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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE FILING BY
TUCSON ELECTRIC POWER COMPANY TO
AMEND DECISION NO. 62103.

DOCKET NO. E-01933A-05-0650

**STAFF'S COMMENTS IN RESPONSE TO
THE COMMENTS OF OTHER PARTIES
REGARDING TUCSON ELECTRIC
POWER COMPANY'S PROPOSED FORM
OF ORDER**

Consistent with the directions provided by the Administrative Law Judge at the conclusion of the hearing in this matter, Tucson Electric Power Company ("TEP" or "Company") submitted a Proposed Recommended Opinion and Order in the matter. Thereafter, on March 28, 2007 Parties submitted comments in response. The Judge's directions contemplated that by April 4, 2007 Parties would submit comments responsive to those submitted by others. Accordingly, Staff hereby submits these brief responses to the comments of other Parties.

I. RESPONSE TO AUIA

As commonly occurs, the Arizona Utility Investors Association comments provide little more than an echo of the position taken by the Company. Accordingly, Staff's Comments in Response to TEP's Proposed Opinion and Order should be deemed as responding to the comments of AUIA as well.

II. RESPONSE TO M/S/B/S

Mesquite Power, L.L.C., Southwestern Power Group II, L.L.C., Bowie Power Station, L.L.C., and Sempra Energy Solutions (collectively referred to as "M/S/B/S") provided a response to TEP's proposal that addressed a limited scope of issues. Specifically, M/S/B/S was concerned that TEP's

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1 proposed form of order would have the effect of prejudging the issue of whether to retain the
2 opportunity for future retail competition within TEP's service territory.

3 In Staff's view, any proceeding that is commenced without having resolved the issues raised
4 by the pending docket should be held in such a manner as to provide the Commission with as much
5 information as possible, without prejudging the positions of parties on specific underlying issues.
6 Accordingly, Staff agrees with M/S/B/S that the issue of whether TEP's service territory should
7 regain an element of "exclusivity" should be decided in the course of deciding the rate case filing,
8 rather than as an attribute of the order preserving issues from this docket so that a rate case can be
9 considered.

10 **III. RESPONSE TO SWEEP**

11 Southwest Energy Efficiency Project ("SWEEP") submitted comments limited to a discussion
12 of the manner in which Demand Side Management ("DSM") proposals should be considered during
13 the pendency of the upcoming rate proceeding. SWEEP proposes that DSM be the subject of a third
14 docket, separate from the pending Motion to Amend and rate case docket, and separate from the
15 docket assigned to review TEP's Renewables proposals. SWEEP anticipates that this approach will
16 allow the resolution of DSM issues more promptly than would otherwise be the case.

17 Staff does not oppose the proposal to have a comprehensive review of DSM proposals
18 conducted in a separate docket from the rate case docket. However, Staff continues to have concerns
19 about whether such a docket will facilitate significant increased spending on DSM in the absence of a
20 cost recovery proposal. Staff continues to suggest that the Commission should consider authorizing
21 an accounting order or other regulatory order to provide for the capitalization and later recovery of
22 DSM costs to the extent they exceed the costs currently provided in base rates. The mechanism could
23 be discussed and established in conjunction with the separate DSM docket envisioned by SWEEP. It
24 is certainly desirable to consider the size of approved expenditures by reference to the likely cost
25 effectiveness of the DSM proposals under consideration, as well as giving consideration to an overall
26 cost structure.

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1 **IV. RESPONSE TO DOD**

2 The Department of Defense (“DOD”) submitted comments discussing the fact that no party
3 other than TEP had their proposals referenced in TEP’s proposed form of order. In addition, DOD
4 noted that TEP’s proposal to accomplish the rate stability aspects of its recommendation by adjusting
5 the MGC mechanism is unnecessary. DOD further noted that TEP’s proposed treatment of the
6 revenues recovered following the date the when the Fixed CTC would ordinarily expire appears to
7 unfairly prejudice the ultimate treatment of those revenues, and notes that it is unnecessary to
8 determine a refund period for any required refund of CTC revenues at this time.

