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**Arizona Corporation Commission, May 26, 1998
DOCKETED**

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

MAY 26 1998

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MAY 26 1998

DOCKETED BY *[Signature]*

**Re: Preliminary Response of Citizens Utilities Company
To Staff's Second Proposal for Electric Restructuring
Docket No. U-00000-94-0165**

Dear Mr. Williamson:

Thank you for providing Citizens Utilities with a copy of the Commission Staff's Statement of Position. You have requested that the stakeholders in retail electric competition provide Staff with feedback regarding its position by noon today. Citizens received your position statement by fax on the afternoon of May 19th, which did not allow the company the time to do an in-depth review of Staff's position. Therefore, please consider these to be Citizens' initial and cursory comments; the Company will provide more extensive comments as the Commission moves forward with this process.

Citizens expects that it will have full opportunity to address the issues raised by Staff's position through the rulemaking process required by state law. You have noted that the "implementation of most of [Staff's] positions will require revisions to the current rules".¹ Citizens agrees that the Staff Statement of Position proposes substantial revisions to the Commission's Retail Competition Rules.² The Staff's Statement of Position includes proposals that have a sweeping impact on numerous aspects of the current rules, and raise fundamental questions about the scope of the Commission's jurisdiction and the legal rights of the Affected Utilities. Staff's Statement of Position represents substantial and dramatic changes to the current rules. These proposed changes mandate that the stakeholders and the public have full opportunity to participate in the rulemaking process, pursuant to the Arizona Administrative Procedure Act³.

As Citizens pointed out in its response to Staff's Proposal, which it filed with the Commission on May 14, 1998, there are a number of critical elements that are not

¹ Staff's Statement of Position, p. 1.
² AAC R14-2-1601 - R14-2-1616.
³ A.R.S. sec. 41-1001 - 41-1084.

addressed in Staff's Statement of Position. Citizens has concerns regarding the following issues:

A. *Stranded Cost*

Citizens agrees with the Staff's interpretations of the goals of the Arizona Corporation Commission. Unfortunately, much of Staff's Statement needs to be clarified, rethought, or completely changed in order to carry out these goals.

1. The provision that prohibits Affected Utilities or their affiliates from purchasing generation assets at any divestiture auction of any Affected Utility is an unnecessarily severe restriction and may be unconstitutional as well. If the auction is properly established and administered, there should be no reason why a non-regulated affiliate of an Affected Utility could not bid on its affiliated company's generation resources or the resources of any other Affected Utility. Further, why shouldn't APS or an APS affiliate created to own generation assets of APS be allowed to bid on Citizens' "generation?" What purpose would this serve, other than to reduce the number of qualified bidders and perhaps reduce the amount of the winning bid? This restriction should be removed.
2. There appears to be an inconsistency regarding treatment of non-divested resources. In this section Staff basically says that an Affected Utility is required to spin-off generation assets that it chooses not to divest, unless it can show that it is "not practical and not in the public interest" to do so. In this case the generation assets would be transferred to a separate corporate affiliate at a value to be determined by the Commission. For the retained assets, the Commission would provide "transition revenues, if necessary, to preserve financial integrity." Later, at the end of the document, the Staff states: "The Commission shall determine which generation units are must-run units for distribution reliability and mitigation of market power, and will regulate the price of power from such units." How could the Commission allow less than an opportunity to earn a reasonable return on and of invested capital in such facilities, if the public interest supports the utility retaining the assets?
3. If generation is being used largely for providing standard offer service at regulated prices, it should not need to be spun-off. Moreover, it should be made clear that only "non-essential" (to use Mr. Rudibaugh's phrase) generation would be spun off. In Citizens' case, the APS contract would be essential because it would support Standard Offer services and the Nogales facilities would also be essential because they support area reliability as part of our transmission (or distribution) charges.

