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Utilities Div.
EXEC'S.

ACC:

Do not mess this up
Where every small
consumer gets stuck
for the STRANDED costs!
Every resident in the state
of Ariz HAS BEEN paying
for SRP's STRANDED costs!
Quassio government
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Arizona Corporation Commission

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AUG 03 1998

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Utility Deregulation

Breach of contract suits brought by utility companies to recover costs.

THE GROWING deregulation of the U.S. electric utility industry has set off a litigation explosion. Utility partners are suing each other over billion-dollar investments that now look shaky, everyone's suing to get out of long-term power contracts, and utilities are suing state and federal governments, charging that deregulation is a violation of the regulatory compact that granted the utilities service monopolies.

A chief element of this last wave of litigation involves the issue of "stranded costs." At the behest of regulatory agencies, electric utilities built expensive plants, including nuclear facilities, and entered into long-term, above-market contracts, notes Sheila Hollis, of the Washington, D.C., office of Philadelphia's Duane, Morris & Heckscher L.L.P. With deregulation, she says, the utilities are unable to recover many of these costs.

"The price of electricity is falling, and these utilities are stuck with expensive plants," Ms. Hollis says. "Now along comes deregulation and all bets are off." About 30 states and the federal government have begun deregulation, she says.

In some states, the regulatory authorities "are allowing competition and then refusing to recognize any legal obligation to a utility and its shareholders," adds Daniel W. Fessler, of the San Francisco office of New

York's LeBoeuf, Lamb, Greene & MacRae L.L.P. "Under the regulatory compact, a utility was burdened by a government-imposed duty and, in exchange, was protected as a monopoly. Now they're telling the utilities that they can't be monopolies, but that their competitors will be allowed to use their infrastructures."



Daniel Fessler: The attorney sees some legal problems in utility deregulation.

As a result, Ms. Hollis says, "A number of utilities are telling the regulatory agencies that 'you have to allow us to recover the stranded costs.'" To do so, some utilities are filing breach-of-contract actions against the agencies. In many suits, attorneys have applied the *Winstar* principle, claiming that denying recovery violates the U.S. Constitution's "takings" clause.

In *U.S. v. Winstar Corp.*, 95-865, the Supreme Court held in 1996 that the federal government is liable for breaching agreements it made during the 1980s to encourage investors to take over ailing thrifts. The *Winstar* principle has proved successful already for some utilities. Attorneys for Peco Energy Corp. used this argument recently in attaining a settlement that will allow Peco to recover \$5 billion in stranded costs over the next 10 to 12 years. The costs will be paid by electricity consumers and new market entrants, notes Peco attorney Michael Carvin, of Washington, D.C.'s Cooper, Carvin & Rosenthal. The New Hampshire Public Service Corp. also cited *Winstar* in its suit over stranded costs, he says.

Litigation over stranded costs is in an embryonic stage, Mr. Carvin says. But energy litigators predict more action ahead. "Based on our experience in the restructuring of the natural gas industry, this is going to be a long battle," Ms. Hollis says. "It's just now warming up." ☐

LOCAL NEWS

Hearing today on electricity

Panel to study cost of changing utility

By Bill Muller
The Arizona Republic

Today, the Arizona Corporation Commission will try to answer the \$2 billion question: How much will consumers have to pay for the right to choose their own electric company?

Commissioners will decide whether such utilities as Arizona Public Service can add the cost of switching to a competitive market to their customers' bills, and whether that would mean they must sell their power plants.

At issue are about \$2 billion in "stranded costs," or money spent by utilities on such expensive past projects as the Palo Verde Nuclear Generating Station. Utilities say that competition will strip them of customers and devalue their plants, making it impossible to recoup such investments.

Current plans call for consumers to make up the difference by paying a surcharge on their bills to cover stranded costs. Consumer groups say such a charge should be capped.

"No customer should pay more through transition than he is paying now in a regulated monopoly," said Stan Barnes, president of Arizonans for Electric Choice and Competition.

For utilities, there's still a catch.

