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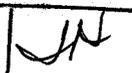
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Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Arizona Corporation Commission
DOCKETED

FEB 04 1998

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Re: Docket No. U-0000-94-165

Dear Sir or Madam:

Enclosed for filing are an original and ten copies of the summary of testimony of James F. (Rick) Gilliam, Senior Technical Advisor, Land and Water Fund of the Rockies, in the above referenced docket. Please note that this witness is not pre-filing additional testimony at this time.

Sincerely,

Bruce Driver
Special Counsel
Energy Project
Land and Water Fund of the Rockies

BD/sp
Encl.

Idaho Office

Laird J. Lucas
Director

408 W. Idaho Street
P.O. Box 1612
Boise, ID 83701
(208) 342-7024
FAX: (208) 342-8286

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BEFORE THE ARIZONA CORPORATION COMMISSION RECEIVED
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IN THE MATTER OF COMPETITION IN)
THE PROVISION OF ELECTRIC SERVICES)
THROUGHOUT THE STATE OF ARIZONA.)
_____)

DOCKET NO. U-0000-94-165

SUMMARY OF TESTIMONY OF JAMES F. (RICK) GILLIAM
ON BEHALF OF
THE LAND AND WATER FUND OF THE ROCKIES
AND THE GRAND CANYON TRUST

On December 26, 1996, the Arizona Corporation Commission (ACC or the Commission) issued Decision No. 59943 in this docket adopting proposed competitive electric rules as a framework for the transition to a competitive environment. In that decision, the Commission noted:

The parties were generally in agreement that competition will provide the benefit of reduced costs, at least for some consumers. However, there were concerns raised regarding the quality of service, as well as concerns that not all customers, particularly residential customers, will receive the benefits of competition as quickly as some large industrial customers. And of course, the incumbent utilities were greatly concerned regarding the recoverability of stranded costs.

The impact of the accelerated recovery of uneconomic costs related to the production of electricity in Arizona (stranded costs) is potentially so large as to overwhelm other utility obligations and the benefits of a competitive energy market itself. We are concerned that unless recovery of legitimate, unmitigated stranded costs is kept within reasonable bounds, that the Commission's Restructuring Rule may result in price increases, effectively squeezing out funding for important public interest benefits. Thus, stranded cost calculations and recovery methods are critically important to public interest considerations and to the success of a competitive market.

As a preliminary matter, with respect to the definition of stranded costs, we recommend that the Commission clarify that the "value ... under traditional regulation" in Section R14-2-1601(8)a refers to book value, and that stranded costs are derived only from costs related to the production of electricity.

We believe that divestiture of assets in the open market would likely provide the most accurate market value and best market power result. However, we recognize the ACC may not have the necessary authority to require Affected Utilities to divest all or a portion of their production assets. Thus, we recommend that if stranded costs are to be determined utilizing an administrative method, the Commission clarify that market *value* consider factors other than price. For example, the net revenues lost method determines strandable costs as the difference between revenues received by a utility in a continued regulated regime and revenues received by the utility in a competitive energy supply market. In the competitive marketplace, to the extent that customers perceive certain characteristics of the incumbent utility to have value (e.g. reliability, customer service, etc.), then that utility can charge prices for electricity supply, and thus generate revenues, greater than the market clearing price. The greater the competitive revenue generated, the smaller the actual stranded cost.

Second, the recovery method for stranded costs, if improperly designed, could have a detrimental effect on the incentives for customers to use energy efficiently and consider on-site distributed renewable generation. For example, customer payments of stranded costs collected through a flat fee mechanism are unaffected by reductions in energy use related to increased customer efficiency or installation of distributed renewable resources (such as rooftop PV). This method reduces cost recovery risk for utilities below present practices, and reduces the incentive for customers to invest in clean and efficient energy technologies. Further, a flat fee would be at odds with Section R14-2-1607(J) of the Commission's Restructuring Rule. The design of the cost recovery mechanism should mirror current cost-recovery practices. In other words, any stranded costs deemed recoverable from customers in a competitive market should be allocated consistent with current practices, and the recovery mechanism designed on a volumetric basis (i.e. per kW and/or per kWh).

