



Arizona Corporation Commission

BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED  
DEC 19 1996

RECEIVED  
AZ CORP COMMISSION

DEC 19 2 35 PM '96

1  
2  
3 RENZ D. JENNINGS  
4 Chairman  
5 MARCIA WEEKS  
6 Commissioner  
7 CARL J. KUNASEK  
8 Commissioner

DOCKETED BY

DOCUMENT CONTROL

9 IN THE MATTER OF THE COMPETITION IN ) DOCKET NO. U-0000-94-165  
10 THE PROVISION OF ELECTRIC SERVICES )  
11 THROUGHOUT THE STATE OF ARIZONA. ) **EXCEPTION TO PROPOSED**  
12 ) **ORDER ADOPTING RULES ON**  
13 ) **ELECTRIC INDUSTRY**  
14 ) **RESTRUCTURING**

15 On October 1, 1996, the Utilities Division ("Staff") of the Arizona Corporation Commission  
16 ("Commission") filed Proposed Rules in the above-referenced Docket. On October 10, 1996, the  
17 Commission issued Decision No. 59870 that authorized that a Notice of Proposed Rule Making be  
18 forwarded to the Secretary of State. This commenced the formal adoption process of the Proposed  
19 Rules under the Arizona Administrative Procedures Act. The Commission held public comment  
20 sessions on the Proposed Rules on December 2, 3 and 4, 1996. On December 13, 1996, Staff issued  
21 a Proposed Order which, if approved by the Commission, would adopt the Proposed Rules. Tucson  
22 Electric Power Company ("TEP" or "Company") hereby submits this Exception to the Proposed  
23 Order.

24 **I. INTRODUCTION**

25 TEP supports retail electric competition in Arizona. TEP, however, cannot support the  
26 Proposed Rules and urges the Commission to reject the Proposed Order. Although supporters of the  
27 Proposed Rules may allege that the Company is merely attempting to delay the advent of retail  
28 electric competition in Arizona, quite the contrary is true. The Company has never said that the  
29 flaws of the Proposed Rules could not be fixed within the Commission's timeframe for  
30 implementing retail electric competition. Instead, the Company has consistently stated that the rule  
adoption process should not be rushed but should include a comprehensive evaluation that will result  
in a rule that adequately addresses the major issues that will affect all parties, including, but not  
limited to, electric utilities, shareholders, other energy providers and customers.

1           As currently drafted, the Proposed Rules unnecessarily leave major financial, legal,  
2 operational, pricing and reliability issues unresolved. By initiating a consensus building process as  
3 has been followed in other jurisdictions, many of these issues can be expeditiously resolved and  
4 retail electric competition may be brought to Arizona quickly and efficiently, and within the  
5 timetable set forth in the Proposed Rules. Competition dockets in other jurisdictions have  
6 recognized the need for careful consideration of the issues raised in electric industry restructuring  
7 *prior* to adopting legislation or rules. Instead, the Proposed Rules take a “we’ll figure this out later”  
8 approach to these major issues without regard to their inevitable implications.

9           Although it has been alleged throughout the proceedings that the Commission is ready to  
10 adopt rules because it has been studying electric competition issues for over two years, this is only  
11 partially true. Until recently, the process that has been followed, the reports that have been issued  
12 and the workshops that have been held have only served the purpose of *identifying broad issues*. At  
13 no time have the *specific solutions* that have been offered by any of the Affected Utilities been  
14 incorporated into the Proposed Rules. Nor have any attempts been made to build a consensus among  
15 stakeholders, as has been done in other jurisdictions including California and FERC. As a result, the  
16 Commissioners and the Proposed Order have referred to the Proposed Rules as a mere “framework”  
17 to build upon for future amendment. Why then, adopt Rules that are admittedly flawed? Arizona  
18 administrative agency rules have the same force and affect of law with corresponding obligations  
19 and sanctions contained therein. As TEP has previously recommended, because the Commission  
20 acknowledges that changes need to be made, it can simply adopt the Proposed Rules as a Statement  
21 of Policy with a timetable to adopt definitive rules in the future. This would preserve the timeframes  
22 set forth in the Proposed Rules for phasing-in competition, thereby eliminating the *delay* the  
23 Commission fears. It would also negate the inevitable appeal and litigation of the Proposed Rules  
24 which could potentially create the very delay the Commission is trying to avoid.

25           Although supportive of competition, practically all of the primary stakeholders (with the  
26 exception of those that have a major pecuniary motivation to see the Proposed Rules adopted in their  
27 present form and at this time) oppose the adoption of the Proposed Rules at this time because they  
28 are simply incomplete. Further, the process that the Commission has followed for such important  
29 rules is unfair and is a departure from the Commission’s usual procedure for rulemaking. For  
30 example, instead of an independent Hearing Officer evaluating the Proposed Rules, along with all of

1 the written and oral comments, a Proposed Order has been prepared by Staff, the very party that  
2 initially proposed the rules. Further, given the timeframe for adoption of the Proposed Rules, the  
3 Commission has not had adequate time to review the hundreds of pages of comments that have been  
4 filed or the transcripts of public comment sessions.

