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November 30, 1998

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

Subject: IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF ITS PLAN FOR STRANDED COST RECOVERY, DOCKET NO. E-01345A-98-0473;

IN THE MATTER OF THE FILING OF ARIZONA PUBLIC SERVICE COMPANY OF UNBUNDLED TARIFFS PURSUANT TO A.A.C. R14-2-1601 et seq., DOCKET NO. E-01345A-97-0773;

IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR APPROVAL OF ITS PLAN FOR STRANDED COST RECOVERY, DOCKET NO. E-01933A-98-0471.

IN THE MATTER OF THE FILING OF TUCSON ELECTRIC POWER COMPANY OF UNBUNDLED TARIFFS PURSUANT TO A.A.C. R14-2-1601 et seq., DOCKET NO. E-01933A-97-0772.

IN THE MATTER OF COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA, DOCKET NO. RE-00000C-94-0165.

Ladies and Gentlemen:

Pursuant to Decision No. 61259, dated November 25, 1998, the Land and Water Fund files the attached testimony. This testimony is concurrently being served on all parties of record by facsimile by the Land and Water Fund.

Sincerely,

David Berry
Executive Consultant

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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 APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF ITS PLAN FOR STRANDED COST RECOVERY.	DOCKET NO. E-01345A-98-0473
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TESTIMONY OF DAVID BERRY

ON BEHALF OF

THE LAND AND WATER FUND

NOVEMBER 30, 1998

Q. Please state your name, position, and business address.

A. My name is David Berry. I am an Executive Consultant with Resource Management International, Inc. (RMI). My business address is 302 North First Avenue, Suite 810, Phoenix, Arizona 85003.

Q. Whom are you representing in this proceeding?

A. I am representing the Land and Water Fund (LAW Fund), a non-profit environmental group that advocates clean energy policies in six western states. The LAW Fund has been engaged in issues before the Arizona Corporation Commission for about seven years and has participated in restructuring issues in Arizona since 1994.

Q. What are your qualifications for presenting testimony in this proceeding?

A. I have 27 years of experience in economic analysis of energy, land, and natural resource issues. With RMI, I have conducted economic analyses for public and private sector clients concerning retail electric competition, strategic planning, electric demand forecasting, pricing of energy services, anti-trust issues in a restructured electric industry, contracts to buy or sell energy, risk management, solar power, and evaluation of energy alternatives. I have testified before the Arizona Corporation Commission and the Maine Land Use Regulation Commission.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present the LAW Fund's response to the Staff, Arizona Public Service Company (APS), and Tucson Electric Power Company (TEP) Settlement Agreement. In general, the Law Fund is supportive of the clean energy provisions of the Settlement Agreement, especially those pertaining to the solar portfolio standard. However, the LAW Fund does have some concerns about the governance and structure of the proposed Transco which we believe can be addressed in a subsequent hearing.

Q. What comments do you have on the solar portfolio standard?

A. The LAW Fund believes that the solar portfolio standards incorporated in the Settlement Agreement are important for helping to create a more mature solar industry in Arizona. Solar power helps diversify the electric generation resource mix and reduces adverse environmental impacts associated with some conventional generation. In addition, the manufacture of solar panels and other related equipment in Arizona will contribute to the State's economic base. The LAW Fund believes the provision of the Settlement Agreement endorsing the Commission's August 1998 rule revision helps advance solar power both economically and politically. I urge the Commission to support these provisions of the Settlement Agreement.

Q. What concerns do you have with the Transco proposal?

A. The LAW Fund is concerned about the governance and structure of the Transco which is apparently emerging as a result of the settlement agreement between Staff and TEP. There is insufficient foundation for the Commission and Arizona to embark on a Transco, and the adverse consequences of the proposed financing of the Transco have not been adequately considered. I conclude that the Commission, even if it accepts the settlement agreement, should separately consider the merits and form of a Transco and not let the settlement process exclusively control such an important issue. The development of a Transco is largely outside the scope of the matters addressed by the settlement, such as stranded cost, and has not been adequately reviewed to date. Further, the financing of the Transco by consumers, as required by the settlement agreement, needs to be fully and publicly reviewed.

Q. What is a Transco?

A. There is no one common definition of a Transco. However, in general, a Transco is a company which owns transmission facilities and operates the transmission system. The specific duties of a Transco vary among proposals. In some proposals a Transco is owned by parties who are not stakeholders in the purchase and sale of electricity and related services.

Q. What does acceptance of the settlement agreement by the Commission imply about the Commission's commitments to a Transco?

