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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 TARRIFS PURSUANT TO A.A.C. R14-2-1602 ET SEQ.	DOCKET NO. E-01345A-97-0773
IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.	DOCKET NO. RE-00000C-94-0165 **NEV SOUTHWEST, L.L.C.'S EXCEPTIONS TO RECOMMENDED ORDER DATED AUGUST 26, 1999**

NEV Southwest, LLC ("NEV"), through undersigned counsel, submits these exceptions to the proposed Order dated August 26, 1999 ("Order") concerning Arizona Public Service Company's ("APS") Settlement Agreement ("Settlement Agreement" or "Agreement") dated May 17, 1999 in the consolidated matters captioned above. NEV further requests leave, pursuant to A.A.C. R14-3-101(B), to file these exceptions past the deadline for filing exceptions. Because the Commission's open meeting has been continued to September 21-23, 1999, no party will be prejudiced by this filing.

NEV's primary exception to the Order is the inadequacy of the proposed shopping credits for competitive customers. The Order concludes at page 7, lines 1-2: "Based on the evidence presented, the 'shopping credits' appear to be reasonable to allow ESPs to compete in an efficient manner." NEV takes exception to this conclusion and believes that ample testimony and evidence was presented to the contrary.

As the Order acknowledges, ESPs and Staff testified that the proposed credits are not sufficient to create a viable competitive market in Arizona. That is, they do not provide sufficient savings for customers, or allow competitive suppliers a reasonable chance to cover their costs and earn even a small margin.

As expressed by NEV, other ESPs and Staff, the shopping credit is the most critical part of a competitive market. In the long-run, after stranded costs are retired, there will be no shopping credit per se. ESPs will have to provide generation services at a lower cost than the UDC's standard offer in order to offer savings to customers and retain a margin for their business. The outlook is very promising because, for many customers, the long-term potential savings could be 20 percent or more compared to their current energy costs.

However, in the near-term transition period, competitive customers must also pay APS for past stranded costs. These payments are financed out of potential savings from competition. To accomplish this, a shopping credit is established which limits the potential short-term savings for competitive customers and allows for the remainder of the savings to be paid to APS for stranded costs, through the CTC. What is the appropriate level for a shopping credit? The answer has little to do with economic efficiency or fair prices. Rather, it is a practical solution to accomplish two goals: the payment of stranded cost and the development of a viable competitive market. If the shopping credit is set too high, more customers will participate in competition due to higher savings, but stranded costs will not be adequately covered. If the shopping credits are too low, large payments will be made towards stranded costs, but few customers or ESPs will participate in the competitive market.

As discussed by NEV, Staff, and others, the proposed Agreement makes this trade-off even more difficult because it offers near-term rate reductions to all customers. These excess revenues could have been used instead to help pay for stranded costs and thus increase the potential savings from competition. NEV does not object to rate relief for residential and small business customers, who initially may have difficulty accessing the competitive market. However, medium and large commercial and industrial customers who can readily benefit from competition should not receive an incentive to stay with APS' standard offer service, an incentive paid for by other competitive customers who are financing APS' stranded costs.

Do the shopping credits proposed by the Order accomplish the two goals outlined above? We do not believe so. We believe that ample testimony and evidence was provided by the ESPs and Staff to show that for many customer groups, the proposed credits would not even cover the basic costs of delivering wholesale power to retail customers.

The Order references an APS analysis of 40 kW to 200 kW customers as evidence that the shopping credits are reasonable. *See* Order, page 6, line 24. We concur that a select group of small commercial customers with poor load factors appear to have positive savings under the proposed shopping credits. However, APS' estimated margin of 8 mils is overstated because it underestimates the energy, transmission, scheduling, and potential imbalance costs of serving such low load factor customers. We believe that 4 mils would be a more reasonable estimate of the shopping credit margin for this customer segment. Furthermore, the additional costs of the interval metering requirements for these small customers will erode much these projected savings. However, we believe that the net result could be a modest potential savings for this customer segment, in the 1.0 to 3.0 percent range, assuming no profit for the ESP.

This, however, is hardly evidence of adequate shopping credits. The customer segment in question represents a fairly large number of diverse customers, but a small amount of load, which makes them difficult to acquire. In addition, the poor load factors make energy modeling, forecasting, scheduling and delivery very difficult, which increases the costs and risks to serve them. Furthermore, evidence was provided by ESPs and Staff that showed the shopping credits for other residential, commercial, and large industrial customers are either very low or negative. In other words, APS carved out its least desirable customers (from a competitive market perspective), gave them a positive shopping credit, and proposed low or negative shopping credits for all other customers to ensure that they remain APS customers.

The Order also cites as evidence of adequate shopping credits that APS' credits are higher than SRP's. This result (accurate or not) is largely immaterial because SRP's credits are negative for the vast majority of residential, commercial, and industrial customers. And for the few customers who can reap positive savings, SRP can merely meet a competitive offer with a lower offer of their own (from SRP, not New West Energy), the difference financed by their other captive customers. SRP is hardly a competent yardstick for determining the adequacy of shopping credits. Frankly, NEV does not consider the SRP market open for competition; we are hoping that the Commission will avoid the same mistake as to APS.

