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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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3 WILLIAM A. MUNDELL
Chairman
4 JIM IRVIN
Commissioner
5 MARC SPITZER
Commissioner
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8 IN THE MATTER OF THE GENERIC
9 PROCEEDINGS CONCERNING ELECTRIC
RESTRUCTURING ISSUES

Docket No. E-00000A-02-0051

10 IN THE MATTER OF ARIZONA PUBLIC
11 SERVICE COMPANY'S REQUEST FOR A
VARIANCE OF CERTAIN REQUIREMENTS OF
A.A.C. R14-2-1606

Docket No. E-01345A-01-0822

12 IN THE MATTER OF THE GENERIC
13 PROCEEDING CONCERNING THE ARIZONA
14 INDEPENDENT SCHEDULING
ADMINISTRATOR

Docket No. E-00000A-01-0630

15 IN THE MATTER OF TUCSON ELECTRIC
16 POWER COMPANY'S APPLICATION FOR A
VARIANCE OF CERTAIN ELECTRIC
17 COMPETITION RULES COMPLIANCE DATES

Docket No. E-01933A-02-0069

18 IN THE MATTER OF THE APPLICATION OF
19 TUCSON ELECTRIC POWER COMPANY FOR
APPROVAL OF ITS STRANDED COST
RECOVERY

Docket No. E-01933A-98-0471

**STAFF'S NOTICE OF FILING
SUPPLEMENTAL TESTIMONY**

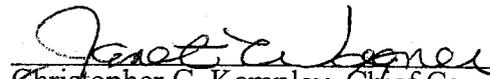
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21 Staff hereby provides its Notice of Filing of Supplemental Testimony of Matthew Rowell.

22 RESPECTFULLY SUBMITTED this 17th day of June, 2002.

23
24 Arizona Corporation Commission

DOCKETED

JUN 17 2002



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28 DOCKETED BY



1 Original and ten copies of the foregoing
2 filed this 17th day of June, 2002,
with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington
Phoenix, AZ 85007

6
7 Copy of the foregoing mailed this 17th
8 day of June, 2002, to:

9 All parties of record

10 Nancy Roe

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BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL

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IN THE MATTER OF THE GENERIC)	DOCKET NO. E-00000A-02-0051
PROCEEDINGS CONCERNING ELECTRIC)	
<u>RESTRUCTURING ISSUES</u>)	
IN THE MATTER OF ARIZONA PUBLIC)	DOCKET NO. E-01345A-01-0822
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VARIANCE OF CERTAIN REQUIREMENTS OF)	
<u>A.A.C. R14-2-1606</u>)	
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PROCEEDING CONCERNING THE ARIZONA)	
INDEPENDENT SCHEDULING)	
<u>ADMINISTRATOR</u>)	
IN THE MATTER OF TUCSON ELECTRIC)	DOCKET NO. E-01933A-02-0069
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VARIANCE OF CERTAIN ELECTRIC)	
<u>COMPETITION RULES COMPLIANCE DATES</u>)	
IN THE MATTER OF THE APPLICATION OF)	DOCKET NO. E-01933A-98-0471
TUCSON ELECTRIC POWER COMPANY FOR)	
APPROVAL OF ITS STRANDED COST)	
<u>RECOVERY</u>)	

SUPPLEMENTAL

TESTIMONY

OF

MATTHEW ROWELL

CHIEF: TELECOMMUNICATIONS AND ENERGY SECTION

UTILITIES DIVISION

JUNE 17, 2002

1 **Introduction**

2 **Q. Please state your name and business address for the record.**

3 A. My name is Matthew Rowell. My business address is Arizona Corporation Commission, 1200
4 West Washington, Phoenix, Arizona 85007.

5
6 **Q. Are you the same Matthew Rowell who filed direct testimony in this proceeding on May
7 29, 2002?**

8 A. Yes.

9
10 **Q. What is the purpose of your testimony?**

11 A. The purpose of this testimony is to provide a supplement to my pre-filed testimony that is
12 intended to clarify some of the points made in my direct testimony. Specifically, I will address
13 the Staff's recommendations regarding a cost of service standard in a post transfer world.