A. The agreement states that "In order to prevent the occurrence of vertical market power, it is the intent of the Staff and, by its approval of this Agreement, the Commission, that TEP's transmission company affiliate be the sole builder and owner of transmission assets in the state." (p. 7)

Q. Does the settlement agreement require all transmission owners in Arizona to sell their facilities to the Transco?

A. Yes. However, the Transco, as envisioned in the settlement agreement, will require the cooperation of facility owners who are not parties to the settlement. Further, some facility owners are not subject to the jurisdiction of the Commission.

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Q. Has the Commission undertaken a thorough investigation of the Transco option with public input?

A. I am not aware of such an investigation. The Commission established an ISO and Spot Market Development Working Group which submitted a report on November 18, 1997. The report does not address Transcos.

Q. Does the settlement agreement specify a structure for the anticipated Transco?

A. Only in a very limited sense. The agreement indicates that the Transco should be a monopoly affiliated with TEP and the agreement indicates some general principles for pricing and non-discriminatory access to the transmission system. However, the settlement does not address many other issues which must be considered before adopting a Transco approach. Among the issues not considered are:

- Alternatives to the monopoly Transco, the advantages and disadvantages of each alternative, and the incentives to the transmission owners and other stakeholders inherent in each alternative.
- Independent and unbiased oversight of the transmission system.
- Operation of the control area.
- Determination of available transfer capability.
- Planning.
- Scheduling.
- Accounting.
- Billing.
- Congestion management.
- Dealing with imbalances.
- System reliability.
- Treatment of existing contracts.
- Governance.

Q. If a Transco is a for-profit enterprise, will it pursue transmission policies that are in the public interest?

A. Maybe. A private firm will have incentives to be efficient, but inasmuch as the proposed Transco will be a monopoly without competitive pressures, such incentives may be blunted. Another possible problem is that the Transco may have incentives to maximize use of its transmission assets instead of using generation and transmission facilities and demand side management jointly to maximize overall efficiency in the supply of and demand for electric energy services. For example, if a new generation unit were to be connected to the grid, that unit might reduce revenues to the Transco as transmission system congestion is eased. The Transco might seek to delay connection of the new plant to the grid. Further, to overcome potential market power, a Transco should not be owned by parties affiliated with generation or distribution services.

Q. Has the LAW Fund considered alternative governance structures for a Transco which may help to remove incentives to a Transco to act against the public interest?

A. The LAW Fund has begun such analyses. It is particularly interested in a non-profit, structure which will eliminate incentives to maximize profits at the expense of society-wide efficiency and equity. One attractive structure is that of a cooperative in which consumers, environmental groups, and energy service providers are a part of the management oversight team for the Transco.

Q. What is the LAW Fund's opinion on the settlement agreement's pursuit of a policy to implement a monopoly Transco?

A. It is premature for the Commission to adopt a policy on Transcos at this time. There is inadequate public input, inadequate consideration of alternatives, inadequate consideration of structure and governance, and inadequate authority to obligate the State to create a monopoly Transco.

Q. How does the settlement agreement provide for financing the Transco?

A. The agreement allows TEP to use some or all of the gains on sales of its generation assets (above net book value) to capitalize the Transco so that the Transco can acquire additional transmission facilities. To a limited extent, under the settlement agreement, TEP's customers receive a reduction in jurisdictional rates over a long time period: 1) while the Competitive Transition Charge (CTC) is in effect, TEP's jurisdictional rates will be reduced by an amount equal to TEP's rate of return applied to the gain invested in transmission; 2) after the CTC expires, TEP's rates will be reduced to reflect the recovery of the common equity balance from the gain invested by the Transco (apparently using a hypothetical capital structure of 35 percent equity) over a ten year period.

Q. What is the LAW Fund's opinion on this financing arrangement?

A. The LAW Fund believes that the financing associated with future transmission facilities should not be resolved as part of this Settlement Agreement. For example, it may be inappropriate for consumers in TEP's traditional service area to face a higher CTC so that the Transco can acquire additional facilities. The Transco could obtain financing from willing investors and lenders, just as other private businesses do.

Q. What are the LAW Fund's recommendations regarding the Transco?

A. The LAW Fund recommends that the Commission explicitly state in its Order regarding the settlement that its acceptance of the settlement (or the settlement as modified) expresses no intent regarding the desirability, ownership, structure, financing, or governance of any Transco.

Q. How should a Transco be explored and, if beneficial, be pursued?

A. It is our understanding that any transfer of assets must ultimately be approved by this Commission. The LAW Fund recommends that the Commission revisit these issues surrounding Transco ownership, financing, structure, and governance as a part of the asset transfer approval process. Also, sometime before a Commission filing, we would encourage TEP to convene interested stakeholders to identify potential differences among the parties and try to resolve them. This process might be undertaken in conjunction with, or separately from, the discussions surrounding the development of Desert Star, an Independent System Operator.

Q. Does this conclude your testimony?

A. Yes.