



0000120782

MUNGER CHADWICK, RECEIVED
BY CORP COMMISSION

JOHN F. MUNGER
MARK E. CHADWICK
MICHAEL S. GREEN
JOAN L. JAKEL

ATTORNEYS AT LAW
A PROFESSIONAL LIMITED LIABILITY COMPANY
NATIONAL BANK PLAZA
333 NORTH WILMOT, SUITE 300
TUCSON, ARIZONA
(520) 721-1900
FAX (520) 747-1550

MAR 23 4 08 PM '98

OF COUNSEL
LAWRENCE V. ROBERTSON, JR.
ADMITTED TO PRACTICE IN:
ARIZONA, COLORADO, MONTANA,
NEVADA, TEXAS, WYOMING,
DISTRICT OF COLUMBIA

MICHAEL M. RACY
GOVERNMENT RELATIONS DIRECTOR
(NON-LAWYER)
DIRECT LINE: (520) 850-4646

PHOENIX APPOINTMENT ADDRESS:
5225 N. CENTRAL
SUITE 235
PHOENIX, ARIZONA 85012-1452
(602) 230-1850

OF COUNSEL
MILLER, LA SOTA AND PETERS, P.L.C.
PHOENIX, ARIZONA

OF COUNSEL
OGARRIO Y DIAZ ABOGADOS
MEXICO, D.F., MEXICO
(LICENSED SOLELY IN MEXICO)

DOCKET CONTROL

March 23, 1998

Docket Control Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Attn: Ms. Carmen Madrid
Docket Control

Re: Docket No. RE-00000C-94-0165
Competition in the Provision of Electric Services
Throughout the State of Arizona

Dear Ms. Madrid:

Enclosed are the original and ten copies of PG&E Energy Services Corporation's Reply Brief in the matter referenced above.

If you have any questions, please feel free to contact me at (520) 721-1900.

Sincerely,

Lawrence V. Robertson, Jr.

LVR: alk
Enclosures

Arizona Corporation Commission
DOCKETED
MAR 23 1998

DOCKETED BY

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 JIM IRVIN
3 COMMISSIONER – CHAIRMAN
4 RENZ D. JENNINGS
5 COMMISSIONER
6 CARL J. KUNASEK
7 COMMISSIONER

RECEIVED
AZ CORP COMMISSION

MAR 23 4 08 PM '98

DOCUMENT CONTROL

8 IN THE MATTER OF THE COMPETITION IN) DOCKET NO. RE-00000C-94-0165
9 THE PROVISION OF ELECTRIC SERVICES) REPLY BRIEF OF PG&E
10 THROUGHOUT THE STATE OF ARIZONA.) ENERGY SERVICES CORPORATION

11 **INTRODUCTION**

12 Pursuant to the Chief Hearing Officer's directive, PG&E Energy Services Corporation
13 ("Energy Services") hereby submits its Reply Brief in connection with the "stranded costs"
14 hearings recently concluded in the above-captioned proceeding. In its Reply Brief, Energy
15 Services will address certain of the matters discussed by various other hearing participants in their
16 respective Initial Briefs. The absence of any discussion as to other matters raised or argued by
17 other participants should not be construed as an assent thereto by Energy Services. Similar to
18 the format utilized in Energy Services' Initial Brief, the discussion set forth below will be
19 organized so as to address the issues discussed in the same sequence in which they were
20 identified in the Commission's December 1, 1997 Procedural Order and the December 11, 1997
21 First Amended Procedural Order.

22 **DISCUSSION**

23 Issue No. 3: What costs should be included as part of "stranded costs" and how should these costs be calculated?

24 Sub-Issue No. 3(A): What calculation methodology is recommended, and what assumptions are made including any determination of market price?

