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ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE UNBUNDLING OF)
THE RATES OF ENERGY ARKANSAS, INC.)

DOCKET NO. 99-249-U
ORDER NO. 14

ORDER

Pursuant to Order No. 1 entered on September 15, 1999, Energy Arkansas, Inc. (EAI) filed on December 15, 1999, rates and tariffs supported by a current cost of service study that unbundled EAI's then-effective rates into the minimum functional components of generation, transmission, distribution, and customer service. In support of its unbundling filing, EAI filed the testimony and exhibits of Thomas J. Wright, Andrew Frits, J. David Wright, and James R. Thornton.

EAI filed unbundled rates and tariffs in compliance with Ark. Code Ann. §23-19-205(a) which requires that before January 1, 2000, "each electric utility shall file rates and tariffs supported by a current cost of service study that unbundles its then effective rates into minimum functional components of generation, transmission, distribution, and customer service operations."

On July 11, 2000, the General Staff of the Arkansas Public Service Commission (Staff) filed the prepared testimony and exhibits of Lee Smith, and the Attorney General of the State of Arkansas (AG) filed the prepared testimony of and exhibits of William B. Marcus. On August 1, 2000, EAI filed the

rebuttal testimony of James R. Thornton and Andrew Frits. On August 22, 2000, Staff filed the surrebuttal testimony of Lee Smith, and the AG filed the surrebuttal testimony of William B. Marcus.

On October 3, 2000, the Staff, EAI, and the AG (collectively, the parties) filed a Joint Motion To Approve Joint Stipulation And Partial Settlement And Set A Procedural Schedule (Joint Motion). The Joint Stipulation Of Partial Settlement (Joint Stipulation) was attached as Exhibit A to the Joint Motion. The Joint Stipulation would resolve all of the issues in this docket except certain rate design issues.

On October 4, 2000, the Commission issued Order No. 11 establishing a procedural schedule to file testimony addressing the Joint Stipulation and the rate design issues still in dispute. On October 31, 2000, the parties filed additional testimony addressing the Joint Stipulation and the disputed rate design issues. The AG filed the supplemental testimony of William B. Marcus, EAI filed the supplemental testimony of James R. Thornton, and the Staff filed the supplemental testimony of Lee Smith supporting the Joint Stipulation.

On November 9, 2000, the Commission issued Order No. 12 scheduling a public hearing for November 28, 2000. On November 13, 2000, the AG filed the supplemental rebuttal testimony, on the disputed rate design issues, of William B. Marcus.

On November 17, 2000, the Staff, EAI, the AG, Arkansas Electric Energy Consumers (AEEC), Reliant Energy Arkla (Arkla), Oklahoma Gas & Electric Company (OG&E), and the Arkansas Municipal League (AML) filed a Unanimous Stipulation and Waiver (Waiver Stipulation).¹ Under the Waiver Stipulation, all testimony and exhibits pre-filed in this docket would be admitted into the hearing record,

¹Order Nos. 2, 3, 6, and 7 granted intervention to AEEC, Arkla, OG&E, and AML.

the parties would waive cross examination of all the witnesses who pre-filed testimony, and all witnesses would be excused from the scheduled hearing. On November 17, 2000, the Commission issued Order No. 13 approving the Waiver Stipulation.

At the public hearing held on November 28, 2000, the Commission heard opening statements by Mr. Jeff Broadwater, representing EAI, Mr. Stephen N. Joiner, representing AEEC, Mr. Eric Estes, representing the AG, and Mr. Gil Glover representing the Staff. The Joint Stipulation and the pre-filed testimony of the parties were introduced into the record. The Commission provided an opportunity for public comments, however, none were offered.

THE STIPULATION

Under Section 1 of the Joint Stipulation, EAI's unbundled cost of service study would be accepted as the basis for unbundling EAI's currently effective rates. In Section 2, the parties agreed that the sum of EAI's unbundled rates will equal EAI's currently approved bundled rates. Under Section 3, within sixty (60) days of a final Commission order in this docket, EAI is required to file compliance tariffs in the format discussed in Staff witness Smith's August 22, 2000 surrebuttal testimony. Under Section 4, EAI will provide, prospectively, more accounting detail for Account 451 and Accounts 907-910. In Section 5.A., the parties agreed to address, in a future proceeding, the appropriate rate of return for EAI's distribution function and/or other regulated functions. In Section 5.B., within forty-five (45) days after the FERC's approval of EAI's Open Access Transmission Tariff, or at least ninety (90) days before the implementation of ROA, whichever is earlier, EAI will initiate a proceeding to address transmission issues.

CONTESTED ISSUES

In the Joint Motion, the parties state that the unresolved rate design issues are: (1) whether the declining block rate (DBR)² structure of the generation component of EAI's unbundled residential rates should be eliminated or reduced (Issue No. 1), and (2) whether a larger portion of the generation component of EAI's unbundled large general service (LGS) and large power service (LPS), including LGS and LPS time-of-use service, than proposed by EAI should be recovered from an energy charge (Issue No. 2). Also, in the Joint Motion, the parties state that they believe additional prefiled testimony on Issue Nos. 1 and 2 would be useful to the Commission. The parties proposed a procedural schedule to file additional testimony addressing and limited to Issue Nos. 1 and 2.

