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BEFORE THE ARIZONA CORPORATION COMMISSION

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

COMMENTS AND REQUEST FOR HEARING ON STRANDED COST

COMPLIANCE FILING OF TUCSON ELECTRIC POWER COMPANY

SUBMITTED BY ENRON CORP.

Arizona Corporation Commission
DOCKETED

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Summary

The filings of Arizona Public Service and Tucson Electric Power are not consistent with the ACC's directives regarding stranded cost filings and are anti-competitive. As a result, evidentiary hearings should be scheduled to address stranded cost issues. In the event those proceedings are not concluded prior to January 1, 1999, the Arizona Corporation Commission should proceed with open access on January 1, 1999 and not allow any recovery of stranded costs until the completion of the evidentiary hearing process.

The appropriate method is to use a fixed, non-available Market Transition Charge (MTC) to recover a pre-determined, approved level of stranded costs over a pre-set number of years. This approach provides the opportunity for recovery of the requisite amounts of funds, does not distort the customer's choice of energy supplier or of market signals, and is not anti-competitive.

In addition, a stand-alone shopping credit must be calculated. It is critical that the shopping credit reflect all related cost of providing energy to the retail customer and not just the wholesale energy price. Otherwise, customers would be paying twice for services – once to the utility who no longer is providing the service and once to the new supplier who is providing the service.

The sum of MTC and the shopping credit replace the utility's embedded cost of generation in the rate structure. The recovery period of the MTC should be sufficient length to allow the shopping credit to be suffiently large to capture all the costs related to generation and still not exceed the ACC's goal with respect to the overall rate level.

Introduction

In accordance with Decision No. 60977 of the Arizona Corporation Commission, Enron hereby submits its comments on several of the filings for stranded cost recovery. Enron has specifically reviewed the filings of Arizona Public Service and Tucson Electric Power. Enron has not reviewed the other filings in sufficient detail to offer a critique.

Many of Enron's Comments are applicable to both APS and TEP. As a result, these Comments are being filed in both dockets. In addition, these Comments supplement those submitted by AECC.

The ACC's Finding of Fact # 26 in Decision No. 60977 was that "Any stranded cost recovery methodology must balance the interests of the Affected Utilities, ratepayers, and a move toward competition." Enron believes this finding was not followed by the APS or TEP in their stranded cost recovery plans.

Enron supports a reasonable opportunity being provided for utility recovery of all prudently incurred, unmitigable stranded costs that result from the transition from a regulated to competitive environment. However, this recovery should not come at the expense of ratepayers paying any more than necessary for stranded costs, or at the expense of delaying the move toward competition. These comments will briefly describe an approach to achieve this finding by the ACC and describe why the filings of APS and TEP do not achieve this goal.

General Comments

As a general proposition, stranded costs should not be recovered as the difference between the current regulated rate and some market price of energy and capacity and imposed until all recoverable costs are collected. This "residual" approach tends to prevent the accurate transmission of market signals. As market prices fluctuate, the residual between the regulated rate and the market price of energy and capacity will fluctuate in an inverse relationship to market changes. Customers will see no fluctuation in the rates they are paying, regardless of their choice of supplier and despite changes in market conditions.

There is an approach to stranded cost recovery which, in Enron's view, does balance the interests of utilities, ratepayers, and the move toward competition. Enron's preferred approach uses a fixed, non-avoidable Market Transition Charge (MTC) to recover a pre-determined, approved level of stranded costs over a pre-set number of years. Periodic reconciliation of MTC revenues with stranded costs may be necessary to adjust for certain factors, but the over-use of reconciliation during the recovery period should be recognized as a possible deterrent to effective utility mitigation of stranded costs.

Enron's approach to MTC is to create a collection mechanism which does not distort the customer's choice of energy supplier, while allowing collection of the requisite amount of funds. The fixed, non-bypassable MTC acomplishes this objective. The customer pays this charge regardless of which energy provider is chosen.

At the same time, a stand-alone shopping credit must be calculated separate from the MTC. The shopping credit must create opportunity for and movement toward competition. The shopping credit is the part of the utility's price for default service which the customer does not pay if energy is purchased from an alternative provider. Customers who shop for energy have this shopping credit as a target price which they must beat to make shopping worthwhile. Customers who do not shop pay the equivalent of the shopping credit as the price for default service from the utility or other default service provider.

