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BEFORE THE ARIZONA CORPORATION COMMISSION
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7
8 IN THE MATTER OF THE FILING BY
TUCSON ELECTRIC POWER COMPANY
9 TO AMEND DECISION NO. 62103.

Docket No. E-01933A-05-0650

10
11 **RUCO's RESPONSE TO TEP'S MOTION TO AMEND DECISION NO. 62103**

12 Tucson Electric Power Company's ("TEP") Motion to Amend Decision No. 62103
13 ("Motion") purports to provide a pathway by which the Commission can "provide customers
14 with rate stability...and predictability, and protection from future volatile energy charges."
15 Motion at 3. TEP believes that it is necessary to amend Decision No. 62103 to travel its
16 proposed path. While RUCO has serious concerns whether TEP's proposed path is the
17 appropriate one to take, it sees no reason why Decision No. 62103 would need to be amended
18 to pursue that course.

19
20 **BACKGROUND**

21 The Stranded Cost Settlement Agreement

22 The Commission adopted the Electric Competition Rules ("Rules") in 1996 to provide a
23 legal basis to transition the electric industry in Arizona from a regulated to a competitive
24

1 environment.¹ The Rules required TEP to divest all its generation assets and obtain all its
2 power for Standard Offer Service from the market.² The Rules further required TEP to offer
3 Standard Offer Service at regulated rates.³

4 In 1999, TEP entered into a Settlement Agreement to allow competition to commence in
5 TEP's service territory in accordance with the Rules. On November 30, 1999, the Commission
6 adopted the Settlement Agreement with modifications in Decision No. 62103.⁴ The Settlement
7 Agreement required TEP to transfer its generation assets to a subsidiary by December 31,
8 2002.⁵ The Settlement Agreement also provided for a rate freeze through December 31,
9 2008.⁶ The frozen rates include TEP's stranded cost recovery which is further broken down
10 into a fixed charge (fixed CTC) and a variable charge (floating CTC). The Agreement also
11 provided for a review of TEP's rates in 2004, although rates could only be decreased or remain
12 the same as a result of that proceeding.⁷

13 The fixed CTC is a fixed per-kWh charge, and it terminates when it yields a total of \$450
14 million, or on December 31, 2008, whichever occurs first.⁸ The floating CTC is designed to
15 recover an estimated remaining stranded cost of \$233 million. Like the fixed CTC, the floating
16 CTC has a termination date of December 31, 2008. The floating CTC, however, is calculated
17 on a market-based methodology. The market-based component of the floating CTC involves a
18 Market Generation Credit ("MGC"). The MGC varies inversely with the floating CTC, so that if
19 the MGC rises, the floating CTC falls, and vice-versa.⁹

21 1 A.A.C. R14-2-1601, et seq.

22 2 A.A.C. R14-2-1606(B) and 1615(A).

23 3 A.A.C. R14-2-1606(A).

24 4 On December 28, 1999, the parties to the Agreement filed an Amended Settlement Agreement
reflecting the modifications required by Decision No. 62103. Unless stated otherwise, all references shall be to
the Amended Agreement.

5 Settlement Agreement § 3.1.

6 Settlement Agreement § 5.1.

7 Settlement Agreement § 5.2.

8 Settlement Agreement at § 2.1(b).

9 Settlement Agreement at § 2.1 (c) and (d).

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

4
5 The Track A Decision

6 In January 2002, TEP requested an extension of its compliance with A.A.C. R14-2-
7 1606(B) (which required TEP to purchase its generation for Standard Offer Service from the
8 competitive market) and A.A.C. R14-2-1615(A) (which required TEP to divest its competitive
9 generation assets and services).¹⁰ In response, the Commission re-evaluated its Rules in light
10 of apparent dysfunctions in the wholesale electric market in what became known as the Track
11 A proceeding. On September 10, 2002, the Commission issued Decision No. 65154 modifying
12 portions of both its Rules and Decision No. 62103. Specifically, Decision No. 65154 granted
13 TEP a waiver of A.A.C. R14-2-1615(A), and modified Decision No. 62103 and required TEP to
14 cancel any plans to divest interests in any of its generation assets.¹¹ The Decision also stayed
15 A.A.C. R14-2-1606(B)'s requirement to procure 100 percent of power for Standard Offer
16 Service from the competitive market.¹²

17
18 TEP rate review

19 In 2004 TEP filed the rate review required by Decision No. 62103. In June 2005, RUCO
20 and other parties filed testimony in the rate review proceeding. No party concluded that TEP
21 was overearning. The Commission suspended the procedural schedule in the rate review and
22 no further action has been taken in that docket.

23
24

¹⁰ See Direct Testimony of James Pignatelli, Docket No. E-00000A-02-0051 et. al., page 15; Tucson
Electric Company's Request For A Variance, Docket No. E-01933A-02-0069.

¹¹ Decision No. 65154 at 32.

¹² Decision No. 65154 at 33.

