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Home Builders Association OF CENTRAL ARIZONA

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AZ CORP COMMISSION
DOCKET CONTROL

Kris Mayes, Chairman
Gary Pierce
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Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

RE: Line Extension Policies of Electric Utilities, Docket No. Docket No. E-00000J-10-0044

Dear Commissioners,

The Home Builders Association of Central Arizona would like to thank the ACC, and in particular Commissioner Gary Pierce, for your decision to host public workshops to discuss the line extension/utility infrastructure policies adopted for electric utilities over the last three years. One of the major concerns our association has had since the policy shift occurred during the 2007 APS rate case was that the change was made with a last second amendment that received little discussion or debate, in particular with the groups that were most adversely affected by the change. We hope that the workshops will bring transparency and an open and honest dialogue to the issue.

In particular, we hope that the workshops will provide an evaluation of the unintended consequences associated with the policy change and how requiring payment for all utility infrastructure up front actually forces new customers to pay way more than their fair share. There is no question that this new cost burden has slowed economic growth and devalued land across Arizona.

Additionally, while we agree that public utility providers should not be required to provide unlimited amounts of infrastructure that offers little in return, we reject the position taken by some that providing free footage or credits for infrastructure is a "subsidy" or a "giveaway" to new growth. New customers are ratepayers for life, and the infrastructure provided is owned by the utility. This is not a cost, but rather is an investment that benefits utility providers and existing ratepayers, which is why the policy has worked for over fifty years.

Attached are our answers to the Notice of Inquiry (NOI) that was provided by the commission. We look forward to discussing this policy and looking for solutions that will treat new and existing customers fairly and allows electric utility providers to receive an appropriate rate of return.

Sincerely,

Arizona Corporation Commission
DOCKETED
APR 16 2010

DOCKETED BY

Connie Wilhelm
President and Executive Director

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1) What factors should the Commission consider when establishing policies governing electric line extensions?

We believe that three factors should be considered:

1) Ensuring that new customers are treated the same as existing customers, in particular that for over 50 years new customers received free utility infrastructure and now new customers are paying for those line extensions (through rates) on top of paying the full cost for their own line extension.
2) Evaluate the benefits to existing customers of adding capacity to the grid and expanding the rate base. Line extensions should be treated as an investment by the utility, not as a "cost" or "subsidy" to the new customer.
3) Providing consistent treatment of all new customers. All new ratepayers should be treated equally since all provide equal benefit to the utility provider.

2) Should the principles of cost-causation be the predominant consideration (i.e. requiring costs to be borne by the cost-causer)? If not, what should be the predominant consideration?

No, see response to Q1.

3) Is it possible for the Commission to devise line extension policies that will result in existing customers subsidizing growth? If so, please provide an example.

Under the old schedule 3, economic feasibility studies were conducted that allowed APS to determine cost/benefit relationship for providing infrastructure to a new customer. If the costs exceeded the overall investment benefit, APS would require a payment from the applicant. As a result, existing customer would actually benefit from a utility's ability to expand the rate base by investing in additional infrastructure without having to pay for a bad investment. If the utility provider is allowed to perform an economic feasibility study and is allowed to charge for costs that exceed the benefits (as allowed under the old schedule 3), existing customers cannot subsidize growth.

4) Is it possible for the Commission to devise line extension policies that will result in growth subsidizing existing customers? If so, please provide an example.

Yes, the new policy does in fact subsidize existing customers. In fact, new customers are now paying 3 times for their line extension. Here is how:
1) New customers are required to pay the full cost of their line extensions, and in some instances are required to pay a "gross up" to cover the income tax obligations of the private utility.
2) In addition, new customers have to pay, through rates, for line extensions provided to existing customers under the old policy.
3) Since utility providers are allowed to make a rate of return from their investment, new customers end up paying for the extension again when the utility goes to the commission for their next rate increase. Even if "credits" are provided that reduce the amount a utility may ask for on that infrastructure, the benefits from those credits are given to all ratepayers, not just the new customers who paid for the infrastructure.

