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# EXCEPTION

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May 14, 1998

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Associate General Counsel

Mr. Ray Williamson  
Director, Utilities Division  
Arizona Corporation Commission  
1200 W. Washington  
Phoenix, AZ 85004

Arizona Corporation Commission  
**DOCKETED**

MAY 14 1998

**RE: Staff's Proposal for Electric Restructuring**  
**Docket No.: U-00000-94-0165**

DOCKETED BY

Dear Mr. Williamson:

Citizens Utilities appreciates the opportunity to attend last week's meeting where a new proposed plan for electric restructuring was discussed. The proposal appears to be a comprehensive plan for the restructuring of the electric industry, and included a recommended approach for stranded cost recovery. Although Mr. Rose, the Commission's Executive Secretary, introduced the plan, it is our understanding that this is Staff's proposal. Citizens recognizes that a settlement of electric restructuring issues would be an effective way to bring competition to Arizona, and acknowledges the efforts Staff has made to initiate settlement discussions.

However, Citizens believes that there are a number of unresolved issues that must be an integral part of any settlement agreement. The Staff's proposal is ambiguous and/or incomplete in several respects, including the type of stranded cost charges to be used, the manner in which it will be computed, and the duration during which it will be imposed. These and other issues must be resolved, as they are critical elements of any electric restructuring plan. Citizens' specific concerns are outlined below.

## **Stranded Cost Issues**

With respect to the issue of stranded cost recovery, the Staff's proposal creates significant doubt about the Affected Utilities' ability to continue to apply Statement of Financial Accounting Standards ("SFAS") No. 71. The level of assurance of future recovery required for continuing application of SFAS No. 71 simply does not exist under the proposal. Clearly, the option under which utilities would be required to absorb 50% of stranded costs will trigger the write-off of all regulatory assets, and any assets impaired under the criteria of SFAS No. 121.

In addition, Citizens has a number of questions about the Staff's proposal related to stranded cost identification, quantification, and recovery:

- How will "stranded cost" be defined under the Staff proposal?
- How will regulatory assets be treated?
- Will there be any provisions for "stranded employees"?
- How will the local distribution company ("LDC") transition costs, such as handling new supply and demand transactions, be treated?
- Does the divestiture option require that generation needed for local system support ("must-run" generation) be divested, or can such units remain within the regulated LDC?
- Will LDCs be allowed to offer metering and billing services at regulated prices without structurally separating these services?
- What guidance will be provided on forecasting market-clearing prices for utilities opting for the new revenues lost approach?
- For utilities opting for divestiture, how will firm system power contracts with others be handled, particularly system power contracts? Will a "slice" of a system power contract be sold with each unit?
- How will stranded costs be allocated among rate classes?
- Which customers will be required to pay stranded costs?
- Will "exit fees" be allowed as a means to "buy-out" stranded costs?
- How will the stranded cost recovery mechanism work?
- What is the period over which stranded costs would be recoverable?

### ***Rate Freeze Issues***

The Staff proposal appears to include requirements that the Affected Utilities freeze rates and/or lower rates by 10-15%. Citizens has concerns regarding these provisions. As a non-generating utility, Citizens will realize no savings or increased profitability attributable to the deregulation of electric generation in the State of Arizona. The Company obtains, and passes through to ratepayers with no markup, Purchased Power and related costs under contracts approved by both the Federal Energy Regulatory Commission and the Arizona Corporation Commission with no profit being achieved by Citizens from its generation activity. There exists no enhanced revenue source or expected cost reductions from which customer rate reductions may be derived.

Moreover, this company is facing substantial required improvements and upgrades to its electric transmission and distribution delivery system, to enhance system safety and reliability and enable customers to obtain power from competitive sources. The magnitude of these projects will undoubtedly result in the company filing for future rate increases, some of which may be substantial.

## ***Divestiture Requirement***

Citizens is opposed to the requirement that all competitive services must be conducted from a fully separate subsidiary, as proposed by Staff. The only affected assets that Citizens has are an insignificant investment in a peaking generation unit and its inventory of metering and billing equipment. Notwithstanding our opposition to considering metering and billing as competitive services at this time, we are opposed to divestiture because the cost of creating a separate entity and the related asset transformation far exceeds any potential benefits to be derived therefrom.

## ***Pilot Program***

Citizens opposes the required introduction of residential pilot programs. As evidenced in New Hampshire and Illinois, where residential pilots have been attempted, the results can be inconclusive or even misleading. Such programs of limited duration frequently produce unrealistic prices or marketing gimmicks that are either misleading to consumers or unsustainable in the long run.

## ***Legal Issues***

Citizens' fundamental concern with the Staff's proposal is the assertion that Staff intended to have the Hearing Officer's Recommended Order in the stranded cost proceeding "pulled", with Staff's recommendation substituted for that order. Citizens believes that such action would violate the fundamental principles of due process. In February of this year, a stranded cost evidentiary hearing was held. That hearing lasted weeks and dozens of witnesses testified regarding the issues of stranded costs. The Hearing Officer's Recommended Order was based upon the evidence and testimony presented in that hearing. If this Commission were to allow Staff to interfere with the process that is already in place, it would be a clear abuse of process. Instead, Staff, as a party in the stranded cost proceeding, should be limited to presenting its exceptions to the Recommended Order, as all of the other parties are.

In addition, Citizens has concerns regarding ex-parte communications with Commissioners. At last week's meeting, the Executive Secretary presented Staff's proposal and indicated that all the Commissioners supported Staff's new proposal. From those remarks, Citizens has inferred that the Commissioners must have had either written or oral communication regarding this proposal. The Commission's rules prohibit "communication ... concerning the substantive merits of a contested proceeding to a Commissioner or Commission employee involved in the decision-making process for that proceeding."<sup>1</sup> On the other hand, the rules also specifically state that the ex parte rules do not apply to rule making proceedings.<sup>2</sup>

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<sup>1</sup> A.A.C. R14-3-113(C)(1)

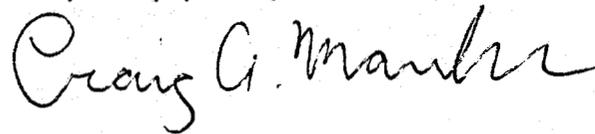
<sup>2</sup> A.A.C. R14-3-113(B)

The proceedings in this matter have been unique. The Electric Competition Rules docket was reopened, yet the hearing addressing stranded cost was clearly an evidentiary hearing, with all the attributes of being a "contested matter". Witnesses were cross-examined, evidence was introduced into the record, and briefs were filed regarding specific legal issues. As a "contested matters", the ex-parte rules would have applied from the time the matter was set for hearing.<sup>3</sup> Under those circumstances, any communications with the Commissioners would be inappropriate as they are the final decision-makers in this matter.

If the Commission views the stranded cost hearing as simply part of the rulemaking process, Citizens believes that Commission should notify the parties of that position. If it is proper, Citizens would like to have the opportunity to discuss it's position regarding electric restructuring issues with the Commissioners. Other parties would probably like to have the same opportunity.

In closing, Citizens supports retail competition and believes that a settlement of these issues would move Arizona closer to the implementation of a competitive market. I would be happy to discuss these issues with you further. Please feel free to give me a call at 532-4433, at your convenience.

Very truly yours,



cc Docket Control Division  
Jerry Rudibaugh  
Paul Bullis  
Ray Williamson  
All parties of record

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<sup>3</sup> *Id.*