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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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IN THE MATTER OF THE GENERIC
PROCEEDING CONCERNING ELECTRIC
RESTRUCTURING ISSUES.

Docket No. E-00000A-02-0051

IN THE MATTER OF THE GENERIC
PROCEEDING CONCERNING THE
ARIZONA INDEPENDENT SCHEDULING
ADMINISTRATOR.

Docket No. E-00000A-01-0630

IN THE MATTER OF TUCSON ELECTRIC
POWER COMPANY'S APPLICATION FOR A
VARIANCE OF CERTAIN ELECTRIC
COMPETITION.

Docket No. E-01933A-02-0069

IN THE MATTER OF ARIZONA PUBLIC
SERVICE COMPANY'S REQUEST FOR A
VARIANCE OF CERTAIN REQUIREMENTS
OF A.A.C. R14-2-1606

Docket No. E-01345A-01-0822

**RUCO'S RESPONSE TO TUCSON ELECTRIC POWER COMPANY'S MOTION FOR
DECLARATORY ORDER AND REQUEST FOR PROCEDURAL CONFERENCE**

The Residential Utility Consumer Office ("RUCO") files the following response to Tucson Electric Power Company's ("TEP") Motion for Declaratory Order and Request for Procedural Conference ("Motion"). RUCO takes issue with the "foundational premise" of TEP's Motion that after December 31, 2008, TEP's generation service rates will be based on the Market Generation Credit ("MGC"). RUCO believes that TEP's premise is fundamentally flawed and that the Arizona Corporation Commission ("ACC" or

1 "Commission") has not committed to market-based rates after 2008. Nor does RUCO
2 believe that the Commission needs to decide at this time the exact rate treatment that will
3 be afforded TEP's generation assets after December 31, 2008.

4 **BACKGROUND**

5 The Commission adopted the Electric Competition Rules (A.A.C. R14-2-1601, et
6 seq., "Rules") in 1996 to provide a legal basis to transition the electric industry in Arizona
7 from a regulated to a competitive environment. The Rules required TEP to divest all its
8 generation assets and obtain all its power for Standard Offer Service from the market.
9 A.A.C. R14-2-1606(B) and 1615(A). The Rules further required TEP to offer Standard
10 Offer Service at regulated rates. A.A.C. R14-2-1606(A). Since the adoption of the Rules,
11 the electric utilities, the Commission, the courts and other interested parties have all
12 played significant roles in shaping this transition and the regulatory environment as it
13 presently exists. Several events, as TEP notes, have taken place since the adoption of the
14 Rules.

15 First, in 1999, TEP entered into a Settlement Agreement ("Agreement") to allow
16 competition to commence in TEP's service territory in accordance with the Rules. On
17 November 30, 1999, the Commission adopted the Agreement with modifications in
18 Decision No. 62103.¹ The Agreement required TEP to transfer its generation assets to a
19 subsidiary by December 31, 2002. Agreement §3.1. The Agreement also provided for a
20 rate freeze through December 31, 2008. Agreement § 5.1. The frozen rates include TEP's

23 ¹ On December 28, 1999, the parties to the Agreement filed an Amended Settlement Agreement reflecting
24 the modifications required by Decision No. 62103. Unless stated otherwise, all references shall be to the
Amended Agreement.

1 stranded cost recovery which is further broken down into a fixed charge (fixed CTC) and a
2 variable charge (floating CTC).

3 The fixed CTC provides for the recovery of \$450 million and is set to equal a charge
4 of 0.93 cents/kWh. The fixed CTC terminates when it yields a total of \$450 million, or on
5 December 31, 2008, whichever occurs first. Agreement at § 2.1(b). The floating CTC is
6 designed to recover an estimated remaining stranded cost of \$233 million. Like the fixed
7 CTC, the floating CTC has a termination date of December 31, 2008. The floating CTC,
8 however, is calculated on a market-based methodology. The market-based component of
9 the floating CTC involves a Market Generation Credit ("MGC"). The MGC varies inversely
10 with the floating CTC, so that if the MGC rises, the floating CTC falls, and vice-versa.
11 Agreement at § 2.1 (c) and (d).

12 The Agreement, as well as the Decision, is silent as to what TEP's generation
13 service rates will be after December 31, 2008. However, as stated above, neither the fixed
14 nor the floating CTC will be included in the rates after December 31, 2008.

15 The second event occurred in 2002. In January 2002, TEP had requested an
16 extension of its compliance with 1) R14-2-1606(B) (which required TEP to purchase its
17 generation for Standard Offer Service from the competitive market) and 2) R14-2-1615(A)
18 (which required TEP to divest its competitive generation assets and services). See Direct
19 Testimony of James Pignatelli, Docket No. E-00000A-02-0051 et. al., page 15; Tucson
20 Electric Company's Request For A Variance, Docket No. E-01933A-02-0069. In response,
21 the Commission re-evaluated its Rules in light of apparent dysfunctions in the wholesale
22 electric market. On September 10, 2002, the Commission modified portions of its Rules
23 and Decision No. 62103 in Decision No. 65154 ("Track A"). Specifically, Track A granted
24

1 TEP waivers of A.A.C. R 14-2-1615(A), and modified Decision No. 62103 and required
2 TEP to cancel any plans to divest interests in any of its generation assets. Track A at 32.
3 Track A also stayed A.A.C. R14-2-1606(B)'s requirement to procure 100 percent of power
4 for Standard Offer Service from the competitive market. Track A at 33.