5) Should growth pay for growth or should it be subsidized by existing customers? If you believe growth should be subsidized by existing customers, in what amount and by what mechanism? Should

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growth costs be included in base rates and allocated to all customers or should they be allocated to specific customer classes?

We reject the notion that providing line extensions are a "subsidy," they are an investment by the utility. It was not a subsidy when the policy was put in place 60 years ago, and it is not a subsidy now. Additionally, as mentioned in our responses to questions 3 and 4, under the current policy new customers are paying a disproportionate share of the costs since they are paying for the expansion of services for existing customers through the rate base, and also being required to pay for the expansion of their facilities.

6) Should growth be required to pay for more than growth? If not, why not? Does APS' existing line extension policy require growth to pay for more than growth?

No, growth should not pay for more its fair share (see questions 1-5). Yes, the current APS policy requires growth to pay more than its fair share (see question 4).

7) Should certain customer groups (such as low income customers, Native Americans on Native American lands, rural customers, etc.) be exempted from an otherwise generally applicable line extension policy? If so, what groups should be exempted and why?

No, if a policy is established it should be uniformly applied (see question 1).

8) Should new line extensions have excess capacity? If so, should new customers be required to pay for that excess capacity? Is there a minimum level of electric capacity that all new customers should be required to have irrespective of their own electric demand? If so, what is that minimum electric capacity and what is the potential incremental cost of installing electric lines at the minimum electric capacity versus the customer's actual electric demand? What percentage of line extensions are single-customer installations, versus those that 'grow the grid' to further extend company service capability?

If it is prudent to provide for excess capacity, the utility requiring the excess capacity should enter into a payback agreement with the initial customer paying for the infrastructure. Payback shall be made as subsequent customers require capacity. We do not have the information necessary to respond to the remainder of the question.

9) Explain how any applicable line extension charges should be calculated. Under what circumstances and on what basis, are customer refunds of customer-financed line extensions appropriate? Should the initial applicant be required to pay the total cost with a refunding mechanism if subsequent applicants use any common facility paid for by the original applicant or should the initial customer only be required to pay for the common plant constructed on a pro rata basis?

Line extension charges should be based on the future customer base (and therefore future revenue) that will be generated through the installation of the line extensions. It should be based on an economic model that allows for the utility to recoup its infrastructure costs over a reasonable period of time. Should the applicant not be able to perform under the conditions of the land development agreement, they would be charged for the infrastructure investment by the utility. If the applicant is asking for line extensions in an area that the utility feels the investment can be justified with a reasonable time for their rate of return through hookups, a payback agreement may not be necessary, and the utility may advance the excess capacity costs. If however, the utility company does not see a lot of capacity demand occurring in an area where a customer has requested service, it may be necessary to require the customer to advance the excess capacity charge and be reimbursed through a payback agreement.

10) Should line extension policies vary depending on the type of customer? In other words should line extension policies vary among the following types of customers:
- an individual owner, or a small group of owners, of land who will not subdivide their respective properties and are seeking service exclusively for a future residence and not for a development.
- larger developments, residential subdivisions, or master-planned communities.
- commercial and/or industrial customers.

No, new customers should be treated as equally as possible, solely based on the value of the investment by the utility provider.

11) What were the original considerations for establishing a 1,000 foot line extension policy for APS, and why wasn't the same line extension policy adopted for the other electric utilities?

We do not have the information to respond to this question.

12) Has the changed character of APS's service territory, i.e. rural/urban mix, removed the need for a line extension subsidy? Given the fact that APS' line extension policy was in place for 50+ years prior to 2006, has the original purpose of this subsidy been served?

We reject the notion that providing line extensions is a subsidy. Providing utility infrastructure is an investment by the utility, just like any other business (cell phone providers, direct TV, etc.) that makes investments to attract new customers. Also, this policy has disproportionately impacted rural Arizona, so any reference to a rural/urban mix or change in demographics has nothing to do with this policy. Rural Arizona was served by this policy 50 years ago, and should continue to be served by the utility providers.