1 **TEP's MOTION**

2 On September 12, 2005, TEP filed its Motion, along with testimony from its Chairman.
3 TEP proposed four "amendments" to Decision No. 62103. RUCO will describe the four
4 proposals in the course of its response below.

5
6 **RUCO's RESPONSE**

7 RUCO does not disagree with TEP's stated goal of providing customers with rate
8 stability and predictability and protection from future volatile energy charges. RUCO does
9 differ with TEP over whether the four items it proposes are all necessary to achieve that goal.
10 However, even if the Commission desires to pursue any of the four aspects of TEP's proposed
11 path, there is no need to amend Decision No. 62103 to do so.

12
13 Rate Freeze

14 TEP claims that after December 31, 2008, it will be charging a market-based rate for its
15 generation services, and that under current conditions customers could experience rate
16 increases of 10-15% for generation services at that time. As an alternative to such market-
17 based rates in 2009, TEP's first proposal is that current rates, which are frozen through 2008,
18 be continued through 2010.

19 Not all parties to the Settlement Agreement concur that, absent some action by the
20 Commission, TEP's retail rate will be market-based beginning in 2009.¹³ At the time the
21 Settlement Agreement was approved, it was contemplated that TEP would divest its
22 generation assets and acquire generation for its customers from the wholesale market.
23 However, as a result of the Commission's Decision No. 65154, TEP continues to own

24

¹³ See argument of Arizonans for Electric Choice and Competition at Procedural Conference of
June 7, 2005 in Docket No. E-01933A-04-0408, Transcript pg. 49.

1 generation resources, and thus does not acquire most of the power for standard offer
2 customers at market-based prices. TEP will continue to own most of the generation resources
3 necessary to serve its load, and will only be required to obtain a portion of its energy resources
4 from the wholesale market. Therefore, it will not be necessary for customers to pay TEP
5 market-based retail prices for generation. Further, the MGC, which is used to calculate the
6 floating CTC under the current rate structure, has no particular relevance after the termination
7 of the floating CTC at the end of 2008. Likewise, the Rules never required the retail rate for
8 Standard Offer Service (which includes generation) to move automatically with changes in the
9 wholesale electric market. While the Rules did require TEP to obtain power from the
10 competitive market (this mandate was suspended by the Commission in Decision No. 65154),
11 the Rules have always provided that Standard Offer Service be made available *at regulated*
12 *rates*.¹⁴

13 Despite the fact that there is disagreement about what retail rates would be in 2009 if
14 the Commission took no further action, there is no need to resolve that issue because nothing
15 prevents the Commission from acting to establish a different rate model for 2009 than is
16 currently in place through 2008. The Settlement Agreement and Decision No. 62103 are silent
17 as to what TEP's generation service rates will be after December 31, 2008, except to indicate
18 that neither the fixed nor the floating CTC will be included in those rates. The Commission is
19 therefore free to adopt whatever rates are appropriate once the rate freeze of Decision No.
20 62103 expires. In fact, Staff's witness in TEP's recent rate review proceeding recommended
21 that the Commission require the Company to file for new rates to be effective when the current
22 rate freeze ends.¹⁵

14 A.A.C. R14-2-1606(B) (subsequently stayed by Decision No. 65154); A.A.C. R14-2-1606(A).

15 See prefiled Direct Testimony of James J. Dorf, filed June 24, 2005 in Docket No. E-01933A-04-0408 at pg. 27-28.

1 Additionally, the Commission may determine that the rates in 2009 could be decreased
2 from today's levels. The fact that no party to the recent rate review concluded that TEP was
3 overearning should not be taken to mean that the Company would necessarily be entitled to a
4 rate increase in 2009. Eighty-one million dollars of fixed CTC revenues and \$25.8 million of
5 stranded cost amortization were removed from consideration in the rate review.¹⁶ Likewise,
6 rates established to begin in 2009 would not include stranded cost amortization expenses, as
7 the stranded costs will be fully amortized by the end of 2008. Therefore, it is possible that the
8 \$81 million in CTC revenue would not be necessary, and rates that were set to recover
9 stranded costs could be decreased in 2009. The Commission should act cautiously before
10 agreeing to maintain rates at their current levels past 2008.

11 TEP's Motion asks the Commission to act now to determine rates for 2009 and 2010.
12 Regardless of when the Commission believes it is appropriate to set rates for that period, there
13 is no need to amend Decision No. 62103 to adopt new rates to be effective after the terms of
14 Decision No. 62103 are fulfilled.

15 Retain current CTC amortization schedule

16 TEP's second proposed action to amend Decision No. 62103 is to retain the current
17 amortization of the fixed CTC that was set forth in the Settlement Agreement and approved in
18 Decision No. 62103. Pursuant to the Settlement Agreement, the fixed CTC would be
19 amortized over the period 1999 to 2008. RUCO is not aware of any party to the Settlement
20 Agreement who has suggested that the amortization schedule be modified. In any event, there
21 would be no need to modify Decision No. 62103 to maintain the effectiveness the terms of
22 Decision No. 62103.