25 Answer: See discussion below.

26
27
28
MUNGER CHADWICK, P.L.C.
ATTORNEYS AT LAW
NATIONAL BANK PLAZA
333 NORTH WILMOT, SUITE 300
TUCSON, ARIZONA 85711
(520) 721-1900

MUNGER CHADWICK, P.L.C.
ATTORNEYS AT LAW
NATIONAL BANK PLAZA
333 NORTH WILMOT, SUITE 300
TUCSON, ARIZONA 85711
(520) 721-1900

DIVESTITURE

1
2 For the several reasons discussed in its Initial Brief, Energy Services is recommending a
3 stranded cost calculation and recovery procedure which contemplates divestiture and the use of
4 an auction procedure. [See Energy Services' Initial Brief, page 8, line 1 - page 9, line 18.]
5 Certain of the other hearing participants have registered their objections to this proposal, either
6 directly or indirectly, but their opposition is not well-founded.

7 First, Energy Services' proposal does not contemplate mandatory divestiture.¹ Rather,
8 an Affected Utility would have the option of retaining ownership of its electric generation
9 facilities and purchased power contracts. These would be accorded their present undepreciated
10 book value, and the Affected Utility would forego any claim for treatment of any portion of those
11 assets as "stranded costs." As noted in Energy Services' Initial Brief, the decision as to how to
12 proceed would be in the discretion of the management of the Affected Utility. In this regard, it
13 should be noted that the undepreciated book value option provides for recognition of the then
14 remaining value of the investment of the Affected Utility and its shareholders in the assets in
15 question. Thus, there would not be a confiscation or taking.

16 Second, Energy Services' proposal contemplates that all generation assets would be subject
17 to the prospect of divestiture for an Affected Utility selecting that option. Hence, there is no
18 basis for the criticism that this approach requires the time and effort necessary for making a
19 "bottom-up" determination of the value for each generation asset. Further, as discussed in the
20 testimony of its sponsoring witness (Douglas Oglesby), Energy Services' proposal provides a
21 valuation and recovery procedure in the situation where an Affected Utility is unable to dispose
22 of a generation asset (nuclear or non-nuclear) through auction or negotiated sale.

23 Third, contrary to the contentions of the Commission's Staff, the time necessary to set up
24 the appropriate procedures for conducting an auction need not delay the onset of competition
25

26
27 ¹ However, it should be noted that the Commission Staff has stated that "the Commission's
28 broad constitutional ratemaking and classification authority provide the Commission the necessary
ability to require divestiture." [See Commission Staff's Initial Brief, page 10, lines 12-16.]

1 beyond the currently scheduled January 1, 1999 commencement date. [See Commission Staff
2 Initial Brief, page 10, lines 2-4.] Auctions for a similar purpose have already been successfully
3 conducted in other jurisdictions, and constructive guidance for the Commission and Affected
4 Utilities is readily available by timely examination of those situations. Similarly, there would be
5 no occasion or need for a "fire sale" mentality or atmosphere. Moreover, as Ajo/Morenci/Phelps
6 Dodge witness Alan Rosenberg testified, it is possible to utilize a post-commencement date true-
7 up procedure to address any situations where the net auction proceeds were less than the
8 undepreciated book value of the generation assets in question. [See Tr. 2251, line 20 - Tr. 2259,
9 line 17.] In these circumstances, the potential for over-recovery would not exist, as contrasted
10 with the situation where a true-up is used in connection with an administratively determined cost
11 methodology.

12 Fourth, the fact that certain generation assets of Affected Utilities are either nuclear in
13 nature and/or the subject of a joint ownership arrangement need not preclude effective or timely
14 use of the auction procedure. As noted by Citizens in its Initial Brief,

15 "Capacity and energy from such a facility could be
16 sold on the open market under standard long-term
17 contracts. The total realized from the sales would
18 then be compared to the book value for the facility
19 to determine the stranded costs (positive or negative)
20 associated with the facility." [See Citizens Utilities
21 Company's Initial Brief, page 15, lines 17-21.]

22 In this regard, a variation on the post-commencement true-up procedure described by Dr.
23 Rosenberg could also conceivably be utilized to deal with such delays, if any, which might arise
24 from obtaining the necessary regulatory and private sector approvals.