If the Commission is looking for examples, we believe it should consider the type of shopping credits proposed in TEP's agreement. While we would like TEP's credits to be somewhat larger, we believe TEP has made an honest attempt to achieve both goals of collecting a CTC and creating the opportunity for near-term customer savings from competition. The potential savings are very modest, but at least they allow most customers a reasonable opportunity to access the competitive market.

In summary, we do not believe the shopping credits proposed by the Order are adequate for competition for the following reasons:

1. Only limited segment of small commercial customers with poor load factors can hope to achieve any meaningful savings from the proposed credits.

2. This segment represents only a modest portion of APS' overall load.

3. This segment is the least desirable from a competitive standpoint because the customers are small, diverse, and have poor load factors, which increases the costs and risks to serve them.

4. The potential savings for residential customers are very low or negative.

5. The potential savings for medium commercial customers are very low or negative.

6. The potential savings for large commercial and industrial savings are negative.

7. Virtually all commercial and industrial customers above 200 kW will be excluded from the competitive market.

8. Virtually all commercial and industrial customers with medium and high load factors will be excluded from the competitive market.

9. If a solar portfolio is required to serve competitive customers, the shopping credits for all customers, net of these additional costs, are likely to be negative.

Staff recommended a modest increase in the shopping credits with adders specific to each customer class. NEV concurs with Staff and believes that its recommendation would allow a larger number of customers to be able to participate in the competitive energy market in Arizona. However, Staff recommended financing the credits by increasing the period for recovering stranded costs. NEV recommends that the increased credits be financed by reducing the rate reductions for medium and large commercial customers. The rate reductions for residential and small business customers should remain as proposed.

In conclusion, NEV views the shopping credits proposed in the Order to be in the same general level as those at SRP, which has virtually prevented a competitive market in its territory.

If the credits are not increased, NEV would not consider the APS market to be realistically open for competition.

RESPECTFULLY SUBMITTED this 15th day of September, 1999.

ROSHKA HEYMAN & DeWULF, PLC

By ______________________

Raymond S. Heyman
Randall H. Warner
400 North 5th Street, Suite 1000
Phoenix, Arizona 85004-3906

Attorneys for NEV Southwest, L.L.C.

Original and ten copies of the foregoing filed this 15th day of September, 1999 with:

Docket Control
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Copy of the foregoing hand-delivered this 15th day of September, 1999 to:

Jerry L. Rudibaugh, Chief Hearing Officer
Hearing Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Paul Bullis, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Ray Williamson, Acting Director
Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona

Copy of the foregoing mailed this 15th day of September, 1999 to:

Maricopa Community Colleges
2411 W. 14th Street
Tempe, Arizona 85281-6942

Timothy M. Hogan
Arizona Center for Law in the
Public Interest
202 E. McDowell Road, Suite 153
Phoenix, Arizona 85004

C. Webb Crockett
Fennemore Craig, P.C.
3003 N. Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913

Leslie Lawner
Enron, Inc. 712 N. Lea
Rosewell, New Mexico 88201

Christopher Hitchcock
Hitchcock, Hicks & Conlogue
P.O. Box 87
Bisbee, Arizona 85603-0087

Bradley S. Carroll, Esq.
Tucson Electric Power Company
220 W. Sixth Street
P.O. Box 711
Tucson, Arizona 85702-0711

Michael A. Curtis, Esq.
Martinez & Curtis, P.C.
2712 N. Seventh Street
Phoenix, Arizona 85006-1003

Lex Smith
Michael Patten
Brown & Bain, P.C.
2901 N. Central Avenue
Phoenix, Arizona 85001-0400

Jesse W. Sears
City of Phoenix
200 W. Washington Street, #1300
Phoenix, Arizona 85003-1611

Bill Murphy, P.E.
City of Phoenix
101 S. Central Avenue
Phoenix, Arizona 85004

Lawrence V. Robertson, Jr.
Munger Chadwick PLC
333 N. Wilmot, Suite 300
Tucson, Arizona 85711-2634

Robert S. Lynch, Esq.
340 E. Palm Lane, Suite 140
Phoenix, Arizona 85004-4529

K.R. Saline
K.R. Saline & Associates
160 N. Pasadena, Suite 101
Mesa, Arizona 85201-6764

Douglas C. Nelson, Esq.
7000 N. 16th Street, Suite 120-307
Phoenix, Arizona 85020-5547

Walter W. Meek, President
Arizona Utilities Investors Association
2100 N. Central Avenue, Suite 210
Phoenix, Arizona 85004

Betty K. Pruitt
Arizona Community Action Association
2627 N. Third Street, Suite 2
Phoenix, Arizona 85004

Greg Patterson
RUCO
2828 N. Central Avenue, Suite 1200
Phoenix, Arizona 85004

Barbara Klemstine,
Arizona Public Service Company
Law Dept., Station 9909
P.O. Box 53999
Phoenix, Arizona 85072-3999

Kenneth C. Sundlof, Jr.
Jennings, Strouss & Salmon, P.C.
Two N. Central Avenue
Phoenix, Arizona 85004-2393

M. Dodd

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