TESTIMONY ON CONTESTED ISSUES

On July 11, 2000, the Staff filed the prepared (direct) testimony of Staff witness Lee Smith, and the AG filed the direct testimony of William B. Marcus. In the direct testimony of Staff Witness Smith, Ms. Smith did not recommend any rate design changes to EAI's as-filed generation, distribution, transmission, customer service rates. (T.147-148). AG witness Marcus contends that declining block rates (DBR) should not be offered for generation in the residential and small commercial classes. Mr. Marcus asserts that the generation rate should be lowered and the revenue from the generation rate should be shifted to the non-competitive distribution rate until a future rate case. (T.108-109). For larger customers, Mr. Marcus argues that it is appropriate to recover generation costs through energy charges. Mr. Marcus contends that the new market is based on real-time or time-differentiated energy prices. (T.109).

²Under a DBR structure, the more electricity a customer uses, the less the per-unit price.

On August 1, 2000, EAI filed the rebuttal testimony of James R. Thornton. Mr. Thornton does not agree with any of the AG's rate design recommendations for residential, small commercial, or large customers. EAI argues that the AG's proposal would create intra- and inter-class revenue shifts. EAI further states that the Commission should not have to expend time and effort on rate design issues that have been previously resolved and found to be reasonable and cost responsive. (T.84-85).

In surrebuttal testimony, Staff witness Smith disagrees with the AG's rate design changes. Ms. Smith contends that it would be unwise to make rate design changes based on speculation regarding the development of the Arkansas competitive retail electric market. (T.160). In surrebuttal testimony, AG witness Marcus proposes to modify his residential proposal to assure revenue neutrality and also demonstrate that his proposal for large customers can be implemented in a revenue neutral way. Mr. Marcus asserts that, based on his experience in other states with competitive generation markets, EAI's residential DBR gives EAI a future competitive advantage by offering them something the market has not offered. (T.117).

On October 31, 2000, the parties filed additional testimony addressing the Joint Stipulation and Issue Nos. 1 and 2. The AG filed the supplemental testimony of William B. Marcus, EAI filed the supplemental testimony of James R. Thornton, and Staff filed the supplemental testimony supporting the Joint Stipulation of Lee Smith.

In supplemental testimony, Mr. Marcus contends that EAI's use of a DBR in the generation rate for residential customers is anticompetitive and should not be offered by a default supplier of generation. Mr. Marcus proposes to reduce the DBR residential generation rate from 18 mills per kWh to 10 mills per

kWh. (T.122-123). Mr. Marcus asserts that his experience in other states such as California, Pennsylvania, and New Jersey indicates that marketers are offering flat rates as opposed to DBR which vary with usage. The AG contends that DBR give EAI a competitive advantage because large users will be unable to find a better deal than EAI's default service and larger customers will be among the most motivated to shop for electricity. (T.123). Mr. Marcus states that most of the electric distribution cooperatives (coops) that have gone through the unbundling process to-date have flat generation rates. Most of these coops have DBR only in the distribution function, if at all. (T.124). Mr. Marcus' supplemental testimony did not address Issue No. 2.

EAI witness Thornton does not agree with Mr. Marcus's proposed changes to EAI's residential generation rates. EAI contends that, unless as part of the total bundled rates in the standard service package (SSP), unbundled generation rates in this filing will never be offered to residential customers. EAI agrees with Staff witness Smith that the type of rates that will be offered by other generation suppliers is not known at this time. Further, Mr. Thornton contends that, at this time, it would not be feasible to attempt to design the kind of generation rates that will be offered at retail open access (ROA). (T.91-92). Mr. Thornton states that EAI has several concerns with the AG's proposed rate design change. Mr. Thornton argues that Mr. Marcus' rate design proposal modifies the pricing for the distribution function to exactly reflect the generation pricing revisions. Mr. Thornton asserts that these modifications produce a negative impact on residential distribution customers. Mr. Thornton contends that at ROA, while the AG's rate design proposal would end for non-SSP customers, the distribution rate for these customers would continue to contain inequitable intra-class customer bill impacts. EAI argues that the impact of the AG's proposal

is to shift revenue from the generation to the distribution function. This results in lower use customers receiving higher monthly bills while higher use customers receive lower monthly bills. (T.93-97). With regard to Issue No. 2, EAI contends that while there is merit in moving the distribution rate design toward demand charges, this is not the time to make such a change. (T.96-97). EAI is also concerned that Mr. Marcus' proposal could cause larger customers to migrate to smaller customer classes in order to reduce their bills. (T.98-99).