25 Fifth, there is no basis in fact to support the contentions of the Commission's Staff to the
26 effect that:

27 ". . . even if divestiture helps to mitigate the
28 uneconomic costs by selling assets at greater than
book value, the purchasers will nevertheless need to
recover their costs of the assets through the rates
they charge its customers. . . Thus, while the
utility's uneconomic costs may be reduced, these
costs would simply have to be recovered by the new

MUNGER CHADWICK, P.L.C.
ATTORNEYS AT LAW
NATIONAL BANK PLAZA
333 NORTH WILMOT, SUITE 300
TUCSON, ARIZONA 85711
(520) 721-1900

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
27
28

owners." [See Commission Staff's Initial Brief, page 10 lines 4-9.] [Emphasis added.]

In reality, the matter is not that simple. Nor is the cause-effect relationship an automatic given, as the Commission's Staff endeavors to suggest. To the contrary, as Staff Witness Kenneth Rose conceded under cross-examination, the new owners would be subject to the pressures of the competitive marketplace as to the prices they could charge and the costs they could seek to recover for generation services. Thus, the consumers in question would actually receive two benefits under this set of circumstances: (i) a reduction in the Affected utility's "stranded costs" by reason of the above-book value sale of its generation assets; and (ii) the benefits of the competitive marketplace as to future prices for generation service.

Finally, there is no demonstrable basis for anticipating that auction sales of generation assets of Affected Utilities in Arizona would not produce the above-book value results experienced to date in other jurisdictions. As Energy Services' Witness Oglesby observed, the characteristics of those assets and the dynamic growth nature of the Arizona market are likely to provide them with certain intrinsic values unique to Arizona. In addition, as observed by Citizens in its discussion of the premiums paid for generation assets sold through auction in other jurisdictions,

"Part of the reason these premiums have been earned is linked to investors' expectations about profit potential inspired by the newness of the market opportunity. Coupled with a robust competitive bidding process, these expectations can contribute to higher prices in the auction process. Reports in industry periodicals suggest that divestiture will be good for utilities that undertake it in the near term. Arizona remains on the leading edge of industry restructuring nationwide." [See Citizens Utilities Company's Initial Brief, page 17, lines 13-18.]

Thus, Arizona is in a position to take advantage of these circumstances if the Commission acts promptly and adopts the auction approach to "stranded costs" valuation and recovery.

In summary, the reasons favoring adoption and use of a voluntary auction procedure for "stranded costs" calculation and recovery purposes far outweigh those submitted against it. As

1 previously noted, Energy Services has identified seven of those reasons in its Initial Brief. The
2 Initial Brief of Citizens includes three of those seven in connection with its proposal for use of
3 an auction procedure. [See Citizens Utilities Company's Initial Brief, page 16, line 4 - page 18,
4 line 23.] In addition, Citizens discusses a fourth reason in support of its proposal, which Energy
5 Services would also endorse.² That reason relates to "risk transfer", with respect to which
6 Citizens makes the following observation:

7 **"Risk transfer.** Bidders in the auction would base
8 their bids on what they believe future market prices
9 for power will be. By purchasing generation assets
10 or contracts, successful bidders would assume price
11 forecasting risk, and in particular, the risk that future
12 power prices would be lower than projected. By
13 contrast, under administrative approaches that
14 employ true-up mechanisms, customers would bear
15 the risks of under-forecasting future prices, and pay
16 the differences between established stranded charges
17 and the actual amount of above-market costs on a
18 forward-going basis." [See Citizens Utilities
19 Company's Initial Brief, page 16 lines 11-17.]

20 "NET REVENUES LOST" APPROACH

21 In its Initial Brief, Energy Services discussed several reasons why it is firmly opposed to
22 the use of (i) administrative cost determination methodologies in general and (ii) the "net
23 revenues lost" procedure in particular in conjunction with the calculation and recovery of
24 "stranded costs". [See Energy Services' Initial Brief, page 9, line 19 - page 10, line 18.] Other
25 participants expressed their opposition in even stronger terms in their Initial Briefs. For example,
26 one participant, representing both Affected Utility and industrial consumer perspectives, made the
27 following cogent observation:

28 "Of all the administrative approaches to estimation
of strandable costs, the net revenues lost is clearly

² Also, the Initial Brief of the Electric Competition Coalition, Enron Corporation and Enron Energy Services, Inc. ["EEC/Enron"] contains a summary description, by participant and witness, of the degree to which and the circumstances under which those identified do or could support divestiture as a calculation and recovery procedure. [See EEC/Enron Initial Brief, page 6, line 23- page 13, line 3.]

