

ORIGINAL



0000120759

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

BEFORE THE ARIZONA CORPORATION COMMISSION

~~Arizona Corporation Commission~~

DOCKETED

MAR 16 1998

DOCKETED BY *[Signature]*

RECEIVED  
AZ CORP COMMISSION  
MAR 16 3 51 PM '98  
DOCUMENT CONTROL

JIM IRVIN  
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

INITIAL POST HEARING BRIEF OF INTERVENORS  
AJO IMPROVEMENT COMPANY, MORENCI WATER & ELECTRIC COMPANY  
AND PHELPS DODGE CORPORATION

DATED: March 16, 1998.

BROWN & BAIN, P.A.

By *[Signature]*  
Lex J. Smith  
Michael W. Patten  
2901 North Central Avenue  
Post Office Box 400  
Phoenix, Arizona 85001-0400

Attorneys for Intervenors  
Ajo Improvement Company, Morenci  
Water & Electric Company and  
Phelps Dodge Corporation

TABLE OF CONTENTS

1		
2		
3	1.	The Assertion of a "Regulatory Compact" in this Proceeding
4		is a Prohibited Collateral Attack on a Final Order of the
5		Commission and Should Not be Considered by the
6		Commission. . . . . 2
7	a.	The Commission has Already Rejected the Claim That the
8		Rules are Precluded Because of a "Regulatory
9		Compact." . . . . . 2
10	b.	The Policy Underlying the So Called "Regulatory
11		Compact" Provides a Reasonable Balancing of Consumer
12		and Shareholder Interests; It Does Not Insure the
13		Utilities Against the Consequences of Competition. . . . . 5
14	2.	A Statewide Uniform Surcharge to Recover All Strandable
15		Costs of All Utilities is Bad Public Policy, Makes No Sense
16		and Should be Rejected. . . . . 9
17	3.	The Burden of Proof of Alleged Strandable Costs and
18		Mitigation Measures is Squarely on the Utilities. . . . . 11
19	4.	The Net Revenues Lost Approach Proposed by the Utilities is
20		Completely One-Sided and Would Insure That Utilities
21		Recover a <u>Minimum</u> of 100% of Their Alleged Strandable
22		Costs. . . . . 14
23	5.	Decreased Value of Generation Assets Occurring From
24		Competition: The "Used and Useful" Rule and "Fair
25		Value". . . . . 17
26	a.	Used and Useful Rule. . . . . 19
	b.	Fair Value. . . . . 20
	6.	The Commission Should Beware of Artificially Low Market
		Price Indicators. . . . . 22
	7.	A Strict Code of Conduct Should be Adopted by the
		Commission to Govern Affiliate Transactions Among Utilities
		and Their Marketing Entities. . . . . 24
	8.	The California "Model" Should Have no Bearing on Resolution
		of Strandable Costs in Arizona. . . . . 25
	9.	The Transition Cost Mechanism Must be Designed to Enable -
		Not Prevent - New Entrants to Compete. . . . . 26

1	10. Market Power Considerations. . . . .	28
2	CONCLUSION . . . . .	29
3		
4		
5		
6		
7		
8		
9		
10		
11		
12		
13		
14		
15		
16		
17		
18		
19		
20		
21		
22		
23		
24		
25		
26		

1           Intervenors Ajo Improvement Company ("AIC"), Morenci Water &  
2 Electric Company ("MWE") and Phelps Dodge Corporation ("PD") through  
3 their undersigned counsel, hereby submit their Initial Post Hearing  
4 Brief in the referenced proceeding. AIC and MWE are Arizona public  
5 service corporations and are among the "Affected Utilities" defined  
6 in A.A.C. R14-2-1601.1 of the Commission's Retail Electric  
7 Competition Rules ("Rules"). PD is a large consumer of electric  
8 power and energy. Although designated as Affected Utilities, AIC and  
9 MWE along with PD are aligned with the interests of those parties who  
10 promote competition at the lowest reasonable cost. AIC, MWE and PD  
11 actively participated in the rulemaking docket leading up to the  
12 adoption of the Rules on December 26, 1996 in Decision No. 59943 and  
13 were acknowledged as Intervenors in Procedural Orders issued December  
14 1, 1997, December 11, 1997 and December 15, 1997.

15           Intervenors AIC, MWE and PD sponsored three witnesses in the  
16 proceeding: Kevin Higgins, Dr. Robert Malko and Dr. Alan Rosenberg.  
17 This Initial Post Hearing Brief will focus on certain issues that  
18 arose during the proceeding as a result of the pre-filed and hearing  
19 testimony of the parties. AIC, MWE and PD respectfully reserve the  
20 right to respond to the positions of any other party on any issue  
21 presented in the reply brief portion of this proceeding. Intervenors  
22 AIC, MWE and PD join with AECC, et. al. in presenting a summary of  
23 answers to the questions posited by the Procedural Orders for  
24 determination and they are contained in Attachment A hereto. What  
25  
26

1 follows will be an examination from a legal and regulatory  
2 perspective of a number of issues that arose during the proceeding.<sup>1</sup>

3 **1. The Assertion of a "Regulatory Compact" in this Proceeding**  
4 **is a Prohibited Collateral Attack on a Final Order of the**  
5 **Commission and Should Not be Considered by the Commission.**

6 Various parties to this proceeding have asserted that there is  
7 a "regulatory compact" or a "regulatory contract" that must be  
8 "honored" in Arizona that creates an "entitlement" for the utilities.  
9 This assertion is false and unsupported. It has been twice made and  
10 twice rejected - once by a final order of this Commission and once by  
11 the court reviewing the Commission's order. The assertion is now  
12 being urged for a third time and represents a prohibited collateral  
13 attack of a final Commission order that is legally barred.

14 **a. The Commission has Already Rejected the Claim That the**  
15 **Rules are Precluded Because of a "Regulatory Compact."**

16 In Decision No. 59943, the Commission considered the  
17 utilities' assertion that the Rules could not be adopted because it  
18 would "modify or abrogate the regulatory compact." Id. at 35. That  
19 argument was considered and soundly rejected by the Commission which  
20 found and concluded:

21 "We are not convinced that the  
22 regulatory policy of the state has  
23 formed any sort of contract with the  
24 Affected Utilities."  
25 Id. at 36 line 28; 37 line 1.

---

26 <sup>1</sup> Parties will be referred to herein as they were abbreviated  
for purposes of marking of exhibits. Transcript page notations will  
be cited as "TR" followed by page (and line where applicable).

1           When applications for rehearing of Decision No. 59943 were  
2 denied by operation of law, the order became final and conclusive and  
3 could not be collaterally attacked. A.R.S. § 40-252.

4           TEP, APS, AEPCO and certain distribution cooperatives  
5 sought review of Decision No. 59943 in Maricopa County Superior  
6 Court. The various cases have been consolidated before Judge Colin  
7 A. Campbell and are pending in cause number CV-97-03748, et. al.  
8 (consolidated). In the Superior Court proceeding, TEP's complaint  
9 asked the court to declare that the Rules:

10                         "...violate the contract clauses of  
11                         the U.S. Const. and Ariz. Const. by  
12                         impairing the contract ("Regulatory  
                          Compact") between TEP and the State of  
                          Arizona...." (Complaint, p. 10)

13           TEP then filed a motion for summary judgment requesting a  
14 finding that Decision No. 59943 "has breached the regulatory contract  
15 entered into between the State of Arizona and TEP." (Motion for  
16 Summary Judgment, p. 1.) TEP's president, Charles Bayless, filed an  
17 affidavit in which he asserted:

18                         "It is TEP's position that it has  
19                         entered into a regulatory contract  
                          with the State of Arizona...."  
                          (Bayless Affidavit, p. 1.)

20           During the Superior Court proceeding, the Commission and  
21 other intervenors denied the existence of any so-called "regulatory  
22 compact" or "regulatory contract" and maintained that the statutory  
23 circumstances providing for regulation of public service corporations  
24 represent public policy that is subject to change in the public  
25 interest.  
26

1           The Superior Court rejected TEP's assertion and granted the  
2 Commission's and other intervenors' cross-motions for summary  
3 judgment. The Court held that:

4                       "2. TEP's motion for summary judgment  
5 insofar as it seeks a ruling that the  
6 Commission cannot as a matter of  
7 contract change from a regulated  
8 marketplace to a competitive  
9 marketplace is denied. Cross-motions  
10 for summary judgment on this issue are  
11 granted." Minute Entry Order dated  
12 November 19, 1997, p. 5.

