 investments from all ratepayers, through a small system benefits
3 charge.

4 7. It allows for legitimate and prudent transition costs for establishing
5 retail competition to be recovered from ratepayers through a CTC
6 charge.

7 8. It makes the need to divest the purchased power contract with APS
8 much less likely.

9 9. It allows all but the very largest customers (greater than 1 megawatt)
10 to return to standard offer service if they leave that service, thus
11 protecting them from the possibility of significant rate increases if the
12 market price for power turns out to be well above Citizens' APS
13 contract price.

14 10. It will reduce transaction costs by not requiring the competitive market
15 purchase of standard offer generation.

16
17 Q. WHY ARE THESE PROVISIONS IN THE PUBLIC INTEREST?

18 A. It is important to understand that Citizens' situation is atypical within Arizona with
19 regard to stranded generation costs. Citizens buys all of its power under a
20 purchased power contract from Arizona Public Service. As of a couple of years
21 ago, that contract seemed somewhat above market prices, thus leading to the

1 belief that some of the costs of the purchased power would become stranded
2 costs. However, in the interim, Citizens has actively sought to reduce its
3 stranded costs, and has negotiated a rate reduction with APS. It has also
4 recently concluded a further re-negotiation of certain terms of the APS contract,
5 which allow Citizens to take less power if some of its load is lost to retail
6 competition. Citizens claims that beginning in May 2002 it should be able to
7 almost entirely avoid any stranded costs. Based on this understanding, RUCO
8 has agreed to the stranded cost determination and recovery procedures
9 described in the Settlement Agreement. The Agreement provides for a minimal
10 level of stranded costs to be paid by ratepayers in the short run, and almost no
11 stranded costs in the medium to long run.

12
13 This ought to allow customers the use of almost all of their current unbundled
14 generation rates under the standard offer as a baseline with which to shop for
15 alternative supplies of power. Because stranded costs are minimized the
16 possibility that all customers will be able to reduce their electric rates further, by
17 finding alternative generation suppliers who can under-bid the standard offer
18 rates is maximized. Further, if customers cannot reduce their rates in this
19 manner they are protected from further increases above the standard offer by the
20 APS contract rates for more than 10 years. Thus, this agreement appears to

1 maximize the possibility of retail competition, while minimizing both stranded
2 costs and the risks of future rate increases for Citizens' electric customers.
3

4 Q. ARE THERE ANY OTHER ADVANTAGES OF THE SETTLEMENT
5 AGREEMENT FOR RATEPAYERS?

6 A. Yes. The Agreement tends to minimize the transition costs for establishing retail
7 competition because it does not require competitive bidding for standard offer
8 generation. This is particularly important for a small utility like Citizens where the
9 costs of processing and negotiating new generation bids and contracts could be
10 quite significant per kWh sold. Therefore, the newly re-negotiated purchased
11 power contract with APS most likely will prove to be the lowest cost way of
12 meeting the power requirements of Citizens' standard offer customers.
13 Presumably, by now, the prices in the final version of the APS contract are
14 reasonably close to expected wholesale market prices in the region. In fact,
15 given the possible exercise of market power in the region, the prices in the re-
16 negotiated APS contract might turn out to be lower than actual market prices.
17

18 A requirement that Citizens go out to bid for generation for the standard offer
19 customers is therefore unnecessary because doing so would be duplicative of
20 the contract Citizens has successfully re-negotiated. Even prior to the re-
21 negotiation of the APS contract it would not have made sense for Citizens to

1 secure new purchased power contracts through bidding. The transaction costs
2 of arranging for these new contracts would most likely exceed any benefits that
3 could be obtained, thereby serving only to increase either stranded costs or
4 standard offer generation prices.