13) What is the appropriate time interval for examining subsidy costs? I.e., should subsidies be re-examined every 50 years, 10 years, 5 years or less? Should subsidies be set on a downward glide path or is it appropriate for customers to expect their perpetual existence?

Again, this is not a subsidy, but is an investment by the utility. The current policy has been working for several decades and we do not see the need for any time intervals in how utility providers invest in infrastructure. Additionally, land transactions that occurred many years ago were based on the previous policies and the new policy has negatively affected the feasibility of those projects. It is important in the area of land development to have predictability.

14) Is it inconsistent for the Commission to establish some subsidies that decline over time and some subsidies that do not decline over time? Should the Commission pursue an across-the-board phase out of all subsidies?

We do not believe that line extensions are a subsidy. Utility companies make money off of providing electric service, not investing in new infrastructure. If the old policy required that new customers receive a special break or reduction off their utility bill, we would agree that would be a subsidy and should be eliminated.

15) Should line extension policies for electric utilities be uniform across the state and established via rulemaking or should they be decided on a case by case basis? Should electric cooperatives be treated differently than investor-owned electric utilities? If so, how and why or why not?

We should go back to the policies that each utility had adopted for their specific business model.

16) Should line extension policies for electric utilities be uniform with line extension policies for telecommunications, gas, water and sewer utilities?

No, we believe that this should remain focused on electric utilities.

17) If the Commission reinstates a free footage allowance for utilities, should the Commission make the new policy retroactive? Should existing customers be compensated who were previously negatively affected by the "no free allowance" policy? If so, how? If one is opposed to retroactive application, is that opposition based in law, policy or both?

For practical reasons we believe it would be difficult to retroactively implement and may have very adverse effects on publicly traded corporations.

18) What costs should be captured in line extension policies? In other words, should line extension policies consider the costs of local facilities, system or backbone facilities, and upgrades to existing facilities?

It should be similar to what was provided under the old policy. The old schedule 3 under APS provides a good template on what should be captured in any line extension policy.

19) What are the comparative advantages and disadvantages of free footage allowance versus a dollar allowance policies? What would be the cost to ratepayers if the policy were changed to include an "equipment allowance" of a specified amount for only individual residential homeowners?

Do not have information to respond to question.

20) If you are an electric utility, what is your current line extension policy and how has your line extension policy changed over the last fifty years? For APS, what percent of line extensions are installed inside Maricopa County versus outside of Maricopa County? What percentage of line extensions are for residential service versus commercial and industrial service? How many residential line extension estimates has APS provided since 2007 that did not result in a subsequent payment and request for a line extension and service?

Not applicable.

21) Please describe the optimal line extension policy that, in your view, best balances the interests of existing and future customers. If you believe that a historical line extension policy (e.g., APS' 1000 free feet line extension policy) is the best, please explain why you believe it is better than alternative proposals (e.g., why is 1000 free feet better than 500 free feet, why is 1000 free feet better than 2000 free feet, etc.)

Our preference would be to revert to the old policy of allowing utilities to provide line extensions based on economic feasibility. We are open to discuss alternatives related to free footage and utility infrastructure, but it should be based on the revenues generated by new customers to recoup the costs of infrastructure over a reasonable period of time.

22) If the optimal line extension policy is different than existing and/or historical line extension policies, should the Commission transition to the optimal policy? If so, how?

The commission should transition to the optimal policy as quickly and efficiently as possible.

23) Please estimate the impact on the economy and new construction from the current line extension policies. What is the impact on land values?

While we have no actual data, we have had several home builders walk away from projects solely as a result of the new policy's increased costs. We have also communicated with several landowners that have seen their land values plummet as a result of the new extension policy.

24) Should the Commission be concerned about the potential for new line extensions becoming idle (i.e., "*building a line to nowhere*")? If so, what provisions should be made to protect against such contingencies?

No, utility providers should not be "building a line to nowhere." Any extension offered should be based on a feasibility model as was provided under the old APS schedule 3, which allowed for field audits and repayment if permanently connected customers were not provided. Also see question 9.