## 5 **II. MAJOR CONCERNS**

6 TEP's major concerns and comments with respect to the Proposed Rules are set forth in its  
7 First and Second Set of Comments filed on November 7 and December 4, 1996, respectively. These  
8 comments are hereby incorporated herein by reference. The Company will not, therefore, reiterate  
9 what is set forth therein. In support of TEP's request that the Commission reject the Proposed Order,  
10 the Company, however, would like to bring the Commission's attention to the following:

### 11 A. The Proposed Rules "put the cart before the horse."

12 In its written comments, the Company pointed out the many issues that need to be resolved  
13 *prior* to adoption of any rules on electric industry restructuring. These include, but are not limited  
14 to, issues relating to recovery of stranded cost, unbundled and standard offer services, establishment  
15 of an independent system operator ("ISO"), reliability, in-state reciprocity and other legal and  
16 legislative issues. These are all issues that could and should be addressed prior to the proposal of  
17 any rules on industry restructuring.

### 18 B. The Proposed Rules leave many major issues unresolved and are vague and 19 contradictory.

20 1. Stranded Cost - Although R14-2-1607.B indicates that "the Commission *shall*  
21 *allow recovery of unmitigated* Stranded Cost," the remainder of this Rule does not provide any  
22 assurance as to what that Stranded Cost might be and imposes unreasonable and unrealistic factors  
23 for the Commission to consider in making its determination. For example, R14-2-1607.F only  
24 permits Stranded Cost recovery from those "customer purchases made in the competitive market." It  
25 is an unrealistic expectation that a utility would recover the authorized amount of Stranded Cost if  
26 the time period determined in Section E.8 is insufficient. The issue of Stranded Cost recovery is one  
27 of the most important issues to utilities and their shareholders and certainty should be given in any  
28 rule that 100 percent of such determined costs are recoverable. The Company's position and  
29 recommendations on Stranded Cost recovery are set forth in detail in its comments.

30 ...

1           2.     The Proposed Rules do not remedy the “level playing field” issues - TEP, as  
2 well as other parties, identified peculiarities with various utility providers which could hinder  
3 competition. Specifically, the Proposed Rules exempt Salt River Project (“SRP”) (for all intents and  
4 purposes) and potentially the cooperatives because of these peculiarities. These issues must be  
5 resolved prior to implementation of the Proposed Rules in order for there to be robust competition  
6 with the proper attendant pricing signals. Further, the Commission should resolve the legal and  
7 reciprocity issues relating to SRP. The hastily prepared amendment to the Proposed Rules to include  
8 SRP under certain circumstances is an inadequate stop-gap measure which does not resolve these  
9 issues. With the potential exemption of SRP and the cooperatives from the Proposed Rules, the only  
10 players in Arizona with generation assets will be Arizona Public Service Company and TEP. This  
11 will not bring about a robust competitive marketplace in Arizona. Again, the Proposed Rules “put  
12 the cart before the horse.”

13           3.     The Proposed Rules do not require the establishment of an ISO - The  
14 Proposed Rules provide for the Commission to conduct an *inquiry* into an ISO for the transmission  
15 system, but goes on to say that it ultimately *may* only support development of an ISO. As stated in  
16 TEP’s written comments, given the broad reliability concerns and complexities of the electric supply  
17 system discussed above, TEP believes that an independent third party ISO is necessary to facilitate  
18 generation and transmission reliability in a competitive electric supply market. TEP believes that the  
19 ISO must be developed and operational prior to significant opening of the electric supply market to  
20 competition to ensure that the reliability of the bulk power transmission and production systems is  
21 maintained.

22           4.     Services and Rates - The Proposed Rules relating to Services and Rates  
23 (R14-2-1605, 1606 and 1612, respectively) contradict each other. R14-2-1605 lists competitive  
24 services and includes all services in R14-2-1606. R14-2-1606 lists services that Affected Utilities  
25 *must* provide and implies that these are regulated monopoly services (standard offer services). Yet,  
26 in R14-2-1612.A, the Rule states, “[M]arket determined rates for competitively provided services as  
27 defined in Subsection 1605 shall be deemed to be just and reasonable.” Therefore, Electric Service  
28 Providers that are selling services at competitive prices are deemed to be selling at just and  
29 reasonable rates. Consequently, there should be no need to file tariffs with the Commission. This  
30 circular methodology promotes “regulated competition,” which is not a desired outcome and does

1 not promote economic efficiency through market determined rates.

2 In R14-2-1606.I, the Proposed Rules require that a series of workshops be conducted to  
3 explore issues concerning unbundling. First, these workshops should be completed before the  
4 Proposed Rules are finalized. Second, specific ratemaking issues need to be addressed such as:

- 5 • Cost allocation between competitive and monopoly services
- 6 • Cost allocation between customer classes
- 7 • Using different ratemaking methodologies between FERC and Commission
- 8 jurisdictions
- 9 • Determination of a competitive market
- 10 • The extent of Commission involvement with market determined rates

11 It is essential that proper pricing be implemented during the transition phase to a competitive  
12 marketplace in order for customers to make proper economic decisions. The issues mentioned above  
13 should be fully evaluated and resolved before the first phase of competition takes place.