9 Staff is in general agreement with all of DOD’s comments. Certainly a Recommended
10 Opinion and Order in this matter should appropriately recognize that there is a fully developed record
11 present in this matter and that TEP’s proposals are generally unsupported on that record. Staff’s
12 comments were clear that we are willing to consider permitting recovery of Fixed CTC revenue
13 amounts following the time when it is scheduled to expire, but only with clear provisions that such
14 revenues may be subject to refund upon the Commission’s determination. As DOD correctly points
15 out, the MGC plays no role in that matter, and should not be accorded any status in connection with
16 the determination. Most importantly, the issue of whether refunds will be required of revenues
17 collected once the Fixed CTC expires is one that should be left for consideration in the upcoming rate
18 case. The order in this matter should be primarily concerned with preserving issues, not with
19 prejudging them in a manner that suits TEP.

20 **V. RESPONSE TO AECC**

21 Phelps Dodge Mining Company and Arizonans for Electric Choice and Competition
22 (collectively “AECC”) submitted comments covering five different areas. As will be described in the
23 subsequent paragraphs, Staff agrees with certain of AECC’s suggestions, but disagrees with others.

24 First, AECC indicates that the Commission has a sufficient record in this docket to reject
25 TEP’s claim that the Settlement Agreement sets standard offer generation rates based on the MGC.
26 Staff agrees with AECC on this issue. Staff does not believe this to be a critical aspect of the pending
27 rate case, but it is clear from the record developed to date that the MGC was created as a device used
28 to set the Floating CTC in connection with stranded cost recovery.

1 AECC next indicates a willingness to engage in settlement discussions aimed at reaching what
2 TEP has called a “regulatory solution”, or an agreement to modify the 1999 Settlement Agreement
3 and Decision No. 62103. AECC indicates a specific willingness to consider TEP’s “hybrid
4 proposal”. While Staff is willing to engage in Settlement discussions, the context should be clear.
5 Staff believes that TEP’s rates should be set in the course of a complete, cost-of-service rate
6 proceeding, including an examination of all of TEP’s generation, transmission, and distribution costs.
7 Staff would be willing to engage in settlement discussions during the course of the proceeding. It is
8 important to note that, as a general matter, in Staff’s view any settlement involving any of TEP’s
9 generation rates to be set on a market based approach would likely entail agreement for TEP to divest
10 itself of any such assets and acquire generation to supply standard offer customers from the market.

11 Thirdly, AECC opposes allowing TEP to retain the current level of standard offer rates after
12 the Fixed CTC expires. As has been explained earlier in this document, as well as in Staff’s original
13 comments, Staff is willing to permit TEP to continue to recover rates at their current level, although it
14 must be clear that any recovery beyond what would have been required to amortize the Fixed CTC
15 must be subject to refund if the Commission so determines. Staff also concurs with AECC’s
16 comments noting that the mechanism proposed by TEP for retaining the current level of rates should
17 not be permitted to “bootstrap” significance onto the MGC in a manner that is inconsistent with the
18 record in this matter. The MGC is a stranded cost recovery device, used to calculate the Floating
19 CTC. It should not be used as a means of tracking revenue recovery after the Fixed CTC is fully
20 recovered, unless it is made clear that the sole purpose is to track revenues related to the Fixed CTC
21 for possible refund if the Commission so determines.

22 Staff agrees with AECC’s fourth assertion, relating to the manner in which TEP’s proposals
23 should be presented. TEP’s proposed form of order was wholly inadequate in the manner by which it
24 failed to reflect the positions of parties other than the Company.

25 Finally, Staff’s position with regard to the adoption of funding arrangements for new DSM
26 and RES requirements is clear. RES funding should be addressed by TEP in the same manner and at
27 the same time as other electric utilities upon the REST rules becoming effective. DSM expenditures
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1 that exceed those currently being recovered in base rates should be the subject of an accounting order
2 or other mechanism to allow them to be capitalized for later recovery.

3 **VI. RESPONSE TO IBEW LOCAL 1116**

4 Local Union 1116, International Brotherhood of Electrical Workers, AFL-CIO, CLC (“IBEW
5 Local 1116”) submitted comments essentially noting that the result of TEP’s proposed form of order
6 is to convert the pending Application into a rate case. IBEW Local 1116 offered some opinions with
7 regard to the potential outcome of the rate case, as well as some opinions regarding the manner in
8 which certain matters were portrayed in TEP’s proposed form of order.

