

Management Brief on Rehearing

I. Rehearing Arguments by the Attorney General

The Attorney General applies for rehearing on all three resolutions adopted by the Board on December 7, 1998: the resolution on the prior applications for rehearing, the resolution on the terms and conditions of competition, and the resolution on pricing. The points raised by the Attorney General are not specific to any particular resolution.

Attorney General Argument Number 1: SRP has Established no Legal claim to Stranded Costs – SRP’s Stranded Costs are a Disguised Rate Increase and are Anticompetitive.

SRP Management Response

A. SRP has specific statutory authority to recover stranded costs.

There is a very simple response to this assertion, and that is that the legislature has specifically authorized the recovery of stranded costs by SRP. In A.R.S. § 30-805(A)(3), the legislature provided that a public power entity “shall”:

Establish a temporary surcharge on electric distribution service prices to pay for all or a portion of the unmitigated stranded costs of electric generation service, if any, that were incurred as a direct result of competition among electricity suppliers, that were incurred by public power entities to serve their customers in this state before December 26, 1996 and that may not be recoverable in a competitive electric generation service market. Unmitigated stranded costs may include employee severance costs necessitated by electric competition including unemployment compensation, training and severance benefits.

B. “Stranded Costs” Are A Part Of Current Generation Prices Which Are Being Unbundled And Phased Out.

“Stranded costs” are nothing new. They are the part of the current, cost based generation price, which is above the price which will exist in a competitive electricity market. Very simply, the legislature has required that this component of current price be unbundled into a separate price component (the competitive transition charge), and that this component of price be phased out over six years. The result is a smooth transition from cost-based pricing by vertically integrated monopoly providers, to pricing established in a competitive market. The result will also be lower prices for customer as this component of current price is eliminated.

No party claims that the cost based prices which have been charged for years are beyond SRP’s authority. Under its authority in Title 48, SRP has authority to charge prices which

are based on cost of service. A.R.S. § 48-2334. Stranded costs are a part of current price. Even putting aside the provisions of the Electric Power Competition Act, SRP certainly has authority to unbundle the elements of its current price, and to phase out a portion of the price over time.

The Electric Power Competition Act reaffirms this authority and provides some guidelines and requirements for separately identifying and phasing out this charge. The action of SRP is consistent with these requirements.

C. A.R.S. § 30-805 Proves that the Existence of a “Regulatory Compact” Is Irrelevant to SRP’s Authority to Recover Stranded Costs.

The Attorney General argues that a public power entity cannot recover stranded costs because it did not enter into a “regulatory compact” with the State. The Attorney General apparently bases this assertion on the fact that SRP is not regulated by the Commission. Accepting the Attorney General’s argument, SRP could never under any circumstances recover stranded costs, in spite of the legislative directive. This would be contrary to the express authority granted by the legislature and would render A.R.S. § 30-805(A)(3) meaningless

As discussed above, stranded costs are simply a component of current generation prices which are above a market based generation price. It is appropriate in a transition to a competitive market to recognize that all vertically-integrated utilities, both public and private, made investments in good faith to serve customers under the then-in-force state policy of electric service by a single provider. Even without considering the Electric Power Competition Act, SRP has authority to charge these prices and to provide for a transitional pricing program to phase out this element of current price. A.R.S. § 48-2334.

The argument of “regulatory compact” is one used by investor-owned utilities to *force* the regulator to allow recovery of stranded costs. The argument made by investor utilities is that the regulator *must* allow stranded costs because it is *required* under the regulatory compact. The existence of a regulatory compact does not relate to the *authority* of the regulator to allow the recovery of these costs. The regulator may allow any levels or components of price, consistent with the underlying premise that prices be “just and reasonable” and consistent with other requirements of law.

Moreover, the public policy foundation for stranded costs recovery by public power entities is not the same as the public policy foundation for recovery of stranded costs by public service corporations. The language of the Electric Power Competition Act demonstrates that the legislature did not intend that the existence of a “regulatory compact” should be a pre-requisite to stranded cost recovery. To the contrary, the legislature expressly stated that it intended, in enacting the Electric Power Competition Act, to allow for “[r]ecovery of existing utilities’ stranded costs as determined by the corporation commission *and the governing body of the public power entity.*” HB 2663,

§ 35(A)(5) (emphasis added). Thus, there is no legal basis for the arguments of the Attorney General with respect to SRP's authority to recover stranded costs.