To recoup 100 percent of stranded costs under the plan, they must sell their generating plants. That would determine a true market price, and allow regulators to determine whether competition has really devalued the companies' assets.

"If a utility says, 'Hey, we want to get (stranded costs), sell those assets and you're guaranteed to have them,' Commission Chairman Jim Irvin said. "I'm not seeing anything that says these assets are going to be undervalued because we go to a competitive model."

Beginning next year, large industrial users will be able to select their power company, like phone customers pick a long-distance carrier, under a plan proposed by the commission staff.

Except for a small pilot program, residential users would have to wait until January 2001 to choose their provider, but they'll receive a rate cut of 3 to 5 percent in the meantime.

The commission rules apply to customers of APS and Tucson Electric Power. The Legislature has drafted similar rules for Salt River Project.

The stranded cost plan, which will be considered at a public hearing today, also would accomplish another goal sought by regulators. It would split the generation side of the electric business from the distribution side, keeping utilities from cross-subsidizing their operations.

"If you really want to have a truly competitive market, then utilities need to get out of the generation business," said Doug Oglesby, general counsel of PG&E Energy Services, a California power marketing company with designs on Arizona.

"The utilities don't want to do that for a variety of reasons," he said. "The Number 1 reason is they want to continue to control their supply markets."

But investors in such utilities as APS aren't too thrilled about divestiture.

"I just think it's an incredibly bad idea," said Bill Meek, president of the Arizona Utility Investors Association, "particularly for Arizona electric consumers.

"This divestiture proposal is not going to solve the stranded investment problem. It's simply going to eliminate a lot of very good power plants that will go into the hands of out-of-state owners."

If the companies choose not to sell their plants, they could still recover some stranded costs, if the commission agrees. But that scenario probably means far less money for the utilities.

Bill Muller can be reached at 444-8178 or at bill.muller@pni.com via e-mail.

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From: Del & Barb Mc Donald <rei@azstarnet.com>
To: CC.UTIL(mailmaster)
Date: 7/22/98 8:16pm
Subject: Rules Input - Electric Restructuring

Dear Commissioners,

I attended the public hearing meeting you hosted in Tucson for the proposed Electric Restructuring rules. It was very informative and I appreciated the opportunity to attend such a meeting.

One area of the proposed rules concerns me. It is the Solar Portfolio Standard (R14-2-1609). My fear is that the proposed approach is going to have a negative result and not the positive result most people anticipate.

There are two parts of the rule that concern me specifically:

- (1) The fact that the rules force each generator to dedicate part of his/her generating capital to solar, and
- (2) The fact that the rules try to enforce #1 by imposing a penalty for noncompliance.

In regard to where I am coming from, my brother and I are seriously considering going into the generation business, and I live in AZ; so, any rules that impact our means to be competitive or impact me as a residential ratepayer are of concern. If you impose costs on the generators that are only passed onto the ratepayer, then the ratepayer's reasonably anticipated savings from competition are diminished by the passed-on cost. This will be anti-competitive in the end and the ratepayer will take the brunt of the special interest parties' narrow efforts to promote only their fuel source for limited benefit.

I offer the following arguments against the two points above and matching alternatives for consideration.

CONCERN #1 - "The fact that the rules force each generator to dedicate part of his/her generating capital to solar."

DISCUSSION: Granted, solar offers some good potential and has some good benefits. But, like any technology, it must mature if it wants to be included in the competitive mix. If the solar advocates (technologists and ratepayers) think it is the right thing to do, then the rules should give them a chance to invest in the development of the technology. Moreover, the ratepayer should have the option to select solar as their source of generation up to the point that the existing solar capacity is

exhausted. But, the solar user should pay the going rate that it takes to produce solar without receiving subsidies from other ratepayers i.e., pass through of the penalty from other generators.

A generator offers a solution and invests in it in order to increase his/her competitive edge. The generator specializes in their selected type of generation (coal, natural gas, oil, fuel cell, solar, etc.) and does not try to do every type of generation. You cannot do everything for everyone. If you do, you will be good at nothing and are doomed to fail. You pick a market niche and you go after it. This is what the solar generators must do, just like all of the other generator types have had to do.