5

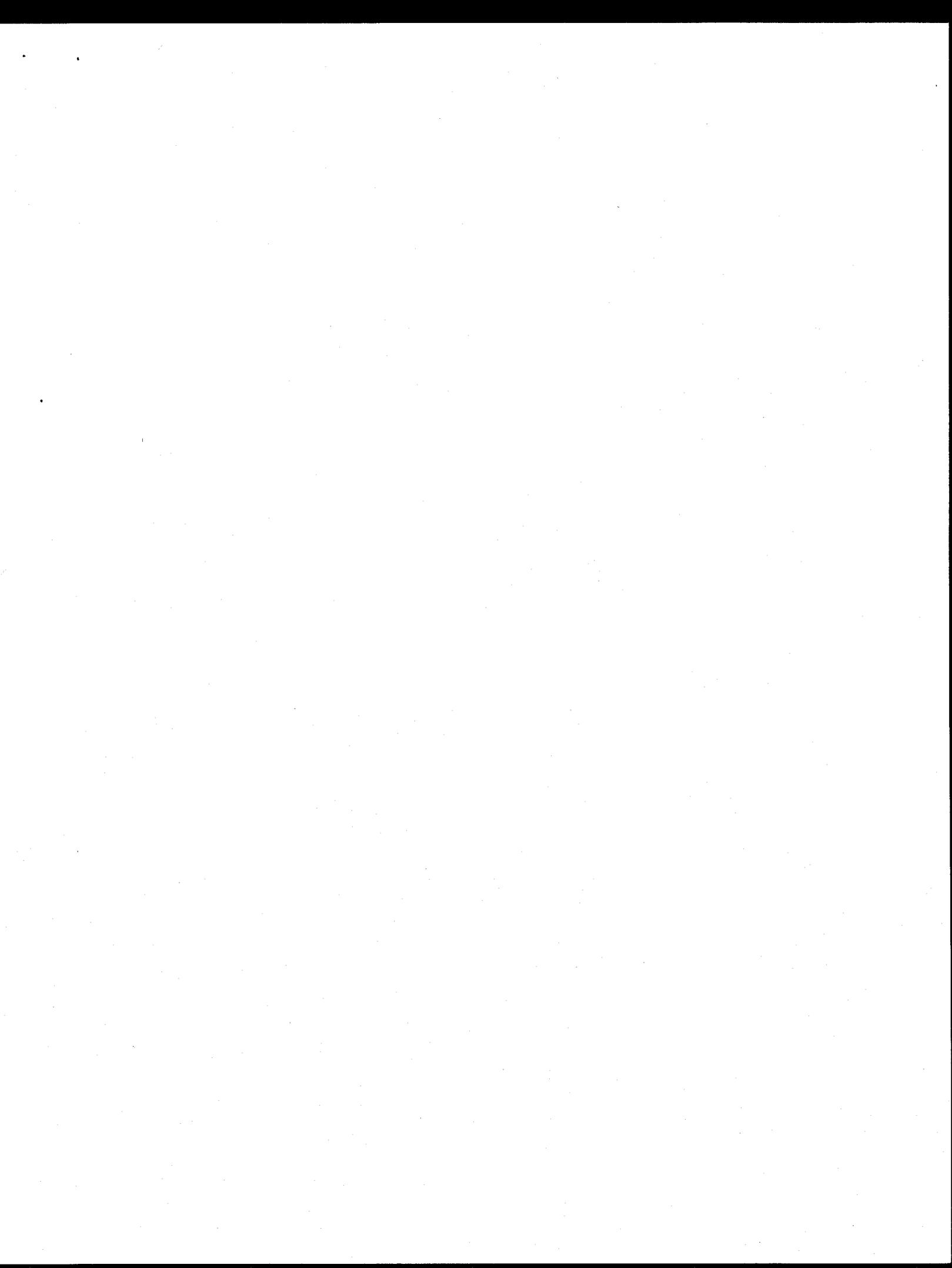
6 Q. SHOULD THE SETTLEMENT AGREEMENT BE APPROVED?

7 A. Yes. The Settlement Agreement reaches fair and reasonable resolution of the
8 issues in this docket and is in the public interest.