Furthermore, the strongest reflection of the legislature's intent in the substantive provisions of the Electric Power Competition Act is found in the provisions related to public power entities. In A.R.S. § 30-805, the legislature expressly permitted recovery of stranded costs by public power entities. In contrast, the legislature also "confirmed" the Arizona Corporation Commission's authority to take certain acts related to deregulation. *See* A.R.S. § 40-202(B). However, unlike § 30-805, there is no express statement of policy or authority with respect to stranded costs for public service corporations. Like § 30-805, the legislature did confirm the Corporation Commission's authority "not [to] consider the profits or losses associated with electric generation service when regulating electric distribution service." A.R.S. § 40-202(B)(8). In addition, like § 30-805, stranded costs are an express exception to this rule. Thus, although the Electric Power Competition Act recognizes that public service corporations may recover stranded costs under Corporation Commission rules, the legislature did not directly reflect its intent to permit stranded cost recovery by public service corporations. In contrast to the opinion expressed by the Attorney General, therefore, there is no expression of statewide public policy that stranded cost recovery is, or should be, available only to public service corporations. On the contrary, the legislature expressly stated its intent to allow such recovery by all "existing utilities," and the strongest legislative statement in the Electric Power Competition Act with respect to such intent relates to the stranded costs of public power entities.

The lack of a "regulatory compact" requirement is also demonstrated by a comparison of the Corporation Commission's definition of stranded costs and the definition stated in § 30-805(A)(3). The Commission's definition of stranded costs is "[t]he value of all the prudent jurisdictional assets and obligations necessary to furnish electricity . . . acquired or entered into prior to the adoption of this Article, *under traditional regulation of Affected Utilities . . .*" A.A.C. R14-2-1601(38) (emphasis added). For public power entities, however, "stranded costs" are costs "incurred by public power entities *to serve their customers* before December 26, 1996 . . ." A.R.S. § 30-805(A)(3) (emphasis added). Therefore, contrary to the arguments of the Attorney General, § 30-805(A)(3) recognizes the equivalence between "traditional regulation" and the provision of electric service by public power entities. Such equivalency is demonstrated by the fact that the legislature granted public power entities equal authority with Affected Utilities to recover their stranded costs. Thus, if the Attorney General is correct that the grant of authority to Affected Utilities is in recognition of a "regulatory compact," then the legislature recognized that the engagement of public power entities to provide service to their customers prior to competition was equal to, if not an essential element of, the "regulatory compact" of public service corporations.

The substantive structure of § 30-805 also reflects the legislature's determination that public power entities and public service corporations should have an equal opportunity to recover stranded costs. Section 30-805 requires public power entities to unbundle prices

for transmission, distribution, and “other” services and to charge prices for such services “that reflect the just and reasonable price for providing the service.” A.R.S. § 30-805(A)(1). The statute further provides that, as a general rule, a public power entity cannot consider profits or losses associated with generation service in establishing its distribution prices. *Id.* Section 30-805 also establishes, however, that stranded costs are the only “profits or losses associated with electric generation service” that can be reflected in distribution prices. To be eligible for recovery, stranded costs must have been incurred prior to December 26, 1996, have become a loss due to competition, and, notwithstanding the fact that there is a loss, such loss may not be recoverable in the competitive generation service market. The requirement that the loss may not be recoverable indicates legislative intent that stranded costs are costs that, if not recovered through a temporary surcharge on the distribution price, would cause the public power entity to suffer competitive injury. Therefore, the Attorney General’s argument that SRP is faced with a business decision about whether to raise generation prices, demonstrates a fundamental misconception about (or perhaps disagreement with) the legislative policy behind stranded cost recovery. The legislature expressly determined that stranded costs should be recovered, not through the generation service price, but through a temporary surcharge on distribution prices.

D. The Competition Transition Charge Is Not a Disguised Price Increase.

A Competition Transition Charge is not a “disguised rate increase,” as the Attorney General argues. It is a legislatively designed mechanism to unbundle an element of current cost as part of a transition from cost-based pricing to market-based pricing. That the stranded cost surcharge is not a “disguised rate increase” is demonstrated by two provisions of A.R.S. § 30-805. First, a CTC cannot cause an increase in the standard offer price in effect on December 30, 1998. A.R.S. § 30-805(B). Second, the allocation of the CTC among customer classes must be “consistent with the specific public power entity’s current rate treatment of the stranded asset, in order to effect a recovery of unmitigated stranded costs that is in substantially the same proportion *as the recovery of similar costs from customers or customer classes under current rates.*” A.R.S. § 30-805(C) (emphasis added). Thus, the legislature’s stranded cost recovery mechanism is, in essence, a temporary allocation to distribution price of certain generation-related costs already being recovered in standard prices, such that the aggregate charge to customers in a class will not increase. “Stranded costs” are an element of current prices which are being phased out over time. There is no price increase.