The reason for this restructuring of the electric rules is to encourage competition. The solar advocates must step up to the bar and compete on the same playing field like all of the other generator technologies must do. If you favor this alternative fuel (solar) group of generators, then my brother and I will also expect some favors for our different alternative fuel generation technology (distributed diesel).

RECOMMENDATION: Don't write the rules so each generator must dabble in solar; leave it up to the solar experts to provide this source of alternative fuel generation. Then the other non-solar generator types can provide the kind of savings that are due the ratepayer and which are anticipated through competition.

The idea of competition is for the market to determine what goes and what does not go. The rules should allow the solar generators to compete and go after their niche of customers who are willing to pay more to promote the industry. If the market really wants solar, it will make the investment to reduce the cost of solar generation. Don't force every generator to operate in a part of the industry (solar generation) that is not their expertise.

In regard to pollution control and limited resources, clean air and the prudent use of natural resources is everyone's responsibility. That is why there are existing rules governing these responsibilities for non-solar generators.

CONCERN #2 - "The fact that the rules try to enforce #1 by imposing a penalty for noncompliance."

DISCUSSION: A penalty approach is sure to backfire. The penalty will be passed on to the ratepayer, who does not have a choice in the matter, and will have the same effect as an additional tax. The idea of

competition is to give the ratepayer choices that he/she has never had under the current monopoly.

My brother and I are investigating the possibilities of using an alternative fuel (waste oil) to power our distributed-generation units. The used oil is processed into a derivative of diesel fuel that is used in an engine. Does it make sense to require each generator to include in their generation mix a percentage of diesel-oil generation? Does it make sense to require each generator to face a penalty fee that is used to buy diesel-generated electricity? I like the latter requirement but don't think it is in the best interest of the ratepayer.

Our family's development of new, cost-effective technology is currently being forced to compete on the same field as generators using coal, fuel cells, natural gas, etc. Why should any one type of new generation technology (solar) receive any special competitive advantage at the price of excluding other new generation technologies?

RECOMMENDATION: I do believe that there is a place for the promotion of alternative fuels. If the development of alternative fuels is what the public wants, then each generator might pay a certain small fee (not a penalty) to an alternative fuel research fund, and developers of alternative fuels shall compete for these research fund dollars.

CONCLUSION:

I hope these concerns and ideas help you meet the tough task of developing the right rules. We appreciate your hard work and dedication to making electricity generation truly competitive. Thank you.

Regards,

Del McDonald
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OPEN MEETING ITEM

RECEIVED
AZ CORP COMMISSION

AUG 3 4 52 PM '98

From: billm <billm@aepnet.com>
To: CC.UTIL(mailmaster)
Date: 7/29/98 12:25pm
Subject: Deregulation of Electric Industry (Please forward to the 3 Commissioners)

DOCUMENT CONTROL

Dear Gentlemen,

It is with sincerity and best wishes that I address some concerns over the recent events surrounding the deregulation of the electric industry. It is my sincere hope and attempt for each commissioner to read my correspondence. I recognize and appreciate the overwhelming task at hand for each commissioner. I wish to express my appreciation to each of you regarding your efforts and sacrifice in reviewing the issues surrounding the deregulating of the electric industry. Please take the time to read this entire letter. Let me tell you that I am in total favor of deregulating the electric industry. However, I am not in favor of the direction you folks are going. My comments will not be directed to the specifics of the recent ruling published on 07/24/98. Instead I would comment to the more weighty reasons as to why I feel this most recent pronouncement is flawed.

Obviously, there are many perspectives, many agenda's, and many community needs that require consideration when thinking of electric deregulation. Though ultimately not single every person maybe absolutely pleased, I am firm believer that a Win-Win solution can be derived and implemented. You may be familiar with that term, Win-Win thinking and how Dr. Stephen R. Covey, world-renowned business consultant and educator, uses that term. In short, it means not your way, not my way, but the best way. To achieve a Win-Win agreement or solution it will take integrity and maturity. All of which I am confident you gentlemen possess. It will also take some rethinking of your approach to the whole problem.

