

EXCEPTION



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BEFORE THE ARIZONA CORPORATION COMMISSION

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

ARIZONA CORPORATION COMMISSION
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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 COMPETITION
IN THE PROVISION OF ELECTRIC
SERVICES THROUGHOUT THE STATE
OF ARIZONA

DOCKET NO. RE-00000C-94-0165

**EXCEPTIONS OF ARIZONA PUBLIC SERVICE COMPANY
TO RECOMMENDED OPINION AND ORDER**

Arizona Public Service Company ("APS" or "Company") hereby submits its
Exceptions to the Presiding Officer's Recommended Opinion and Order ("Recommended
Order") dated August 26, 1999. Although the Recommended Order approves much of the
Company's May 14, 1999 Settlement Agreement ("Settlement" or "Agreement"), it requires
significant changes to the Settlement that rob APS of certain of the primary benefits
negotiated by the Company in the Agreement. In other respects, the Recommended Order is
ambiguous as to its requirements, if any, relative to the Settlement. Therefore, APS urges
the Presiding Officer and the Commission to grant these Exceptions and to adopt the
Company's proposed alternative language in its final Opinion and Order.

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I.

INTRODUCTION

On May 17, 1999, APS and representatives of every one of the Company's major customer constituency groups submitted a Settlement to the Arizona Corporation Commission ("Commission"). Such an Agreement and the consensus it represents are unprecedented. APS reminds the Commission of this fact only to establish the point that those who ask for changes to the Settlement risk destroying that very consensus.

The Settlement is just that – a settlement. APS has already made numerous concessions in order to achieve this Agreement. These include:

- 1) an immediate \$234 million write-off;
- 2) automatic rate reductions for both Standard Offer and Direct Access customers that could total as much as \$475 million through 2004;
- 3) allowing additional customers to take Direct Access prior to 2001;
- 4) a mandatory rate review in 2004, when stranded cost and regulatory asset recovery will be completed;
- 5) submission of an interim code of conduct not required under the Commission's Electric Competition Rules;
- 6) continued support for state and regional transmission organizations to assure equal and fair access to essential transmission facilities;
- 7) a commitment to continue the present level of funding for low-income programs; and,
- 8) dismissal with prejudice of all pending litigation by APS against the Commission.

Moreover, because it is not a unilateral APS proposal that APS can amend at will, any change to the Settlement, no matter how trivial (or even favorable to APS), must be accepted by all the parties to such Settlement. APS has, however, discussed its concerns with the other parties to the Settlement and will attempt to be in a position to represent to the

1 Commission at Open Meeting that these parties can accept any changes to the Agreement as
2 are proposed herein by the Company.

3
4 **II.**

5 **SECTION 2.8 - THE "REOPENER"**

6 The Recommended Order would modify Section 2.8 of the Settlement to give the
7 Commission a unilateral right to "reopen" the Settlement, either upon its own motion or
8 upon complaint under A.R.S. § 40-246, subject only to the proviso that the Commission
9 would not "modify the collection of stranded cost approved herein." *See* Recommended
10 Order at 8. Moreover, the exercise of this "reopener" could never result in a rate increase
11 (even if the Commission's investigation showed such an increase was warranted) or even a
12 reduction in the Settlement's mandated rate reductions for Standard Offer and Direct Access
13 customers. Thus, the "reopener" is strictly one-sided, ignores all that the Company
14 conceded to the other parties in return for the rate stability otherwise assured by the
15 Settlement,¹ and may even be argued by some to negate the Company's right under Section
16 2.8 to seek emergency relief – a provision that has been contained in every multi-year rate
17 settlement approved by the Commission since at least 1980.

18 APS believes the Commission has discretion not only in the manner and scope of its
19 regulation of public service corporations, but also the discretion to forebear certain activities
20 in the exercise of its jurisdiction for specified periods of time and for specified reasons when
21 it reasonably believes, based on the evidence before it, that such forbearance is in the public
22 interest and will result in rates that are "just and reasonable." After all, "just and
23 reasonable" rates are the Commission's ultimate goal. The factual determination of things
24

25 ¹ The Recommended Order appears to believe that the only thing the Company bargained for in the Settlement was the
26 provision allowing \$350 million dollars of stranded costs (plus continuation of the previously authorized recovery of
regulatory assets). That was simply untrue. The moratorium provisions of the Settlement were crucial to the
Agreement. APS would never have agreed to the level of stranded cost disallowance called for in the Settlement or the
mandatory rate reductions if there were no assurances of rate stability during the envisioned rate moratorium period.