1 the most one-sided in favor of the utilities. This
2 type of approach should clearly be avoided.
3 Otherwise the stranded cost charge will be too high
4 and will have to be recovered over [too long] a
5 period of time and will adversely affect the
6 emergence of competition." [See Ajo Improvement
7 Company/Morenci Water and Electric
8 Company/Phelps Dodge Corporations' Initial Brief,
9 page 15, lines 13-18.]

10 An equally harsh assessment was expressed by the Commission's Staff in connection with its
11 discussion of the attempt by certain major Affected Utilities to advance a methodology for
12 guaranteeing recovery of uneconomic costs:

13 "The utilities do not explain why stranded costs
14 should be granted a higher assurance of recovery in
15 the transition to a competitive market than those
16 same costs would have enjoyed under continued
17 regulation. Lip service is paid to the notion that
18 what the utilities seek is the opportunity to recover
19 stranded costs, but that lip service is belied by the
20 proposals presented. Implementation of a net lost
21 revenues approach, for purposes of determining cost
22 recovery, as presented by APS and TEP, necessitates
23 the leap of faith of assuming that it is possible to
24 determine what revenues would have occurred under
25 the continuation of regulation. And while a true-up
26 mechanism has the comforting attribute of
27 minimizing the risk of over-recovery, it acts as a
28 guarantee of recovery, the likes of which does not
even occur under traditional regulation." [See
Commission Staff's Initial Brief, page 23, lines 20-
28.] [Emphasis in original.]³

In light of these criticisms, it is clearly evident that use of the "net revenues lost" methodology

³ Two additional observations are in order in connection with the Commission Staff's comment on "guarantee of recovery." First, there is a need to reduce the return on equity on generation to be allowed under any "stranded costs" recovery method which may be adopted. That is because the return on equity originally determined in an earlier rate proceeding involving the Affected Utility in question assumed a higher risk as to the prospect of recovery of the underlying capital than will in fact be the case under the "stranded costs" procedure. [See Energy Services' Initial Brief, page 10, lines 10-11; and Footnote Number 5.] Second, the higher the guarantee of recovery under a given methodology, when coupled with the use of a true-up, the lower the return level which should be authorized. For example, if the assurance of recovery is effectively 100%, the return on equity allowed on generation should not be any higher than the 30-year Treasury Bill rate.

1 for calculation and recovery purposes would not provide for that balancing of retail electric
2 customer, Affected Utility and new market entrant interests, respectively, which the Commission
3 should seek in conjunction with the development of a "stranded costs" recovery procedure. [See,
4 in this regard, Energy Services' Initial Brief, page 6, line 4 - page 7, line 27.]

5 Additional criticisms noted in the Initial Briefs of other hearing participants include the
6 following. First, by its very nature and design, the "net revenues lost" methodology contains the
7 potential for overstating stranded costs. The resulting recovery charge, in turn, can create market
8 entry problems for new competition. While a true-up mechanism can be designed to address the
9 problem of over-recovery prospectively, it cannot compensate for the barriers to market entry
10 which have previously been experienced.

11 Second, as contrasted with divestiture, which reflects actual market place values, the "net
12 revenues lost" methodology places heavy reliance upon long-term forecasts of market prices and
13 generation costs. By their very nature, these are subject to the possibility of error. Depending
14 upon the number, type and magnitude of such error(s), the resulting adverse affects can be
15 substantial for customers and competitors of the Affected Utility in question.

16 Third, the "net revenues lost" approach also requires the use of an economic model.
17 Despite the best of intentions, these models are subject to the prospect of manipulation and
18 misuse, not to mention inadvertent error. Depending upon the circumstances, the resulting
19 distortions can be significant.