4. It is unclear what the Staff means by the statement: "Any mechanism used for the recovery of stranded cost shall be competitively neutral." There was a misconception floating around during recent hearing that stranded cost recovery would somehow give incumbents an unfair advantage. Yet, there was no compelling evidence proffered that any of the recovery mechanisms, other than APS' pseudo net-revenues-lost-method, would create such an advantage. Staff should clarify what it means by this statement.
5. What is the definition of "Special Contract Customers?" Why are "special contract" customers exempt from stranded cost recovery or transition charges? These customers are just as responsible as residential customers for the investments that Affected Utilities have historically made to serve them. Does the Staff propose that standard offer customers (largely residential) absorb these costs or that Affected Utilities eat them? This requirement would also appear to particularly disadvantage Affected Utilities that largely rely upon purchased power contracts.
6. The Staff Statement says that the Commission "shall determine appropriate stranded cost recovery mechanisms and recovery periods." How is this to be done? Over the last three years, the Commission has asked for comments, conducted a formal rule-making, held workshops and has overseen contested-case proceedings, all without answering this fundamental question. It seems rather cavalier to just assume that this question will soon be answered.
7. **General questions concerning stranded cost recovery:** In many cases, the Staff Statement raises more questions than it answers. For example:
 - a. Are the stranded costs resulting from deregulation of metering and billing recoverable? If so, how?
 - b. What constitutes "good cause" to obtain Commission waiver of the divestiture requirement?
 - c. How would generation assets be divested -- by private solicitation, auction, sale to state agency, etc?
 - d. The Staff Statement says that stranded benefits should be used to offset regulatory assets. What does Staff mean by "stranded benefits?" Are these regulatory liabilities, deferred tax reserves or something different? Also, what happens with stranded liabilities and unrecorded regulatory assets?

- e. Would the Commission continue to regulate any affiliates to which generation is transferred? If so, how?
- f. How would releases and approvals be obtained from bond-holders, partners, lessors and regulatory agencies such as the Nuclear Regulatory Commission? If the releases could not be obtained, would the utility be denied stranded-cost recovery?

B. *Affiliate Rules*

- 1. Why should "costs associated with restructuring the affected utility into separate corporate affiliates be borne by the shareholders", particularly if this transfer is required by the Commission for any assets that are not divested?
- 2. This section states that "Affected Utilities [must] create separate corporate affiliates for competitive activities and monopoly activities." This would rule out Affected Utilities from providing metering and billing at regulated prices to its LDC customers. If metering and billing prices are regulated by the Commission, while customers are free to choose alternative suppliers, there should be no problem with the LDC's providing metering and billing services. Allowing them to continue to provide such services would also avoid some difficult transition issues that would have to be resolved if other companies were to provide such services. It seems counterproductive to force customers to wait for competition while these logistics are worked out.
- 3. Are G&T cooperatives required to restructure their operations and, if so, who bears the cost since there are no stockholders? If G&T cooperatives are not required to restructure their operations, how can the Commission achieve its stated goal of ensuring fair and reasonable treatment of all consumers?
- 4. Concerning the comment that cost sharing between a utility and its affiliate is forbidden, what about joint costs of a parent company that benefit a number of subsidiaries? This is an issue for Citizens, APS and TEP.

C. *Implementation of Competition*

- 1. What are the "benefits in lieu of competition to customers without direct access" to which Staff refers?
- 2. Timing and Customer Selection. Staff recommends that all customers with a load of 1 MW or more have access to competitive electric power service on 1/1/99. What is the basis of the 1 MW load level? The only rationale Citizens is aware of for 1 MW is that it is the smallest increment that can be scheduled and

tracked by control area operators. Just because 1 MW is used by control areas does not mean it is a reasonable level at which to begin open access. Citizens expects that there are very few schedules in the 1 MW range that are being handled by control areas today. The volume of transactions at the 1 MW level resulting from the transition to competition may overwhelm the control area operators because the systems, processes and people will not be in place by 1/1/99 to handle them. A higher load level may be prudent to allow time to develop the needed systems and trained staff.

2. Targeted Rate Decreases. Citizens continues to vigorously oppose arbitrary, non-cost-based, mandatory rate reductions. These would be totally inconsistent with Staff's goal to "provide Affected Utilities an opportunity for full recovery of stranded cost." To espouse full recovery, while requiring a three to five percent rate roll-back from Commission-approved, cost-based rates, is disingenuous.

As Citizens has previously stated, because it is a non-generating utility, it will realize no savings or increased profitability attributable to the deregulation of electric generation in the State of Arizona. Citizens 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, Citizens 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.

3. Residential Phase - In Program. Are the costs associated with administering the residential phase-in to be recovered in rates to those who choose competitive suppliers? What is the base from which the number of eligible customers are to be calculated? How will participants be selected?