9

10 Q. DOES THAT CONCLUDE YOUR TESTIMONY?

11 A. Yes.



APPENDIX I

Qualifications of Marylee Diaz Cortez

- EDUCATION:** University of Michigan, Dearborn
B.S.A., Accounting 1989
- CERTIFICATION:** Certified Public Accountant - Michigan
Certified Public Accountant - Arizona
- EXPERIENCE:** Audit Manager
Residential Utility Consumer Office
Phoenix, Arizona 85004
July 1994 - Present

Responsibilities include the audit, review and analysis of public utility companies. Prepare written testimony, schedules, financial statements and spreadsheet models and analyses. Testify and stand cross-examination before Arizona Corporation Commission. Advise and work with outside consultants. Work with attorneys to achieve a coordination between technical issues and policy and legal concerns. Supervise, teach, provide guidance and review the work of subordinate accounting staff.

Senior Rate Analyst
Residential Utility Consumer Office
Phoenix, Arizona 85007
October 1992 - June 1994

Responsibilities included the audit, review and analysis of public utility companies. Prepare written testimony and exhibits. Testify and stand cross-examination before Arizona Corporation Commission. Extensive use of Lotus 123, spreadsheet modeling and financial statement analysis.

Auditor/Regulatory Analyst
Larkin & Associates - Certified Public Accountants
Livonia, Michigan
August 1989 - October 1992

Performed on-site audits and regulatory reviews of public utility companies including gas, electric, telephone, water and sewer

throughout the continental United States. Prepared integrated proforma financial statements and rate models for some of the largest public utilities in the United States. Rate models consisted of anywhere from twenty to one hundred fully integrated schedules. Analyzed financial statements, accounting detail, and identified and developed rate case issues based on this analysis. Prepared written testimony, reports, and briefs. Worked closely with outside legal counsel to achieve coordination of technical accounting issues with policy, procedural and legal concerns. Provided technical assistance to legal counsel at hearings and depositions. Served in a teaching and supervisory capacity to junior members of the firm.

RESUME OF RATE CASE AND REGULATORY PARTICIPATION

<u>Utility Company</u>	<u>Docket No.</u>	<u>Client</u>
Potomac Electric Power Co.	Formal Case No. 889	Peoples Counsel of District of Columbia
Puget Sound Power & Light Co.	Cause No. U-89-2688-T	U.S. Department of Defense - Navy
Northwestern Bell-Minnesota	P-421/EI-89-860	Minnesota Department of Public Service
Florida Power & Light Co.	890319-EI	Florida Office of Public Counsel
Gulf Power Company	890324-EI	Florida Office of Public Counsel
Consumers Power Company	Case No. U-9372	Michigan Coalition Against Unfair Utility Practices
Equitable Gas Company	R-911966	Pennsylvania Public Utilities Commission
Gulf Power Company	891345-EI	Florida Office of Public Counsel

Jersey Central Power & Light	ER881109RJ	New Jersey Department of Public Advocate Division of Rate Counsel
Green Mountain Power Corp.	5428	Vermont Department of Public Service
Systems Energy Resources	ER89-678-000 & EL90-16-000	Mississippi Public Service Commission
El Paso Electric Company	9165	City of El Paso
Long Island Lighting Co.	90-E-1185	New York Consumer Protection Board
Pennsylvania Gas & Water Co.	R-911966	Pennsylvania Office of Consumer Advocate
Southern States Utilities	900329-WS	Florida Office of Public Counsel
Central Vermont Public Service Co.	5491	Vermont Department of Public Service
Detroit Edison Company	Case No. U-9499	City of Novi
Systems Energy Resources	FA-89-28-000	Mississippi Public Service Commission
Green Mountain Power Corp.	5532	Vermont Department of Public Service
United Cities Gas Company	176-717-U	Kansas Corporation Commission
General Development Utilities	911030-WS & 911067-WS	Florida Office of Public Counsel
Hawaiian Electric Company	6998	U.S. Department of Defense - Navy
Indiana Gas Company	Cause No. 39353	Indiana Office of Consumer Counselor