In fact, SRP has reduced prices for its bundled offer to its customers by an overall 5.4%. This decrease includes all components of price, including the CTC. The Attorney General should not make the unfounded allegations that the Board has “mislead consumers”, or has made a “false promise”. These allegations simply reflect a misapprehension of the facts.

E. The Decision is not Anti-Competitive

Without a great deal of elaboration, the Attorney General argues that the decision is anti-competitive. It appears that the argument is that competition would be greater if there were no CTC charge at all.

This is an argument that the Attorney General should have made to the legislature. The legislature has determined that the proper way to transition to a competitive market is to allow a period of time to transition to pure market based pricing. Over this period of time, the legislature allows a “competitive transition charge”, not to pay for “inefficient” costs, as alleged by the Attorney General, but to pay for “prudently” incurred costs which cannot be recovered in competitive markets.

Finally, the Attorney General implies (with no supporting facts whatsoever) that there have been improper communications between SRP and Arizona Public Service Company. Since the agreement with the Attorney General in May, 1998, there have been no negotiations or agreements between APS and SRP on the subject of stranded cost recovery or methodology.

Attorney General Argument Number 2: The Twenty Percent Limit on Aggregation is Unlawful

SRP Management Response

The Attorney General raises the argument that the provisions of the Electric Power Competition Act allowing for aggregation of accounts overrides the provision in the Act which provide that public power entities, beginning December 31, 1998, are required to open only 20 percent of their 1995 load to competition. As authority for this proposition, the Attorney General argues that since SRP does not have a Certificate of Convenience and Necessity, SRP “has no legal entitlement to control its customers and prevent them from obtaining every benefit competition has to offer.”

There is no support for the Attorney General’s contention. First, the Electric Power Competition Act is quite clear that a public power entity is only required to open twenty percent of its 1995 load to competition during the first phase. Specifically the Act provides in section 30-803:

- A. Public power entities may participate in retail electric competition statewide and shall open the service territory currently served by them to competition in the sale of electric generation service not later than December 31, 1998 for at least twenty per cent of the 1995 retail load at least fifteen per cent of which shall be reserved for customers in the residential customer class and shall open their entire service territory to competition not later than December 31, 2000 to electricity suppliers certificated by the commission pursuant to section 40-207 and to providers of other services.

The section on aggregation, section 30-803(E) in no sense overrides this provision:

E. Public power entities shall allow the aggregation of loads by multiple customers.

The only way to consistently read these two parts of the same statutory section is that aggregation is required within the twenty percent approved for competition.

A statute must be interpreted as a whole in order to achieve the goals of the legislature that enacted it. *Achen-Gardner v. Superior Court*, 173 Ariz. 48, 839 P.2d 1093 (1992). Here, as noted above, the legislature established in the same statutory section that competition would occur in two phases and that public power entities must permit aggregation. The Attorney General's argument, if true, could force a public power entity to make competition available to a larger number of customers during the first phase of competition than is required under A.R.S. § 30-803(A). Statutes must be construed in harmony to avoid leaving any part of them superfluous, void, contradictory, or insignificant. *Estate of Ryan*, 187 Ariz. 311, 928 P.2d 735 (App. 1996). The Committee's interpretation of section 30-803(E) is in harmony with the phases of competition established in § 30-803(A). The Attorney General's interpretation, in contrast, would render the two provisions contradictory.

Second, *every customer* who timely responded to SRP's solicitation to participate in the first phase of competition was selected. No customer can complain if the customer did not make the request.

Specifically, here are the number of customers who responded by the December 1 cut off date set out in SRP's solicitation, compared to the number of customers eligible for competition under the twenty percent rule:

	Customers Eligible	Customers Requesting Participation
Residential	11,000	59,799
Stratum A Commercial ¹	6,000	5,640
Stratum B Commercial	6,000	5,551
Large Industrial ²	192	129

The Board has fully complied with the statute by opening twenty percent of its load to competition and allowing aggregation within the twenty percent.

¹ Commercial customers were divided into strata of smaller and larger customers.

² Of the 194 large general service customers (E-60) not under contract, 129 opted to be part of the first phase. The 112 mw allocated to that entire class was allocated proportionately according the customer's coincident peak. The result was that 60% of the load of these customers will be open to competition.

Attorney General Argument Number 3: SRP's Code of Conduct is Inadequate

SRP Management Response

Because the Code of Conduct was determined by SRP Board by Resolution dated November 9, 1998, Code of Conduct was not part of the December 7 resolutions. For this reason the Board did not rule upon this part of the Attorney General's application, and SRP management will not respond on this point.

We also point out that the stranded cost resolution was issued by the SRP Board on November 9, 1998. This application for rehearing, filed on December 28, 1998, is outside the twenty day limit for requesting rehearing, set forth in A.R.S. § 30-810.