I recognize that the media rarely prints or reports the "full picture." I'm sure each of you has been misquoted, misunderstood and misrepresented on more than one occasion by the press during this whole process. I sense that feelings have been tense and injured, appreciation for your hard work and dedication has been little, and few words of encouragement and confidence has been shared towards you gentlemen. Please know that I have confidence in you. That may not be a lot to bank on, but I hope it does convey a message that there are citizens who recognize and appreciate your efforts and work, even though we may not agree with your final product.

It is now with courage and consideration that I also recognize that

there appear to be separate agenda's and considerations amongst you three gentlemen regarding deregulation of the electric industry. In other words, you folks are not truly working together effectively. This is evident by the public bickering, the turnover rate of commission staff, and the ambiguous products being proposed as the direction that the electric industry should follow. I would guess you folks, despite your sincere efforts and hard work, are truly not happy with the final product. It needs a lot of work.

That is all the more reason why you gentlemen should work synergistically together. Table the agenda's and think short term, think long term and look for a true Win-Win solution. A solution that truly benefits the consumer, increases services and reduces prices through competition, and that truly makes the playing field of competition level for all electric utilities, considering their past, their presence and their future. I appreciate that this may not follow the normal course business found within the political games that most politicians are accustomed too are often required to play. However, I am confident that you folks can see beyond that and truly work together.

Begin with the end in mind by updating your homepage with why you gentlemen are there. You might say, "He has not looked at the excerpt that says, "What were about"." This is not a mission statement! Instead, this is a sterile explanation of facts. The real reason you've been elected is to serve the people of Arizona, to help insure that all persons have access to affordable and reliable utility services. To insure that businesses operate within the laws and constitution of Arizona, and to protect the public as well as the environment from those who would abuse or disregard. You may well be responding at this time with the thought "That's exactly what I am doing!" I would concur that each of you is working very hard. Where we may differ in opinion is that I don't think the commission needs to work harder, but more effectively and together. Despite differing political parties, despite diverse backgrounds, I am confident you guys can do this daunting task. I don't know any one of you folks well or personally. But your biographies speak of talent, service and family. If individuals possess these types of attributes and backgrounds then it is more than possible that they can work together using their individual diversity to build rather than separate.

I would recommend to each of you to review materials written by Dr. Stephen R. Covey. I'm sure you've heard his name as a business consultant who has positively effected companies throughout the world. If you gentlemen incorporate the principles found within the text "7 Habits of Highly Effective People" you will produce a product, a

guideline or set of rules, that will transcend all others regarding electric deregulation. You folks will become the ensign for all to follow. More importantly you would find a strong personal satisfaction in producing a product that you and your families can be proud of.

It takes courage and consideration to implement what I've spoken of. I truly believe that you gentlemen care for Arizona. I think that your diverse backgrounds and opinions make a wonderful combination. Don't fight against diversity but use it to Arizona's advantage. Peter Drucker and Warren Bennis had some interesting thoughts regarding management in crisis. They said; "Management is doing things right: leadership is doing the right things." And "Management is efficiency in climbing the ladder of success; leadership determines whether the ladder is leaning against the right wall."

Work together, choose your ladder as well as your wall carefully and Arizona will move forward because of you three leaders. I challenge each of you to see if what I have espoused in this letter is not true. I would even go so far as to find a way to fund, (no cost to you or to the state, if and only if it does not breach any law or etiquette), for each of you, to attend a Covey leadership session. In other words, I'm willing to put my money where my mouth is! Even if you gentlemen are familiar with this material a refresher, together, would be an enlightening and good experience. If I may be of any assistance to you gentlemen in anyway please let me know. Once more, I have confidence in you. Please consider carefully what I have said. Thank you for your time and consideration and have a great day!

Sincerely,

William H. Mertz III,

A concerned citizen

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