Pennsylvania American Water Co.	R-00922428	Pennsylvania Office of Consumer Advocate
Wheeling Power Co.	Case No. 90-243-E-42T	West Virginia Public Service Commission Consumer Advocate Division
Jersey Central Power & Light Co.	EM89110888	New Jersey Department of Public Advocate Division of Rate Counsel
Golden Shores Water Co.	U-1815-92-200	Residential Utility Consumer Office
Consolidated Water Utilities	E-1009-92-135	Residential Utility Consumer Office
Sulphur Springs Valley Electric Cooperative	U-1575-92-220	Residential Utility Consumer Office
North Mohave Valley Corporation	U-2259-92-318	Residential Utility Consumer Office
Graham County Electric Cooperative	U-1749-92-298	Residential Utility Consumer Office
Graham County Utilities	U-2527-92-303	Residential Utility Consumer Office
Consolidated Water Utilities	E-1009-93-110	Residential Utility Consumer Office
Litchfield Park Service Co.	U-1427-93-156 U-1428-93-156	Residential Utility Consumer Office
Pima Utility Company	U-2199-93-221 U-2199-93-222	Residential Utility Consumer Office
Arizona Public Service Co.	U-1345-94-306	Residential Utility Consumer Office
Paradise Valley Water	U-1303-94-182	Residential Utility Consumer Office

Paradise Valley Water	U-1303-94-310 U-1303-94-401	Residential Utility Consumer Office
Pima Utility Company	U-2199-94-439	Residential Utility Consumer Office
SaddleBrooke Development Co.	U-2492-94-448	Residential Utility Consumer Office
Boulders Carefree Sewer Corp.	U-2361-95-007	Residential Utility Consumer Office
Rio Rico Utilities	U-2676-95-262	Residential Utility Consumer Office
Rancho Vistoso Water	U-2342-95-334	Residential Utility Consumer Office
Arizona Public Service Co.	U-1345-95-491	Residential Utility Consumer Office
Citizens Utilities Co.	E-1032-95-473	Residential Utility Consumer Office
Citizens Utilities Co.	E-1032-95-417 et al.	Residential Utility Consumer Office
Paradise Valley Water	U-1303-96-283 U-1303-95-493	Residential Utility Consumer Office
Far West Water	U-2073-96-531	Residential Utility Consumer Office
Southwest Gas Corporation	U-1551-96-596	Residential Utility Consumer Office
Arizona Telephone Company	T-2063A-97-329	Residential Utility Consumer Office
Far West Water Rehearing	W-0273A-96-0531	Residential Utility Consumer Office
SaddleBrooke Utility Company	W-02849A-97-0383	Residential Utility Consumer Office

Vail Water Company	W-01651A-97-0539 W-01651B-97-0676	Residential Utility Consumer Office
Black Mountain Gas Company Northern States Power Company	G-01970A-98-0017 G-03493A-98-0017	Residential Utility Consumer Office
Paradise Valley Water Company Mummy Mountain Water Company	W-01303A-98-0678 W-01342A-98-0678	Residential Utility Consumer Office
Bermuda Water Company	W-01812A-98-0390	Residential Utility Consumer Office
Bella Vista Water Company Nicksville Water Company	W-02465A-98-0458 W-01602A-98-0458	Residential Utility Consumer Office
Paradise Valley Water Company	W-01303A-98-0507	Residential Utility Consumer Office
Pima Utility Company	SW-02199A-98-0578	Residential Utility Consumer Office
Far West Water & Sewer Company Interim Rates	WS-03478A-99-0144	Residential Utility Consumer Office
Vail Water Company Interim Rates	W-01651B-99-0355	Residential Utility Consumer Office
Far West Water & Sewer Company	WS-03478A-99-0144	Residential Utility Consumer Office
Sun City Water and Sun City West	W-01656A-98-0577 SW-02334A-98-0577	Residential Utility Consumer Office
Southwest Gas Corporation ONEOK, Inc.	G-01551A-99-0112 G-03713A-99-0112	Residential Utility Consumer Office
Table Top Telephone	T-02724A-99-0595	Residential Utility Consumer Office
U S West Communications Citizens Utilities Company	T-01051B-99-0737 T-01954B-99-0737	Residential Utility Consumer Office



BEFORE THE ARIZONA CORPORATION COMMISSION

CARL J. KUNASEK
Chairman
JIM IRVIN
Commissioner
WILLIAM A. MUNDELL
Commissioner

IN THE MATTER OF THE APPLICATION OF)
CITIZENS UTILITIES COMPANY FOR)
APPROVAL OF ITS STRANDED COST)
RECOVERY.)