25) Should an economic model be used to determine the benefits of new customers versus the costs associated with providing line extensions?

Yes, just like what was done under the old extension policy (see question 9 and 24).

26) What prompted the changes to line extension policies that go beyond the elimination of free footage allowances? For example, what prompted the change in categorizing line extensions associated with subdivisions from "advances in aid of construction" to "contributions in aid of construction"? If the policy was changed back to an "advance" what would be the impact on electric utility rates? What would be the impact on electric utilities' financial condition?

We do not have the information to answer this question.

27) How much, if any, additional funding has the change in line extension policies brought to electric utilities?

We do not have the information to answer this question.

28) Is it possible to change line extension policies without affecting rates? If so, how?

We do not have the information to answer this question.

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29) How do the costs of construction of electric lines compare today with the costs of construction in 2006? How are adjustments made to the costs of construction? Are adjustments made to these costs pursuant to a tariff?

While we believe that construction costs are significantly lower than in 2006, we do not have the information to provide a detailed analysis.

30) If the actual costs associated with construction are less than the amounts paid in advance by the developer, are those overages refunded? Can ratepayers obtain the actual costs for materials and the actual labor costs? What is the linear cost difference between buried electric line extensions and overhead, pole-attached line extensions?

We do not know if overages are refunded.

31) Should the Commission adopt a separate line extension policy for "extraordinary" customers, waiving costs or the like for developer commitments such as, all electric subdivisions, Energy Star homes, or solar installation programs, etc. If so, what should be the criteria for establishing such waivers?

Absolutely not, all new customers should be treated the same under any line extension policy. The benefits received from being an Energy Star home or an all electric subdivision will show up in the electric bill, it should not be considered when providing line extensions. Incentives based on energy usage should be addressed as a separate issue.

32) What flexibility does a utility or cooperative have in interpreting and implementing line extension policies? What flexibility *should* they have?

The new policy does not provide any flexibility. The old policy did provide flexibility in allowing utilities to determine the cost/benefit of hooking up new customers and charging for costs that exceeded the investment benefits (see questions 3 and 9).

33) What changes in line extension policies can occur in a generic docket? What changes must occur in a rate case?

Do not have the necessary information to answer this question

34) Would a change in the line extension policy be detrimental to energy efficiency or DSM goals?

Do not have the necessary information to answer this question

35) Would a change in the line extension policy provide an economic incentive to build homes in Arizona? If so, does the benefit of increased construction outweigh the costs of increased rates for all ratepayers? Can any increase in new home construction be quantified?

Without knowing what the change would be, it is impossible to answer this question.

<u>Accounting Treatment of Line Extension Proceeds</u>:

36) Are the funds associated with line extensions treated as contributions in aid of construction (CIAC) or as revenue in your electric utility?

We know that APS counts it as revenue, but we do not have the information on how every utility treats it.

37) Should the accounting treatment for any funds collected for line extensions be treated as revenues, as contributions-in-aid of construction, or determined on a case-by-case basis?

Do not have the necessary information to answer this question.

38) To what extent is the accounting treatment of line extension proceeds relevant to the over-arching policy discussion regarding who pays for the cost of the line extension and whether growth pays for growth?

It is relevant to the extent that when counted as revenue a utility is allowed to earn a rate of return on the extension, meaning new customers are paying for infrastructure that the utility can then claim as their own investment. Under this scenario, new customers will be paying every month, through rates, for an investment they made, not the utility. In other words, the utility receives all of the benefits from the new customer without having to make any investment.