1 such as “fair value”, rate of return, test year, etc., are all just parts of a process historically
2 used to set rates by the Commission. It is not the only process this Commission has ever
3 employed and certainly should not be confused with the goal itself.

4 If the Commission still believes that Section 2.8 requires modification, APS would
5 propose that, as was suggested by Staff, the already existing “emergency” language could be
6 modified to become bilateral and therefore allow the Commission to seek or authorize rate
7 changes under analogous circumstances. Such language has been used in some prior APS
8 settlement agreements without the adverse market reaction seen in response to the
9 Recommended Order. As revised, Section 2.8 would read as follows:

10 2.8 Neither the Commission nor APS shall be prevented from seeking or
11 authorizing a change in unbundled or Standard Offer rates prior to
12 July 1, 2004, in the event of (a) conditions or circumstances which
13 constitute an emergency, such as an inability to finance on reasonable
14 terms, or (b) material changes in APS’ cost of service for Commission-
15 regulated services resulting from federal, tribal, state or local laws,
16 regulatory requirements, judicial decisions, actions or orders. Except for the
17 changes otherwise specifically contemplated by this Agreement, unbundled
18 and Standard Offer rates shall remain unchanged until at least July 1, 2004.

16 III.

17 CREDITS FOR REVENUE CYCLE SERVICES

18 The Recommended Order requires APS to amend the Settlement to give Direct
19 Access customers credits for revenue cycle services (metering, meter reading, and billing)
20 not provided by APS based on the Company’s fully allocated embedded costs. Fully
21 allocated embedded costs are admittedly well above the marginal cost of providing these
22 services (or the decremental costs of not providing them). This means that the credit will
23 exceed any costs savings to APS, thus creating a revenue shortfall. No party has denied this
24 fact nor argued that APS is not entitled to recover its full cost of providing revenue cycle
25 services. Thus, not only will pricing these services above marginal cost encourage
26 inefficient new entrants into the business of providing revenue cycle services (which

1 increases the total societal resources devoted to the provision of electric service), it will
2 eventually impose an additional burden on Standard Offer customers. Perhaps for this
3 reason alone, APS is not aware of any jurisdiction that has actually implemented revenue
4 cycle service credits based on 100% of fully allocated embedded costs.

5 California has also struggled with the contradictory desires to promote a competitive
6 market for revenue cycle service providers while avoiding the shifting of costs on to
7 Standard Offer customers. The resolution seemingly underway in California appears
8 reasonable to APS. As called for in the APS Settlement, California is using short-run
9 marginal or decremental costs during the transition period (as applicable to this proceeding,
10 1999-2004), while developing a long-run marginal cost pricing scheme for the post-
11 transition market. Since the Settlement already calls for a post-transition APS rate review,
12 this option could be implemented without a change to the Settlement.

13 If the Commission is nonetheless determined to subsidize Direct Access customers
14 and their revenue cycle service providers at the expense of Standard Offer customers, they
15 must also adopt Staff's second and corresponding recommendation to preserve the
16 economics of the Settlement for APS. Staff's recommendation relative to revenue cycle
17 services had two parts, the second of which was inexplicably ignored by the Recommended
18 Order. The first was the setting of revenue cycle service credits at fully allocated embedded
19 cost. The second was the adjustment of the Company's stranded cost recovery to account
20 for the revenue shortfall described above. To implement the second leg of Staff's proposed
21 treatment of revenue cycle services, APS would propose the following changes to Section
22 3.3 of the Settlement:

23 3.3 The Parties agree that APS should not be allowed to recover \$183 million
24 net present value of the amounts included above. APS shall have a reasonable
25 opportunity to recover \$350 million net present value through a competitive transi-
26 tion charge ("CTC") set forth in Exhibit A attached hereto. APS shall also have
the opportunity to recover through such CTC the difference between the revenue
cycle service credits shown on Exhibit A attached hereto and those previously set
forth in Exhibit A as attached to the original agreement of the Parties dated May
14, 1999. Such CTC shall remain in effect until December 31, 2004, at which

1 time it will terminate. If by that date APS has recovered more or less than the
2 \$350 million net present value, as calculated in accordance with Exhibit B attached
3 hereto, plus any additional amounts collectible by virtue of this Section 3.3, then the
4 nominal dollars associated with any excess recovery/under recovery shall be
5 credited/debited against the costs subject to recovery under the adjustment clause
6 set forth in Section 2.6(3). [CHANGES ARE DENOTED BY UNDERLINE]

7 IV.

8 TRANSFER OF COMPETITIVE ASSETS

9 Page 10, lines 13-15 of the Recommended Order states:

10 Further, while the Commission supports and approves the concept
11 of transferring generation assets and competitive services to an
12 affiliate, the Commission reserves the right to review and approve
13 of the actual assets and services to be transferred.

14 This language is vague as to what specific authorizations, if any, the Company has actually
15 received to divest its competitive electric service assets as required by the Agreement and
16 the Commission's Electric Competition Rules [A.A.C. R15-2-1615 (A)] and is silent about
17 the valuation of such assets. APS can not approach the numerous parties (creditors, co-
18 participants, lessors, vendors, federal agencies, etc.) whose approvals are also required to
19 effectuate the required divestiture with this kind of uncertainty hanging over the transaction.
20 Moreover, the Company can not accept the idea of a second proceeding in which parties can
21 again contest the divestiture itself or again argue over valuation of assets.

22 APS believes that the intent of the Hearing Officer's language was to preserve the
23 Commission's right to review the specific list of assets to be transferred from APS to an
24 affiliate or affiliates by year-end 2002 so as to assure itself that all generation and other
25 competitive electric service assets will, in fact, be transferred and conversely, that no assets
26 necessary for the provision by APS of non-competitive services have been inadvertently
included. The Commission may also wish to assure itself that the transfers have, in fact,
been made at net book value as called for under the Agreement. APS has no quarrel with
this legitimate exercise of regulatory oversight authority and would substitute the following
language for that quoted above:

1 The Commission supports and authorizes the transfer by APS to an
2 affiliate or affiliates of all its generation and competitive electric service
3 assets as set forth in the Agreement no later than December 31, 2002.
4 However, we will require the Company to provide the Commission with a
5 specific list of any assets to be so transferred, along with their net book values
6 at the time of transfer, at least thirty days prior to the actual transfer. The
7 Commission reserves the right to verify whether such specific assets are for
8 the provision of generation and other competitive electric services or whether
9 there are additional APS assets that should be so transferred.

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V.

COSTS OF DIVESTITURE

The Recommended Order at page 10 allows APS to recover just 67% of the costs of complying with A.A.C. R14-2-1615 (A). There was no testimony or other evidence to support that disallowance of otherwise prudently incurred costs. In fact, their recovery was one of the few non-controversial issues in this entire proceeding.

This is not just an issue of principle. Divestiture will cost literally millions of dollars, even to an affiliate. Divestiture was not a “business decision” or even the Company’s idea – it was a Commission mandate. The distinction referenced in the Recommended Order between divestiture to an affiliate or divestiture to a non-affiliate has never been made in the Electric Competition Rules, and efforts such as this to coerce the latter (divestiture to a non-affiliate) were expressly rejected by Decision No. 61677 (April 27, 1999). As to “mitigation,” the Company has already taken steps to mitigate the largest share of avoidable costs by seeking an extension of the time in which to divest these assets. Moreover, all parties, including the Commission have the full opportunity to contest the reasonableness of the deferred costs of divestiture prior to their actual recovery in rates post-July 1, 2004. This more than protects APS customers from paying for unreasonably incurred costs. This provision in the Recommended Order (page 9, line 25 – page 10, line 3) should be deleted in the Commission’s final Opinion and Order.

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VI.