DOCKET NO. E-01032C-98-0474

IN THE MATTER OF THE APPLICATION OF)
CITIZENS UTILITIES COMPANY OF)
UNBUNDLED AND STANDARD OFFER)
SERVICE TARIFFS PURSUANT TO A.A.C.)
R14-2-1601 ET SEQ.)

DOCKET NO. E-01032C-97-0774

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

DOCKET NO. RE-00000C-94-0165

DIRECT

TESTIMONY

OF

LEE SMITH

CONSULTANT

LA CAPRA ASSOCIATES
BOSTON, MASSACHUSETTS

June 20, 2000

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1 Q. What is your name and business address?

2 A. My name is Lee Smith, and I work for La Capra Associates, 333 Washington Street,
3 Boston, Massachusetts.

4
5 Q. On whose behalf are you testifying in this proceeding?

6 A. I am testifying on behalf of the Arizona Corporation Commission ("Commission") Staff.

7
8 Q. Please describe your background and experience.

9 A. I am a Managing Consultant and Senior Economist at La Capra Associates. I have been
10 with this energy planning and regulatory economics firm for 16 years. Prior to my
11 employment at La Capra Associates, I was Director of Rates and Research, in charge of
12 gas, electric, and water rates, at the Massachusetts Department of Public Utilities. Prior
13 to that period, I taught economics at the college level. My resume is attached as Exhibit
14 LS-1.

15
16 Q. What is the purpose of your testimony?

17 A. I am testifying in support of the Settlement signed by Citizens, the ACC Staff, and the
18 Residential Utility Consumer Office ("RUCO"). My testimony will discuss the opening
19 of retail access, the stranded costs and the mitigation of stranded costs, rate unbundling
20 provisions, and treatment of potential other transition costs.

21
22 Q. What does the proposed Settlement accomplish?

23 A. All customers will receive direct retail access to competitive services. All customers will
24 pay a CTC that will ensure that the Company collects its power supply costs, and also
25 ensure that retail access will not have any detrimental impact on customers who continue
26 to purchase from the Company. Customers will receive unbundled bills that inform
27 customers as to how much their bill will decrease (i.e. their shopping credit) if they
28 choose an alternative supplier.

1 **I. RETAIL ACCESS PROVISIONS**

2 Q. Does the Settlement provide Citizens' retail customers with open access in a timely
3 manner?

4 A. Yes. Provisions two through four of the Settlement provide for open access to all
5 customers, without phase-in. If an Order is issued before September 1, 2000, the
6 Citizens' system will be open for retail access by December 1, 2000. If an Order is
7 issued after September 1, 2000, but before September 30, 2000, Citizens will attempt to
8 open access within four months of the final Order in this case, if that order does not occur
9 before. If the Settlement has not been approved by September 30, 2000, Citizens has the
10 right to withdraw from the agreement.

11

12 **II. STRANDED COSTS MITIGATION AND RATE REDUCTIONS**

13 Q. Since the Company owns almost no generating assets, why may it have generation
14 transition costs, or stranded costs?

15 A. Stranded generation costs are the difference between embedded costs and avoided costs.
16 The Company is served by an all requirements power supply contract with APS. The
17 majority of power is supplied through Schedule A, which contains a large fixed demand
18 component. If load decreases due to retail access, the Company is unable to sell these
19 kWhs; it simply does not purchase them from APS. It also does not avoid this demand
20 charge. Embedded power costs, which reflect the demand charge, will generally be
21 higher than avoided costs, which currently do not reflect any avoidance of demand costs.
22 Unless there is a CTC, the only way that the Company could recover this demand charge
23 would be through increasing the rates to other customers.

