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CORPORATION COMMISSION

EXCEPTION

JAMES M. IRVIN
CHAIRMAN
TONY WEST
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

ORIGINAL FILED
AZ CORP COMMISSION

FEB 16 4 52 PM '99

IN THE MATTER OF COMPETITION IN THE) DOCUMENT CONTROL
PROVISION OF ELECTRIC SERVICES) DOCKET NO. L
THROUGHOUT THE STATE OF ARIZONA) RE-00000C-94-0165

NOTICE OF FILING

The Arizona Utility Investors Association hereby provides notice of filing exceptions to the recommended order of the Hearing Officer in amending Decision No. 60977 in the above-captioned matter.

DATED THIS 16TH DAY OF FEBRUARY, 1999.

WALTER W. MEEK, PRESIDENT

Original and ten (10) copies of the referenced Exceptions were filed this 16th day of February, 1999, with:

Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Copies of the referenced Exceptions were hand-delivered this 16th day of February, 1999, to:

James M. Irvin, Chairman
Tony West, Commissioner
Carl J. Kunasek, Commissioner
Paul M. Bullis, Legal Division
Ray Williamson, Utilities Division
Jerry Rudibaugh, Hearing Division
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

Copies of this Notice were mailed this 16th day of February, 1999, to all parties of record in the above-captioned docket.



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BEFORE THE ARIZONA CORPORATION COMMISSION

JAMES M. IRVIN
CHAIRMAN
TONY WEST
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF COMPETITION IN THE) DOCKET NO.
PROVISION OF ELECTRIC SERVICES) RE-00000C-94-0165
THROUGHOUT THE STATE OF ARIZONA)

EXCEPTIONS
BY THE ARIZONA UTILITY INVESTORS ASSOCIATION
TO THE HEARING OFFICER'S
RECOMMENDED OPINION AND ORDER

1. Introduction

On May 26, 1998, AUIA responded to the Chief Hearing Officer's proposed order in this matter by praising his "reasoned approach to the question of stranded investment." We said, "He has ... tried to resolve dozens of disparate and contradictory views in a manner that is fair to Affected Utilities and their investors yet meets the objectives of retail competition."

Soon thereafter, the proposed order was sandblasted with Staff amendments, culminating in Decision No. 60977, the infamous divestiture order. Then the parties engaged in months of useless wrangling, sending shareholder values into the regulatory toilet.

AUIA has learned its lesson: let others praise the efforts of the Hearing Officer. Instead, we will simply concur laconically with his judgment that Decision No. 60977 should be modified in order to give the Affected Utilities and the Commission more flexibility in dealing with stranded costs.

AUIA offers its comments regarding the specific options:

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1 **2. Stranded Cost Options**

2 **Option No. 1 - Net Revenues Lost Methodology**

3 Net revenues lost (NRL) was the preferred methodology offered by AUIA in
4 its direct testimony in the evidentiary hearing in February 1998. As such, we
5 support the inclusion of this approach as one of the options.

6
7 Specifically, the Hearing Officer recommends a modified NRL methodology
8 similar to that presented by Arizona Public Service Company in that hearing.
9 However, the Hearing Officer asserts that the APS approach contains "a major
10 flaw" in that customers would have little incentive to utilize another
11 competitive supplier because "they would have to purchase generation at
12 below market price in order to reap any savings."

13
14 In order to compensate for this purported flaw, the Hearing Officer proposes
15 to put the utilities at greater risk for mitigation. Using the customer base at
16 December 31, 1998, to calculate stranded cost, he would allow 100 percent to be
17 collected the first year, both through standard offer service and a Competitive
18 Transition Charge (CTC) on purchases in the competitive market. Thereafter,
19 he would reduce the amount of stranded cost that could be recovered through
20 the CTC by 20 percent each year during a five-year transition period.

21
22 The Hearing Officer proposes that customers who remain on standard offer
23 service will continue to pay 100 percent of the stranded costs allocated to them
24 during the transition. For calculation purposes, the customer base would be
25 held at the 1998 level and the utilities would be entitled to the revenues
26 resulting from customer growth after 1998. Since the CTC collection average
27 would be approximately 60 percent over the five-year period, the utilities'
28 opportunity for full recovery of stranded cost would depend on customer
29 growth and further cost savings.

30
31 AUIA is concerned about the methodology recommended by the Hearing
32 Officer in several respects.

1 First, we disagree that the APS approach is flawed in the manner the Hearing
2 Officer has described. Market price as it is used in the APS proposal is not the
3 lowest spot price to be found but a market average. Buyers will be able to
4 make purchases below that average. They are doing it today.

5
6 Second, we are not persuaded that the recommended methodology will meet
7 the objective of giving Affected Utilities a reasonable opportunity to recover
8 all of their stranded costs. The mathematics of the Hearing Officer's proposal
9 are that some 40 percent of stranded costs assigned to customers in the
10 competitive market must be made up by future customer growth and cost
11 mitigation efforts.

