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BEFORE THE ARIZONA CORPORATION COMMISSION

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E-01933A-02-0069

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

Docket No.

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DIRECT TESTIMONY OF

STEVEN J. GLASER

On Behalf of Tucson Electric Power Company

April 2, 2002

Arizona Corporation Commission  
DOCKETED

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DIRECT TESTIMONY OF STEVEN J. GLASER

Q: Please state your name and your business address.

A: My name is Steven J. Glaser. My business address is Tucson Electric Power Company ("TEP"), P.O. Box 711, Tucson, Arizona 85702.

Q: What is your position with TEP?

A: I am employed by TEP as Senior Vice President and Chief Operating Officer for the Utility Distribution Company.

Q: What are your duties and responsibilities at TEP?

A: My duties and responsibilities include overseeing all aspects of TEP's transmission and distribution systems. I am also responsible for overseeing TEP's filings and proceedings related to the Arizona Corporation Commission ("Commission").

Q: What is the purpose of your direct testimony?

A: The purpose of my testimony is to explain and support TEP's Request for a Variance in this docket.

Q: Please summarize TEP'S Request For a Variance.

A: TEP is requesting that the Commission grant an extension of the compliance date for A.A.C. R14-2-1606.B, which requires that power purchased by TEP for Standard Offer Service "shall be acquired from the competitive market through prudent, arm's length transactions, and with at least 50% through a competitive bid process". TEP is also requesting an extension of the compliance date for A.A.C. R14-2-1615.A, which requires that all competitive generation assets and competitive services be separated from TEP.

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1 Specifically, TEP is requesting that the compliance dates be extended to either December  
2 31, 2003 or a date six months after the Commission has issued a final order in "In the  
3 Matter of the Generic Proceedings Concerning Electric Restructuring Issues," A.C.C.  
4 Docket No. E-00000A-02-0051 (the "Generic Restructuring Docket"), whichever is the  
5 later date. Lastly, although TEP does not believe that this Request for a Variance will  
6 require a modification of the Settlement Agreement approved in Decision No. 62103 (the  
7 "TEP Settlement Agreement"), TEP is requesting that, to the extent required, the  
8 Commission approve any modification to the TEP Settlement Agreement deemed  
9 necessary in connection with the Request for a Variance.

10  
11 Q: Why does TEP believe that it is appropriate to file a Request for a Variance at this time?

12 A: Under the current Electric Competition Rules (A.A.C. R14-2-1601 et seq.; sometimes  
13 referred to as "Rules"), TEP is required to take significant steps at a time when the  
14 Commission is evaluating the status of the Rules. TEP believes that it would be prudent to  
15 maintain the status quo until the Commission has completed its evaluation and determines  
16 how it will proceed with competition in this State. As TEP stated in its comments in the  
17 Generic Restructuring Docket and in the Application filed in this docket, it is appropriate  
18 for the Commission to state whether it expects TEP to divest its generating assets and  
19 acquire its power needs from the competitive market during the re-evaluation of the Rules.  
20 Specifically, pursuant to A.A.C. R14-2-1606.B (as modified by the TEP Settlement  
21 Agreement), TEP will be obligated to purchase at least 50% of the power for its Standard  
22 Offer Service through a competitive bid process starting January 1, 2003 ("50% bid  
23 requirement"). Pursuant to A.A.C. R14-2-1615.A, TEP will be obligated to separate its  
24 "competitive generation assets and competitive services" by transferring them to either an  
25 unaffiliated party or to a separate corporate affiliate or affiliates ("generation separation  
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requirement"). I should note that although the Rules originally set a compliance date of January 1, 2001, the TEP Settlement Agreement established a new deadline of December 31, 2002. The 50% bid requirement and the generation separation requirement will require a significant commitment of TEP funds, time and resources to effectuate. And, the generation separation requirement will permanently alter the Commission's regulation of TEP's generation assets. It just does not seem prudent to take these steps at a time when the Commission is re-visiting the Rules, which might result in a modification of the 50% bid requirement and the generation separation requirement. So, TEP filed the Request for a Variance.

Q: What will be the impact of TEP's Request for a Variance?

A: If, granted, TEP's requested variance will merely maintain the status quo while the Commission re-visits the Rules and related issues rather than force TEP to take costly and permanent steps that might negatively impact TEP, its customers and the Commission's jurisdiction over TEP's generation assets.