24

25 Q. Are the Company's stranded costs determined entirely by this demand charge?

26 A. No. The situation is actually more complicated than that. CUC is supplied with power
27 from APS through three separate schedules. The pricing terms vary dramatically.
28 Schedule A, as described above, contains a large demand component and a relatively low

1 energy charge. If load decreases due to retail access, Citizens' only avoids energy
2 charges on Schedule A, so the demand cost per kWh sold increases. However, a number
3 of other changes to power purchasing occur, some of which have offsetting effects. The
4 amount of power which can be purchased at the off-peak price of Schedule A changes;
5 the amount of power which is purchased on Schedules B and C, which have low or
6 avoidable demand costs and generally high energy prices, will also decrease. As a result,
7 the amount of costs that Citizens will avoid depends on how much load chooses
8 alternative suppliers, and on the shape of that load.

9

10 Q. Does the Settlement reflect both mitigation of stranded costs and rate reductions to
11 customers?

12 A. Yes. Due to two renegotiations of its power supply contract with APS, stranded costs
13 have been greatly reduced from the Company's initial filing. The Company has already
14 decreased its rates once to reflect the effect of the first renegotiation of its power supply
15 contract with Arizona Public Service. Also, as noted in Provision 6 of the Settlement
16 there has been a second renegotiation of the contract with APS that provides additional
17 mitigation. After January 1, 2002 Citizens will be able to reduce its contract demand
18 obligation to reflect lost load. This renegotiation may bring about a further power cost
19 reduction which will be passed through to customers.

20

21 Q. Will there still be some "stranded costs" even after the Company is allowed to reduce its
22 demand?

23 A. Yes. The reduction in the demand obligation may occur after the Company's generation
24 load has decreased. This means that during each year as additional load leaves, the
25 capacity obligation will be higher than the actual load until the next time (May 1 of the
26 following year) that the demand obligation can be reduced.

27 ...

28 ...

1 Also, from the inception of retail access until May 1, 2002, in order to keep existing
2 customers whole, departing customers must pay a CTC that reflects the difference
3 between their original charge and the costs avoided as they leave. If the demand charge
4 were the only cost component that changes, the CTC would equal the original demand
5 cost divided by the full load.

6
7 After May 1, 2002, there would be no further capacity cost obligation associated with
8 departing customers who had been counted when the capacity obligation for the next year
9 was determined. However there might be some excess capacity cost obligation
10 associated with customers who left after January 1 but before May 1, and if additional
11 customers left from May 1 through December 31, they would also create new excess
12 capacity costs.

13
14 Q. How does the Settlement provide for the collection of stranded costs?

15 A. A CTC shall be computed, for each year of the transition period, that will provide for
16 recovery of the difference between generation revenues that would have been paid by
17 departing customers and the costs that will be avoided as load departs. This provision
18 ensures that Standard Offer customers will not pay more than they would have absent
19 retail choice.

20
21 **III. RATE UNBUNDLING IN THE SETTLEMENT**

22 Q. Does the Settlement result in rates that will inform customers of what they pay the utility
23 for each service, so they can compare different providers?

24 A. Yes. The Company has previously computed distribution, metering and billing, system
25 benefits, and generation rates. The current generation component will be further divided
26 into a transmission component, a CTC, and a shopping credit. Class CTCs should be set
27 for each class equal to the difference between the embedded generation rate (not
28 including transmission) and the avoided cost.

1 Q. Given the restructuring of the contract with APS, why does the CTC need to reflect the
2 power contract interactions you described above?

3 A. Because the capacity obligation cannot be reduced until 2002, there will be stranded costs
4 at least until that time. Any load that leaves before this time will result in changes in
5 average power costs because of the demand charge and differential reductions on the
6 various power schedules. Moreover, it does not appear that the demand obligation will
7 be reduced prospectively. Therefore, each year there may be some stranded costs
8 associated with load that chooses alternative suppliers during the year.