In the Staff's supplemental testimony, Staff witness Smith recommends that the Commission approve the Joint Stipulation. Staff further recommends that the AG's rate design proposals for Issue Nos. 1 and 2 not be adopted. Staff witness Smith supports the rate design methods proposed by EAI. (T.165-169). Staff witness Smith argues, first, that it is premature to assume that the AG's rate design method would result in rates that would more closely reflect the rates that competitive suppliers will propose. Staff further asserts that the AG's rate design method could have the effect of moving the unbundled distribution and/or transmission rate farther away from their appropriate design in a competitive market. Staff additionally contends that rates should not be designed without a thorough review of the appropriate rate design for all functions. (T.169).

On November 13, 2000, AG witness Marcus filed supplemental rebuttal testimony. EAI and Staff did not file supplemental rebuttal testimony. Mr. Marcus disagrees with EAI's position that generation rates will not be offered to residential customers. The AG contends that the generation rate will be a part of the frozen standard service bundled rate. (T.127). In response to EAI's and the Staff's agreement that it is unknown what rates other suppliers will offer, the AG argues that generation suppliers in other states are

not offering DBR. (T.128). Mr. Marcus contends that the AG's rate design is based on revenue neutrality. Mr. Marcus further argues that only the relationship between the generation and distribution rate would change. (T.129). The AG contends that, under its distribution rates, lower use customer's overall rates will not change if they stay with the SSP. High use customer's rates, the AG argues, are decreased making it easier for them to get a better rate by shopping. (T.130). Mr. Marcus' supplemental rebuttal testimony did not address Issue No. 2.

COMMISSION FINDINGS

Based on the Joint Stipulation and the parties' support for the Joint Stipulation, the Commission finds, with one modification, that the Joint Stipulation (attached to the Joint Motion as Joint Exhibit A) filed by the parties on October 3, 2000, is in the public interest and should be approved. At the hearing held on November 28, 2000, AEEC expressed concern that, under Section 5.B. of the Joint Stipulation, 90 days before ROA does not allow for sufficient time for parties to address transmission issues related to FERC approval of EAI's Open Access Transmission Tariff. AEEC recommended that 180 days before ROA would be more appropriate. In response to questions from the Commission concerning AEEC'S proposed modification, the attorneys for EAI, Staff, and the AG stated that they had no objection to the Joint Stipulation being modified to accept AEEC's recommendation. With this modification, the Joint Stipulation is approved.

The Commission will now address Issue Nos. 1 and 2 which the Joint Stipulation did not resolve. The AG proposes to reduce the DBR rate differential for the generation function for residential customers (Issue No. 1) and increase the generation energy charges while eliminating the energy charges for the

distribution function for large general and power service customers (Issue No. 2). EAI and the Staff oppose the AG's rate design proposals. EAI and the Staff contend that this is not the time to make the rate design changes proposed by the AG. EAI and the Staff claim that modifying the generation rates could negatively impact the distribution and/or transmission rates. The Commission agrees with EAI and the Staff. It is premature to assume that the AG's rate design proposals would result in rates that would more closely reflect the rates that alternative generation suppliers will offer in Arkansas at ROA. No one knows, at this time, what type of rates alternative suppliers will offer. It would not be practical to design rates for Arkansas customers on the speculative basis of what kind of rates might be offered in Arkansas, or on the basis of the type of rates that are currently being offered by alternative suppliers in other jurisdictions. The Commission agrees with EAI and the Staff that changing the generation rates could result in moving rates for other functions farther away from their appropriate design in a competitive market. Considering the Commission's recent recommendation to delay the date for the start of ROA in Arkansas,³ it would be premature to adopt the AG's proposals without having the additional time and information about the future competitive market in Arkansas. We also agree with Staff that it is not appropriate to design rates on a piecemeal basis without a comprehensive review of the appropriate design of all of the functional components of rates. (T.169). EAI's existing rates were established in a rate case filed by EAI in Docket No. 96-360-U. EAI's unbundling filing in this proceeding is based on the cost of service from Docket No. 96-360-U. Even the AG states that "in a future rate case not subject to a rate freeze, the Commission can - and should - change distribution rate design away from declining block rates." (T.129).

³Progress Report to the General Assembly on the Development of Competition in Electric Markets and the Impact on Retail Customers, Amended November 29, 2000, Docket No. 00-190-U.

Accordingly the Commission orders as follows:

1. Based upon the record in this proceeding, the Joint Stipulation, as modified by AEEC's recommendation, is hereby approved.

2. Regarding the appropriate functional rate design, the Commission finds that EAI's approach is in the public interest and is approved. The rate design proposals made by the AG are rejected.

3. EAI is directed to file tariffs in compliance with the provisions of the Joint Stipulation, as modified by this order within sixty (60) days of the date this order is entered.

BY ORDER OF THE COMMISSION.

This _____ Day of December, 2000.

Sandra L. Hochstetter, Chairman

Sam I. Bratton, Jr., Commissioner

Betty C. Dickey, Commissioner

Diana Wilson Vaughn
Secretary of the Commission