BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED

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DOCKETED BY

JIM IRVIN
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

DECISION NO. 61677

ORDER

Open Meeting
April 14, 1999
Phoenix, Arizona

BY THE COMMISSION:

On December 26, 1996, in Decision No. 59943, the Arizona Corporation Commission ("Commission") enacted A.A.C. R14-2-1601 through R14-2-1616 ("Rules" or "Electric Competition Rules"). On June 22, 1998, the Commission issued Decision No. 60977 which required each Affected Utility to file a plan for stranded cost recovery. On December 11, 1998, the Commission issued Decision No. 61272, which adopted all of the Commission's Utilities Division Staff ("Staff") proposed Amendments to the Electric Competition Rules. The Commission held an Open Meeting on December 31, 1998, after the close of normal business hours, in order to issue Decision No. 61309, which denied the numerous Applications for Rehearing of Decision No. 61272. On January 11, 1999, the Commission issued Decision No. 61311 which stayed the effectiveness of the Rules and related Decisions, including Decision No. 60977.

DISCUSSION

Decision No. 60977 provided Affected Utilities with a choice of two options for stranded cost recovery: the Divestiture/Auction Methodology; and the Transition Revenues Methodology.

The first option was a mandatory divestiture/auction of all generation assets in order to determine the amount of stranded costs. The second option was to "provide sufficient revenues necessary to maintain financial integrity, such as avoiding default under currently existing financial instruments for a period of ten years . . .". It appeared the second option was designed to provide

sufficient revenues to stay out of bankruptcy. By limiting Affected Utilities to these two "options", the only viable option for stranded cost recovery was a forced divestiture/auction of all generation assets. Based on the record of this proceeding, we are not convinced that conditioning recovery of stranded costs upon forced divestiture is in the public interest.

Accordingly, we shall modify Decision No. 60977 to allow each Affected Utility to choose from the following five options. No customer or customer class shall receive a rate increase as a result of stranded cost recovery by an Affected Utility under any of these options.

Option No. 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. The Affected Utilities will collect stranded costs from all retail electric customers through a competition transaction charge ("CTC") which is based on the amount of generation purchased from any supplier[1]. 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 be reduced each year for those customers purchasing competitive generation service. 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. 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

[1] Under each methodology, although the CTC will appear on the bills of customers taking competitive generation and customers on standard offer, the CTC will in no event result in double recovery of stranded costs from standard offer customers.

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. While customers remaining on the standard offer will not receive an annual reduction in the CTC charge, all stranded cost recovery for generation related assets shall cease five years after Commission approval of an Affected Utility's stranded cost recovery implementation plan. In order to encourage Affected Utilities to voluntarily reduce standard offer rates prior to the end of the five year period, any such voluntary reduction can be used to offset the cessation of stranded cost recovery at the end of the five years.

Because regulatory assets are more difficult for Affected Utilities to mitigate 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 as part of the CTC charge whether taking standard offer or competitive service. 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 [2] there would be no return allowed on such assets. As the rate of return is reduced, the CTC charge should be reduced accordingly. Upon expiration of the amortization period for regulatory assets, standard offer rates should be reduced to reflect the removal of the regulatory assets. If the Affected Utility voluntarily reduces rates prior to extinguishment of the regulatory assets, those voluntary reductions can be used to offset the removal of the regulatory assets recovery. Any voluntary reduction used as an offset to the generation related asset stranded cost recovery cannot be utilized again as an offset to the cessation of regulatory assets recovery.

Option No. 2 – Divestiture/Auction Methodology

The second option is to determine the amount of stranded costs by divesting/auctioning off all non-essential generation assets. Each generation asset will have to include its portion of the appropriate regulatory assets. The difference between the net market value and book value will be stranded costs. We will permit the Affected Utility to collect 100 percent of the stranded costs on an equal basis over a ten year period.[3] The Affected Utilities will collect stranded costs from all retail electric customers through a CTC which is based on the amount of generation purchased from any supplier. We will not allow any

[2] Including the initial five-year period, any rate of return will be completely phased out after a total of ten years. However, nothing in this section is intended to extend the term of an Affected Utility's regulatory asset recovery beyond its current Commission-approved recovery schedule.