13           In sum, TEP's claims that the Rules violate a "regulatory  
14 compact" have been rejected by the court. Neither TEP nor other  
15 parties can be heard to assert that the so called "compact" has any  
16 reborn legal significance in this generic stranded cost proceeding.  
17 Such claims are prohibited collateral attacks on a final order of the  
18 Commission. Moreover, as to TEP, such claims are further barred as  
19 being res judicata and law of the case, it being noted that the  
20 administrative docket number of this proceeding, U-0000-94-0165, is  
21 the same as that contained in Decision No. 59943.

22           It is somewhat ironic to note that the most outspoken  
23 proponent of recognizing a "regulatory compact" in this proceeding  
24 and attaching legal significance to it is TEP -- the same party who  
25 unsuccessfully urged the same theory in the Superior Court. TEP's  
26 primary spokesman on the so-called "regulatory compact" was Daniel  
Fessler. It is not surprising that the cases cited in Mr. Fessler's  
testimony were all cited by TEP in its unsuccessful motion for

1 summary judgment.<sup>2</sup> These citations must have been spoon-fed by TEP  
2 to Mr. Fessler, reviewed at his customary \$600 per hour rate and  
3 regurgitated into his testimony. Whether such regurgitation is  
4 expensive or merely parrots an assertion already made and rejected is  
5 irrelevant. What is important here is that as a matter of law, the  
6 assertion in this proceeding of the existence of a "regulatory  
7 compact/contract" is a prohibited collateral attack on a final order  
8 of the Commission. It has no weight in this proceeding.

9 Since other parties intend to brief the nature of the so-called  
10 "regulatory compact," some additional legal and regulatory  
11 perspective concerning the origin of the phrase may be helpful.

12 **b. The Policy Underlying the So Called "Regulatory**  
13 **Compact" Provides a Reasonable Balancing of Consumer**  
14 **and Shareholder Interests; It Does Not Insure the**  
15 **Utilities Against the Consequences of Competition.**

16 According to some authorities the term "regulatory compact"  
17 arose during the 1980's in connection with carping by utilities  
18 concerning regulatory disallowances of bloated generation plant  
19 construction projects -- notably nuclear generation projects. See C.  
20 Phillips, *The Regulation of Public Utilities*, 21 (3rd ed. 1993)  
21 quoting a piece by Irwin Stelzer in a Wall Street Journal Article.  
22 Other commentators were more direct: "Actually, there never was a

---

23 <sup>2</sup> The Application of Trico Electric Cooperative, Inc., 92 Ariz.  
24 373, 377 P.2d 309 (1962); New England Coalition on Nuclear Pollution  
25 v. Nuclear Regulatory Comm'n., 727 F.2d 1127 (D.C. Cir. 1984);  
26 Washington Utils. & Transp. Comm'n. v. Puget Sound Power & Light Co.,  
62 P.U.R. 4th 557 (Wash. 1984); Walla Walla City v. Walla Walla Water  
Co., 172 U.S. 1 (1898); New Orleans Water Works v. Rivers, 115 U.S.  
674 (1885) and others. Compare Fessler Rebuttal Testimony pp. 3-10  
with TEP's motion for summary judgment pp. 3-6.

1 compact -- only a wishful delusion by utilities." Studness, The  
2 Regulatory Compact That Never Was, Public Utilities Fortnightly,  
3 September 1, 1991, p. 34.

4 As Dr. Coyle noted on behalf of the City of Tucson, the two  
5 leading treatise writers on utility regulation, James Bonbright and  
6 Alfred Kahn do not discuss any "regulatory compact" at all. If the  
7 concept had any legal consequence or meaning (other than as a mere  
8 metaphor for the policy of regulation) it surely would have been  
9 discussed in cases like Pennsylvania Electric Company v. Pennsylvania  
10 Pub. Util. Comm'n., 502 A.2d 130 (Pa. 1985). There, the court did  
11 not discuss the so called compact but nevertheless affirmed a rate  
12 reduction due to disallowance in rate base of two damaged Three Mile  
13 Island nuclear reactors, where the reactors had been previously  
14 included in rate base and only one was damaged. In that case, the  
15 court reexamined the value of property that was previously included  
16 in rate base as prudent. No regulatory compact prevented such  
17 reexamination. In fact, not to have adjusted values under the  
18 circumstances presented would have been unconscionable.

19 Similarly, if the "compact" had any legal significance, it  
20 certainly would have been discussed in Duquesne Light Co. v. Barasch,  
21 488 U.S. 299 (1989), where the United States Supreme Court sustained  
22 the validity of a state statute that precluded rate recovery of  
23 plants that were not used and useful though they had previously been  
24 approved as prudent. Neither one of these famous court cases  
25 occurred to APS witness Dr. John Landon, who steadfastly maintained  
26 that (other than cases of imprudence) once a plant was in rate base,

1 its value and recovery could never under any circumstances be  
2 reexamined by the regulator. TR 2931-35, line 19.

3 Fortunately for consumers everywhere, the United States  
4 Supreme Court has never sanctioned Dr. Landon's restrictive  
5 shareholder-tilted view of the public policy of utility rate  
6 regulation. The Affected Utilities in this proceeding, now clamoring  
7 for entitlements to full recovery of stranded costs, are seeking  
8 nothing short of blank check indemnification from ratepayers of all  
9 costs which might become "above market" in a competitive regime.  
10 This is precisely the approach that repeatedly has been rejected by  
11 the high court over many years. Rate regulation has never protected  
12 -- as a constitutional right -- regulated industries from the effects  
13 of economic forces.

14 In 1933, the Court stated:

15 "[the due process clause] does not  
16 assure to public utilities the right  
17 under all circumstances to have a  
18 return upon the value of the property  
19 so used. The loss of, or the failure  
20 to obtain, patronage, due to  
21 competition, does not justify the  
22 imposition of charges that are  
23 exorbitant and unjust to the public.  
24 The clause of the Constitution here  
25 invoked does not protect public  
26 utilities against such business  
27 hazards." Public Serv. Comm'n. of  
28 Montana v. Great Northern Utils. Co.,  
29 289 U.S. 130, 135 (1933).

30 In Market St. Ry. Co. v. Railroad Comm'n. of California,  
31 324 U.S. 548, 567 (1945), the Court observed:

32 "...it may be safely generalized that  
33 the due process clause never has been  
34 held by this Court to require a

1 commission to fix rates on the present  
2 reproduction value of something no one  
3 would presently want to reproduce, or  
4 on the historical valuation of a  
5 property whose history and current  
6 financial statements showed the value  
7 no longer to exist, or on an  
8 investment after it has vanished, even  
9 if once prudently made, or to maintain  
10 the credit of a concern whose  
11 securities already are impaired. The  
12 due process clause has been applied to  
13 prevent governmental destruction of  
14 existing economic values. It has not  
15 and cannot be applied to insure values  
16 or to restore values that have been  
17 lost by the operation of economic  
18 forces." (Emphasis added.)

19 The Duquesne case, supra, confirms that the proper mission  
20 of a utility regulatory agency should be to balance the interests of  
21 the consumer with the interests of the shareowners. Indeed, that has  
22 been a hallmark of this Commission's regulation of Arizona public  
23 service corporations over the years. That balancing is a material  
24 part of the Commission's constitutional responsibilities in setting  
25 just and reasonable rates -- whether in granting an increase or  
26 decrease in rates or in establishing a recovery mechanism to address  
strandable costs.

Whether the value of the utility's property has been  
damaged by accident or external causes (e.g. Pennsylvania Electric,  
supra) or has been adversely affected because of the economic forces  
of competition, (Market St. Ry., supra), the Commission has no  
constitutional obligation to favor the interests of the shareholders  
over those of the consumer.