20 Fourth, the "net revenues lost" methodology is predicated upon a determination of what
21 the utility's net revenues would have been had it continued to operate in a regulated monopoly
22 environment. However, the purpose of the exercise is to calculate the difference between the
23 book value of generation assets and their market value resulting from competition. The former
24 in effect assumes the continuation of "business as usual." The latter recognizes that is precisely
25 not the case. Thus, there is a serious "conceptual disconnection" between the methodology and
26 the intended result.

27 Finally, the methodology is predicated upon a frozen or static "moment in time."
28

1 Generally speaking, the parameters of that moment are the assumptions made as to forecasted
2 market prices, generation costs, and, perhaps, system load growth. The spatial length or duration
3 is the period of projection selected. As a consequence, there is no provision for reflecting the
4 effects of changes in society, technology or the economy during the intervening months and years
5 as they occur. Any attempt at reconciliation occurs only after the fact, and at the risk of being
6 ineffective or incomplete as to all who may have been affected by the intervening changes.

7 In light of the foregoing considerations, as well as the criticisms raised in Energy
8 Services' Initial Brief, it is apparent the "net revenues lost" methodology is not appropriate for
9 use for the purpose of "stranded costs" calculation and recovery. Indeed, the Commission's Staff
10 conceded as much as it endeavored to distinguish its recommended "transition revenues" approach
11 from that of the "net revenues lost" advocates:

12 "It is important to recognize the distinction between
13 the adoption of a method to calculate stranded costs
14 and the consideration of a method of recovery.
15 Staff's proposed "top-down" calculation
16 methodology is very similar to the calculation
17 methodology suggested by parties sponsoring a "net
18 revenues lost" approach to stranded cost recovery.
19 Stranded cost calculations under Staff's proposal
20 would suffer the same types of infirmities as the
21 calculations made to support a net revenues lost
22 approach. The difference is that Staff's approach
23 does not rely on the calculation of uneconomic costs
24 as a mechanism to establish recovery levels. The
25 recovery levels are solely determined by reference to
26 Commission established criteria to meet financial or
27 other requirements. Accordingly, the stranded cost
28 calculations are only a "reference point", useful as a
general guide for considering a utility's competitive
situation, but not directly related to stranded cost
recovery levels." [See Commission Staff's Initial
Brief, page 25, lines 3-13.] [Emphasis added]

ARIZONA PUBLIC SERVICE COMPANY'S PROPOSED METHODOLOGY

Arizona Public Service Company ("APS") also endeavored to distinguish the methodology
proposed by it from the more traditional "net revenues lost" approach. In advocating adoption
of its approach, APS made the following statements in its Initial Brief:

1 ". . . the APS proposal avoids the forecasting errors
2 and contentious speculation inherent in other
3 applications of the net revenues lost method. . ."
4 [See APS's Initial Brief, page 6 lines 23-25.]

* * *

5 "The most significant problem with other generic net
6 lost revenues approaches is that they attempt to
7 calculate stranded costs over the remaining life of
8 the generation assets (which could be decades) and
9 involve inevitable and likely significant forecasting
10 errors, both with regard to the market price of
11 generation and future cost of generation." [See
12 APS's Initial Brief, page 7, lines 19-25.]

13 However, the company "doth protest too much," for its proposed methodology is also subject to
14 some of the same criticisms as the more conventional "net revenues lost" approach. In addition,
15 it warrants some on its own.

16 More specifically, like the "net revenues lost" approach, APS's proposed methodology
17 adopts a "business as usual" perspective for the intended eight-year period of operation. Thus,
18 it is subject to the previously discussed flaws of (i) a "conceptual disconnection" as between the
19 recovery methodology and its intended purpose, and (ii) the lack of any incentive to reduce
20 generation costs. To the contrary, it would allow APS to recover through prospective annual
21 Stranded Cost Recovery Charge ("SCRC") adjustments revenues intended to reimburse it for the
22 preceding year's costs as incurred. As Citizens has observed, the effect of this would be to
23 "allow APS to recover all above-market costs between now and the year 2006 and then keep all
24 below-market costs [savings] after that date." [See Citizens Utilities Company's Initial Brief,
25 page 19, lines 14-17.]