[3] If the stranded costs amount is determined to be negative, ratepayers and shareholders should receive an equal share of such amount.

carrying charges on the unamortized balance. If the resulting customer charge would result in an increase in the standard offer rate, the Affected Utility will have to defer those excess amounts for future periods without any carrying charges.

Option No. 3 – Financial Integrity Methodology

The third option would be to maintain financial viability of the Affected Utility for a period of ten years. This would require sufficient revenues to at least meet minimum financial ratios such as Times Interest Earned Ratio ("TIER") and Debt Service Coverage ("DSC") levels required by the Rural Utility Service ("RUS"). At the end of ten years, there would be no remaining stranded costs. The Affected Utilities will collect stranded costs from all retail electric customers through a CTC which is based on the amount of generation purchased from any supplier.

Option No. 4 – Settlement Methodology

Some iteration/combination of Option Nos. 1, 2, or 3 which parties submit as a settlement option.

Option No. 5 – Alternative Methodology

An Affected Utility may file an Alternative Methodology Plan ("Plan") but will be required to demonstrate that its proposed Plan is in the best interest of all stakeholders.

As a result of these modifications to Decision 60977, each Affected Utility shall have until June 14, 1999 to amend their previously filed implementation plan(s).

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. On December 26, 1996, in Decision No. 59943, the Commission enacted the Electric Competition Rules. The Rules established a schedule to resolve issues and phase in retail electric competition beginning January 1, 1999.

2. On June 22, 1998, the Commission issued Decision No. 60977, the Stranded Cost Order, in association with the Rules.

3. On December 11, 1998, in Decision No. 61272, the Commission adopted amendments

to the existing Rules, including Staff's additional changes proposed on November 24, 1998.

4. On December 31, 1998, numerous Parties timely filed Applications for Rehearing of Decision No. 61272.

5. On December 31, 1998, after normal business hours, in Decision No. 61309, the Commission denied the Parties' Applications for Rehearing.

6. The Commission has not resolved issues critical to creating a transition to a competitive market in the public interest.

7. The Commission has not established a consistent market structure between other jurisdictions and the Affected Utilities.

8. The Commission has not resolved questions of federal and state jurisdiction on transmission issues critical to system reliability.

9. The Commission has not resolved issues on pricing and cost recovery for must run generation.

10. The Commission has neither considered nor approved unbundled tariffs for APS, TEP, or Citizens Utilities Company.

11. The Commission has not resolved the issue of stranded costs for any Affected Utility.

12. On January 11, 1999, the Commission issued Decision No. 61311 which stayed the effectiveness of the Rules and related Decisions, including Decision No. 60977.

CONCLUSIONS OF LAW

1. The Affected Utilities are public service corporations within the meaning of the Arizona Constitution, Article XV, under A.R.S. §§ 40-202, -203, -250, -321, -322, -331, -332, -336, -361, -365, -367, and under the Arizona Revised Statues, Title 40, generally.

2. The Commission has jurisdiction over the Affected Utilities and of the subject matter contained herein.

3. On January 11 1999, the Commission issued Decision No. 61311 which stayed the effectiveness of the Rules and related Decisions, including Decision No. 60977.

4. There is good cause for the Commission to modify Decision No. 60977.

ORDER

IT IS THEREFORE ORDERED that Decision No. 60977 is hereby amended consistent with the Discussion contained herein.

IT IS FURTHER ORDERED that the Hearing Division shall issue a Procedural Order setting forth procedural dates and hearing dates for consideration of stranded cost and unbundled tariffs for each Affected Utility.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

COMMISSIONER-CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, STUART R. BRACKNEY, Acting Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 27th day of April, 1999.