It is critical that the shopping credit reflect the full cost of providing energy to retail customers and not simply reflect a wholesale price index such as the California PX price. The wholesale price index could comprise one part of the shopping credit, capturing the wholesale market cost of energy (and capacity). To this part, however, must be added costs associated with providing retail service. Otherwise, competing suppliers will be forced to absorb its retailing costs and likely will not operate at a profit. The Pennsylvania PUC noted the need for this critical distinction between wholesale and retail costs to create real incentives for customers to shop for electricity products, and has shaped utility settlements throughout the state around this difference.[1]

A succinct list of retail-related energy costs which should be added to an appropriately chosen wholesale price index was listed in a recent decision involving Public Service Electric & Gas of New Jersey.[2] That list, which Enron endorses, includes

- an allocated share of embedded production-related administrative and general costs and overheads associated with utility generating plants utilized to serve default customers. *Translation:* When utilities provide energy, they employ accountants, lawyers, managers and secretaries who work in offices and use computers, paper and paper clips. These administrative and general costs and overheads are part of the cost to provide energy. Without recognition of these costs in the shopping credit, competing suppliers will have to absorb their administrative, general and overheads costs even though the customer is still paying for the utility's A&G costs through transmission and distribution rates.

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[1] See Pennsylvania PUC Order adopted December 11, 1997 in R-00973953, "Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement".

[2] Initial Decision and Report of Office of Administrative Law (OAL), August 17, 1998, in New Jersey BPU Docket No. EO97070463, pp. 75-76.

- costs of procurement of default service portfolios. *Translation:* Traders, purchasing agents, and system planners work in the utility to assemble and manage a supply portfolio. They often purchase financial risk management instruments for their portfolio to protect against price swings. As with A&G costs, competing suppliers will have similar costs which must be explicitly added to a wholesale energy index.

- costs of all ancillary services, transmission charges and congestion charges directly related to the provision of default service. *Translation:* When the utility generates or purchases supply for default customers, the supply must be moved from the generator or trading point through the transmission system into the distribution system. If the utility does not unbundle these costs, it is presumed the services are all provided by the utility and related costs are part of the transmission rate. However, generation-related ancillary services, such as losses and reserves, should be competitively provided and this requires unbundling these services. If these costs are not included in the shopping credit, it should be clear that the competing supplier incurs no additional costs to have them supplied by the utility.

- marketing costs of the retailer, reflective of the value of the exclusive default service franchise and customer base possessed by the utility. *Translation:* Most customers know and are familiar with their utility. The utility advertises, sends billing inserts each month to customers, and has trucks which travel the streets of the service territory. Costs from these activities are recovered in rates. The competing supplier has to establish name recognition in the local market. Costs for this activity should be recognized in the shopping credit.

Including these costs in the shopping credit protects customers who choose to shop from having to pay for these services twice - once to the utility as part of regulated transmission and distribution rates, and once to the alternative energy service provider as part of its competitive price. From a different perspective, exposing the customer to this double collection all but assures that very, very few customers will even seek a competing seller and that few competing sellers will enter the market.

Even though the MTC and shopping credit are calculated separately under this approach, it is important to consider the impact on competition from their interaction. In theory, the sum of the MTC and the shopping credit replaces the utility's embedded cost of generation in the rate structure. For purposes of calculating the explicit MTC, the choice of the recovery period should result in a MTC which is small enough to allow the shopping credit to capture all of the above mentioned costs and still not exceed the ACC's goal with regard to overall rate level. This may require adoption of a rate cap if the ACC seeks to assure rates at no point will exceed today's bundled price.

Enron's model is completely consistent with the findings and goals of the ACC to establish real competition while balancing the interests of utilities, ratepayers, and movement toward competition. These Comments will now address the utility's filings against this model.

These comments do not specifically address the legitimacy of the stranded cost claims or the functionalization of costs. Enron anticipates that mitigation and functionalization of costs are issues for other hearings or Commission actions. As a general proposition, Enron states that only legitimate, non-mitigable, properly functionalized, historic generation costs are eligible for stranded cost designation. Future investments in generating stations should not be eligible for stranded cost designation.

