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ARIZONA CORPORATION COMMISSION

AZ CORP COMMISSION

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REHEARING 6/6/99

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COMMISSIONER-CHAIRMAN
TONY WEST
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF THE)
COMPETITION IN THE PROVISION)
OF ELECTRIC SERVICES THROUGHOUT)
THE STATE OF ARIZONA)

DOCKET NO. RE-00000C-94-0165

**APPLICATION BY
ARIZONA PUBLIC SERVICE COMPANY FOR
REHEARING AND/OR RECONSIDERATION OF
DECISION NO. 61677**

Arizona Public Service Company ("APS" or "Company") hereby submits its Application for Rehearing and Reconsideration ("Application") of Decision No. 61677, dated April 27, 1999 ("Decision No. 61677" or the "Decision"). In Decision No. 61677, the Arizona Corporation Commission ("Commission") adopted amendments to Decision No. 60977 (June 22, 1998), which dealt with the recovery of stranded costs by Affected Utilities. The stranded cost recovery methodologies and rules adopted in Decision No. 61677 are unreasonable and unlawful for each of the reasons set forth herein. APS requests that the Commission grant rehearing of Decision No. 61677 and adopt the reasonable stranded cost recovery provisions as set forth in APS's Supplemental and Restated Exceptions dated April 7, 1999, attached hereto as Exhibit A and incorporated herein by reference.

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1 **I. DECISION NO. 61677 DOES NOT ASSURE AFFECTED UTILITIES**
2 **A REASONABLE OPPORTUNITY FOR FULL**
3 **STRANDED COST RECOVERY**

4 Although Decision No. 61677 modifies Decision No. 60977—the original stranded
5 cost decision—to add three additional options for the recovery of stranded costs, the amended
6 decision still undermines the clearly established principle that the Commission would “guarantee”
7 all Affected Utilities a reasonable opportunity for full stranded cost recovery. *See, e.g.*, Decision
8 No. 59943 (December 6, 1996) at 47. To rectify this, the Commission should add a finding of fact
9 and conclusion of law stating that “Affected Utilities are entitled to a reasonable opportunity to
10 fully recover their stranded costs.”

11 Additionally, the amended Option No. 1 provides a recovery mechanism that does
12 not assure full stranded cost recovery; instead it systematically and arbitrarily denies full stranded
13 cost recovery. Specifically, the amended option phases out stranded cost recovery after five years,
14 ignoring the fact that Affected Utilities, including APS, will incur stranded costs after that date.
15 Additionally, and more egregious than a five-year cap, the only “full” recovery of stranded costs
16 occurs during the first year. After the first year, stranded cost recovery is systematically reduced
17 by 20 percent per year. Although characterized in part as pre-set mitigation standards, these
18 increasingly-dramatic reductions in stranded cost recovery fail to take into account the specific
19 mitigation situations of Affected Utilities and their ability to mitigate to the levels required by
20 Option No. 1's reduction schedule. Thus, the systematic denial of stranded cost recovery through
21 fixed annual reductions, without considering the actual conditions affecting mitigation for each
22 Affected Utility, will result in the unlawful confiscation of property rights of Affected Utilities.
23 Instead of such an arbitrary process, the Commission should modify Option No. 1 to allow an
24 Affected Utility to propose its own mitigation plan, which may include pre-set mitigation goals.

25 The adoption of Option No. 5—allowing an alternative methodology submitted by an
26 Affected Utility—does not alter the analysis above. Due to Option No. 5's requirement that an
27 Affected Utility must demonstrate that its proposed plan is in the best interest of all stakeholders (a

1 nebulous standard undefined by the Commission), the ratcheting-down provisions of Option No. 1
2 could be viewed by some as minimum standards for any proposed plan under Option No. 5. Only
3 by correcting the provisions of Option No. 1 as suggested above can the Commission conform to
4 its earlier recognition that Affected Utilities are entitled to fully recover stranded costs.

5
6 **II. DECISION NO. 61677 SHOULD ASSURE**
7 **THE RECOVERY OF ALL REGULATORY ASSETS**
8 **UNDER ALL OPTIONS**

9 Unlike some stranded costs, regulatory assets cannot generally be mitigated. This
10 statement of fact is recognized in Decision No. 61677. Option No. 1 for stranded cost recovery
11 provides that “[b]ecause regulatory assets are more difficult for Affected Utilities to mitigate and
12 as such need to have a different treatment, we will permit an Affected Utility . . . 100 percent
13 [recovery of] regulatory assets” Despite appearing in Option No. 1, the remaining options
14 under Decision No. 61677 do not similarly assure 100 percent recovery of regulatory assets. The
15 Commission should add a finding of fact and conclusion of law stating that “Affected Utilities are
16 entitled to fully recover regulatory assets under any stranded cost recovery option.”