9
10 Q. What are the Generation Transition Costs ("GTC") defined in the Settlement?

11 A. The GTC, according to Provision 7a, is the "positive difference between generation rate
12 revenues that would have been paid ...and the costs that will be avoided as a result of this
13 load loss." To determine how many costs it will avoid if a certain amount of load
14 chooses an alternative supplier, the Company will need to perform a simulated dispatch
15 of their full load and also of their load decremented by the load that they expect will
16 choose an alternative supplier.

17
18 Q. How will the Company calculate its Competitive Transition Charges ("CTCs") and the
19 shopping credits?

20 A. The estimated GTC will be divided by the amount of projected lost load. This same CTC
21 will then be applied to all customers. This method of unbundling the generation
22 component of rates will collect the Company's stranded cost and at the same time prevent
23 rate changes to Standard Offer customers. The shopping credit will be the difference
24 between the full generation rate and the CTC. Thus the shopping credits are based on the
25 Company's avoided cost. For individual classes, the shopping credits should be
26 determined by adjusting the system average avoided cost to reflect differences in class
27 load factor.

28 ...

1 The shopping credit will differ for each class. However, I expect the average shopping
2 credit at the retail level to be about 3.8 cents. The Company has estimated its avoided
3 costs at about 3.6 cents, based on generation level sales. This needs to be increased by
4 line losses to be at the retail customer level.

5
6 Q. This method of establishing shopping credits is unique to Citizens. Please explain why
7 you find it appropriate?

8 A. The method is consistent with the cost causation of stranded generation costs for Citizens.
9 Generation owning utilities' stranded costs should be measured relative to the market
10 price of generation; this represents the price at which they can sell power that is no longer
11 purchased by their distribution customers. As noted above, Citizens cannot sell power
12 that is no longer purchased by its distribution customers; its stranded costs should be
13 measured by comparing its loss in revenues to its avoided costs.

14
15 **C. Reconciliation**

16 Q. What happens if the percentage of load that chooses an alternative supplier is different
17 from that projected?

18 A. In this case, the actual cost for the decremented load, and the cost decrement per kWh,
19 will be different from that projected. The actual decremented cost per kWh may also
20 vary from the projection if the load choosing alternative suppliers had a load shape that
21 was different from the average load.

22
23 Q. What will the impact be of these errors in projection?

24 A. They could result in the Company under or overcollecting. They could also result in
25 Standard Offer customers receiving increases or decreases in rates as a result of retail
26 access.

27 ...

28 ...

1 Q. If the CTC has over or undercollected the annual GTC, how will this be addressed?

2 A. There is a potential for considerable variability between the projected GTC and the after-
3 the fact computation of the correct GTC. It will vary because of the amount of load that
4 leaves, the shape of that load, and changes in APS' charges. This is the rationale for
5 allowing a reconciliation mechanism. However, if the GTC could increase significantly
6 the potential for an increase in the CTC could have a very chilling impact on competition.

7

8 Q. Does the Settlement place any bounds on changes in the CTC due to reconciliation?

9 A. Yes. Provision 7 b limits the annual increase to the CTC to 2 mills per kWh. If the
10 reconciliation amount would cause the CTC to increase by more than this amount, some
11 of that amount must remain in the reconciliation account, with carrying charges.
12 Provision 7 g allows the parties to accelerate recovery of the CTC balance if the amount
13 in the account exceeds \$3 million and is expected to continue growing. This seems to be
14 a very unlikely eventuality, but both Company and ratepayers are protected by this
15 provision.

16

17 **D. PPFAC**

18 Q. The Company's rates include an energy adjustment clause. How and why does the
19 Settlement propose to modify this clause?