Arizona Public Service

The APS proposal for stranded cost recovery is seriously flawed in that it does not create opportunity for a competitive retail market to emerge, does create opportunity for a windfall to the Company and its shareholders, and does nothing for the Company's ratepayers. There are three significant flaws:

- APS does not propose an explicit determination of its stranded costs
- APS does not propose an explicit determination of its charge to recover stranded costs
- APS proposes a "wholesale only" shopping credit with no recognition of retail costs

Each of these flaws works to undermine the ACC's goal of balancing interests of the utilities and ratepayers while promoting competition.

APS does not propose an explicit determination of its stranded costs. APS has simply identified a number of years (through 2004) through which it will continue to collect full retail rates for non-shopping customers and full retail rates, less marginal wholesale costs, for shopping customers. In estimating its stranded costs at $533 million, APS supposedly has made "an attempt to be responsive" (p. 4 of its August 21, 1998 filing) to the ACC's requirement that utilities fully supported analyses of unmitigated stranded costs. In addition to not fully supporting its stranded cost estimate with fully supported analyses, APS has not established any direct relationship between its stranded cost estimate and its proposed recovery mechanism.

APS has filed its proposal under the Commission's "Transitional Revenues Methodology" option and has apparently interpreted that option as not requiring it to provide detailed analyses supporting its stranded cost claims. Enron does not believe the Transitional Revenues Methodology option should be used as a way to excuse the utility from determining actual stranded costs. Consistent with other pronouncements of the ACC, including A.A.C. R14-2-1607(C), Enron believes the utility is required to identify, document, and validate its non-mitigable stranded costs and is permitted to devise a recovery plan which provides sufficient revenues to maintain financial integrity. This is not what APS has done.

APS should be required to perform an explicit determination of its stranded costs using a Commission-approved methodology. Even though APS has decided not to divest, there are a number of approaches to choose from. An appraisal performed by an independent third party is acceptable. There are thousands of megawatts of generation capacity that have been auctioned in the market or are currently for sale. Absent divestiture or appraisal, an administrative approach may be acceptable as a fallback, in the interests of bringing this issue to closure.

An administrative approach involves forecasting the market value of plants, relying on best available information on load loss, market prices, and other key variables. This approach could rely on a one and for all estimate, or alternatively, use periodic updates to continually reconcile estimates with actuals. As mentioned previously, reconciliation is objectionable only to the extent it diminishes utility mitigation efforts.

One of the concerns expressed by the Commission in its Decision (p. 10) is the need to move quickly to resolve the stranded cost issues because of the January 1, 1999 date for commencement of the initial phase of competition. Enron supports the Commission in this regard; that certainly is the preferred outcome.

However, if the stranded cost issues are not resolved, Enron believes the Commission can proceed with its plan to initiate open access. The stranded cost issues can be bifurcated and handled separately in a more deliberate and responsible fashion. The Commission can hold evidentiary hearings, make its decision resolving the issues after the evidentiary hearings and allow stranded cost recovery, if any is appropriate, to start shortly thereafter. For the period from January 1, 1999 until the Commission decision, the Commission should decide that no stranded cost recovery shall be allowed.

Enron does not believe that APS is in a position to complain about this approach. APS has not presented the fully supported analysis required. Not having met its burden of proof of going forward, it should not be in a position to complain about the steps necessary to correct for this deficiency.

APS does not propose to explicitly determine its charge to recover stranded costs.

APS should be required to calculate an explicit MTC which will recover an agreed upon level of stranded costs. An explicit MTC is one which is set based on a specific level of stranded costs and a specific anticipated level of sales, and which is changed only as necessary to accommodate reconciliation of these estimates. Length of the recovery period should take into account the minimum amount of time necessary to recover stranded costs but consistent with the ACC's rate stability or reduction goals. As the ACC's Finding #23 in Decision No. 60977 states, "A short transition period and rate reductions are in direct contradiction."

APS' alternative to an explicit MTC is to use a residual stranded cost recovery mechanism. The residual approach leaves customers with no opportunity for savings by purchasing commodity from a competing supplier selling at market. The energy price offered by the competing supplier has to cover the supplier's energy cost as well as other costs incurred to provide retail service and yet be lower than the benchmark price for wholesale transactions in the region. The residual MTC approach effectively forestalls retail competition until the residual MTC no longer applies.