1           **2. A Statewide Uniform Surcharge to Recover All Strandable**  
2           **Costs of All Utilities is Bad Public Policy, Makes No Sense**  
3           **and Should be Rejected.**

4           One of the parties to the proceeding suggested that all of the  
5 utilities' strandable costs should be "pooled" and recovered by way  
6 of a statewide uniform charge assessed on all customers of all  
7 utilities. Testimony of Sean R. Breen, Citizens Utilities Company,  
8 Exhibit CUC-1, p. 28. Mr. Breen's request to approach stranded costs  
9 on a generic basis was criticized by nearly all of the expert  
10 witnesses in the proceeding. Such a proposal effectively guarantees  
11 unreasonable cost shifting and subsidies; and it penalizes the  
12 customers of efficient utilities whose management policies have  
13 minimized or eliminated any strandable costs. Mr. Breen himself  
14 admitted that the uniform surcharge would penalize customers of an  
15 efficient utility. TR 143-45.

16           TEP's witness, Dr. Kenneth Gordon testified:

17                   "I don't think it would be a good idea. It  
18                   would mean the customers of one utility might  
19                   wind up paying the stranded costs of somebody  
20                   else's [sic]." TR 798, lines 2-4.

21           He acknowledged that stranded cost recovery should be analyzed on a  
22 utility specific basis. TR 797, lines 19-22. See generally TR 797-  
23 98.

24           Other witnesses agreed: Enron's witness, Mona Petrochko, favored  
25 the flexibility of analyzing the utilities' filings individually. TR  
26 852, line 16. The Department of Defense witness, Mr. Neidlinger,  
felt that adoption of a uniform statewide surcharge would create  
"cross-subsidization," would be "unfair" and might provoke a "revolt"

1 by dissatisfied customers. TR 1228-29. PG&E's Mr. Oglesby said that  
2 such a proposal makes no sense. TR 1269, lines 10-12; line 21.  
3 Utilities with low stranded costs would be "subsidizing those  
4 utilities with higher stranded costs." TR 1269, lines 19-20. Mr.  
5 Oglesby believes that a statewide uniform recovery mechanism would be  
6 "bad public policy" that "sends inappropriate market signals." TR  
7 1269, lines 20-21.

8 TEP's Mr. Bayless would not like it if his customers were forced  
9 to pay for any costs associated with APS' investment in the Palo  
10 Verde nuclear generation station. He prefers the utility-by-utility  
11 approach. TR 1679, line 22. RUCO's Dr. Rosen felt that the  
12 Commission should deal with the stranded cost issue on a "utility  
13 specific" basis, TR 1812, line 21, since "each utility is going to be  
14 in a situation where different mitigation measures are  
15 appropriate...." TR 1883, lines 9-11.

16 AEPCO's witness, William Edwards "absolutely" agreed that  
17 "stranded costs can most accurately be determined by examining each  
18 utility individually" (TR 2042, lines 21-24) and the Commission  
19 "should retain sufficient flexibility to deal with the differences  
20 that exist between the various affected utilities under its  
21 jurisdiction. AEPCO's Dirk Minson also testified that a uniform  
22 statewide surcharge would "penalize customers" of the rural utilities  
23 who "had no need nor did they participate in Palo Verde." TR 3041,  
24 lines 5-7. Mr. Minson agreed with others that the stranded cost  
25 recovery mechanism should be developed "on a case-by-case basis for  
26 each utility." TR 3041, lines 11-14.

1           Similarly, Staff's witness, Dr. Kenneth Rose, opposes a  
2 statewide stranded cost collection procedure because it would promote  
3 subsidies among customers of various utilities. TR 3073, lines 24-  
4 25; TR 3074, lines 1-3 (Questions by the Chief Hearing Officer).

5           APS' witness, Jack Davis, agreed that there should be no "one  
6 size fits all" (TR 3658, line 14) because the Commission may need to  
7 take each utility's "specific instances" into consideration (TR 3658,  
8 lines 22-23). Mr. Davis also opposed "a uniform statewide charge  
9 that would be equally applicable to all customers." TR 3818, lines  
10 24-25; 3819, lines 1-8.

11           Citizens' proposal for a pooling of all strandable costs and  
12 establishment of a uniform statewide surcharge is plainly unsupported  
13 by any witness other than Citizens' Mr. Breen. The present language  
14 of the Rule provides:

15                   "The Commission shall... determine for each  
16                   Affected Utility the magnitude of Stranded Cost,  
17                   and appropriate Stranded Cost recovery  
                    mechanisms and charges." A.A.C. R14-2-1607I.

18           The Rule's flexibility and discretion should not be abandoned in  
19 favor of Citizens' ill-advised and unsupported proposal.

20           **3. The Burden of Proof of Alleged Strandable Costs and  
21 Mitigation Measures is Squarely on the Utilities.**

22           Implicit in the Rules concerning strandable cost is that the  
23 burden of proof is on the respective utility to prove that the  
24 alleged costs are indeed stranded -- net of stranded benefits --  
25 because of the impacts of competition and that all feasible efforts  
26 have been pursued by the utility to mitigate the occurrence of such  
costs. Although the subject of burden of proof was not a central

1 point of the testimony, it is clearly an important topic because the  
2 proceedings to be filed by the Affected Utilities concerning  
3 strandable costs will be the largest rate cases in the history of the  
4 State of Arizona. The utilities will doubtless seize the opportunity  
5 to include each and every uneconomic cost in their filings -- whether  
6 or not those costs have been stranded because of competition. So  
7 that the stranded cost filings do not become a repository for flaky  
8 claims, the Commission should make it clear that allegations of  
9 strandable costs will be examined with the strictest of scrutiny and  
10 will not be allowed except upon convincing proof.

11 All of the above should be routinely accepted by the utilities.  
12 However, Citizens proposed that this obvious burden should be  
13 reversed and should be placed upon customers, new entrants, RUCO and  
14 the Staff to disprove the utilities' claims. If adopted, Citizens'  
15 proposal would make a mockery of the process and accordingly it  
16 should be rejected.

17 Dr. Coyle, witness for the City of Tucson, testified that the  
18 "consensus that the burden of proof is on the Affected Utilities  
19 should be incorporated more fully in the rules." City of Tucson,  
20 Exhibit 1, p. 5, lines 8-9. Dr. Coyle believes that "the utilities  
21 should have a high burden to show that those costs exist." TR 1041,  
22 lines 22-25. Mona Petrochko for Enron also agreed:

23 Q. That burden should be on the  
24 utilities. Should it be a high burden  
in your opinion?

25 A. I think it should be a high burden for  
26 a couple of reasons. One, part of  
what the Commission is trying to

1 accomplish by going through this  
2 process is to provide for a  
3 competitive market, and to the extent  
4 that that burden is low and the value  
5 of those assets are underestimated,  
6 therefore resulting in very high  
7 stranded costs, it would very much  
8 inhibit the ability of competitors to  
9 enter the Arizona market and provide  
10 the types of services that I have  
11 mentioned earlier....

12 Q. Would it make any sense, from your  
13 perspective, to put that burden on  
14 customers of the utility or the people  
15 seeking to enter the market?

16 A. No, I don't believe that would be  
17 appropriate.... [That] would be an  
18 impediment [to competition]. TR 848,  
19 lines 3-25.

20 Citizens' proposal on burden of proof -- like its uniform  
21 surcharge proposal -- is completely unsupported and would amount to  
22 bad policy. Strandable cost claims must be placed under a microscope  
23 in order to promote - not stifle - the emergence of competition in  
24 this state. That is because, as Dr. Rosenberg testified, the  
25 recovery of strandable costs:

26 "actually impedes economic efficiency by  
interfering with the working of a competitive  
market. Strandable cost recovery allows a  
supplier with above-market costs to compete  
unfairly with potential or actual competitors  
because some of its costs are subsidized by  
strandable cost recovery." AECC, et. al.,  
Exhibit 2, p. 7, lines 12-16.

27 So that the Commission does not promote unfair competition or --  
28 worse yet -- prevent it from ever occurring -- claims for strandable  
29 cost recovery must be carefully examined. The burden of proof should  
30 be high to show that the costs claimed are real; that they have been

1 fully mitigated by every feasible manner of mitigation; that they  
2 have been netted against stranded benefits; and that they would not  
3 have been incurred but for the results of competition. Unless these  
4 claims receive strict scrutiny, the policy makers run the risk of  
5 exorbitant stranded cost allowances that will impede or perhaps  
6 entirely prevent the emergence of competition. Strandable cost  
7 recovery should be seen for what it truly is -- an "extraordinary  
8 proposition." AECC, et. al., Exhibit No. 3, p. 9, line 5.