9 Staff generally agrees that upon approval of an order in this docket, it will largely cease to be
10 a request to amend the 1999 Settlement and primarily become a rate proceeding. Staff agrees with
11 IBEW Local 1116 that TEP could have accomplished essentially the same result by withdrawing its
12 Application to Amend the 1999 Settlement and replacing it with a rate case application.
13 Nevertheless, Staff continues to support the resolution of this docket in a manner that will permit the
14 presentation of a complete rate proceeding, which may include information from which the
15 Commission may conclude that TEP’s proposed “regulatory solutions” should be approved, in whole
16 or in part. Assuming sufficient information is available to the Commission to support its conclusions,
17 Staff has no preconceived notions with respect to the upcoming rate proceeding.

18 Staff does note that, unlike IBEW Local 1116, Staff has no expectation as to whether the rate
19 proceeding will or will not result in a rate increase for TEP. Staff expects to analyze the filing and
20 make appropriate recommendations. Staff does agree with IBEW Local 1116 that TEP has
21 formulated its proposed form of order in a manner that purports to give TEP’s proposals
22 disproportionate weight in considering the way to proceed.

23 **VII. RESPONSE TO RUCO**

24 The Residential Utility Consumer Office (“RUCO”) provided comments proposing that the
25 Commission should simply address the question of what is provided by the Settlement Agreement
26 (characterized by RUCO as the “core” question) in lieu of adopting a process that would allow all
27 potential rate impacts to be examined in a rate case before reaching a definitive conclusion on the
28 question of whether TEP would be able to charge market –based rates after 2008. RUCO goes on to

1 note that TEP's proposed form of order presents a number of problems if the Commission should
2 decide to conduct a rate proceeding before deciding the "core" question.

3 Staff certainly agrees with RUCO that sufficient evidence has been developed on this record
4 from which the Commission could resolve the question of whether the 1999 Settlement somehow
5 authorized TEP to charge market-based generation rates to its standard offer customers commencing
6 in 2009. As was indicated in discussing AECC's comments, Staff believes that the 1999 Settlement
7 Agreement is clear and that the record in this proceeding is sufficiently developed to conclude that
8 TEP has no legal right to commence charging market-based generation rates to its standard offer
9 customers in 2009. Nevertheless, Staff is not opposed to leaving the issue undecided, to be resolved
10 in the course of a full cost-of-service rate case to be filed no later than August 1, 2007. The August 1
11 date was discussed at the conclusion of the hearing along with the procedures for developing a
12 proposed form of order to present to the Commission.

13 Staff does agree with RUCO that the proposed form of order submitted by TEP is inadequate
14 to accomplish this purpose without modification. Staff agrees with RUCO that the provisions under
15 which TEP should be allowed to continue collecting 9.3 mils/kWh of revenue during the rate case
16 must be amended. Staff agrees with RUCO that any revenue collected as a result of the continuation
17 should be subject to complete refund of all revenue collected, including an interest component,
18 subject only to the Commission's determination of the amount and timing of any refund.

19 Staff further agrees with RUCO that the proposed procedure should not be considered as a
20 continuation of any settlement discussions. As discussed earlier, Staff would be willing to entertain
21 settlement discussions as a part of the rate case process, but does not consider the continued
22 proceeding to constitute a settlement process. Rather, Staff considers it to be a rate case process in
23 which TEP's rates will be established by the Commission.

24 Staff understands RUCO's position with respect to what RUCO calls the legal insufficiency
25 of provisions to preserve parties' rights under the 1999 Settlement Agreement. However, Staff does
26 not believe that RUCO's concerns should prevent the Commission from undertaking a rate
27 proceeding before reaching a final resolution on the question of whether to allow TEP to charge
28 market-based generation rates in 2009. Staff does not believe that it is necessary to preserve the

1 rights of parties to the 1999 Settlement Agreement for the Commission to proceed as envisioned. To
2 Staff's knowledge, no party to the 1999 Settlement Agreement (other than TEP in this proceeding)
3 has alleged that the Agreement has been breached. Furthermore, with the possible exception of
4 allowing TEP to collect revenue that arguably relates to the Fixed CTC beyond the otherwise
5 applicable date, no party has alleged that the 1999 Settlement Agreement would be breached if the
6 Commission awaits the outcome of a rate proceeding to fully and finally determine TEP's rates to be
7 effective January 1, 2009. So long as the Commission makes adequate provision for refunds to
8 customers if it determines the Fixed CTC revenues to be subject thereto, Staff believes the
9 Commission can safely proceed in the general manner described in TEP's filing. Of course, there are
10 several changes to TEP's proposed form of order that will be necessary to accomplish this goal.