26 Assuming that APS's embedded generation cost continues to decline and market prices
27 reach long-run marginal cost by 2006, APS would then be in a position to effectively deter any
28 new market entrants from entering its service area after that date. In the interim, APS would
29 have effectively been insulated from competition by virtue of the fact that any generation
30 customers leaving its system would have had to pay APS an SCRC for their allocable share of
31 its "stranded costs."

1 In addition, as APS Witness Jack Davis acknowledged during cross-examination, by
2 reason of its use of historic data, APS's proposed methodology has a lag of one year in terms of
3 reflecting in the calculation of the SCRC what is actually occurring. [See Tr. 3741, lines 9-15.]
4 Thus, if the market price of power is steadily increasing with the passage of time, and APS's
5 generation costs are steadily declining during that same period, by reason of the use of historic
6 data for the annual SCRC adjustment, APS could actually collect more "stranded costs" revenues
7 than the differential it is actually experiencing in a given year. Hence, APS's proposal appears
8 to be designed to provide it with an advantage over prospective new market entrants both during
9 and after its suggested eight-year transition period. Surely this is not a result the Commission
10 would knowingly sanction incident to the development and approval of a "stranded costs"
11 recovery procedure, particularly where the effect would be to inhibit the emergence of a
12 competitive market at the expense of APS's distribution customers!

13 Furthermore, by including only generation related costs, APS methodology effectively
14 eliminates from consideration any opportunities for mitigation which might exist by reason of cost
15 savings in the distribution sector.

16 Finally, APS's proposal creates an additional problem for prospective new market entrants.
17 The eight-year transition period makes it virtually impossible for new entrants to sign existing
18 APS customers to new long-term contracts, given the uncertainty as to SCRC levels due to annual
19 adjustments based on retrospective analysis of data. Under these circumstances, an APS
20 competitor cannot intelligently offer a fixed total delivered price for any meaningful period of
21 time. In this regard, it is Energy Services' general position that any "stranded cost" recovery
22 period should be on the order of a three (3) to five (5) year time frame, regardless of the
23 calculation and recovery methodology selected.

24
25 **COMMISSION STAFF'S "TRANSITION REVENUES" PROPOSAL**

26 The Commission Staff's "transition revenues" proposal does not provide a neat conceptual
27 fit under the analytical framework established in the Procedural Order and the First Amended
28

1 Procedural Order. To quote the Commission's Staff,

2 "The reason is simple. The transition revenues
3 approach does not require the Commission to make
4 any determination about recoverability of
5 uneconomic costs. The Commission does not
6 conclude that such costs are recoverable, or are not
7 recoverable, or what percentage of such costs are
8 recoverable." [See Commission Staff's Initial Brief,
9 page 7, lines 1-4.]

10 Energy Services' decision to address the Commission Staff's proposal under Issue No. 3(A) is
11 thus admittedly arbitrary. For the reason indicated in the preceding quotation, Energy Services'
12 discussion will also necessarily be brief.

13 More specifically, because the "transition revenues" approach is generic in nature and
14 contemplates further rulemaking proceedings incident to the development of the contemplated
15 "Commission - defined criteria," Energy Services is not in a position at this time to determine
16 its potential effect upon (i) the emergence of a competitive market in the provision of electric
17 generation service or (ii) the ability of new entrants to effectively compete with incumbent
18 Affected Utilities. Rather, Energy Services would need to know more detail, which currently
19 does not exist, in order to offer informed comment.

20 However, at a minimum, Energy Services strongly recommends that the Commission not
21 consider adoption of the "transition revenues" approach if use of the same would delay the
22 commencement of competition in the Arizona retail electric market beyond January 1, 1999. In
23 addition, Energy Services urges that any consideration of that approach include an examination
24 of the possible effects of the same upon the ability of new market entrants to effectively compete.