9 **4. The Net Revenues Lost Approach Proposed by the Utilities is**  
10 **Completely One-Sided and Would Insure That Utilities**  
11 **Recover a Minimum of 100% of Their Alleged Strandable**  
12 **Costs.**

13 It was not surprising to see that one common ground existed in  
14 the various utilities' presentations: they all endorse the use of the  
15 administrative net revenues lost approach in calculating strandable  
16 costs. This approach is advocated by APS' Mr. Davis and Dr.  
17 Hieronymus, AEPCO's Mr. Minson, TEP's Mr. Bayless, Dr. Gordon and Mr.  
18 Fessler. While Mr. Dabelstein, the writer of the Staff Report of the  
19 Stranded Cost Working Group, recommended such an approach, it was  
20 clear that there was no consensus in the working group to support the  
21 use of that method. The problems with this approach are legion and  
22 have been discussed in the witnesses' testimony. It should be noted  
23 that Mr. Higgins' use of a restricted version of this approach as a  
24 part of his hybrid recommendation does not suffer these problems.  
25 Briefly, the problems are:

- 26 a. heavy reliance on speculative assumptions

- 1 b. entitlement to recovery of operating  
2 costs in addition to fixed costs  
3 associated with uneconomic generation  
4 units
- 5 c. market price forecast problems
- 6 d. focus on the hypothetical pretense of  
7 continued regulation instead of the  
8 difference between the book value of  
9 generation related costs and the  
10 market value caused by competition
- 11 e. assumption that there will be no  
12 changes in the economy, technology or  
13 society over a long period of years
- 14 f. erroneous assumption that there is an  
15 entitlement to continued regulated  
16 monopoly rate regulation
- 17 g. reliance on computer models, not  
18 market realities

19 Of all the administrative approaches to estimation of strandable  
20 costs, the net revenues lost is clearly the most one-sided in favor  
21 of the utilities. This type of approach should clearly be avoided.  
22 Otherwise the stranded cost charge will be too high and will have to  
23 be recovered over a long period of time and will adversely affect the  
24 emergence of competition. Use of this approach virtually guarantees  
25 that the strandable cost allowance for utilities will be greatly more  
26 than necessary. Since the approach assumes that all costs will be  
forecast, it will heavily be dependent on operating cost assumptions.  
In general, a focus on operating costs of the utility to define a  
revenue stream that would theoretically exist under regulation will  
create a built-in incentive in the mechanism to increase operating  
costs at all levels. Every increased dollar of operating expense  
results in an increased dollar of stranded costs. This would be a

1 perverse incentive that would clearly promote mischief at a time (in  
2 a transition to competition) when market incentives should be  
3 creating a downward pressure on operating costs. But under this  
4 approach, why should a utility attempt to rein in its operating costs  
5 by one dollar if to do so would deprive it of a dollar's worth of  
6 strandable costs? This approach gives the greatest reward to those  
7 utilities which make the worst business decisions. EEC Exhibit 2 at  
8 pp. 8-9.

9 Market based methods, or hybrid methods as proposed by Mr.  
10 Higgins or Dr. Rose on behalf of Staff, are much preferred. They  
11 place incentives where they should be in order to reduce -- not  
12 increase -- the subsidy of a strandable cost allowance.

13 APS' eight year proposal to measure "actual" experience, while  
14 a variant of the stranded forecast approach, is also loaded with  
15 opportunities to increase stranded costs. Under the APS proposal  
16 there is no incentive to reduce operating costs. It should always be  
17 remembered that without incentives, the utilities will not be  
18 motivated to reduce operation costs. The focus should be on  
19 generation and generation related costs -- not creating a  
20 hypothetical "business as usual" model that pretends that competition  
21 will never occur. In fact, the greatest objection to the net revenues  
22 lost approach is that it artificially presumes that the customers  
23 should be required to pay whatever amounts it would have received  
24 without competition. As Mr. Higgins properly noted, "carried to its  
25 extreme, it completely defeats the purpose of moving to a competitive  
26

1 market." AECC, et. al., Exhibit 3, p. 18, lines 12-14. See Enron  
2 Exhibit 1, p. 15.

3 In sum, the administrative net revenues lost approach as  
4 proposed by Mr. Dabelstein and other utilities provides a significant  
5 disincentive to reduce costs and should not be adopted.

6 **5. Decreased Value of Generation Assets Occurring From**  
7 **Competition: The "Used and Useful" Rule and "Fair Value".**

8 The utilities consistently maintain that once an item of rate  
9 base has been included as prudent, the value of the plant may never  
10 be reexamined by the regulator. This notion is behind the utilities'  
11 clarion cry for "100%" or "full" recovery of generation costs  
12 stranded by competition. Unfortunately, the claim is pure hogwash.

13 A utility's plant can be damaged by accidental forces, such as  
14 the Three Mile Island case, or it can be damaged by the forces of  
15 competition as in the Market St. Railway case. It first must be  
16 noted that there is no constitutional right to 100% recovery of  
17 anything in utility rate regulation. Quite the opposite, in fact, is  
18 true. Constitutionally, a utility is not even guaranteed to receive  
19 any net revenues as a result of utility ratemaking. In Federal Power  
20 Comm'n. v. Hope Natural Gas Co., 320 U.S. 591, 603 (U.S. 1944), the  
21 court noted that the setting of rates requires a balancing of  
22 interests between the regulated company's investors and consumers,  
23 and that "'regulation does not insure that the business shall produce  
24 net revenues.'" (Citation omitted). The "balancing" doctrine was  
25 also noted many years earlier in Smyth v. Ames, 18 S.Ct. 418 (1898)  
26 which involved a Nebraska statute setting maximum rates for

1 railroads. The Court noted that the government need not set rates so  
2 high as to enable a common carrier to make a profit in the face of  
3 diverse market conditions, if to do so would impose "unjust burdens  
4 on the public" through unreasonably high rates. Id. at 433.

5 It is clear, therefore, that the constitution does not  
6 "guarantee" a utility's "entitlement" to any particular level of  
7 recovery of costs in the context of regulated utility ratemaking. It  
8 has long been recognized that, where the government acts to set  
9 rates, it need not set the rates so high as to insure a profit when  
10 to do so would require that the price exceed what would be a  
11 reasonable price under ordinary market conditions. In an analogous  
12 context, "'if a corporation cannot maintain.... a highway and earn  
13 dividends for stockholders [when charging reasonable rates], it is a  
14 misfortune for it and them which the constitution does not require to  
15 be remedied by imposing unjust burdens upon the public.'" Smyth v.  
16 Ames, 18 S.Ct. at 433 (citation omitted). See also, Market Street  
17 Ry. Co. v. Railroad Comm'n. of California, 324 U.S. 548, 567 (1945).

18 The constitutional test for "balancing" the interests of  
19 shareowners and consumers provides this Commission with broad  
20 discretion in determining a range of alleged strandable costs that  
21 may be absorbed by shareholders.

22 In addition to constitutional balancing, the Commission has two  
23 other ratemaking doctrines that provide it with authority to disallow  
24 uneconomic costs incurred by utilities in the transition to  
25 competition.

26 . . .

1           **a.   Used and Useful Rule.**

2           A utility plant must be both "used" and "useful" in order  
3 to be considered for rates. If the plant's usefulness is impaired  
4 through economic forces in the marketplace, the regulator is not  
5 obliged to make the utility "whole" by setting unreasonably high  
6 rates.

7           In Denver Union Stock Yard Co. v. United States, 304 U.S.  
8 470, 475 (1938), the Court stated that a utility is "not entitled to  
9 have included any property [in rates] not used and useful for that  
10 purpose."

11           If the forces of competition result in rendering a portion  
12 of a generation plant investment uneconomic, the Commission has a  
13 duty to the public to balance the interests of shareholders and  
14 consumers in arriving at a just and reasonable rate. If the plant  
15 although used is not useful because of its high costs of operation,  
16 the ratepayers need not be the indemnitors of the utility. Even if  
17 a plant was prudently constructed, if not used and useful, it may be  
18 properly excluded from consideration in ratemaking.

