SALT RIVER PROJECT
P. O. Box 52025
Phoenix, AZ 85072-2025
(602) 236-5886

RICHARD H. SILVERMAN
General Manager

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The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Dingell,

We appreciate the opportunity to respond to your April 9, 1997 letter, and provide input for your consideration regarding deregulation of the electric industry. You will undoubtedly receive many opinions on how to best effect the desired outcome for this industry and its customers. Your questions cover an array of complex and broad issues, each warranting its own lengthy discussion. We have chosen to provide a summary discussion of these relevant issues and hope this will be helpful as you examine the question of whether or not the Congress should enact legislation in this area. If we could be of further assistance, do not hesitate to call.

Concerns in connection with increased competition in wholesale markets.

The State of Arizona is considering adopting retail competition both in the legislature and through the Arizona Corporation Commission. The following principles have been and continue to be of key importance to SRP during these proceedings:

- *Rates Jurisdiction* - remain with the existing regulatory bodies. Competition should not result in granting the state utility commissions authority over public powers' rate making authority.

- *Protection for Bond Holders* - must provide a safe harbor from private use restrictions and consequences. Should allow for compliance with debt resolution and bond rating criteria.

- *Service Territories* - nothing should modify or nullify any agreement between retail electric service providers as to distribution service territories.

- *Equity Between Classes* - recoveries of stranded investment should be shared proportionally among all retail customer classes.

- *Sound Public Policy* - should provide for sound public policy as it relates to revenue implications for state and local jurisdictions.

With the recent introduction of marketers in the electric industry, the wholesale electric market experienced unparalleled increase in competition. Further expansion of competition into the retail segment will further emphasize some of the current concerns, which include:

1. Care must be taken to ensure that a minimum standard as to electric system reliability is maintained and enforced. Reliability standards and guidelines established by the North American Electric Reliability Council (NERC) and regional reliability councils should serve as the standard for compliance.

2. There is no technical ability to interrupt specific customer loads for those customers on common substations without impacting the other customers served from the same substation. (This includes all customers except the very largest who have dedicated substations.) With expanded wholesale competition, problems arise under two scenarios: a) when customers are served by a provider other than the control operator and that providers supply is cut, and b) when distribution outages occur, or transmission outages occur for part of a control area, and the supply from outside the control area needs to be reduced, yet there is no specific knowledge as to who is supplying the particular customers impacted by the outage.

   Take the following example to better illustrate the problem. Suppose an out-of-state provider, Provider A, is servicing a chain of 20 grocery stores and a neighborhood of houses, all of which are served by general use substations. Provider A's generating source trips off line due to operating problems and it loses its source of energy. The control area operator has two choices in this situation to bring energy input and output back into equilibrium: either raise the output from its own generating units, if available, or cut supply to the general substations, which would in turn impact many more customers than those served by Provider A. Unless the control area operator is adequately reimbursed for supplying the needed load, the remaining option is to curtail service to customers regardless of supplier.

   The reverse situation can also occur. Suppose that the same Provider A is serving the same chain of 20 grocery stores and a neighborhood of houses. A storm occurs knocking down a row of distribution poles that impacts half of the houses and 3 of the grocery stores. These customers are out of electricity. The supply to these customers must be curtailed to bring the system into balance, yet there is no technical means to immediately identify that Provider A should reduce its output by "x" amount.

3. Increased risks of capacity availability will grow for all suppliers as pressures to delay building a new unit exist. Capital will become more expensive, given the risk of return on such capital has increased.

Challenges from mandated retail competition by a date certain.

A sizable concern for public power over the move to retail competition is the issue of private use restrictions. Public power entities find themselves in a 'catch 22' with mandated competition and open access on one hand, yet limited by federal tax statutes which restrict competition via private use limitations. The current legislation and IRS regulations dealing with private use restrict public power entities in many ways.