STUART R. BRACKNEY
ACTING EXECUTIVE SECRETARY

DISSENT
JLR:dap

SERVICE LIST FOR: ELECTRIC COMPETITION

DOCKET NO. RE-00000C-94-0165

Copies mailed to Service of Docket No. RE-00000C-94-0165

ARIZONA CORPORATION COMMISSION

Commission – Chairman Jim Irvin

Decision No. 61677

Dissenting Opinion

The most contentious debate accompanying restructuring in the electric industry today involves the issue of stranded costs. Affected Utilities claim that as a result of the changes in Arizona's regulatory paradigm, they are left with stranded investments which must be paid by consumers. However, they ignore the fact that much of the stranded investments were voluntarily incurred in order to receive favored regulatory treatment under the old cost-plus monopoly system. It is a highly complex issue, granted, but one that I firmly believe should be negotiated by this Commission with the interests of consumers and ratepayers as a top priority. Unfortunately, the changes adopted today opens a Pandora's box for utilities to claim almost anything as a stranded cost – from imprudent investments to costs associated with transforming the market into a competitive model – and recover the money from mostly residential and small business customers.

The fact that this Commission has amended Decision No. 60977 (Stranded Cost Order) without affording affected parties the opportunity of a hearing violates the provisions of A.R.S. § 40-252, which states in part:

> "The commission may at any time, upon notice to the corporation affected, *and after opportunity to be heard as upon a complaint*, rescind, alter or amend any order or decision made by it." [emphasis added]

After the Commission stayed the Electric Competition Rules – and "related decisions" – on January 11, 1999, the hearing division arbitrarily changed provisions of Decision No. 60977 without input from any party, and subsequently forwarded its recommendations to the Commissioners for adoption at an Open Meeting. In fact, the Order does not state that parties were afforded the opportunity to request a hearing pursuant to A.R.S. § 40-252. As such, I believe that today's Stranded Cost decision violates Arizona law on procedural grounds.

Under the Stranded Cost Order adopted by the Commission on June 22, 1998, two options were available to Affected Utilities for stranded cost recovery (which still remain in the newly adopted Order); 1) Divestiture, and 2) Financial Integrity. Under the new Order, three more options are added – all which favor Affected Utilities. More importantly, however, is the absence of any requirement that Affected Utilities break their vertical integration for full, 100% stranded cost recovery. Deregulation efforts in other major industries such as Telecommunications and Airlines have consistently sought to break market power to create a level playing field for new market entrants, encouraging robust market competition. The related decisions today (i.e. deletion of the affiliate transaction rules section) have moved Arizona far away from such a concept.

As to the specific options added to the Order, I see no harm in including Option No. 4 (Settlement Methodology), as parties can always negotiate an agreement which requires Commission approval. However, the net revenues lost methodology (Option No. 1) makes projections about stranded costs based on estimates and forecasting, with no provision for a "true up" should an Affected Utility over-recover from consumers. This methodology, advanced by Arizona Public Service Co. (APS), has been criticized by

consumer groups such as the Arizona Community Action Association (ACAA) as unfair to residential consumers. The ACAA states,

> "Option One of the proposed stranded cost recovery is extremely unfair to small consumers who are held captive and restricted from the competitive market. Residential Standard Offer customers will not only be denied competitive participation but will also be penalized as a result. Only customers in the competitive market will enjoy a hefty CTC [competition transition charge] discount, which will be limited to large customers."

Finally, the inclusion of the Alternative Methodology (Option No. 5) as a means for stranded cost recovery basically renders the whole Stranded Cost Order itself useless. Under this option, we're going to allow each Affected Utility to utilize *any* methodology it chooses, as long as the Commission approves such a program. This would allow an Affected Utility to set its own timetable. Now imagine the leverage created when an Affected Utility, knowing full well that competition in Arizona cannot start without its participation, comes to the Commission with a stranded cost recovery plan which needs approval prior to opening their territory to competition. Any serious misgivings about the methodology employed, or even just a detailed analysis of that method (assuming it does not fall into one of the established options), would create substantial delay. Hey Arizona, you want competition sooner than later? Accept our stranded cost methodology.

In summary, Affected Utilities will be able to receive hundreds of millions of dollars in stranded cost recovery without having to relinquish one asset – so what has been "stranded" I ask? Under the two options adopted in June 1998, stranded investment would have been a finite number, a figure any ratepayer could look at prior to competition. Under the new options available, the figure might not be known until after the money is paid. Furthermore, the amended Stranded Cost order does not mention stranded "benefits," which under the old version would be shared equally between

shareholders and ratepayers. Because the new options favor utilities at the expense of ratepayers, I cannot support the amendments, and therefore respectfully dissent.