11 Staff agrees with RUCO that the language of TEP's proposed form of order suggests a pre-
12 determination of outcomes in the rate case. Staff requests the Administrative Law Judge to adopt
13 changes to TEP's proposal that would alleviate this situation. Staff believes the comments provided
14 by parties provide sufficient guidance to achieve this result. In this regard, Staff agrees with RUCO's
15 comments regarding DSM and renewable energy cost recovery issues. Staff's earlier comments
16 regarding these issues should be adopted.

17 Finally, Staff offers no comment with respect to whether RUCO believes that a full rate case
18 is necessary to fully evaluate TEP's rate proposals. As indicated earlier, Staff agrees that the "core"
19 question could be resolved based on the record in this proceeding, without a full rate case. However,
20 Staff stands willing to process a full rate case in which TEP is provided the opportunity to suggest
21 alternative means of regulating its generation assets. Staff believes that, so long as an adequate
22 record is presented on all necessary issues, including market studies and transmission adequacy
23 studies, the Commission should have the opportunity to set TEP's rates in whatever manner it deems
24 appropriate, subject only to legal constraints. Within that context, Staff is willing to process the rate
25 case it foresees and offer recommendations to establish just and reasonable rates for TEP to
26 commence at the conclusion of its rate moratorium.

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1 **VIII. CONCLUSION**

2 With appropriate amendments, the proposed order submitted by TEP could form the basis for
3 a proceeding that would resolve the controversy generated by this docket. Staff does not believe that
4 TEP currently prices its standard offer generation on a market-based approach, or that the 1999
5 Settlement somehow authorizes market-based pricing for standard offer generation. Furthermore, the
6 MGC mechanism is intended solely as a device to calculate the Floating CTC associated with
7 stranded cost recovery, not as a basis for pricing generation service to TEP's standard offer
8 customers. The silence of the 1999 Settlement Agreement with respect to rates after January 1, 2009
9 does not imply that market-based generation rates were or are contemplated in that time-frame.
10 Additionally, the Track A and Track B dockets, in conjunction with the *Phelps Dodge* decision,
11 render any proposal to charge market-based rates to standard offer customers extremely problematic,
12 if not simply unlawful.

13 Nevertheless, Staff believes that a full cost-of-service rate case, including generation,
14 transmission and distribution assets will provide the best device from which to determine TEP's rates
15 starting January 1, 2009. Staff further is willing to agree to allow rates to remain unchanged during
16 the pendency of such a case, provided a mechanism is adopted to track the revenue associated with
17 such a decision for potential refund under circumstances to be determined by the Commission in the
18 course of the rate case. TEP should be allowed to offer alternative regulatory structures for the
19 Commission's consideration. However, TEP should have the burden of supplying adequate
20 supporting evidence from which the Commission can decide whether to adopt any such proposals.
21 And, of course, any such proposals must be legal.

22 Finally, Staff does not agree with this proposal based on any "fear" of litigation. Nor should
23 the Commission be considered as "shirking" its responsibilities to regulate if it adopts such a
24 proposal. Rather, it should be seen that the electric utility industry has undergone a period of
25 challenge. Restructuring, which was initially thought to be inevitable, is now largely deemed
26 unworkable. In establishing new rates for TEP as the rate moratorium comes to an end, the
27 Commission should operate in an environment in which it has as much information as possible, and
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1 considers all options. Staff ultimately believes that the result will be cost-of-service based rates in
2 amounts determined by the Commission to be just and reasonable.

3 RESPECTFULLY SUBMITTED this 4th day of April, 2007.

4
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