Q: How will the transfer of generation assets from TEP to another entity impact the Commission's jurisdiction over TEP's generation assets?

A: As presently contemplated, the generation separation requirement will result in the Commission ceding regulation of assets engaged in wholesale transactions to the Federal Energy Regulatory Commission ("FERC").

Q: Please describe what steps TEP must take to comply with A.A.C. R14-2-1606.B. by December 31, 2002.

A: Compliance with A.A.C. R14-2-1606.B will require TEP to develop and administer a solicitation for power supply proposals. The steps required include (1) determination of

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the quantity of energy equivalent to 50%, (2) identification of the desired energy products, (3) drafting Requests for Proposals ("RFPs"), (4) distributing the RFPs, (5) collecting and evaluating responses, (6) selecting a short list of bidders, (7) drafting and negotiating agreements, (8) submitting agreements to the appropriate regulatory authorities for approval, and (9) arranging for delivery of the energy. Additionally, TEP will be required to negotiate agreements for the supply of the remaining 50% of its energy requirements.

Q: Please describe what steps TEP must take to comply with A.A.C. R14-2-1615.A by December 31, 2002?

A: The steps required to comply with A.A.C R14-2-1615.A include forming and staffing a generation entity, and executing contract assignments from TEP to the new entity. These steps will require significant involvement by outside legal and accounting personnel.

The formation of a new generation entity requires (1) establishing the entity, (2) obtaining federal and state tax identification numbers, (3) preparing corporate record books, (4) establishing employee benefit plans, (5) hiring and/or transferring employees, (6) consulting with union officials regarding employee transfers; (7) establishing accounting and other information systems; and (8) establishing operating policies and procedures.

In addition, TEP has identified over 200 agreements and permits that may need to be assigned by TEP to the new generation entity. Certain of these assignments require third party consents, which may require negotiation as to the terms and conditions of each consent.

Finally, in connection with the generation separation requirement, TEP will need to obtain legal, tax and financial accounting services to review the transaction, corporate structure, and intercompany relationships between TEP and the generation entity.

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Q: What costs will TEP incur in connection with compliance with A.A.C. R14-2-1615.A & R14-2-1606.B?

A: The estimated cost that will be incurred to effectuate the 50% bid requirement and the generation separation requirement prior to December 31, 2002 is several million dollars. TEP has already begun the compliance process and requests that the Commission grant the variance before additional and significant costs are incurred.

Q: Do you have any concluding remarks?

A: Yes, I want to express several additional reasons why the Request for Variance is in the public interest.

TEP believes that if it is required to meet the 50% bid requirement within the time frame now set, both TEP and its customers will be subject to the following negative situations. First, the potential availability of reasonable competitive bids is simply unknown. Today, the entire western wholesale power market is in a state of flux. That evolving market – including recent and ongoing FERC activity, numerous proposed merchant plants and uncertainty about transmission issues – makes it difficult to evaluate the reasonableness of competitive bids in terms of duration of a contract and other contract terms.

Also, being obligated to the 50% bid requirement within the current timeframes puts TEP at a distinct disadvantage in obtaining acceptable bids. The experience of utilities in California demonstrated that regulatory obligations placed on retail energy providers (such as TEP), can create economic hardships for those providers in an immature competitive market. The California experience confirms the desirability of financially stable utility distribution companies that can provide reliable service. The potential restrictions of the 50% bid requirement in an uncertain generation market may subject TEP to unwarranted

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financial difficulties.

The financial instability of some power marketers also raises significant concerns. TEP is concerned that if it is dependent upon obtaining a significant amount of its power from these sources, it may not be able to meet its duty to provide reliable power to its customers.

As a final comment, although TEP has only recently received the Staff Testimony in the APS Variance Docket (ACC Docket No. E-01345A-01-0822), and is in the process of thoroughly analyzing the testimony, it does appear that Staff is offering recommendations in that case that are similar to TEP's Request for a Variance. Again, without commenting or taking a position on Staff's recommendations, it does appear that Staff is suggesting that the Commission take a more deliberate approach to transitioning from a regulated electric industry to a competitive marketplace than is presently contemplated. Again, if the Commission is contemplating changes to the Rules which affect the 50% bid requirement, the generation separation requirement and/or the TEP Settlement Agreement, I believe that maintaining the status quo now is prudent for TEP, its customers and the Commission.

Q: Does that conclude your testimony?

A: Yes, it does.