17 **III. DECISION NO. 61677 IS NOT SUPPORTED BY**
18 **SUBSTANTIAL EVIDENCE AND IS ARBITRARY, CAPRICIOUS**
19 **AND AN ABUSE OF DISCRETION**

20 The Commission’s decision in Option No. 1 to arbitrarily reduce stranded cost
21 recovery by 20 percent per year is not supported by substantial evidence. For example, the
22 Commission did not receive evidence in the stranded cost proceeding that any Affected Utility
23 could mitigate its stranded costs by the amounts dictated by the annual recovery reductions in
24 Option No. 1. The Commission must permit each Affected Utility to present its own facts
25 regarding mitigation and the possibility for pre-set mitigation targets. The Commission cannot
26 arbitrarily impose mitigation “targets” that do no more than result in confiscation of Affected
Utilities’ property.

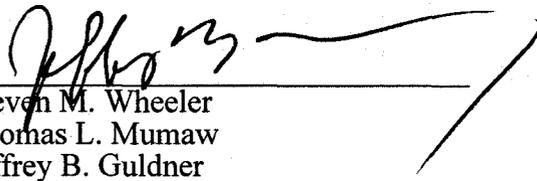
1 coerced divestiture is unlawful and unconstitutional. See APS's Application for Rehearing/
2 Reconsideration of Decision No. 60977 at 4-11.

3
4 **CONCLUSION**

5 Decision No. 61677, although providing additional methodologies for stranded cost
6 recovery, still fails to provide assurances the Affected Utilities are entitled to a reasonable
7 opportunity to recover all unmitigated stranded costs. APS urges the Commission to grant
8 rehearing of Decision No. 61677 and adopt the reasonable stranded cost recovery provisions
9 asserted by APS above.

10 RESPECTFULLY SUBMITTED this 11th day of May, 1999.

11 SNELL & WILMER L.L.P.

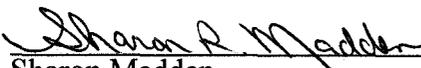
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14 Steven M. Wheeler
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17 Attorneys for Arizona Public Service
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CERTIFICATE OF SERVICE

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2 The original and ten (10) copies of the foregoing document were filed with the
3 Arizona Corporation Commission on this 17th day of May, 1999, and service was completed by
4 mailing or hand-delivering a copy of the foregoing document this 17th day of May, 1999, to all
5 parties of record herein.
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Sharon Madden

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EXHIBIT A

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AZ CORP COMMISSION

BEFORE THE ARIZONA CORPORATION COMMISSION

Apr 7 4 22 PM '99

1 JIM IRVIN
2 Commissioner-Chairman
3 TONY WEST
4 Commissioner
5 CARL J. KUNASEK
6 Commissioner

DOCUMENT NO. 601

7 IN THE MATTER OF THE)
8 COMPETITION IN THE PROVISION)
9 OF ELECTRIC SERVICES THROUGHOUT)
10 THE STATE OF ARIZONA)

DOCKET NO. RE-00000C-94-0165

11 SUPPLEMENTAL AND RESTATED EXCEPTIONS
12 OF ARIZONA PUBLIC SERVICE COMPANY
13 TO RECOMMENDED ORDER AMENDING DECISION NO. 60977

14 Arizona Public Service Company ("APS" or "Company") hereby submits to the Arizona
15 Corporation Commission ("Commission") its supplemental and restated exceptions to the
16 Recommended Order of February 5, 1999, as amended on March 12, 1999 ("Recommended
17 Order"), which Recommended Order would in turn amend Decision No. 60977 (June 22, 1998).¹
18 APS does so even though the March 12th amendments to the February 5th recommendations
19 added little to the earlier proposal of the Hearing Division lest the Commission lose sight of the
20 simple fact that even with the three proposed additional options for the recovery of stranded costs,
21 the amended Decision No. 60977 would still undermine perhaps the only heretofore clearly
22 established principle of electric restructuring in Arizona: that the Commission would "guarantee"
23 all Affected Utilities an opportunity for full stranded cost recovery. See Decision No. 59943
24 (December 6, 1996) at 47. Accordingly, the Company urges the Commission to modify the

25 _____
26 ¹ The second amended recommended order was actually filed on March 22, 1999. However, such order merely incorporated the amendments to the February 5, 1999 recommended order that had already been issued on March 12, 1999.

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1 Recommended Order amending Decision No. 60977 and adopt reasonable stranded cost recovery
2 provisions as set forth below.