19           In this generic proceeding, it is unclear which plant and  
20 property of which utility has in fact ever passed prudence review.  
21 These facts must await the individual filings by the Affected  
22 Utilities. Utilities' investments in generation assets or in new or  
23 amended purchased power contracts may not have ever been thoroughly  
24 examined by the Commission. Even if prudence is established,  
25 however, a facility may become uneconomic due to the economic forces  
26 of competition. Under such circumstances the regulator is under no

1 obligation to require that customers pay a return in rates on such  
2 uneconomic property.

3           **b. Fair Value.**

4           Fair value regulation also provides another basis for the  
5 Commission to exercise its discretion in constitutionally balancing  
6 the interests of shareholders and consumers. The Commission may  
7 consider evidence of "current values" of utility plant and "no rigid  
8 formula is required to be used." Simms v. Round Valley Lt. & Power  
9 Co., 294 P.2d 378, 385 (Ariz. 1956). The Commission has substantial  
10 discretion. For example, if

11                       "...because of mechanical advances the  
12                       existing plant carries a possible  
13                       element of obsolescence. This  
14                       certainly is a matter the Commission  
                      would have the right to consider in  
                      arriving at present fair value." Id.  
                      at 385.

15           Our Supreme Court has also said:

16                       "The amount of capital invested is  
17                       immaterial. Under the law of fair  
18                       value a utility is not entitled to a  
19                       fair return on its investment; it is  
                      entitled to a fair return on the fair  
                      value of its properties devoted to the  
                      public use, no more and no less."  
20                       Arizona Corporation Commission v.  
                      Arizona Water Co., 335 P.2d 412, 415  
21                       (Ariz. 1959).

22           Under settled Arizona law, fair value can be whatever the  
23 Commission justly and reasonably determines it to be. Where  
24 obsolescence shows that a utility invested capital is in excess of  
25 the value of the generation property at issue, a finding of fair  
26

1 value that is less -- perhaps substantially less -- than original  
2 cost is required. Simms, 294 P.2d at 385.

3 "...the duty, power, and procedure to  
4 be followed to ascertain such fair  
5 value are likewise within the  
6 exclusive prerogatives of the  
7 Corporation Commission, and may not be  
8 exercised by any other department or  
9 body." Ethington v. Wright, 189 P.2d  
10 209, 216 (Ariz. 1948).

11 Obviously, under well established Arizona law, if a  
12 utility's plant values have declined or are uneconomic because of  
13 competitive forces, or because new plants can be installed for less,  
14 that fact must be considered in fair value ratemaking.

15 In Duquesne Light Co. v. Barasch, 488 U.S. 299, 316 (1989),  
16 the court in closing its opinion observed:

17 The Constitution within broad limits  
18 leaves the states free to decide what  
19 ratesetting methodology best meets  
20 their needs in balancing the interests  
21 of the utility and the public.

22 Arizona's fair value regulation is uniquely suited to the  
23 changing economic times accompanying the transition to competition in  
24 the electric utility industry. In Duquesne, perhaps presaging events  
25 leading to competition, the Court even suggested that "the emergent  
26 market for wholesale electric energy could provide a readily  
available objective basis for determining the value of utility  
assets." Id. at 316 n.10. Obviously, the "market" for wholesale  
electric energy addresses market values not embedded cost of  
operations. Wholesale energy markets present yet another factor that

1 the Commission can evaluate in determining fair value for a  
2 particular Affected Utility.

3 In summary, there is no constitutional basis for the  
4 utilities' claims of entitlement to 100% of the uneconomic costs of  
5 their above-market generation facilities. Under a reasonable  
6 application of the "used and useful" rule or otherwise in the course  
7 of determining fair value, the Commission has full and complete  
8 authority and discretion to "balance the interests of the utility and  
9 the public." Id. at 316.

10 **6. The Commission Should Beware of Artificially Low**  
11 **Market Price Indicators.**

12 APS' Mr. Davis maintains that a good proxy for Arizona's market  
13 clearing price would be the Southern California Power Exchange (PX)  
14 price. TEP's Mr. Bayless claimed that the Dow Jones Palo Verde Index  
15 would be a good proxy. Obviously, neither of these indices can  
16 purport to be market based insofar as the objective is to determine  
17 and forecast what the retail market for competitive generation would  
18 be in Arizona. The California index simply does not yet even exist  
19 and is going to be driven by considerations and factors peculiar to  
20 California -- not Arizona. Both indices are wholesale -- in that the  
21 prices are created by transactions between and among wholesale  
22 utilities or municipal power entities. Neither index will be the  
23 result of purchases by a retail customer of competitive energy.  
24 Other objections to the use of such indices as a proxy are that they  
25 are short term or spot in nature (TR 557, lines 6-7 Fessler: "very  
26 short term history"). The costs for creation of the PX benefit

1 Californians but would be included in the cost producing the market  
2 price at the PX (TR 558-559). Factors and circumstances particular  
3 to California would tend to drive the PX price (TR 569-570).

4 Since the calculation of stranded cost will depend on a forecast  
5 or application of actual market prices, and the stranded cost will be  
6 the difference between market and book, there is ample room here for  
7 the utilities to attempt to "game" the system to their advantage.  
8 The sweetest game of all for the utilities would be if the Commission  
9 were to adopt the net revenues lost approach which would virtually  
10 guarantee that stranded costs would be exorbitant and unrealistic.  
11 Another game could occur if either the PX or the Dow Jones Palo Verde  
12 index were to be adopted as the proxy for market energy in the  
13 calculation. That is, because all other things being equal, the  
14 lower the market clearing price used in the calculation, the higher  
15 would be the resulting stranded cost falling out of the calculation.  
16 Mr. Davis, in fact, admitted as much. TR 3810, lines 12-22.

17 The utilities are thus incited to promote the lowest wholesale  
18 type prices for use in the computation. The Commission must reject  
19 these claims and develop a retail market price for competitive  
20 generation. That price should take into account transmission and  
21 distribution losses, mark-ups and other factors. It should be a  
22 retail - not wholesale - market price that is meaningful for Arizona  
23 not California. It might include looking at certain market indices  
24 as a starting point but it clearly would be inappropriate and  
25 unreasonable to end there. TR 882-883 (Ms. Petrochko).

26 . . .

1           7.    **A Strict Code of Conduct Should be Adopted by**  
2                    **the Commission to Govern Affiliate Transactions**  
3                    **Among Utilities and Their Marketing Entities.**

4            Another issue that did not receive much attention during the  
5            proceeding is the topic of affiliated interest transactions.

6            At present, both APS and TEP have formed marketing entities and  
7            are vigorously pursuing new markets. There are no codes of conduct  
8            or rules proposed or adopted that prescribe the standards of conduct  
9            that must be adhered to in order to let the forces of competition --  
10           not collusion -- drive the price of electricity. Of course, as yet  
11           there is no retail competition in generation and the utilities will  
12           argue that they are entitled to use shareholder money in any way they  
13           please. That argument would be true if, in fact, the monies expended  
14           were all shareholder -- not ratepayer financed.

15           During the evolution to competition, PG&E Energy Services Mr.  
16           Oglesby and Mr. Nelson on behalf of the Electric Competition  
17           Coalition both have voiced justifiable concerns about this problem.  
18           Mr. Oglesby remarked:

19                    To the extent that the regulated utilities will  
20                    be permitted to conduct competitive activities  
21                    from the utilities' structure, there absolutely  
22                    needs to be functional separation, and that  
23                    needs to be policed by a stringent code of  
24                    conduct that will assure that there is no cross  
25                    subsidy from the regulated side to the  
26                    unregulated side....

                  I would strongly advocate that the utilities  
                  would be prohibited from conducting competitive  
                  activities out of the utility. And, in fact,  
                  would conduct their competitive activities out  
                  of a separate corporate entity.... TR 1261,  
                  lines 6-13; lines 19-23.