5 The last event of relevance to the Motion was the Arizona Supreme Court's recent
6 Decision to deny Review of Phelps Dodge v. Arizona Corporation Commission, 207 Ariz.
7 95, 83 P. 3d 573 (App. 2004) ("Phelps Dodge case"). In the Phelps Dodge case, the
8 Arizona Court of Appeals invalidated R14-2-1615(A) which required electric utilities to
9 divest their generation assets, and other aspects of the Rules.

10 **THE COMMISSION NEVER COMMITTED TO GENERATION SERVICE RATES**
11 **BASED UPON THE MGC FORMULA AFTER DECEMBER 31, 2008**

12 The "foundational premise" of TEP's motion is that its generation service rates will
13 continue to be determined after 2008 based on the MGC formula. Motion at 4. However,
14 there is nothing in the Agreement that suggests that, after 2008, the MGC would still be
15 used to set the standard offer price of electricity.

16 The only purpose of the MGC under the Agreement is as a mechanism to determine
17 the floating CTC. See Agreement § 2.1(C). The floating CTC will terminate on December
18 31, 2008. Agreement §2.1(C). R14-2-1606(A)'s requirement that Standard Offer Service
19 be made available "at regulated rates" will continue in effect after December 31, 2008.
20 Thus, the MGC has no relevance after the termination of the floating CTC and the end of
21 2008.

22 The continued implementation of cost-based Standard Offer rates after 2008 is
23 consistent with what the Commission found and ordered in Track A. In Track A, the
24 Commission found that the wholesale power market was not mature enough to be the

1 exclusive basis for standard offer retail rates. In response, and, in part, at the request of
2 TEP itself, the Commission agreed to waive divestiture and stay the Rule's provision that
3 power be acquired 100% from the market². It is difficult to understand why TEP is now
4 advocating that its retail rates will be market-based after 2008 when it only recently
5 successfully advocated for the Commission to lift the Rule's requirement to divest
6 generation assets and rely exclusively on the wholesale market for standard offer power
7 needs.

8 Even before the recent actions by the Commission and the courts, the Rules never
9 required standard offer rates to move automatically with changes in the wholesale electric
10 market. R14-2-1606(A) requires that as an Affected Utility and Utility Distribution
11 Company ("UDC"), TEP "shall make available Standard Offer Service and Noncompetitive
12 Services at regulated rates." (Emphasis added). Prior to the Commission staying it in
13 Track A, R14-2-1606(B) required UDCs to acquire power from the competitive market.
14 Thus, the Rules spoke to procurement of power from the competitive market, but require
15 that the price for Standard Offer Service be at "regulated rates." Nothing in the Rules or
16 the Agreement provides for automatic pass-through of market rates to retail customers.

17 While it is clear that the Commission has never required TEP to pass through
18 market-based electric rates after 2008, RUCO would not oppose a declaration by the
19 Commission reconfirming Track A's conclusion that TEP would not be required to rely on
20 the wholesale market to obtain power from standard offer customers.

21
22 ² Track A modified the R14-2-1606(B) requirement that 100 percent of the Standard Offer Service be
23 acquired from the competitive market. In its place, the Commission said that any power that TEP cannot
24 produce from its existing assets should be acquired through a competitive process to be defined in Track B.
Thereafter, the Court of Appeals in Phelps Dodge reversed R14-2-1615(A)'s requirement to divest. The
Court's decision did not overturn R14-2-1606's requirements.

1 **THE COMMISSION DOES NOT NEED TO DECIDE AT THIS TIME THE RATE**
2 **TREATMENT THAT WILL BE AFFORDED TEP'S GENERATION ASSETS AFTER**
3 **DECEMBER 31, 2008.**

4 The Commission is under no obligation at this time to determine the exact
5 ratemaking treatment that will be afforded TEP's generation assets after 2008. The
6 analysis required to consider the ratemaking treatment at this time would be speculative as
7 well as premature. Frankly, it is unnecessary and bad public policy.

8 Seldom has the Commission committed to future rate-making treatment. The
9 circumstance would have to be highly unusual and extraordinary. No such circumstances
10 exist here. It is not known what the future holds for the electric industry. However, the
11 Commission, the electric utilities, and other interested parties all have recognized that it is
12 too early for a competitive market in Arizona. The last nine years has been spent in Open
13 Meetings and courtrooms reshaping the Rules and the law to recognize the current state of
14 competition (or lack of competition) in the electric industry. It does not make sense for the
15 Commission to now consider committing to future utility rates. The Commission does not
16 have to commit now to the exact rate treatment it will afford TEP's generation assets after
17 2008.

18 **CONCLUSION**

19 There is no need for the Commission to grant TEP's Motion. The Commission has
20 never indicated that TEP's post-2008 standard offer rates will be based on the MGC.
21 Further, the Commission has already instructed TEP to retain its generation assets and
22 stayed the rule requiring that TEP obtain power for standard offer customers from the
23 market. Thus, the Commission has already acted to substantially diminish the influence of
24 the wholesale electric market on TEP's costs to meet its standard offer load. There is no

1 need now for the Commission to make any determination of the rate treatment it will afford
2 TEP's generation in any future rate case. Because RUCO believes the Commission has
3 already addressed the issues raised in TEP's motion, RUCO believes that a procedural
4 conference is not necessary and the Commission should proceed with the rate review
5 proceeding as scheduled.

6
7 RESPECTFULLY SUBMITTED this 17th day of May, 2005.

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