16 Revised Schedule C-2 , filed September 15, 2004 in Docket No. E-01933A-04-0408.

1 TEP's agreement to not seek rate base treatment for certain assets

2 TEP's third action proposed for the amendment of Decision No. 62103 is that TEP
3 indicates it would agree to not seek rate recovery of certain generation assets. Again, no
4 amendment of Decision No. 62103 is necessary for the Company to decline to seek recovery
5 of its recently acquired interest in the yet-unconstructed Luna plant, or any other asset. If the
6 Company believes that such an offer provides benefits to customers, it can propose it in a
7 future proceeding at which time the Commission would be considering rates for some period
8 after 2008.

9
10 Adjustor Mechanism in 2009

11 TEP's final proposed amendment to Decision No. 62103 is its request for the
12 implementation of an adjustor mechanism effective in 2009. Like TEP's other proposals in the
13 Motion, granting of this request would not require any modification to Decision No. 62103.
14 Nothing in the Settlement Agreement or Decision No. 62103 fixes rates for any period after
15 December 31, 2008. Therefore, if the Commission believes an adjustor mechanism is an
16 appropriate device for TEP to recover certain costs, it need not amend Decision No. 62103 to
17 adopt such a mechanism. RUCO will provide its analysis of the merits of any such adjustor
18 mechanism proposal at such time as the Commission might undertake a consideration of it.

19 Regardless of whether implementation of such a mechanism requires amendment of
20 Decision No. 62103, it is completely inconsistent with TEP's first proposed amendment to that
21 Decision, which proposed fixing customers rates through 2010. Beginning in 2009, the
22 proposed adjustor mechanism would accrue for later recovery the difference between TEP's
23 current fixed generation rate and a market energy rate for all energy above TEP's 2003 retail
24 load. If customer rates were truly fixed through 2010, nothing related to the costs the
Company incurs to self-generate all of its required energy or acquire any of that energy from

1 others should result in a change in customer rates. The proposed adjustor mechanism,
2 however, would allow certain amounts related to energy consumed prior to 2009 to be passed
3 through to customers in addition to the rates currently in effect.

4 5 Fair Value Finding

6 While it would not be necessary to amend Decision No. 62103 to adopt TEP's first and
7 fourth proposals, the Commission could only adopt those proposals in conjunction with a
8 finding of the fair value of TEP's rate base.¹⁷ A fair value finding must be made at the time the
9 Commission establishes rates.¹⁸ The last time the Commission made a finding of TEP's fair
10 value rate base was in connection with the adoption of a rate settlement in 1998.¹⁹ In Decision
11 No. 62103, the Commission made no fair value finding, concluding that the mere unbundling of
12 TEP's previously authorized rates did not require any additional financial analysis.²⁰ The 1998
13 fair value finding, which was agreed to by the parties and not subjected to a hearing, is already
14 nearly seven years old, and by the time these "revised" provisions would become effective,
15 that fair value finding would be more than 10 years old. The Commission should reject any
16 suggestion by TEP to rely on such a stale fair value finding as a basis to determine rates to be
17 effective in 2009 and 2010.

18 19 **CONCLUSION**

20 Regardless of the merit of any of TEP's four proposals, there is no need to reopen
21 Decision No. 62103 to adopt them. The Commission can act as appropriate to set rates for
22

23 ¹⁷ *Simms v. Round Valley Power & Light Co.*, 80 Ariz. 145, 294 P.2d 378, (1956); *Residential Util.*
24 *Cons. Off. v. Ariz. Corp. Comm'n*, 199 Ariz. 588, 20 P.3d 1169 (App. 2001).

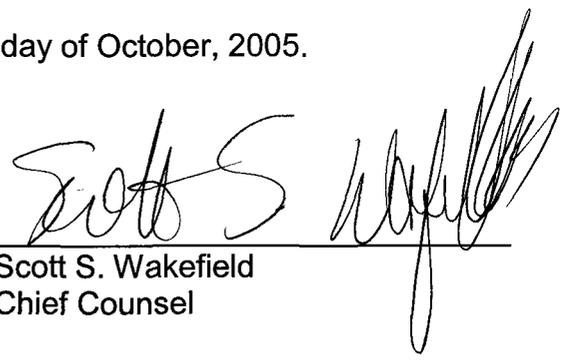
¹⁸ *Simms*, 80 Ariz. at 151, 294 P.2d at 382.

¹⁹ Decision No. 61104. In Decision No. 62103, the Commission relied on the fair value finding it had
made just a year earlier, and did not enter a separate finding of fair value rate base.

²⁰ Decision No. 62103 at 5.

1 2009 and beyond without implicating the terms of Decision No. 62103. However, any action to
2 adopt TEP's first or fourth proposal should be accompanied by a more current finding of fair
3 value rate base than the one found in 1998.

4 RESPECTFULLY SUBMITTED this 12th day of October, 2005.

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