We also recommend that, as the final step in the determination of stranded cost recovery, the Commission consider the amount of electricity generated by renewable resources owned by the Affected Utility, consistent with R14-2-1607(I). An incentive should be provided through the Commission's stranded cost recovery policy for the Affected Utilities to achieve their renewable resource goals. Amounts necessary to remedy shortfalls in meeting renewable resource goals by the end of the year 2000 should be funded through an increase in the System Benefits Charge and a commensurate reduction in the stranded cost charge. The effect is to make full stranded cost recovery contingent upon the utility achieving its established renewable resource goals. This approach effectively eliminates additional rate impacts for the Affected Utility to achieve its renewable resource targets, while providing a strong incentive for the utility to meet its goals.

Finally, several specific stranded cost mitigation methods are described which fall within Rule Section R14-2-1607(A). First, the revenue enhancement benefits related to Arizona's rapid demand and energy growth should be captured. Second, we recommend that the useful lives of assets potentially strandable in a competitive market be reviewed for possible extension, and commensurate adjustments be made to depreciation and amortization expenses. This *deceleration* of strandable asset recovery can result in a cost reduction for these assets.

BEFORE THE ARIZONA CORPORATION COMMISSION

JIM IRVIN

Commissioner - Chairman

RENZ D. JENNINGS

Commissioner

CARL J. KUNASEK

Commissioner

IN THE MATTER OF THE COMPETITION IN)
THE PROVISION OF ELECTRIC SERVICES)
THROUGHOUT THE STATE OF ARIZONA.)

DOCKET NO. U-0000-94-165

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the original and 10 copies of the summary of testimony of James F. (Rick) Gilliam, Senior Technical Advisor, The Land and Water Fund of the Rockies, were sent via Federal Express to Docket Control, Arizona Corporation Commission, 1200 West Washington Street, Phoenix, Arizona 85007 this 3rd day of February, 1998 and a true and correct copy was sent by United States mail, first class, postage pre-paid, to the following persons:

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

Michael A. Curtis
MARTINEZ & CURTIS, P.C.
2712 N. Seventh Street
Phoenix, Arizona 85006

Walter W. Meek, President
ARIZONA UTILITY INVESTORS ASSOCIATION
2100 N. Central Avenue, Suite 210
Phoenix, Arizona 85004

Creden Huber
SULPHUR SPRINGS VALLEY ELECTRIC COOPERATIVE
P.O. Box 820
Willcox, Arizona 85644

Mick McElrath
CYPRUS CLIMAX METALS COMPANY
P.O. Box 22015
Tempe, Arizona 85285-2015

Dan Neidlinger
23020 North 17th Drive
Phoenix, Arizona 85015

Jessica Youle
SALT RIVER PROJECT
PAB 300
P.O. Box 52025
Phoenix, Arizona 85072-2025

Patricia Cooper
AEPCO
P.O. box 670
Benson, Arizona 85602-0670

Clifford Cauthen
GRAHAM COUNTY ELECTRIC CO-OP
P.O. Drawer B
Pima, Arizona 85543

Marv Athey
TRICO ELECTRIC COOPERATIVE
P.O. Box 35740
Tucson, Arizona 85740

Wayne Retzlaff
NAVOPACHE ELECTRIC CO-OP, INC.
P.O. Box 308
Lakeside, Arizona 85929

Craig Marks
CITIZENS UTILITIES COMPANY
2901 N. Central Avenue, Suite 1660
Phoenix, Arizona 85012

Steve Kean
ENRON
P.O. Box 1188
Houston, Texas 77251-1188

Lawrence V. Robertson, Jr.
MUNGER CHADWICK, P.L.C.
333 North Wilmot, Suite 300
Tucson, Arizona 85711-2634