39) Does the shift in accounting treatment from CIAC to revenue result in growth subsidizing existing customers? In answering this question please respond to the following scenarios.
The Commission recently authorized Arizona Public Service Company (APS) to treat all Schedule 3 proceeds as revenue instead of CIAC. Under the settlement agreement approved by the Commission, APS will be allowed to treat as revenue all line extension funds collected during January 1, 2010 and the earlier of December 31, 2012 or the conclusion of its next general rate case. Thereafter, Schedule 3 proceeds will be recorded as CIAC unless otherwise ordered by the Commission. APS' next base rate change from its next rate case will be effective no sooner than July 1, 2012. Assuming that the test year of APS' next general rate case ends on December 31, 2011 and that the Commission allows Schedule 3 proceeds to revert back to CIAC, please answer the following:

A. A hypothetical new customer pays APS $25,000 to extend a line 1000 feet to his new home in 2011. Would such a customer be better off having his $25,000 treated as revenue instead of CIAC? Will such a customer begin to pay for his line "again" once it is placed into rate base and put into APS' rates on July 1, 2012? To what extent, can it be said that existing customers have been insulated from the costs of growth, if the $25,000 paid by the new customer, is still placed into APS' rates on July 1, 2012? To what extent, if any, has this new customer benefitted by having his $25,000 treated as revenue instead of CIAC? Will this new customer receive any benefits under a revenue approach if he first begins taking service from APS on December 31, 2011? What if he first begins taking service from APS on June 30, 2012, the day before the next APS rate case is decided? To the extent that this new customer is not benefitted by treating his $25,000 as revenue instead of CIAC, are there other customers who are benefitted? Who are these customers and how have they benefitted? Has the change in accounting treatment resulted in this new customer subsidizing these other customers? Does the shift in accounting treatment result in growth subsidizing existing customers?

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If the funds are treated as revenue rather than CIAC, new customers will certainly pay for their line again if it is put into APS' rates on July 1, 2012. Additionally, existing customers will not be insulated from the costs, and will eventually pay for the line extensions in future rate cases.

Also, as mentioned in question 4 and 38, new customers will be subsidizing existing customers if the funds are treated as revenue in the 2012 rate case. Any reductions in rates or credits offered only results in new customers further subsidizing lower rates for existing customers, especially when new rate increases go into effect on future dates.

B. A hypothetical developer is developing a new community along the East Verde River, ten miles west of Payson and is paying the full cost (approximately $6 million) for extending electric services from Payson to the new community. The developer pays the full $6 million to APS in 2011 and the lines are constructed, and become used and useful to the new community by December, 2011. Are the developer and the residents of this new community better off having the $6 million treated as CIAC or revenue? Will existing customers have to pay for the $6 million "again" after it is put into rate base and APS' new rates become effective on July 1, 2012? Once APS' new rates go into effect will APS begin to earn a rate of return on the $6 million that was paid by the developer?

If it is treated as revenue, the new customers will pay for it again after it is put into the rate base. APS will be able to earn a rate of return on the infrastructure paid for by the developer, and as mentioned in questions 4, 38, and 39, and credits offered in an attempt to lower rates will only lead to further subsidization of existing customers at the expense of new customers.

Third Party Vendors:

40) Should third-party contractors or vendors be allowed to install electric line extensions? If so, under what circumstances and conditions?
41) What are the potential cost-savings of third-party vendors?
42) What should be the scope of third-party involvement? (e.g., design; construction; right-of-way acquisition; licenses and permits, etc.)
43) How should the host utility ensure quality control? How should warranty, insurance and liability issues be resolved? Who would bear responsibility for accidents, injuries, and fatalities among patrons and workers resulting from substandard work from third-party contractors?
44) Can we be certain that any benefits from a third-party contractor option will not be offset by safety and reliability issues?
45) Would the inclusion of a third-party option generally promote the "convenience, comfort, and safety, and the preservation of the health, of the employees and patrons" of electric utilities?
46) Have other jurisdictions permitted third-party contractors to construct line extensions? If so, what has been their experience? Have there been any "hidden costs" (e.g., design, inspection, and repair costs borne by utilities and ratepayers, but not captured in contractors' prices), delays, and complaints associated with such work?

Our Response to Questions 40-46:

The discussion regarding third party contractors or vendors should not be one that involves the line extension policy or the ACC. The regulated utility should work with their customers to determine if it is in their best interest to allow for third party contractors or vendors and under what conditions. There are many good models out there currently in use for various aspects of the development process; but it has been our experience that price is not always the overriding consideration in promoting the use of third party contractors.