The primary issue in private use is the potential loss of a large percentage of our customer load under a customer choice scenario. If this were to happen, and SRP were able to resell this power at the wholesale level, private use rules would be violated.

The rules restrict our ability to retain and compete for customers through contractual arrangements. Special contracts, especially for large customers, are being requested and will become a necessity in a competitive future. Proposed IRS "requirements contract" rules will prevent public power entities from being able to effectively contract to retain their largest customers. Loss of a large customer may shift revenue burdens to smaller commercial and residential customers.

Asset divestitures will increase as the industry restructures. In fact, some current proposals require asset divestiture for stranded cost recovery. Public power must have the ability to take cost effective remedial actions if bond financed assets are sold. Past accounting practices make it difficult to allocate debt to a specific asset and comply with change-in-use rules.

Use of transmission facilities to wheel power for private parties can prevent the issuance of tax-exempt bonds to finance the transmission facility or can result in loss of tax-exemption for outstanding bonds. Mandated wheeling is a significant problem for public power, notwithstanding FERC recognition of the problem.

Privately owned independent system operators (ISOs) and regional transmisison groups (RTG) marketing of power creates significant potential for private use of transmission systems under existing law.

The proposed regulations severely limit the ability of a municipal utility to dispose of unexpected, excess capacity through short-term sales contracts. Given the long lead time for generation projects and the likely displacement of large customers, this would impose tremendous burdens on public power.

The complexity of private use regulations and electric systems make them difficult to interpret and plan for the future. In a fully competitive environment, the lengthy private letter ruling process is unworkable.

Securitization Risks
Securitization has been proposed as a tool to provide rate reductions (as contemplated in California), or as a tool to fund stranded cost recovery. While there remain key threshold questions to be answered by the IRS and the SEC, this approach to financing has associated benefits and costs.

Benefits include:
- reducing risk and uncertainty of stranded cost recovery for utilities through legislation,
- possible immediate rate reductions for all consumers (although this reduction is paid back over the life of the securitized bonds),
- a reduction in financing costs for investor-owned utilities specifically and all utilities with high financing costs in general as these high costs are replaced with lower cost debt financed with state backed bonds.

The 'costs' of securitization include:
- government issued bonds may be more expensive for public power entities, such as SRP, than their current cost of debt associated with the stranded assets. This can be due to the timing of when the debt is incurred and what the market price is at the time and the credit rating of the individual entities,
- it reduces advantages built up over the years by more efficient utilities and may reward those that have been managed less efficiently,
- the funds may be used for uses other than reducing financing costs, particularly for IOUs who typically have lower debt levels than public power entities.

To address the foregoing issues, proceeds from securitization bonds should be used exclusively to redeem outstanding debt which is associated with stranded assets and to affect immediate rate reductions for residential and small commercial customers.

Reciprocity Requirements
SRP supports a reciprocity requirement for competition to be fully realized. Absent this provision, the home-state utilities are put at a great disadvantage. This may be a larger concern for smaller states, where there are fewer consumers for the host utility to shift sales to, than in California, where the reciprocity requirement was not implemented as part of the transition to competition. While SRP believes this provision is necessary, we further believe that the jurisdiction for this decision should remain with the individual states and therefore, does not need federal action.

Other Issues
A final issue that is paramount to a successful transition to competition is stranded cost treatment. SRP supports consistency between states in stranded cost recovery. Consistency is desired to prevent the development of a competitive disadvantage for one state compared to another based on approaches to stranded cost recovery. Such distortions can occur due to timing

considerations, the ability to export and/or bypass stranded costs, inequities in allocating stranded costs to customer classes and as a result of tax implications arising from stranded cost treatment.

Thank you again for the opportunity to provide input on these very important issues. Should you have any questions, please contact Debbie Kimberly, Manager of Finance & Administration (602) 236-5403.

Very truly yours,

Richard H. Silverman

Richard H. Silverman
General Manager
Salt River Project