Tom Broderick
6900 E. Camelback Rd. #700
Scottsdale, Arizona 85251

Michael Grant
GALLAGHER & KENNEDY
2600 N. Central Avenue
Phoenix, Arizona 85007

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

Vinnie Hunt
TUCSON DEPARTMENT OF OPERATIONS
4004 South Park Avenue, Bldg. 2
Tucson, Arizona 85714

William Sullivan
MARTINEZ & CURTIS, P.C.
2716 North Seventh Street
Phoenix, Arizona 85006

Elizabeth S. Firkins
INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS L.U. #1116
750 South Tucson Boulevard
Tucson, Arizona 85716

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

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

David C. Kennedy
LAW OFFICES OF DAVID C. KENNEDY
100 West Clarendon Avenue, Suite 200
Phoenix, Arizona 85012-3525

Thomas C. Horne
Michael S. Dulberg
HORNE, KAPLAN & BISTROW, P.C.
40 North Central Avenue, Suite 2800
Phoenix, Arizona 85004

Barbara S. Bush
COALITION FOR RESPONSIBLE ENERGY EDUCATION
315 West Riviera Drive
Tempe, Arizona 85252

Rick Lavis
ARIZONA COTTON GROWERS ASSOCIATION
4139 East Broadway Road
Phoenix, Arizona 85040

Steve Brittle
DON'T WASTE ARIZONA, INC.
6205 South 12th Street
Phoenix, Arizona 85040

Karen Glennon
19037 N. 44th Avenue
Glendale, Arizona 85308

COLUMBUS ELECTRIC COOPERATIVE, INC.
P.O. Box 631
Deming, New Mexico 88031

CONTINENTAL DIVIDE ELECTRIC ASSOCIATION
P.O. Box 1087
Grants, New Mexico 87020

DIXIE ESCALANTE RURAL ELECTRIC ASSOCIATION
CR Box 95
Beryl, Utah 84714

GARKANE POWER ASSOCIATION, INC.
P.O. Box 790
Richfield, Utah 84701

Douglas Mitchell
SAN DIEGO GAS AND ELECTRIC CO.
P.O. Box 1831
San Diego, California 92112

Sheryl Johnson
TEXAS-NEW MEXICO POWER CO.
4100 International Plaza
Fort Worth, Texas 76109

Ellen Corkhill
AARP
5606 North 17th Street
Phoenix, Arizona 85016

Andrew Gregorich
BHP COPPER
P.O. Box M
San Manuel, Arizona

Larry McGraw
USDA-RUS
6266 Weeping Willow
Rio Rancho, New Mexico 87124

Jim Driscoll
ARIZONA CITIZEN ACTION
2430 S. Mill, Suite 237
Tempe, Arizona 85282

William Baker
ELECTRICAL DISTRICT NO. 6
P.O. Box 16450
Phoenix, Arizona 85011

General Counsel
NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP.
2201 Cooperative Way
Herndon, Virginia 21071

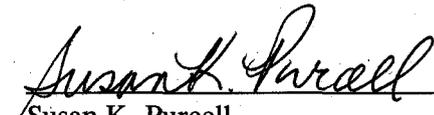
Wallace Tillman
Chief Counsel
NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
4301 Wilson Blvd.
Arlington, Virginia 22203-1860

Myron L. Scott
1628 E. Southern Avenue, No. 9-328
Tempe, AZ 85282-2179

Barbara R. Goldberg
OFFICE OF THE CITY ATTORNEY
3939 Civic Center Blvd.
Scottsdale, Arizona 85251

Thomas Pickrell
Arizona School Board Association
2100 N. Central Avenue
Phoenix, Arizona 85004

By:



Susan K. Purcell
Secretary, Energy Project
Land and Water Fund of the Rockies