3 I. THE PROBLEM

4 Even as modified by the Recommended Order, none of the options for stranded cost
5 recovery would, on their face, provide APS with a reasonable opportunity to fully recover its
6 stranded costs both as required by law and as recognized in every version of the Electric
7 Competition Rules adopted by the Commission and in the version of such rules currently pending
8 before the Commission. APS has previously commented on Option No. 2 (Divestiture/Auction)
9 and Option No. 3 (Financial Integrity Methodology) and will not repeat its analysis of how those
10 options are either patently unlawful or systematically, deliberately and arbitrarily prevent the full
11 recovery of stranded costs.

12 The Recommended Order proposes a new Option No. 1 that is similar, but not identical, to
13 that advanced in this docket by the Chief Hearing Officer in the Recommended Opinion and Order
14 dated May 6, 1998. Unfortunately, this option contains several material defects, some of which
15 are new to this latest version of Option No. 1.

16 The Recommended Order would phase out stranded cost recovery after five (5) years from a
17 Commission order approving a stranded cost recovery plan and any associated transition charges.
18 Assuming such approval later this year, that would mean that stranded cost recovery would end
19 some time in 2004. As APS indicated during last year's stranded cost hearing (a contention which
20 was not refuted by any witness), APS would in fact incur stranded costs through at least 2006 and
21 perhaps well beyond. The Recommended Order allows no opportunity to recover so much as a
22 dime of these post-2004 stranded costs.

23 Even within the five (5) year recovery "window" allowed by the Recommended Order, APS
24 is given a reasonable opportunity for stranded cost recovery only during the first year. Thereafter,
25 its stranded cost recovery is reduced 20% for the second year, 40% for the third year, 60% for the
26 fourth, and then by 80% in year five. This averages just 60% for the five-year period and is an

1 even smaller percentage of total stranded costs when the post-2004 years are factored into the
2 total.² APS is unaware of any regulatory agency or state legislature that has attempted to so
3 summarily confiscate such a large percentage of utility equity. Although APS does not oppose in
4 principle establishing reasonable pre-set goals for mitigation of stranded costs (in lieu of endless
5 quarreling over this or that specific mitigation measure), what is a "reasonable" target may well
6 vary from utility to utility, and therefore each Affected Utility should be allowed to make some
7 specific proposal in that regard as part of its stranded cost filing.³ The Company finds this a better
8 approach than using some arbitrary percentage of disallowance. Moreover, there is certainly no
9 evidence (and none is cited) that would support the apparent assumption that Affected Utilities
10 could mitigate (through customer growth or otherwise) almost 50% of their stranded costs during
11 the period 1999-2004 and 100% thereafter.⁴

12 The Recommended Order attempts to justify this disallowance as a mere "modification" of
13 the APS proposal to rectify a perceived "major flaw" in such proposal. The so called "major flaw"
14 is the lack of incentive for customers to switch to alternative suppliers unless they can "purchase
15 generation at below market price." Recommended Order at 2. Yet if a customer can not, in fact,
16 purchase generation for a lower cost than APS can purchase or generate that same power, why
17 should such a customer expect or deserve "to reap any savings"? Far from being a "major flaw,"
18 the Company's proposal both promotes and reflects principles of economic efficiency.

20 ² The Chief Hearing Officer's original May 6, 1998, Recommended Opinion and Order proposed a less
21 draconian "reduction schedule" that would have provided greater stranded cost recovery. No explanation for this
22 change is offered.

23 ³ In fairness, it is perhaps such an individual utility filing that is contemplated under Option No. 5 of the
24 Recommended Order. If that is the case, some of the Company's concerns have been addressed by this March 12th
25 amendment to the earlier recommendation of the Hearing Division.

26 ⁴ As was thoroughly demonstrated at the stranded cost hearing, it is not the disallowance of stranded cost
recovery that incentivizes mitigation but rather the establishment of a fixed mitigation standard. To that end, any
percentage less than 100% would likely be as effective as any other. See APS Reply Brief, Section I.C., The
"Incentive to Mitigate" Myth, at 13. However, selecting a goal that is all but unobtainable is simply punitive and may
actually prove counterproductive to mitigation efforts.

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II. THE CURE

To remedy the problems identified above, APS recommends that the Commission consider adopting the Recommended Order with several changes.

First, The Commission should add a finding of fact and conclusion of law, both of which would state that "Affected Utilities are entitled to a reasonable opportunity to fully recover their stranded costs." Such a finding would be fully consistent with the Electric Competition Rules.