APS proposes a "wholesale only" shopping credit with no recognition of retail costs incurred by a competing supplier. The Market Generation Credit (MGC) as proposed by APS simply reflects an estimate of the cost avoided by a wholesale purchaser buying commodity at the Palo Verde interchange point. There is no indication that APS will recognize in its credit any administrative and general costs and overheads, any transmission-related ancillary service costs necessary to bring the power to the distribution system or that APS will continue to provide all such services to the shopping customer as part of its transmission delivery charge. Nor is there recognition of other retail costs in the proposed MGC, reflecting customer acquisition, customer information, portfolio acquisition, or advertising. As a result, the shopping customer pays twice for these services - once to APS, and once to the customer's supplier (unless the supplier absorbs these costs).

APS should be directed to calculate a market-based MGC which includes appropriate recognition of administrative and general, transmission and retailer costs, as described earlier in these comments.

One additional item regarding the APS proposal deserves mention. *APS proposes an energy index to measure market value of energy in Arizona which is different from that used by Tucson Electric.* APS' filing describes a formula approach to determining MGC using day ahead unconstrained California PX prices, multiplied by a ratio of NYMEX futures prices for the month at Palo Verde to California PX on-peak prices for a given week. The resultant price is taken as a proxy for Arizona market prices. The approach used by Tucson Electric to measure Arizona market prices is quite different. Tucson relies instead on the NYMEX Palo Verde Index, trued up to actual costs as measured by the Palo Verde Index.

Without debating at this time the technical merits of either approach, Enron simply notes that the ACC should convene a technical conference to determine one market measurement technique for Affected Utilities. Different techniques will only serve to further fragment the market. For the sake of efficient competition and customer understanding of competition, a uniform market measurement technique should be used.

Tucson Electric

TU's choice of Option 1 - the Divestiture/Auction methodology for stranded cost recovery will result in a Competitive Transition Charge (CTC) that generally meets the ACC's criteria for a balanced approach to stranded cost recovery. Enron makes this statement under the presumption that separate proceedings will have fully analyzed the many costs that TEP alleges will be incurred in divestiture and will have properly resolved issues concerning mitigation and functionalization. TU's estimate is that this CTC will be implemented January 1, 2001, or whenever the divestiture process is complete.

In Enron's view, there is ambiguity in TU's filing concerning how the proceeds from divested assets are accumulated for stranded costs. It is Enron's understanding that proceeds from individual assets will be aggregated for stranded cost purposes. In other words, above book value sales will offset below book value sales and stranded costs will be calculated on a net basis. Enron objects to TU's proposal if it instead does not use a net calculation.

Prior to January 1, 2001, however, TU proposes to use an Interim CTC (ICTC) which in structure is essentially identical to the MTC proposal of APS. The ICTC has the same shortcomings as described for APS' MTC. Specifically, for these years:

- TU does not propose an explicit determination of its charge to recover stranded costs
- TU proposes a "wholesale only" shopping credit with no recognition of retail costs

Each of these flaws works to undermine the ACC's goal of balancing interests of the utilities and ratepayers while promoting competition, and effectively assures that competition in TU's service territory will not occur prior to 2001.

TU should be required to calculate an explicit ICTC which will be applicable during the period prior to January 1, 2001 (or whenever divestiture is complete). The rate should be calculated so as to recover total estimated stranded costs over a ten year period. TU has provided an estimated range for stranded costs (of between $0.6 and $1.1 billion) instead of a point estimate, as required by the ACC. A point estimate should be provided by TU, approved by the ACC, and used for the calculation of the ICTC. Revenues collected from the ICTC during 1999-00 would be recognized in the calculation of the CTC beginning in 2001.

Enron supports TU's request to allow early payment options (TU refers to them as "exit fees") for customers who are willing to pre-pay CTC charges. If the ACC approves Enron's request to require an explicit calculation for ICTC, Enron recommends that the ACC also allow the pre-payment option to begin immediately for customers who have access to choice of suppliers.

<u>Relief Requested</u>

In summary, Enron recommends that the ACC

1) require APS and TU to file, for ACC approval, documented, fully supported point estimates of their non-mitigable stranded costs using an approach acceptable to the ACC,
2) require APS and TU to file, for ACC approval, shopping credits applicable to customers who choose an alternative supplier which include market-based energy costs and provision for inclusion of appropriate retail costs, as described herein,
3) convene a technical conference leading to adoption of a uniform methodology for determining market energy prices,

4) conduct hearings to resolve each of these matters in a manner which will not interfere with the ACC's goal of beginning competition January 1, 1999, and

5) deny recovery of stranded costs until completion of the evidentiary hearing process.

September 21, 1998

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