12
13 No evidence has been submitted by any party in this proceeding to show that
14 such a level of recovery could be accomplished through growth or mitigation
15 or both. In fact, each witness supporting a so-called sharing proposal was
16 asked under cross-examination to identify such sources of mitigation and
17 none was able to do so.

18
19 Third, in our view the uncertainty surrounding this recovery program does
20 not assure the revenue stream required for continued application of FAS 71
21 and could result in significant write-offs.

22
23 Finally, standard offer service is under pressure from several directions in the
24 electric competition rules and we question whether it can be counted on as a
25 source of revenue growth and stranded cost recovery. For example, APS and
26 TEP have reduced rates within the past year and are expected to do so again
27 under current rate orders. Furthermore, the pending rules require the
28 utilities to suggest "possible mechanisms to provide benefits, including rate
29 reductions of 3% - 5%, to all Standard Offer customers." Lastly, the pending
30 rules create further uncertainty about Standard Offer rates by requiring
31 Affected Utilities to purchase energy after 2000 through competitive bids or
32 on the open market.

1 A separately stated CTC within standard offer service could offer some
2 protection against erosion of the standard offer rate, provided that it remains
3 in place regardless of other adjustments to the rate. The Hearing Officer
4 proposes a separately stated CTC "to insure that standard offer customers do
5 not pay twice." If his NRL approach is adopted, a permanent, separately stated
6 CTC may provide the only assurance that standard offer customers will
7 continue to pay their share of stranded costs.

8
9 We doubt that the Hearing Officer's approach to net revenues lost can achieve
10 the objective of allowing Affected Utilities a reasonable opportunity to
11 recover their stranded costs. Without a separately stated CTC, it would be
12 impossible. This is especially true if regulatory assets are to factored in as a
13 component of the CTC.

14
15 AUIA believes the Hearing Officer is correct in separating the treatment of
16 regulatory assets from that of generation assets and to allow 100 percent
17 recovery of regulatory assets. However, in order to avoid write-offs, the
18 revenue stream supporting the recovery of regulatory assets must be
19 unambiguous and predictable.

20
21 Also, if the amortization period for regulatory assets (accelerated or
22 otherwise) extends beyond the transition period, there must be a provision to
23 continue that portion of the CTC dedicated to regulatory assets. We are
24 disturbed by the Hearing Officer's proposal to phase out any allowed return
25 on regulatory assets and would point out that this approach could result in a
26 potentially significant discount from present value.

27
28 **Option No. 2 - Divestiture/Auction Methodology**

29 As we made abundantly clear in our direct testimony and our cross-
30 examination of various witnesses, AUIA is adamantly opposed to mandatory
31 divestiture of generation assets as a means of determining stranded cost.

1 We believe it is a short-sighted strategy which could, in fact, drive up energy
2 costs and deprive Arizona consumers of reasonably priced electric generation.
3 Divestiture may be appropriate if the management of an Affected Utility
4 determines that it is in the best interest of shareholders and/or customers.
5 The Hearing Officer's proposal is not mandatory, but as a matter of first
6 impression this proposal tilts the available choices in favor of divestiture
7 because it is the only option that assures 100 percent stranded cost recovery.

8
9 However, this proposal also contains flaws. Prescribing a levelized 10-year
10 amortization without carrying charges or securitization could leave an
11 Affected Utility with insufficient resources to meet its fixed obligations. In
12 addition, the Hearing Officer's approach requires a divesting utility to defer
13 for future recovery without carrying charges any amounts that would cause
14 an increase in the standard offer rate.

15
16 This open-ended application of divestiture could produce disastrous results
17 for accounting applications and in the financial markets.

18
19 Other aspects of the divestiture option are unclear:

- 20 • What comprises "non-essential generation assets?" Is this meant to
21 exclude must-run units?
22 • What are "appropriate regulatory assets" and why should they be included
23 in an auction? They have no value to a potential buyer and would simply
24 drive up the price of generation assets.

25
26 **Option No. 3 - Financial Integrity Methodology**

27 We would be surprised if any Affected Utility would avail itself of this option.

28
29 **Option No. 4 - Settlement Methodology**

30 Some of our best friends are lawyers, but rather than spend the next four
31 months in daily association with this bevy of barristers, AUJA prays that the
32 parties will take advantage of this option.

1 **3. Conclusion**

2 In his proposed modifications to Decision No. 60977, the Chief Hearing
3 Officer is offering valuable guidance in expanding the stranded cost options
4 that should be available to the Commission and the utilities under its
5 jurisdiction. As usual, the Devil is in the details and AUIA believes that
6 Option Nos. 1 and 2, as they are presented here, fall short of providing
7 utilities a fair opportunity to recover their stranded costs. That does not
8 mean that they can't be modified to become workable or that the parties can't
9 negotiate settlement proposals that will advance the cause of retail
10 competition.

11
12 RESPECTFULLY SUBMITTED,

13 This 16th day of February, 1999

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16 _____

17 WALTER W. MEEK, PRESIDENT

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