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August 29, 2008

Hand Delivered

Ernest Johnson, Director
Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 850007

Re: Sulphur Springs Valley Electric Cooperative, Inc's Comments Regarding The Investigation of Regulatory and Rate Incentives for Gas and Electric Utilities – Docket Nos. E-00000J-08-0314 and G-00000C-08-0314

Dear Mr. Johnson:

Pursuant to your letter dated August 1, 2008 requesting comments regarding the questions set forth in your letter, Sulphur Springs Valley Electric Cooperative, Inc. ("SSVEC") hereby submits its attached responses. Please note that although Grand Canyon Electric Cooperative Association ("GCECA") will also be filing somewhat similar comments on behalf of SSVEC and other electric cooperatives, SSVEC's attached comments augment and further expand on the GCECA comments. This includes a proposed "streamlined" approach for cooperative rate cases discussed in SSVEC's responses to questions 2 and 13 and set forth in greater detail in Exhibit A to SSVEC's comments.

Please do not hesitate to contact me if you have any questions.

Sincerely,

Snell & Wilmer

Bradley S. Carroll

BSC:jyb
Enclosures

cc: Docket Control (Original plus 13 copies)
Service List (Via U.S. Mail)

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SULPHUR SPRINGS VALLEY ELECTRIC COOPERATIVE, INC.'S RESPONSES TO THE ARIZONA CORPORATION COMMISSION'S 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 ("ACC") Utilities Division ("Staff") filed a letter in the above-referenced dockets requesting comments on questions related to regulatory and rate incentives to be answered by interested parties. That request followed correspondence from Commissioner Mundell suggesting that creative solutions should be explored on a number of subjects.

Sulphur Springs Valley Electric Cooperative, Inc. ("SSVEC") hereby submits the following comments in response to Staff's questions:

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?**

SSVEC Response: *SSVEC is a not-for-profit entity that is controlled by our member/customers. There is no conflict between a shareholder ownership base and the consumer base. SSVEC has a motive to maintain positive margins in order to pay our expenses and debt payments but does not have a profit motive. Any monies received by SSVEC in excess of our cost of service and necessary reserve requirements are returned (or rotated back) to the members over time or reinvested in the cooperative. Since 2000, SSVEC has returned to our members $5,857,222 in patronage capital (profit/margins).*

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Cooperatives such as SSVEC have a "margin" incentive, but not a profit incentive. Under Arizona and IRS cooperative laws, rules and regulations, positive margins are gained from operating efficiencies and cost controls and those margins are either temporarily reinvested or passed back and returned to member/customers ("Return of Patronage Capital"). SSVEC has a Board of Directors that is elected by the membership to serve the members by making policy decisions on financial and operational matters. In SSVEC's case, the owner is the customer/member.

Given this "member-owned non-profit" rather than "investor-owned for-profit" structure, classic rate-of-return ("ROR") regulation is not well suited for SSVEC or 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. SSVEC's' 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.

Moreover, 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. For a Class A electric utility such as SSVEC, it takes a minimum of 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 (or longer) rate case processing period has expired some 18 months or more 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 ACC than is necessary.*

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

SSVEC's Response: *As discussed above, SSVEC believes ROR is 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, SSVEC is hereby providing several suggestions on how to streamline ACC processes in an attempt to decrease regulatory expenses, speed the result and save ACC resources associated with* *rate and financing cases. Those suggestions are attached to these comments as Exhibit A.*

3. How do adjustment clauses affect utility incentives?

SSVEC's Response: *Given the inherently different consumer-owned, consumer-controlled and non-profit nature of cooperatives, "incentives" are probably not effective. However, purchased power and fuel adjustment clauses ("PPFACs") clauses are absolutely* <u>*vital*</u> *to SSVEC and 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 over which the cooperatives have no control. 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 that most, if not all, of the State's cooperatives, would have defaulted on their mortgage covenants. Without the adjustment clause, SSVEC would not have had the cash to pay the fuel charges Arizona Electric Power Cooperative, Inc. ("AEPCO") passes through to its members.*