25 Issue No. 7: Should there be a true-up mechanism and, if so, how would it operate?

26 Answer: See discussion below.

27 Following consideration of the Initial Briefs filed by other hearing participants, Energy
28 Services desires to supplement the response set forth in its Initial Brief. [See Energy Services'
Initial Brief, page 12, line 16 - page 13, line 5.] More specifically, Energy Services believes that

MUNGER CHADWICK, P.L.C.
ATTORNEYS AT LAW
NATIONAL BANK PLAZA
333 NORTH WILMOT, SUITE 300
TUCSON, ARIZONA 85711
(520) 721-1900

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
27
28

a true-up mechanism should not be allowed to provide affected utilities a guaranteed recovery of those "stranded costs" identified as appropriate for recovery. As various Affected Utility witnesses acknowledged while testifying, and as the Commission Staff and Energy Services' Initial Briefs have noted, Affected Utilities are entitled to an opportunity to endeavor to recover such costs, but not a guarantee of recovery. [See Commission Staff's Initial Brief, page 23, lines 20-28; and Energy Services' Initial Brief, page 1, line 25 - page 2, line 10.]

CONCLUSION

For all of the reasons discussed in its Initial Brief and this Reply Brief, Energy Services believes that the Commission should issue an opinion and order (i) adopting the "stranded costs" calculation and recovery proposal submitted by Energy Services, (ii) clarifying and modifying its Electric Competition Rules in the manner recommended by Energy Services, and (iii) taking such additional actions as may be necessary to preserve the January 1, 1999 date for the commencement of retail electric competition in Arizona.

DATED: March 23, 1998

Respectfully submitted,



Lawrence V. Robertson, Jr.
MUNGER CHADWICK, P.L.C.
National Bank Plaza
333 North Wilmot, Suite 300
Tucson, Arizona 85711
Attorney for PG&E Energy Services Corporation

Certificate of Service

I hereby certify that I have this 23rd day of March, 1998, served the foregoing Reply Brief on the following parties or counsel of record in this proceeding who filed Initial Briefs, by mailing a copy thereof, properly addressed with first class postage prepaid to:

Betty Pruitt
Arizona Community Action Assoc.
202 E. McDowell Road, Suite 255
Phoenix, AZ 85004-4535

Bradley Carroll
Tucson Electric Power Company
Post Office Box 711
Tucson, AZ 85702

Craig Marks
Citizens Utilities Company
2901 N. Central Ave., Ste. 1660
Phoenix, AZ 85012

C. Webb Crockett
Fennemore Craig
3003 N. Central Ave., Ste. 2600
Phoenix, AZ 85012-2913

Robert S. Lynch
340 East Palm Lane, Suite 140
Phoenix, AZ 85004-4529

Paul Bullis, Chief Counsel
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

Albert Sterman
Arizona Consumers Council
2849 East 8th Street
Tucson, AZ 85716

Michael Grant
Gallagher & Kennedy
2600 North Central Avenue
Phoenix, AZ 85004

Suzanne Dallimore
Attorney General's Office
1275 West Washington Street
Phoenix, AZ 85007

Lex Smith/Michael Patten
Brown & Bain PC
2901 North Central Avenue
Phoenix, AZ 85001-0400

Steve Wheeler/Thomas M. Mumaw
Snell & Wilmer
One Arizona Center
400 East Van Buren Street
Phoenix, AZ 85004-0001

William Sullivan
Martinez & Curtis PC
2716 North 7th Street
Phoenix, AZ 85006

Douglas Nelson
Douglas C. Nelson PC
7000 N. 16th St., Suite 120-307
Phoenix, AZ 85020

Barbara Klemstine
Arizona Public Service Company
Law Department, Station 9909
Post Office Box 53999
Phoenix, AZ 85072-3999

Teena Ingram Wolfe
RUCO
2828 North Central Avenue,
Suite 1200
Phoenix, AZ 85004

Walter W. Meek
Arizona Utility Investors
Association
2100 North Central Avenue,
Suite 210
Phoenix, AZ 85004

Rick Gilliam
Land and Water Fund of the
Rockies
2260 Baseline Road, Suite 200
Boulder, CO 80302

Norman J. Furuta
Department of the Navy
900 Commodore Drive, Building
107
San Bruno, CA 94066-5006

Barbara Sherman
120 East McKellips Road
Tempe, AZ 85281

Loretta Humphrey
Principal City Attorney
Post Office Box 27210
Tucson, AZ 85726-7210

By: Lawrence V. Robertson, Jr.
Lawrence V. Robertson, Jr.