1 Mr. Nelson agreed that a code of conduct is essential in order  
2 to:

3 "...protect ratepayers from the shifting of  
4 information, personnel, assets, from one entity  
5 to the other, with the borrowing without  
6 compensation of any of those resources, and also  
7 to assure that there is [sic] no anti-  
competitive activities that are occurring  
between the monopoly distribution side and the  
marketing nonregulated side." TR 4200, lines  
11-17.

8 See also the testimony of Mona Petrochko, Enron Exhibit 1 at pp. 24-  
9 25.

10 The Commission should develop rules to insure that regulated  
11 operation customers are not paying for the marketing and  
12 administrative costs that are supporting each company's efforts to  
13 tap new markets outside of their service areas. It is unclear that  
14 the Commission's affiliated interest rules are tailored to meet the  
15 potential for cost shifting that can exist where unregulated  
16 marketing operations are being conducted by the utilities.

17 **8. The California "Model" Should Have no Bearing on Resolution**  
18 **of Strandable Costs in Arizona.**

19 Mr. Fessler eloquently described the circumstances leading up to  
20 the adoption of AB1890 in California in his testimony. Those  
21 circumstances find absolutely no parallel in Arizona. Arizona has no  
22 high cost state-mandated PURPA contracts that artificially drove up  
23 energy costs as were prevalent in California. Arizona is not reeling  
24 from a recession with the loss of 800,000 jobs due to cutbacks in the  
25 defense industry. And Arizona is under no compulsion to provide the  
26 same kind of blank check that was given to the regulated utilities in

1 California. See Mr. Fessler, TR 523, lines 24-25, 616-617; PGE  
2 Exhibit 1, p. 20 (Mr. Oglesby); TR 141 (Mr. Breen). Unlike  
3 California, Arizona is one of the fastest growing states in the  
4 nation.

5 A recent article noted now that the first bills for energy  
6 service are being received by California customers, the cost of the  
7 monthly securitization fee perversely exceeds the monthly "savings"  
8 derived from capped rates. California Energy Markets, March 6, 1998  
9 at p. 14. As Robinsons-May representative Mr. Venne said on the  
10 first day of hearing during public comment, Arizona should indeed be  
11 wary of the California approach. TR 25. Even more telling is the  
12 statement of Mr. Oglesby representing an affiliate of an incumbent  
13 utility in California: "Indeed, the California structure is  
14 unnecessarily complex and is not essential to the creation of a true  
15 competitive market. It should not be replicated in Arizona." PGE  
16 Exhibit 1, p. 23, lines 12-14 (Emphasis added.)

17 Since there is a voter sponsored recall or initiative underway  
18 in California to undo the consumer damage created by AB1890, Arizona  
19 would be well advised not to follow suit. Even Mr. Fessler did not  
20 claim that California's solution should be adopted in Arizona. TR  
21 415, lines 6-9. It clearly should not.

22 **9. The Transition Cost Mechanism Must be Designed to Enable -**  
23 **Not Prevent - New Entrants to Compete.**

24 The strandable cost recovery charge must be carefully designed  
25 in order to avoid what is occurring in California and elsewhere.  
26 This issue is only addressed briefly here because it surely will be

1 addressed in the briefs of the new entrants, PG&E Energy Services,  
2 Enron and ECC and perhaps others. As we understand the issue, in a  
3 competitive environment the customer's bill will include various  
4 elements, but the major components will include (1) a "wires" charge  
5 encompassing the fixed costs of the distribution utility, (2) a  
6 transition charge encompassing strandable cost charges, system  
7 benefit charges, etc. and (3) the generation charge, which should  
8 include generation, remote transmission, losses, etc. If there is a  
9 rate cap adopted, the ceiling in any particular tariff will be the  
10 existing approved rates for the particular class of customers. If a  
11 rate cap is not adopted, the standard offer rate for each rate  
12 classification will likely become a de facto ceiling rate. Under  
13 this ceiling, the only truly variable or "contestable" charge will be  
14 the charge for competitive generation. If the wires charge and the  
15 transition charge are set too high, such rate design will reduce the  
16 range (below the de facto ceiling or cap) for new entrants to seek to  
17 offer competitive generation. During the hearings, this range was  
18 sometimes referred to as "headroom".

19 In California, there is scant "headroom" and some marketers and  
20 generators are electing not to compete in the state, thus further  
21 entrenching the incumbent utility's hold on the captive customer. In  
22 order to encourage new entrants to participate in the Arizona market,  
23 the design of the transition charge and the wires charge must be  
24 carefully accomplished. The transition charge cannot be established  
25 so high in a particular rate class that when combined with the wires  
26 charge there is no room left over for new entrants to offer

1 generation and hope to earn a profit. In addition, the transition  
2 charge must be known and fixed -- and not a residual calculation.  
3 See Enron Exhibit 1, p. 30-31.

4 This problem is real and was addressed by a number of witnesses.  
5 AECC et. al. Exhibit 2, pp. 36-37 (Dr. Rosenberg); TR 4158-4163, line  
6 5 (Mr. Higgins); TR 4183, line 16 - 4184, line 23 (Mr. Nelson); PGE  
7 Exhibit 1, p. 22, lines 7-20 (Mr. Oglesby).

#### 8 **10. Market Power Considerations.**

9 Throughout the proceeding the subject of market power was  
10 variously discussed, usually in the context of colloquies about  
11 divestiture. The existing Rule A.A.C. R14-2-1607(I) contemplates  
12 that the subject of competition and the impact of stranded cost  
13 recovery on competition should be considered by the Commission in  
14 weighing stranded cost allegations of each utility. No market power  
15 analysis to our knowledge has ever been performed in the region. But  
16 anecdotal evidence exists from the weekly fluctuation of spot prices  
17 in the Dow Jones Palo Verde index. When any of the Palo Verde  
18 stations is out of service for repairs, maintenance (scheduled or  
19 otherwise) spot prices for energy jump. Mr. Davis tried to brush  
20 this price activity off (TR 3800, lines 4-13), but we submit that  
21 this may be symptomatic of a very large market power question ahead  
22 since Palo Verde is the region's largest generation resource. We  
23 suggest that in each stranded cost filing made by the utilities,  
24 there should be an affirmative analysis of vertical and horizontal  
25 market power consideration and that each utility should have the  
26 burden of establishing that its respective strandable cost claim and



1 develop an approach to strandable costs that balances the interest of  
2 the consumer with that of the shareholder and creates meaningful  
3 incentives for the utilities to reduce or eliminate then strandable  
4 cost claims. Utilities are not "entitled" to a blank check in this  
5 process -- the public interest must be protected.

6 DATED: March 16, 1998.

7 Respectfully submitted,

8 BROWN & BAIN, P.A.

9  
10 By *Lex J. Smith*  
11 Lex J. Smith  
12 Michael W. Patten  
13 2901 North Central Avenue  
14 Post Office Box 400  
15 Phoenix, Arizona 85001-0400

16  
17 Attorneys for Intervenors  
18 Ajo Improvement Company, Morenci  
19 Water & Electric Company and  
20 Phelps Dodge Corporation

21 ORIGINAL and ten (10) copies of  
22 the foregoing Initial Post  
23 Hearing Brief filed this 16th  
24 day of March, 1998 with:

25 Docket Control  
26 Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

Two copies of the foregoing  
lodged with:

Jerry Rudibaugh  
Chief Hearing Officer  
Hearing Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007-2927

1 COPIES of the foregoing hand-  
2 delivered to Docket Control of  
3 the Arizona Corporation Commission  
4 this 16th day of March, 1998:

5 C. Webb Crockett  
6 FENNEMORE CRAIG  
7 3003 N. Central Avenue, Suite 2600  
8 Phoenix, Arizona 85012-2913  
9 Attorneys for ASARCO, Inc.,  
10 Cyprus Climax Metals Co.,  
11 Enron, Inc. and AAEC

12 Deborah R. Scott  
13 RUCO  
14 2828 N. Central Avenue, Suite 1200  
15 Phoenix, Arizona 85004

16 Bradley S. Carroll  
17 TUCSON ELECTRIC POWER CO.  
18 P.O. Box 711  
19 Tucson, Arizona 85702

20 Barbara A. Klemstine  
21 ARIZONA PUBLIC SERVICE CO.  
22 Manager, Regulatory Affairs  
23 P.O. Box 53999, M.S. 9909  
24 Phoenix, Arizona 85072-3999

