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THE MATTER OF THE INVESTIGATION OF REGULATORY AND RATE INCENTIVES FOR GAS AND ELECTRIC UTILITIES	DOCKET NO. E-00000J-08-0314 DOCKET NO. G-00000C-08-0314 **COOPERATIVES' COMMENTS**

On August 1, 2008, the Arizona Corporation Commission Staff filed a letter in these dockets requesting that certain questions related to regulatory and rate incentives be answered by interested parties. That request followed correspondence from Commissioner Mundell suggesting that creative solutions should be explored on a number of subjects.

On behalf of Arizona Electric Power Cooperative, Inc., Duncan Valley Electric Cooperative, Inc., Graham County Electric Cooperative, Inc., Graham County Utilities, Mohave Electric Cooperative, Inc., Navopache Electric Cooperative, Inc., Trico Electric Cooperative, Inc. and Sulphur Springs Valley Electric Cooperative, Inc. (collectively "Cooperatives"), Grand Canyon State Electric Cooperative Association is submitting the attached comments on Staff's questions.

Arizona Corporation Commission
DOCKETED

AUG 29 2008

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Further communications and notices concerning these Dockets should be directed to:

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RESPECTFULLY SUBMITTED this 29th day of August, 2008.

By

John Wallace
Grand Canyon State Electric Cooperative Assn. Inc.
On Behalf of the Cooperatives

Original and fifteen (15) copies filed this 29th day of August, 2008, with:

Docket Control
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Phoenix, AZ 85007

ELECTRIC COOPERATIVE COMMENTS

ON THE INVESTIGATION OF REGULATORY AND RATE INCENTIVES FOR GAS AND ELECTRIC UTILTIES (DOCKET NOS. E-00000J-08-0314 & G-00000C-08-0314)

AUGUST 29, 2008

Introduction

On August 1, 2008, the Arizona Corporation Commission Staff filed a letter in these dockets requesting that certain questions related to regulatory and rate incentives be answered by interested parties. That request followed correspondence from Commissioner Mundell suggesting that creative solutions should be explored on a number of subjects.

The following comments on Staff's questions are provided by the Arizona Electric Power Cooperative, Inc. ("AEPCO"); Duncan Valley Electric Cooperative, Inc. ("DVEC"); Graham County Electric Cooperative, Inc. ("Graham"); Graham County Utilities ("Graham Utilities"); Mohave Electric Cooperative, Inc. ("Mohave"); Navopache Electric Cooperative, Inc. ("Navopache"); Trico Electric Cooperative, Inc. ("Trico"); and Sulphur Springs Valley Electric Cooperative, Inc. ("Sulphur") (collectively, "Cooperatives").[1]

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[1] The Cooperatives reserve the right, individually and collectively, to provide additional or different comments and positions on any of these issues in the future. The Cooperatives, individually and collectively, also reserve the right to modify the opinions expressed below as new information and input becomes available.

ELECTRIC COOPERATIVE COMMENTS

ON THE INVESTIGATION OF REGULATORY AND RATE INCENTIVES FOR GAS AND ELECTRIC UTILTIES (DOCKET NOS. E-00000J-08-0314 & G-00000C-08-0314)

AUGUST 29, 2008

1. **What basic incentives and disincentives does today's regulatory structure (e.g., rate-of-return regulatory structure, adjustment clauses, test year determination, depreciation policies) provide to Arizona electric and gas utilities?**

   Cooperatives' Response: *Cooperatives are not-for-profit entities that are controlled by their member/customers. There is no conflict between a shareholder ownership base and the consumer base. Cooperatives have a motive to maintain positive margins in order to pay their expenses and debt payments but do not have a profit motive. Any monies received by them in excess of their cost of service and necessary reserve requirements are returned (or rotated back) to the members over time or reinvested in the cooperative. Each cooperative has a board of directors that is elected by the membership to serve the members by making policy decisions on financial and operational matters.*

   Given this "member-owned non-profit" rather than "investor-owned for-profit" structure, classic rate-of-return ("ROR") regulation is not well suited for cooperatives. For example, in a cooperative rate case, a cooperative's rates are driven primarily by expense requirements, including interest and the cash necessary to maintain mortgage compliance and repay long-term debt. A ROR on rate base is essentially unnecessary. The Cooperatives' mission is to provide the highest quality electric service at the least cost. Consequently, many of the incentives that might apply to Investor-Owned Utilities ("IOUs") simply do not apply to and are not "incentives" for cooperatives.