14
15 **Q. On Page 7, Line 6, of your direct testimony you state that, "the established cost of service
16 for existing generators should be used as the price to beat during competitive solicitations
17 whether the utility has transferred its generation assets or not." By this statement, did
18 you mean that utilities that choose not to transfer their assets should be subjected to the
19 same sort of prudence review that Staff is recommending for those that choose to transfer
20 their assets to affiliates?**

21 A. No. This statement is meant to cover the eventuality of a utility that has chosen not to transfer
22 its assets and has also chosen to procure some of its necessary power from a competitive
23 solicitation process (excepting of course power procured to service load growth beyond the
24 utilities current capacity.) A utility that chooses not to transfer its assets and uses its retained
25 assets to serve its native load should not be required to demonstrate that there are no market-
26 based alternatives available. In other words, utilities that chose not to transfer should be
27 subject to traditional cost of service regulation.

28

1 **Q. Specific to the case of a utility that chooses to transfer its generation assets from a UDC**
2 **to an affiliate, under what conditions does Staff recommend that the cost of service of the**
3 **transferred assets be considered?**

4 A. The cost of service along with market prices should be considered during prudence evaluations
5 for retail ratemaking purposes. Of course, cost of service considerations could not be applied
6 when evaluating the prudence of power purchases by a UDC to serve load that is beyond the
7 utilities current capacity to supply.

8
9 **Q. How does Staff envision such a process working?**

10 A. For illustrative purposes, suppose a UDC which has transferred its generation assets to an
11 affiliate procures a portfolio of power resources to serve its standard offer load. Staff expects
12 the UDC's portfolio to contain a balanced mix of short-term contracts, long-term contracts, and
13 possibly a component of spot market purchases. During a rate case to determine the UDC's
14 *retail* rates, the prudence of that portfolio would need to be evaluated. As is usual, the
15 prudence review would only hold the UDC accountable for the information available to it at
16 the time decisions were made. For instance, if the UDC were to enter into a multi-year
17 contract and spot prices were to decline dramatically during its latter years, the costs of that
18 contract should not be automatically disallowed. Multi-year contracts are an appropriate
19 means to manage the risk of price fluctuations. UDCs should not be punished for insuring
20 against price spikes if prices happen to fall.

21
22 The cost of service of the transferred assets enters into the analysis if the cost of the UDC's
23 portfolio of power purchases is substantially higher than the cost of service of the transferred
24 assets. If that is the case, the UDC should expect to be subjected to enhanced scrutiny during
25 the prudence review. This will especially be the case for components of the portfolio that have
26 been purchased from the affiliate at prices above the cost of service. Staff is not proposing an
27 absolute lower of cost or market standard; the utilities should be afforded the opportunity to
28 justify their procurement strategy. Staff is simply stating that if a UDC's costs rise because

1 of the transfer of assets, it will and should be subjected to intense scrutiny during ratemaking
2 proceedings. This is a consideration the utilities should keep in mind when deciding whether
3 to transfer their assets or not. Staff recognizes that prudence reviews are not easy endeavors
4 to undertake; however, they are much more appropriate than the alternatives: an absolute lower
5 of cost or market standard or a straight pass through to retail customers that does not hold the
6 UDC accountable at all.

7
8 **Q. Will the utilities' cost of service always be relevant to prudence reviews?**

9 A. No. Staff sees the use of the cost of service during prudence reviews as a temporary measure.
10 Currently, the wholesale power market lacks a consistent and developed structure in the West.
11 With the lack of an RTO, the FERC's Standard Market Design proceeding unresolved, and
12 an untested AISA; Staff cannot recommend that we rely solely on the wholesale market to
13 arrive at just and reasonable rates. Once the wholesale market is functioning in a robust and
14 competitive manner, the cost of service standard will no longer be necessary.

15
16 **Q. Does this conclude your testimony.**

17 A. Yes, it does.
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