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

Douglas C. Nelson  
DOUGLAS C NELSON PC  
7000 N. 16th Street  
Suite 120-307  
Phoenix, Arizona 85020  
Attorney for ECC, Enron Corp.  
and Enron Energy Services

Michael M. Grant  
GALLAGHER & KENNEDY  
2600 N. Central Avenue  
Phoenix, Arizona 85004  
Attorneys for AEPCO

1 Department of Navy  
Naval Facilities Engineering Command  
2 Navy Rate Intervention  
901 M Street SE, Building 212  
3 Washington, DC 20374  
Attn: Sam DeFrawi  
4

5 COPY of the foregoing hand-  
delivered this 16th day of  
6 March, 1998, to:

7 Paul A. Bullis, Esq.  
Christopher Kempley, Esq.  
8 Janice Alward, Esq.  
Arizona Corporation Commission  
9 Legal Division  
1200 West Washington Street  
10 Phoenix, Arizona 85007-2927

11 COPY of the foregoing sent  
12 via Federal Express this 16th  
day of March, 1998, to:

13 Rick Gilliam  
14 Susan Purcell  
Land and Water Fund of the Rockies  
15 2260 Baseline Road, Suite 200  
Boulder, CO 80302  
16

17 COPIES of the foregoing  
mailed this 16th day  
18 of March, 1998, to:

19 Thomas L. Mumaw, Esq.  
Snell & Wilmer, L.L.P.  
20 One Arizona Center  
400 East Van Buren  
21 Phoenix, Arizona 85004-0001  
Attorneys for APS  
22

Michael A. Curtis  
23 MARTINEZ & CURTIS, P.C.  
2712 N. 7th Street  
24 Phoenix, Arizona 85006  
Attorneys for Arizona Municipal  
25 Power Users' Association  
26

1	Walter W. Meek, President ARIZONA UTILITY INVESTORS ASSOCIATION 2100 N. Central Avenue, Suite 210 Phoenix, Arizona 85004	COLUMBUS ELECTRIC COOPERATIVE, INC. P.O. Box 631 Deming, New Mexico 88031
4	Charles R. Huggins ARIZONA STATE AFL-CIO 110 N. 5th Avenue P.O. Box 13488 Phoenix, Arizona 85002	CONTINENTAL DIVIDE ELECTRIC COOPERATIVE P.O. Box 1087 Grants, New Mexico 87020
7	David C. Kennedy LAW OFFICES OF DAVID C. KENNEDY 100 W. Clarendon Avenue Suite 200 Phoenix, Arizona 85012-3525	DIXIE ESCALANTE RURAL ELECTRIC ASSOCIATION CR Box 95 Beryl, Utah 84714
9	Norman J. Furuta DEPARTMENT OF THE NAVY 900 Commodore Drive, Bldg. 107 P.O. Box 272 (Attn. Code 90C) San Bruno, California 94066-0720	GARKANE POWER ASSOCIATION, INC. P.O. Box 790 Richfield, Utah 84701
13	Thomas C. Horne Michael S. Dulberg HORNE, KAPLAN & BISTROW, P.C. 40 N. Central Avenue Suite 2800 Phoenix, Arizona 85004	Stephen Ahearn ARIZONA DEPT OF COMMERCE ENERGY OFFICE 3800 N. Central Avenue 12th Floor Phoenix, Arizona 85012
16	Barbara S. Bush COALITION FOR RESPONSIBLE ENERGY EDUCATION 315 W. Riviera Drive Tempe, Arizona 85252	Betty Pruitt ARIZONA COMMUNITY ACTION ASSOC. 202 E. McDowell, Suite 255 Phoenix, Arizona 85004
17	Rick Lavis ARIZONA COTTON GROWERS ASSOCIATION 4139 E. Broadway Road Phoenix, Arizona 85040	Mick McElrath CYPRUS CLIMAX METALS CO. P.O. Box 22015 Tempe, Arizona 85285-2015
22	Steve Brittle DON'T WASTE ARIZONA, INC. 6205 S. 12th Street Phoenix, Arizona 85040	A.B. Baardson NORDIC POWER 4281 N. Summerset Tucson, Arizona 85715
24	Karen Glennon 19037 N. 44th Avenue Glendale, Arizona 85308	Michael Rowley c/o CALPINE POWER SERVICES 50 W. San Fernando, Suite 550 San Jose, California 95113
26		Dan Neidlinger 3020 N. 17th Drive Phoenix, Arizona 85015

1	Jessica Youle PAB300	Douglas Mitchell SAN DIEGO GAS AND ELECTRIC CO. P.O. Box 1831 San Diego, California 92112
2	SALT RIVER PROJECT P.O. Box 52025	
3	Phoenix, Arizona 85072-2025	Sheryl Johnson TEXAS-NEW MEXICO POWER CO. 4100 International Plaza Fort Worth, Texas 76109
4	Clifford Cauthen GRAHAM COUNTY ELECTRIC CO-OP	
5	P.O. Box B Pima, Arizona 85543	Ellen Corkhill AARP 5606 N. 17th Street Phoenix, Arizona 85016
6	Joe Eichelberger MAGMA COPPER COMPANY	
7	P.O. Box 37 Superior, Arizona 85273	Phyllis Rowe ARIZONA CONSUMERS COUNCIL 6841 N. 15th Place P.O. Box 1288 Phoenix, Arizona 85001
8	Wayne Retzlaff NAVOPACHE ELECTRIC CO-OP INC.	
9	P.O. Box 308 Lakeside, Arizona 85929	
10	Nancy Russell ARIZONA ASSOCIATION OF INDUSTRIES	Andrew Gregorich BHP COPPER P.O. Box M San Manuel, Arizona
11	2025 N. 3rd Street, Suite 175 Phoenix, Arizona 85004	
12	Barry Huddleston DESTEC ENERGY	Larry McGraw USDA-RUS 6266 Weeping Willow Rio Rancho, New Mexico 87124
13	P.O. Box 4411 Houston, Texas 77210-4411	
14	Steve Montgomery JOHNSON CONTROLS	Jim Driscoll ARIZONA CITIZEN ACTION 2430 S. Mill Avenue, Suite 237 Tempe, Arizona 85282
15	2032 W. 4th Street Tempe, Arizona 85281	
16	George Allen ARIZONA RETAILERS ASSOCIATION	William Baker ELECTRICAL DISTRICT NO. 6 P.O. Box 16450 Phoenix, Arizona 85011
17	137 University Mesa, Arizona 85201	
18	Ken Saline K.R. SALINE & ASSOCIATES	John Jay List General Counsel NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP. 2201 Cooperative Way Herndon, Virginia 21071
19	160 N. Pasadena, Suite 101 Mesa, AZ 85201	
20	Louis A. Stahl STREICH LANG	
21	2 N. Central Avenue Phoenix, Arizona 85004	
22		
23		
24		
25		
26		

1	Wallace Tillman Chief Counsel	Tom Broderick 6900 E. Camelback Road Suite 700 Scottsdale, Arizona 85251
2	NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION	
3	4301 Wilson Blvd. Arlington, Virginia 22203-1860	Albert Sterman ARIZONA CONSUMERS COUNCIL 2849 E. 8th Street Tucson, Arizona 85716
4	Robert Julian PPG 1500 Merrell Lane Belgrade, Montana 59714	Suzanne Dallimore Antitrust Unit Chief Department of Law Building Attorney General's Office 1275 W. Washington Street Phoenix, Arizona 85007
5		
6	Robert S. Lynch 340 E. Palm Lane, Suite 140 Phoenix, Arizona 85004-4529 Attorney for Arizona Transmission Dependent Utility	Loretta Humphrey Office of Tucson City Attorney Civil Division 255 W. Alameda P.O. Box 27210 Tucson, Arizona 85726-7210
7		
8	Douglas A. Oglesby Vantus Energy Corporation 353 Sacramento Street Suite 1900 San Francisco, CA 94111	William Sullivan MARTINEZ & CURTIS, P.C. 2712 N. 7th Street Phoenix, Arizona 85006 Attorneys for Mohave Electric Cooperative and Navopache Electric Cooperative
9		
10	Michael Block Goldwater Institute Bank One Center 201 N. Central Avenue Phoenix, Arizona 85004	Elizabeth S. Firkins INTERNATION BROTHERHOOD OF ELECTRICAL WORKERS, L.U. #1116 750 S. Tucson Blvd Tucson, Arizona 85716-5698
11		
12	Stan Barnes Copper State Consulting Group 100 W. Washington Street Suite 1415 Phoenix, Arizona 85003	Carl Dabelstein 2211 E. Edna Avenue Phoenix, Arizona 85022
13		
14	Carl Robert Aron Executive Vice President and COO Itron, Inc. 2818 N. Sullivan Road Spokane, Washington 99216	
15		
16	Lawrence V. Robertson Jr. MUNGER CHADWICK PLC 333 N. Wilmot, Suite 300 Tucson, Arizona 85711-2634 Attorney for PGE Energy	Larry K. Udall Arizona Municipal Power Users' Assoc. 2712 N. 7th Street Phoenix, Arizona 85006-1090
17		
18		
19		
20		
21		
22		
23		
24		
25		
26		