ROR regulation is time consuming for cooperatives, the Commission and Staff and it is very expensive for cooperative members. ROR regulation in Arizona uses a historic test year to which known and measurable adjustments are made. By the time a rate case decision is issued by the ACC, the financial information included in the test year upon which the rates are based is nearing three years old. There is also a considerable amount of regulatory lag associated with the current ROR regulation structure. It takes about 13 months from the date an application is filed to receive a decision on an application. Given current market conditions and rapid increases in costs, by the time this 13-month rate case processing period has expired some 18 months after the test year has ended, it may be necessary to promptly file a new rate case application. All of these elements – the ROR rate analysis method, use of the historic test year and regulatory lag – result in higher costs for cooperative consumers and more time and effort required of the Cooperatives and Commission than is necessary.

2. What are the alternatives to the Rate Base ROR model?

Cooperatives' Response: *The Cooperatives believe there are several alternatives to ROR regulation but most are irrelevant to the member-owned, member-controlled, non-profit nature of cooperatives. Only alternatives that involve more streamlined regulation and less regulatory expense will be beneficial and cost efficient for cooperatives and their members. In that regard, the Cooperatives would agree to work with ACC Staff* *to streamline ACC processes in an attempt to decrease regulatory expenses, speed the result and save Commission resources associated with rate and financing cases.*

3. **How do adjustment clauses affect utility incentives?**

Cooperatives' Response: *Again, given the inherently different consumer-owned, consumer-controlled and non-profit nature of cooperatives, "incentives" are probably not affected. However, purchased power and fuel adjustment clauses ("PPFACs") are absolutely vital to the Cooperatives. Given recent dramatic fuel cost increases, PPFACs are the only reason that each electric and gas cooperative has not had to file, in some cases, numerous rate case applications to recover these wildly volatile costs over the past several years. The PPFACs have allowed cooperatives to recover these costs without having to incur the time and expense of a rate case. The clauses have also helped protect the Cooperatives' financial health and stability. Absent the clauses, it is very likely most, if not all, of the State's cooperatives would have defaulted on their mortgage covenants. On average, the cooperatives' PPFACs have saved cooperative consumers approximately $60,000 to $300,000 in rate case expense per case and per cooperative, depending on the size of the cooperative.*

4. What are possible alternatives to adjustment clauses?

Cooperatives' Response: *The Cooperatives have not studied alternatives to adjustment clauses. PPFACs are fairly standard in the industry across the country and have been authorized for the cooperatives in Arizona for several decades.*

5. Are incentives an appropriate tool to use in the context of fuel/gas procurement activities?

Cooperatives' Response: *Incentives may be an appropriate tool for IOUs, but the only "incentives" that work for cooperatives are those that increase the quality of service or decrease costs for our members. Instead of a profit incentive, the Cooperatives would rather have the regulatory flexibility to collect necessary expenses in an efficient, cost-effective and timely fashion than an incentive structure designed to increase margins.*

6. Can the regulatory incentive structure be changed to align a utility's financial incentives with energy efficiency investment?

Cooperatives' Response: *The Cooperatives' main goal is to provide the highest quality service at the least cost to our members. Before any investments are made by the Cooperatives, a least-cost analysis is performed. Included in this least-cost analysis is an analysis of the most energy efficient investment. AEPCO, for example, spent several million dollars on its coal blending facility to increase efficiency and lower emissions at*

Apache Station. Currently, the least-cost analysis indicates that it is cheaper to encourage conservation and DSM measures than it is to build expensive new power plants or purchase additional power on the wholesale market. Consequently, several of the cooperatives have implemented DSM programs. The Cooperatives continue to investigate and will implement DSM plans and programs for their members that are beneficial and cost effective. Currently, because of the high cost of new generation, the Cooperatives' financial incentives are already aligned with making investments in energy efficiency. Decoupling mechanisms may also help to protect mortgage compliance, TIER and DSC levels in relation to certain energy efficiency programs at retail.

7. **Can the incentive structure be modified to heighten the utility's incentives for management efficiency?**

Cooperatives' Response: *The Cooperatives have all the management efficiency incentives they need from their consumer-elected boards and their core mission of highest quality service at lowest cost. Of course, the Cooperatives serve some of the State's highest cost areas and, in general, have low densities of customers per mile of line. These and other factors impact efficiency at all levels.*

8. **Can incentives play a role in Arizona efficiently meeting its future utility infrastructure needs?**

Cooperatives' Response: *As mentioned above, incentives are not typically effective for or appropriate to cooperatives. However, it is possible that incentives could play a role in Arizona efficiently meeting its future utility infrastructure needs. For instance, an abbreviated power plant and line siting process for the installation of needed transmission or generation resources would clearly be an incentive for (or diminished roadblock to) the investments required for construction of such facilities by utilities.*

9. **Should the Commission consider "decoupling" mechanisms for electric and gas companies? If so, what type of decoupling?**

Cooperatives' Response: *As mentioned previously, revenue decoupling and possibly weather normalization mechanisms may be advantageous in certain circumstances and should be considered by the Commission.*

10. Can the regulatory incentive structure be altered to change the stakes for a utility making a build-or-buy decision or other infrastructure decisions?