Second, the sentence appearing at Page 2, lines 5-6 of the Recommended Order should be modified to read as follows:

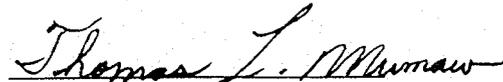
Accordingly, we shall modify Decision No. 61311 to allow each Affected Utility to file a stranded cost recovery plan of its choice that will allow it a reasonable opportunity to recover its stranded costs. Among the options available to each Affected Utility are the following:

This language will make it clear that Affected Utilities are not unreasonably restricted to a specific method of stranded cost recovery, but rather retain the flexibility to propose a plan for Commission consideration, and intervenor review, under Option No. 5, that is tailored to the conditions on their systems and their particular operational and financial circumstances.

Third, the description of Option No. 1 (Net Revenues Loss Methodology) should be modified to eliminate arbitrary stranded cost disallowance percentages and instead encourage a filing Affected Utility to propose its own mitigation plan. Proposed language amending Option 1 is attached hereto as Exhibit A.

RESPECTFULLY SUBMITTED this 7th day of April, 1999.

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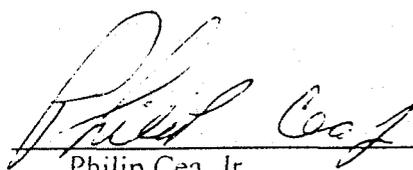


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Thomas L. Mumaw
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CERTIFICATE OF SERVICE

The original and ten (10) copies of the foregoing document were filed with the Arizona Corporation Commission on this 7th day of April, 1999, and service was completed by mailing or hand-delivering a copy of the foregoing document this 7th day of April, 1999 to all parties of record herein.


Philip Cea, Jr.

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EXHIBIT A

Option 1 - Net Revenues Lost Methodology

Utilize a Net Revenues Lost Methodology similar to that set forth by APS witness Davis. In general, the APS proposal compares generation revenues with competition versus revenues without competition. The difference, if any, is considered as potential stranded costs. That amount is then allocated among rate classes utilizing traditional cost allocation and rate design principles. Those customers taking service on the standard offer tariff would already be paying their portion of stranded costs. Customers taking competitive generation service would be charged for their portion of stranded costs through a competitive transition charge ("CTC"). That amount will also be separated out in the standard offer to insure that standard offer customers do not pay twice. Under the APS proposal, the potential stranded costs would be spread over all customers including customers added during the year. If there is enough growth relative to customers taking competitive service, all customers could end up with a decrease in rates. However, there would be little incentive for customers to utilize another competitive service as they would have to purchase generation at below market price in order reap any savings. We believe such a result is a major flaw in the APS proposal. As a result we will modify the APS proposal to place the risk/reward of mitigation more directly on the Affected Utilities.

We will clearly separate stranded costs into generation related assets and regulatory assets. Any growth in customers will not be part of the customer base used in calculating the generation related asset stranded costs. Any such growth would be considered as mitigation which the Affected Utilities can retain. In turn, the percentage of stranded costs that the Affected Utilities will be permitted collect via the CTC charge will could be reduced each year. We will utilize the customer base of the Affected Utility as of December 31, 1998 to calculate stranded costs for each year. Any Affected Utility choosing this method will be permitted to collect 100 percent of its stranded costs in Year No. 1, from all distribution customers either through a CTC charge to any customer who elects to purchase from competitors; in year No. 2, the Affected Utility will be permitted to calculate its stranded costs over the same December 31, 1998 customer base. However, only 80 percent of the proportionate amount can be recovered in a CTC charge to any customer who elects to purchase from competition. Those remaining on the standard offer will still be paying 100 percent of their proportionate share of stranded costs. Any shortfall the Affected Utility may have from the December 1998 customer base could be more than made up from post 1998 customer growth. In Years Nos. 3, 4, and 5, the Affected Utility will utilize the same methodology only the percentages to be collected via the CTC charge will be 60, 40 and 20 percent respectively in a manner to be determined after a hearing and based on substantial evidence.

Because regulatory assets are more difficult for an of Affected Utilities to mitigate cannot be effectively mitigated and as such need to have different treatment, we will permit an Affected Utility to collect 100 percent of the appropriate regulatory assets over its existing amortization period. Further, all existing and future customers should bear their portion of the regulatory assets either as part of the standard offer or as part of the CTC charge. In order to encourage Affected Utilities to make the maximum effort to mitigate regulatory assets, we will

begin phasing out any return on such assets after a five year period. For regulatory assets which are receiving a rate of return, such rate of return should be reduced by 20 percent per year so that after five years there would be no return allowed on such assets. As the rate of return is reduced, all rates including those customers on standard offer rates should be reduced accordingly **unbundled rates**. Upon expiration of the amortization period for regulatory assets, standard offer rates should **could** be reduced to reflect the removal of the regulatory assets. If an Affected Utility believes **unless** other costs have increased to offset the removal of the regulatory assets, it shall file a rate case at least a year before regulatory assets are extinguished.