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4. **What are possible alternatives to adjustment clauses?**

SSVEC's Response: *SSVEC has 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?**

SSVEC's 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?**

SSVEC's Response: *SSVEC's 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. 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. SSVEC has developed and implemented DSM programs for its members. Those DSM programs include the following:

> *<u>The Touchstone Energy Efficient Home</u>: This program is designed to reduce the energy consumption in new construction by setting above normal requirements for insulation, infiltration, glazing, and high efficiency heating and cooling. The program includes the inspection of the home during construction to verify that standards are met. This program also provides for an energy review of plans prior to construction to help the consumer make good energy decisions.*

> *<u>Energy Efficiency Loan Program</u>: SSVEC offer low interest loans to help consumers install high efficiency heat pumps, improved windows, added insulation, and other improvements to lower their energy bills.*

> *<u>Heat Pump Rebates</u>: SSVEC offers a $500 rebated to consumers who install a heat pump with a SEER of 14 or higher. This is used to*

encourage the consumer to install something better than the lowest efficiency allowed (13 SEER).

Free Residential and Commercial Audits: SSVEC offers energy audits to help consumers determine opportunities to lower their energy costs. Suggestions usually include recommendations on proper HVAC filter maintenance, programmable thermostats, using compact florescent lamps, and general conservation advice.

SSVEC has also installed a SCADA system. This system has allowed SSVEC to control voltage and offer time of use rates that allow SSVEC to disconnect load at peak times. As of July 31, 2008, SSVEC estimates it has saved SSVEC's members $20,268,158 since 1995 in power costs through our SCADA system, less the cost AEPCO collected from SSVEC with AEPCO's EuroFresh tariff. 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?

SSVEC's Response: *SSVEC has all the management efficiency incentives it needs from its member-elected Board and from our 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. Rate stability has always been a priority for SSVEC as evidenced by SSVEC currently seeking its first rate increase in sixteen years.*

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

SSVEC's 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?

SSVEC's Response: *Revenue decoupling and possibly weather normalization mechanisms may be advantageous in certain circumstances and should be considered by the ACC.*

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?

SSVEC's Response: *SSVEC's Board of Directors and the basic consumer-owned, consumer-controlled, non-profit nature of cooperatives substitute more than adequately for any regulatory incentive. SSVEC's mission is to deliver power at least cost. There is no incentive to invest capital simply to boost return on rate base.*

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

SSVEC's 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. In addition, ACC 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?

SSVEC's Response: *SSVEC has 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?

SSVEC's Response: *Yes. The streamlining proposals attached by SSVEC as Exhibit A, and any other regulatory efficiency ideas should be addressed because these proposals streamline ACC rate and financing processes, thereby saving distribution cooperatives and their members, the ACC and taxpayers significant time and expense.*

In 2007 SSVEC's total cost of service was $91,624,542. That included power costs from the ACC approved tariffs of AEPCO and Southwest Transmission Cooperative that *amounted to $58,128,422 or 63.4% of our total cost of service. Depreciation and amortization amounted to $7,192,109 and interest expense was $5,800,108. These amounts were 7.8% and 6.3% of our total cost of service respectively. In total, these three components were 77.6% of our total cost of service in 2007. The ACC reviews and approves our construction work plan and financing package which generates the depreciation and interest expense. Without a rate case the ACC is already and effectively reviewing and approving almost 80% of SSVEC's total cost of service. A streamlined process would not reduce the ACC's oversight and is a logical step based on the ACC already reviewing and approving almost 80% of SSVEC's total costs.*

In addition, The PPFAC that has been approved for electric cooperatives should be supplemented to allow SSVEC and other Partial Requirements Members of AEPCO and Southwest Transmission Cooperative to recover cooperative-owned generation resource costs and related transmission costs through the PPFAC. This supplemental change will result in all the costs that are associated with power supply being recovered in a consistent manner through the PPFAC.