1 Roderick G. McDougall  
City Attorney  
2 Attn: Jesse Sears  
Assistant Chief Counsel  
3 200 W. Washington Street  
Suite 1300  
4 Phoenix, Arizona 85003-1611

5 William J. Murphy  
200 W. Washington Street  
6 Suite 1400  
Phoenix, Arizona 85003-1611

7 Russell E. Jones  
8 O'Connor, Cavanagh, et al.  
33 N. Stone Ave., Suite 2100  
9 P.O. Box 2268  
Tucson, Arizona 85702  
10 Attorneys for Trico Electric  
Cooperative,  
11 Inc.

12 Christopher Hitchcock  
P.O. Box 87  
13 Bisbee, Arizona 85603-0087  
Attorneys for Sulphur Springs  
14 Valley Electric Cooperative,  
Inc.

15 Myron L. Scott  
16 1628 E. Southern Avenue  
No. 9-328  
17 Tempe, AZ 85282-2179  
Attorneys for Arizona for a  
18 Better Environment

19 Andrew Bettwy  
Debra Jacobson  
20 SOUTHWEST GAS CORPORATION  
5241 Spring Mountain Road  
21 Las Vegas, Nevada 89102

22 Barbara R. Goldberg  
OFFICE OF THE CITY ATTORNEY  
23 3939 Civic Center Blvd.  
Scottsdale, Arizona 85251  
24

25 Evelyn Maestre  
26

Terry Ross  
Center for Energy & Economic  
Development  
P.O. Box 288  
Franktown, Colorado 80116

Peter Glaser  
DOHERTY RUMBLE & BUTLER PA  
1401 New York Ave., N.W.  
Suite 1100  
Washington, DC 20005

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

A

RECYCLED PAPER MADE FROM 20% POST CONSUMER CONTENT



1 SUMMARY OF ELEVEN ISSUES

2 ISSUE 1: SHOULD THE ELECTRIC COMPETITION RULES BE MODIFIED?

3 The Rules generally provide a workable framework for addressing  
4 stranded cost recovery. AECC believes that the Rules need only  
5 minor supplementation and clarification regarding allocation of  
6 stranded costs and the filing deadlines. See Exhibit A.

7 ISSUE 2: WHEN SHOULD THE AFFECTED UTILITIES BE REQUIRED TO MAKE  
8 A STRANDED COST FILING PURSUANT TO A.C.C. R14-2-1607?

9 AECC recommends that the Affected Utilities be required to file  
10 requests for recovery of stranded costs no less than eight months  
11 before they desire to begin collecting a Commission approved  
12 charge from customers.

13 ISSUE 3: WHAT COSTS SHOULD BE INCLUDED AS PART OF STRANDED COSTS  
14 AND HOW SHOULD THEY BE CALCULATED?

15 Stranded cost recovery should include a portion, between 25 and  
16 50 percent, of an Affected Utility's Commission-approved  
17 generation-related fixed costs plus regulatory assets actually  
18 exposed to competition. Operating costs should not be included  
19 in stranded costs.

20 Stranded costs should be calculated using the replacement cost  
21 valuation approach whereby stranded costs are estimated on an  
22 asset-by-asset basis taking the difference between net book value  
23 and current replacement cost. In the alternative, stranded costs  
24 should be determined using a hybrid of the replacement cost  
25 valuation combined with a net lost revenue approach if the  
26 Commission were to designate a limited transition period of 3-5  
27 years. The net lost revenue approach would be used to estimate  
28 year-to-year stranded costs. The replacement cost would provide  
an upper limit on the total stranded costs over the transition  
period.

29 ISSUE 3a: WHAT IS THE APPROPRIATE TREATMENT OF MARKET PRICE?

30 The appropriate treatment of market price should involve use of  
31 the retail price. This retail price will include a mark-up of  
32 the underlying wholesale price which will be a blend of the spot  
33 market and long-term prices.

34 ISSUE 3b: WHAT ARE THE IMPLICATIONS OF FAS 71?

35 The implications of FAS 71 are dependent on numerous factors,  
36 including the magnitude of stranded costs identified, the  
37 ameliorating effects of the phase-in, and the extent to which the  
38 utility anticipates it can successfully mitigate its stranded  
39 costs. In any event, accounting rules should not drive  
40 regulatory policy.

41 . . .

1 ISSUE 4: SHOULD THERE BE A LIMITATION ON THE TIME FRAME OVER  
2 WHICH STRANDED COSTS ARE CALCULATED?

3 This issue presumes that stranded costs will be calculated using  
4 annual data. It is AECC's position that a method that provides a  
5 total stranded cost estimate at the outset, such as replacement  
6 cost valuation, is preferred. However, if stranded costs are  
7 calculated using annual data, then the period subject to that  
8 calculation must be limited to no more than 3-5 years.

9 ISSUE 5: SHOULD THERE BE A LIMITATION ON THE RECOVERY TIME FRAME  
10 FOR STRANDED COSTS?

11 Yes. The transition period during which stranded costs can be  
12 recovered must be limited to 3-5 years.

13 ISSUE 6: WHO SHOULD PAY FOR STRANDED COSTS AND WHO, IF ANYONE,  
14 SHOULD BE EXCLUDED?

15 Transition charges for stranded costs may only be levied on  
16 purchases made in the competitive marketplace. Those not  
17 participating in competition will pay for stranded costs in their  
18 standard offer and special contract rates, respectively. The  
19 current rules indicate that no stranded cost changes are assigned  
20 to the reduction in energy purchasing associated with self-  
21 generation or demand-side management. This provision of the  
22 rules should be retained. Similarly, interruptible customers  
23 should not pay stranded costs as there are no stranded costs  
24 associated with interruptible service. Stranded costs should be  
25 allocated in a manner consistent with the specific Affected  
26 Utilities' current rate treatment of the stranded asset.

27 ISSUE 7: SHOULD THERE BE A TRUE-UP MECHANISM?

28 A "true-up" is not necessary if the recovery mechanism  
incorporates an equitable and efficient sharing of responsibility  
for stranded cost recovery. A true-up is only necessary to  
correct for deviations in expected market price, particularly if  
the net revenues lost approach is used.

ISSUE 8: SHOULD THERE BE A PRICE CAP OR RATE FREEZE?

Price caps are an essential component of a stranded cost recovery  
program. The objective of a price cap can be met by determining  
stranded costs on a year-to-year basis and requiring customers to  
pay only for stranded costs associated with that year. A price  
cap means that for any customer the sum of the transition charges  
plus delivery charges plus the market price of generation does  
not exceed the current rates for the customer. AECC does not  
support a price freeze.

...

...

28

1 ISSUE 9: WHAT FACTORS SHOULD BE CONSIDERED FOR MITIGATION?

2 The best mitigation incentive is for the utility to be at risk  
3 for a substantial portion of its stranded costs, and to be  
4 financially rewarded when its mitigation efforts are successful.  
5 This is accomplished by designing the transition charge to cover  
6 no more than 50 percent of stranded costs in a given year. Thus,  
7 the utilities are left to implement whatever mitigation actions  
8 they believe to be most effective.

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

27

28