Cooperatives' Response: *RUS regulations and the basic consumer-owned, consumer-controlled, non-profit nature of cooperatives substitute more than adequately for any regulatory incentive. The Cooperatives' mission is to deliver power at least cost. There is no incentive to invest capital simply to boost return on rate base. Finally, RUS regulations require and the cooperative mindset dictates that Request For Proposal ("RFPs") be used to determine whether build or buy is the best least-cost decision.*

11. What impact does the current regulatory structure regarding the buy-or-build scenario have on competitive bidding as a tool in resource selection?

Cooperatives' Response: *The current regulatory structure, the Cooperatives' least-cost mission as well as the Cooperatives' lenders, require a complete analysis of any build versus buy scenario and the use of competitive bidding as a tool in resource selection. For example, the Cooperatives' primary lender, the Rural Utilities Service requires that an RFP using competitive bidding be conducted for wholesale purchased power prior to submitting any proposal for building a new plant. Cooperatives have to demonstrate to RUS that building a plant is less expensive on a net-present value basis than buying the needed power on the market. In addition, Decision No. 70032 also requires competitive resource procurement methods. The Cooperatives' general consumer-owned goals to* *find the most economic resources and these requirements combine to result in the Cooperatives using competitive bidding to determine lowest cost resource options.*

12. **What are the best practices across the nation regarding regulatory incentives?**

Cooperatives' Response: *The Cooperatives have not conducted a study to determine the best practices across the nation regarding regulatory incentives.*

13. **Are there any other specific topics that should be covered in this inquiry?**

Cooperatives' Response: *Yes. We strongly urge that the ACC Staff work with the Cooperatives to develop streamlining proposals and any other regulatory efficiency ideas that should be addressed and adopted because these proposals would streamline ACC rate and financing processes and will save cooperatives, their customers, the ACC and the taxpayers significant resources and expense.*

The PPFAC that has been approved for distribution electric cooperatives should be changed to allow Partial-Requirements Members of Arizona Electric Power Cooperative, Inc. as well as Navopache Electric Cooperative, Inc. to recover distribution cooperative-owned generation resource costs and related transmission costs through the PPFAC. This change will result in all the costs that are associated with power supply being recovered in a consistent manner through the PPFAC.

In addition, the Cooperatives would recommend an adjustor mechanism be adopted by the Commission that would allow the increases and decreases in interest expense to be passed on to customers. This adjustor mechanism would be similar to the current purchased power adjustor mechanism for electric cooperatives, only it would be designed to collect or refund interest expense in excess or below a base interest cost. Such a mechanism would decrease the need for time-consuming and costly rate cases for the Cooperatives.

In addition, this inquiry should address how to make DVEC's gas division and Graham Utilities' gas division purchased gas adjustors ("PGA") more effective. The current PGAs for DVEC and Graham Utilities were approved in Decision No. 61225, dated October 30, 1998. This Decision approved a PGA mechanism for IOUs and these two cooperatives. The PGA mechanism granted by this Decision set up limits that the PGA can be raised or lowered based on a 12-month rolling average. The Decision also approved an interest rate that would be charged on an over-collected or under-collected PGA bank balance. Neither of these concepts should apply to cooperatives because they are not-for-profit, member-owned utilities. The cooperatives attempt to manage their PGAs such that their PGA bank balances are as close to zero as possible. The current DVEC and Graham Utilities PGA mechanisms do not allow these cooperatives to manage and adjust their PGA bank balances as close to zero as possible due to the *limitations on the amount that the PGA can be adjusted on a monthly basis. The current DVEC and Graham Utilities PGAs result in an extension in the amount of time it takes the cooperatives to return or recover over-collected and under-collected bank balances. These small cooperatives cannot afford to fund these fluctuations in gas prices and consequently must apply for gas surcharges that are equally inflexible with regards to changing prices of natural gas. The interest component earned by utilities on under-collected bank balances and by customers on over-collected bank balances do not make sense for cooperatives, because in the case of over-collected or under-collected PGA bank balances, cooperative customers are paying interest on this balance to themselves because they own the cooperative. The current PGA mechanism also does not communicate the correct price signal to customers so they can make informed choices about their consumption. The Cooperatives would recommend the DVEC and Graham Utilities receive the same ACC authority to change their PGA rates as they currently have to change their purchased power adjustor mechanisms for their electric cooperatives.*

14. Are there any legal impediments?

Cooperatives' Response: *The Cooperatives are not aware of any.*