D. *Metering and Billing*

Metering

1. How is metering accuracy to be verified?
2. How are the safety and reliability of meter installations to be assured?

3. How is the format for universal node identifiers, competitive meter equipment specifications, and minimum meter data requirements for the EDI file format to be established and maintained? These are worthy goals to explore, but should be left to the industry to work out versus being mandated in form and timeline by Commission rules. If the Commission were to mandate these targets, the following additional questions would have to be answered:
 - a. Who would be responsible for establishing, maintaining and publishing such standards?
 - b. Will they be published in time for implementation on 1/1/99?
 - c. What are the requirements for meter data to be provided from ESPs or their agents to the Affected Utility that provides local distribution service?
 - d. How will the transition costs associated with moving to these standards be recovered?

Billing

1. Staff maintains that disconnects and reconnects should be "coordinated by the Affected Utility." This language is too weak to assure the safety and reliability of the distribution system. The requirement should be that the operator of the LDC is the **only** entity allowed to perform connects or disconnects of customer service equipment. This requirement would apply to both metering equipment, service drops and service entrance equipment.
2. Staff asserts that customer specific billing data only be released to parties to whom customers have given authorization. How is the LDC supposed to complete its billing or verify billing accuracy for use of its distribution system if the customer can refuse to authorize release of billing data? Does this imply that duplicate meters may be required to protect the interests of the LDC and the associated costs recovered in rates?
3. Can or should the LDC discontinue service to a customer if the customer has not paid its bill to a competitive supplier?
4. Should there be a charge to the customer from the LDC each time the customer changes suppliers? How much?
5. How will these additional costs be recovered from customers?

E. *Local Distribution Company Service*

1. LDCs should be allowed to make spot market purchases instead of longer-term contracts to supply Standard Offer service after the transition period. It would be silly to tie LDC's hands to long-term contracts if spot-market purchases make sense for customers.
2. The transition period is undefined, as well as what triggers the start and end of the period.
3. If power purchases are made under competitive bid, it would make no sense to regulate the cost of power portion of the LDC's charges.
4. What are the rules for the competitive bid process?
5. What are the costs associated with being the provider of last resort that will be recoverable?
6. What type of reporting/approval process will be used for the systems benefit charge?

F. *Transmission and Dispatch:*

1. Staff would lump "distribution" in with the subject of Transmission and Dispatch. Distribution systems are principally radial in nature, owned by only one company (the LDC) and are not subject to the same operating problems or opportunities as interconnected transmission systems. While Citizens does not object to providing equal access to existing distribution systems serving existing customers, it does object to including distribution in the same "pot" as Transmission and Dispatch. Distribution should be handled separately, and by the LDC. This would also avoid conflicts with the FERC.
2. Staff would require the establishment of an Independent System Operator (ISO) and an interim Independent System Administrator (ISA). However, the need, cost or benefits of an ISO or an ISA have not been determined or articulated. The only justification of an ISA is a perceived need by power marketers and new market entrants for a local safety valve to replace FERC. Their arguments seem to be principally that FERC is too slow and a local entity will address complaints more quickly. If so, the proper venue is the FERC. Hasty Commission involvement in this area will only result in jurisdictional showdowns that would be in no party's best interest.

3. Citizens has criticized the Staff Statement for being vague in areas where more guidance is sorely needed. Here, the detailed specifications for the ISO an ISA are premature and serve no purpose. Arizona electric customers have enjoyed the benefit of safe, reliable, sufficient electric service for many years. This status would be threatened by a stampede to establish an ISA by the end of this year. There is simply not enough time to ask the hard questions and develop the reasoned answers needed to support an ISO or even an ISA on this schedule. Further, this process can not be "top down" from the Commission. The utilities must be allowed to participate in setting the detailed parameters for the ISA or ISO. The Commission's role should be to act as a facilitator in the process.
4. Citizens does agree that if one is ordered, the costs of establishing and operating an ISA should be recovered from competitive service providers and new market entrants. We do not agree that the cost recovery mechanism should be through a distribution service charge assessed to competitive [service] customers. This cost would be solely a power supply cost and should be added to the energy bill. The ISA costs should not be added to the LDC "wires" charge.

G. General Comments

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.

Again, Citizens simply has not had sufficient time (less than three days) to evaluate and respond to the Staff Statement of Position. Citizens reserves the right to provide full comments at such time as the full version of Staff's Statement is published as proposed rules. In the mean time, Citizens still intends to file exceptions to Mr. Rudibaugh's proposed order by the May 29, 1998 deadline.

Thank you again for the opportunity to provide you input. Please call me at 532-4433 if you have any questions about any of these comments..

Very truly yours,


Craig A. Marks

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