BILL UNBUNDLING

APS is confused by the Recommended Order's discussion of Unbundled Rates at page 11, lines 9-13. The Company understands that the Hearing Officer meant to substitute the informational unbundling described therein for the express provisions of A.A.C. R14-2-1606 (C) (2) and 1612 (N), but is not precisely sure how he envisioned the integration of APS Attachment AP-1R, Second Revised, with Enron's "Part 1, Part 2 and Part 3" format. Nevertheless, APS will work with the Commission Staff to implement this portion of the Recommended Order if at all feasible.

VII.

CODE OF CONDUCT

On August 6, 1999, APS submitted the Interim Code of Conduct called for under terms of the Agreement. Thus, APS is at a loss to understand what is meant by the sentence of the Recommended Order beginning on line 25 of page 11. If adopted by the Commission, the Company intends to simply send out a letter to the parties indicating that the August 6th filing was meant to satisfy this requirement and that such Interim Code of Conduct was, by terms of its transmittal letter (also dated August 6, 1999), effective as of the date the Commission approved of the Settlement.

The final version of the Electric Competition Rules, which is scheduled to be considered by the Commission at the same Special Open Meeting as the Settlement, calls for a "permanent" code of conduct to be filed within 90 days, with a hearing scheduled thereafter. The hearing on the Interim Code of Conduct contemplated by the Recommended Order appears duplicative of this requirement under the Rules and, in the Company's opinion, unnecessary. Thus, the entire paragraph beginning at line 25 of page 11 in the Recommended Order should be deleted and replaced with the following substitute language:

1 Under the Electric Competition Rules, APS must file a permanent
2 Code of Conduct within ninety days. The Hearing Division will promptly issue
3 a procedural order on such permanent Code of Conduct and will expedite its review
and consideration to the extent possible. Given the relatively short period of time
between the Interim and permanent Code of Conduct, we do not believe a separate
hearing on the Interim Code of Conduct is necessary.

4 At the very least, the Commission should indicate that any hearing on the Company's
5 Interim Code of Conduct is in substitution for and not in addition to the hearing called for
6 by Rule 1616.

8 VIII.

9 CONCLUSION

10 APS is appreciative of the effort made by the Chief Hearing Officer to issue a timely
11 recommendation in this proceeding. The Recommended Order adopts many of the key
12 provisions in the spirit in which they were offered – as a settlement of hotly disputed issues
13 of very great importance to all of the Parties. However, the fact that APS was willing to
14 give up \$183 million (\$234 million, in nominal dollars) to arrive at this Agreement (as
15 contrasted to some other Agreement that the Company did not negotiate) does not mean it is
16 willing to give millions more away, as is suggested by the Recommended Order. The fact
17 that APS was willing to guarantee rate reductions in exchange for rate stability on its own
18 behalf does not mean it is willing to guarantee these same reductions while receiving
19 nothing comparable in return. The fact that APS is willing to drop all of its legal challenges
20 to the Electric Competition Rules does not mean it is willing to forego recovery of the
21 reasonable and prudent costs of complying with such Rules.

22 In its Exceptions, APS has attempted to propose modifications to the Recommended
23 Order that it and the other Parties to the Settlement can support while preserving as much as
24 possible of what the Company believes was the intent of the Presiding Officer. Where the
25 Company has been silent, it will work with the Parties to satisfy the requirements of the
26 Recommended Order for revised language to the Agreement and/or subsequent actions by

1 APS. APS urges the Commission to adopt the Recommended Order with the revisions
2 proposed herein.

3
4 RESPECTFULLY SUBMITTED this 7th day of September 1999.

5 SNELL & WILMER, L.L.P.

6
7 By Thomas L. Mumaw
8 Steven M. Wheeler
9 Thomas L. Mumaw
10 Jeffrey B. Guldner

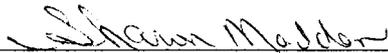
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CERTIFICATE OF SERVICE

The original and ten (10) copies of the foregoing document were filed with the Arizona Corporation Commission on this 7th day of September, 1999, and service was completed by mailing, faxing, e-mailing or hand-delivering a copy of the foregoing document this 7th day of September, 1999, to all parties of record herein.



Sharon Madden

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