20 A. The Settlement provides for modification of the PPFAC, to ensure that Standard Offer
21 customers are not affected by retail access. The CTC and the energy adjustment clause
22 could lead to the double collection of some costs if some accommodation is not made.
23 Without modification, the energy adjustment clause would increase to collect all power
24 supply costs, while the Company will be collecting revenue from retail access customers
25 intended to prevent standard offer customers from paying higher power costs because of
26 retail access. WAPA transmission charges are removed from the PPFAC and put into a
27 separate and transparent rate component. Finally, the revised PPFAC will be adjusted
28 each year simultaneously with the annual CTC adjustment. Currently the factor is

1 adjusted only when the balance of under or overcollections reaches \$2.6 million. This
2 could result in the PPFAC changing at a different time than the CTC, and would result in
3 an inconsistency between the CTC and Standard Offer rates.
4

5 Q. What do you recommend regarding the PPFAC?

6 A. The clause should be modified to reflect the contribution to power costs that will result
7 from CTC revenues. These should be subtracted from total power costs to determine the
8 amount that must be paid through the PPFAC.
9

10 Q. Does this mean that the power supply costs paid by standard offer customers will not
11 change at all?

12 A. No, it does not. For instance, if APS' energy charges increase because of an increase in
13 fuel cost, the energy adjustment clause would increase. This might, in turn, have an
14 impact on the CTC, as both embedded costs and avoided costs would increase. Standard
15 offer customers would, however, be protected from rate increases due to a change in load.
16

17 **IV. OTHER ISSUES AND OTHER TRANSITION COSTS**

18 Q. Has the Company requested an allowance for transition costs other than costs created by
19 the APS contract?

20 A. Yes. The Settlement describes the establishment of a deferred account, a Competitive
21 Transition Deferral Account ("CTDA"), to accumulate costs associated with the
22 transition to competition. These could include new systems and process necessary for
23 retail access, stranded costs associated with the competitive provision of metering and
24 billing services, consumer education, possibly divestiture of the APS Power Service
25 Agreement, participation with the Arizona Independent System Administrator, and
26 carrying charges on deferred balances in the CTDA. Provision 11 and Appendix A of the
27 Settlement limits deferred transition costs to those that have been rate-of-return tested.
28 Collection of any such transition costs is dependent on the Company demonstrating that

1 failure to collect them would lead to an underrecovery of costs. In other words, if the
2 Company was making more than its allowed rate of return, due to either revenue growth
3 or cost reductions, it would not be allowed to defer these costs for separate collection.
4

5 Q. How would these costs be collected?

6 A. The parties agree to support Citizens' recovery of legitimate, prudently-incurred
7 transition costs. Transition costs will not be included in rates until the Commission has
8 determined that they meet the appropriate criteria.
9

10 Q. Are there any other issues associated with regulatory assets or transition costs?

11 A. Yes. The Company has deferred DSM expenses that it proposes to recover. The
12 amortization amount currently allowed in rates is only sufficient to cover carrying
13 charges on this amount. In order to avoid an increase in rates, the Company will utilize
14 the refund associated with the renegotiation of the APS contract toward a reduction of the
15 outstanding DSM balance, and retain the current amortization amount in rates (Provision
16 9). The lower principal amount will mean that the same amount of amortization will
17 allow recovery of the DSM balance.
18

19 Q. Please describe Provisions 12 and 13.

20 A. These provisions address the difficulties associated with divesting the APS contract and
21 with acquiring Standard Offer generation through competitive purchase. It is expected
22 that divesting the APS contract may increase stranded costs. With the revisions to the
23 APS contract, it is unlikely that customers will be better off because of divestiture.
24 Provision 12 provides the Company with latitude regarding the divestiture of the APS
25 contract. Likewise, if as a result of a competitive auction, Citizens choose a supplier
26 other than APS for Standard Offer generation, it would continue to be obligated to pay
27 demand charges to APS. Therefore, Provision 13 requests a waiver of the requirement
28 for competitive market purchase of Standard Offer generation.

1 Q. What are your conclusions?

2 A. This Settlement is consistent with the Electric Competition rules. It will open up retail
3 access and provide benefits to ratepayers. I recommend its approval.

4

5 Q. Does this complete your direct testimony?

6 A. Yes, it does.

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