SSVEC would also recommend an adjustor mechanism be adopted by the ACC that would allow the increases and decreases in interest expense and increases in DSM programs 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 since the ACC already reviews and approves cooperative work plans and financing packages that make up the majority of the interest expense.*

Regulation is normally needed to balance the interest between the investors and the rate payers but cooperatives are different in that our investors and ratepayers are the same people. The Board of Directors can balance these needs which reduce the need for regulation. Our members are now required to pay for an expensive rate case in order to raise their rates – this does not appear to be the best use of their money.

14. Are there any legal impediments?

SSVEC's Response: *Although SSVEC has not conducted a legal analysis, SSVEC does not believe there are any legal impediments to implement what SSVEC is proposing herein.*

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AUGUST 29, 2008

Exhibit A

Rate Case Procedure Changes for Electric Distribution and Gas Distribution Cooperatives

1) The Electric Distribution Cooperatives or Gas Distribution Cooperative (collectively "the Cooperatives") will provide information that is normally requested in Staff's first data request to Staff on the date of filing a rate case application or as promptly as possible thereafter. The Cooperatives will work with Staff to develop a standard set of information to be delivered at time of filing.

2) Cooperatives will provide with their rate applications a proposed form of notice to be published and will publish such notice once in a newspaper of general circulation in their territories within 30 days of filing.

3) The Cooperatives and Staff will develop a list of acceptable test year adjustments which Cooperatives may make in their rate filings and which shall be presumed reasonable. Such list shall not limit either the Cooperative's or Staff's ability to request other adjustments.

4) Cooperatives' Rate Case revenue requirements are primarily driven by Times Interest Earned Ratio ("TIER") and Debt Service Coverage ("DSC") ratios rather than a Rate of Return ("ROR") on rate base. Consequently, rate base is not an important element in determining a cooperative's revenue requirement. Therefore, the Cooperatives will provide as part of the rate case application a statement of utility plant and depreciation that is based on the cooperative's test year audited financial statements. Staff shall accept such specified amounts for the purposes of establishing the fair value rate base.

5) Cost of Service Studies shall be prepared for distribution cooperatives only in cases where a cooperative is proposing more than a plus or minus 10 percent difference in a particular customer class or multiple customer classes ROR versus the overall system ROR.

6) A.R.S.§ 40-250.A allows the Commission to enter a rate order in Cooperative cases without a hearing. Within 90 days of filing, the Cooperative, Staff and interveners, if any, shall meet to determine if a proposed form of order can be jointly agreed to for action by the Commission without a hearing. To facilitate this process, Cooperatives may include with their rate filing a proposed form of order. If a proposed form of order can be agreed to among the Staff, the Cooperative and Intervenors, it shall be promptly

filed in Docket Control, together with a stipulation that it be acted upon by the Commission without a hearing at its next regularly scheduled Open Meeting.

7) If a settlement through a proposed form of order is not possible, Staff/Intervener testimony shall be filed within 120 days of filing, Cooperative rebuttal testimony shall be filed 15 days thereafter, and a hearing shall be conducted within 15 days thereafter.

8) The assigned ALJ will file a recommended opinion and order within 30 days of hearing completion and the matter shall be scheduled for the next available Open Meeting.

Financing Case Procedure Changes for Electric Distribution and Gas Distribution Cooperatives

1) At the time of filing the Finance Application, the Distribution Cooperative will deliver to the Director of the Utilities Division any engineering analysis of the projects to be financed as well as a copy of any application filed with the RUS and/or CFC, if one has been filed.

2) Also at the time of filing, the Cooperative will provide a schedule(s) showing the Cooperative's most recent annual financial results and the effect the proposed financing is projected to have on those results.

3) Absent unusual circumstances, neither published notice nor a hearing will be required on Cooperative Finance Applications.

4) Cooperatives will respond promptly to any intervention or additional data requests Staff may have concerning the Finance Application.

5) Staff will prepare and file with Docket Control both its report and a proposed opinion for Commission consideration within 90 days of the filing of the Finance Application.

6) The matter will then be scheduled for Commission action at its next regularly scheduled Open Meeting.

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