14 5. The Proposed Rules ignore the requirements of tax-exempt financing - As  
15 discussed in greater detail in the Company's written comments, the Proposed Rules do not address  
16 and consider the implications for Arizona utilities which issue tax-exempt bonds on the basis of a  
17 limited certificated service territory. The Internal Revenue Service allows tax-exempt bonds to be  
18 issued for the benefit of an electric utility provided certain conditions are met and maintained,  
19 including the condition that the utility's retail service territory is contained within two contiguous  
20 counties (*i.e.*, the "two-county" rule). Another condition is that each two-county asset financed with  
21 such bonds must be used solely to serve the utility's retail two-county customers, except during  
22 emergencies. Breaking any one of the conditions could eliminate future two-county financing for  
23 the utility and possibly force the utility to redeem all or a portion of outstanding tax-exempt, two-  
24 county debt. The loss of the cheaper financing would have a significant impact on the utility and its  
25 customers. Although the Proposed Rules provide an exemption for cooperatives to the extent their  
26 status is in jeopardy, they do not provide a similar exemption for investor-owned utilities. This is an  
27 important issue that should be considered before adoption of any rules because of the serious  
28 financial implications.

29 6. Standard Offer Bundled Service - Until such time as the *Commission*  
30 determines that competition has been substantially implemented, utilities are required to offer

1 standard offer service (*i.e.*, stand ready, willing and able to provide service.) Even though customers  
2 may obtain service from another competitor, under this provision the utility must stand ready in case  
3 those customers come back. The Proposed Rules provide no compensation for this standby  
4 requirement.

5 7. Other Issues - As discussed in detail in the Company's previous filings, the  
6 following additional issues have not been fully addressed in the Proposed Rules:

- 7 • Legal implications
- 8 • Financial implications
- 9 • Inconsistency with existing statutes and regulations
- 10 • Integrated Resource Planning Rules
- 11 • Affiliated Interest Rules
- 12 • Level playing field considerations
- 13 • Increased administrative requirements
- 14 • Confidentiality
- 15 • Economic impacts regarding state and local taxes

### 16 **III. CONCLUSION**

17 If the Proposed Rules had been submitted as a discussion draft for Staff and the electric  
18 competition participants to build upon, TEP would be applauding Staff for bringing a good first  
19 effort to the process.<sup>1</sup> However, to go from the identification of broad issues to the proposal of  
20 definitive rules in a matter of weeks, with limited input from the participants, has produced a "final"  
21 product that is reflective of the lack of consideration necessary to achieve the desired goal.  
22 Workshops, technical conferences and evidentiary hearings on the major unresolved issues should be  
23 held. Several drafts of rules should be circulated that incorporate the above efforts and interested  
24 parties should be given a sufficient amount of time to comment. Once this has been accomplished,  
25 definitive rules should be proposed. TEP believes that this can be accomplished in the same  
26 timeframes as set forth in the Proposed Rules. As stated hereinabove, this does not have to result in  
27 slowing the process of bringing electric competition to Arizona if the Commission adopts the

---

28  
29  
30 <sup>1</sup> TEP has reviewed Staff's responses to the comments that were filed. Unfortunately, Staff has attempted to merely rationalize keeping the Proposed Rules at status quo rather than incorporate the needed changes suggested by TEP and other Affected Utilities.

1 Proposed Rules as a Statement of Policy. In fact, by going forward with the Proposed Rules at this  
2 time and under these circumstances, the Commission is creating an atmosphere that could result in  
3 potential delays.

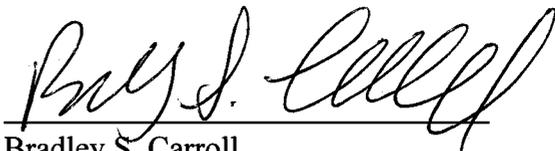
4 As TEP has openly stated, in order to fulfill its fiduciary obligations to its shareholders, the  
5 Company must appeal the Proposed Rules if they are adopted in their current form. TEP would  
6 prefer that the resources of the Commission and the Affected Utilities be spent working together to  
7 build a consensus and to resolve problems with the Proposed Rules before they are adopted.  
8 However, if the Commission rejects this approach in favor of immediate adoption of inherently  
9 flawed Rules, then TEP will be compelled to seek judicial relief.

10 As stated in the Introduction, TEP is in favor of bringing retail competition to Arizona.  
11 However, for the reasons set forth herein, TEP respectfully requests the Commission to reject the  
12 Proposed Order and remand the Proposed Rules to Staff for further study and modification consistent  
13 with the recommendations set forth in TEP's written comments.

14 RESPECTFULLY SUBMITTED this 19th day of December, 1996.

15  
16 TUCSON ELECTRIC POWER COMPANY

17  
18  
19 By:



20 Bradley S. Carroll  
21 Counsel, Regulatory Affairs  
22 Legal Department - DB203  
23 220 West Sixth Street - P.O. Box 711  
24 Tucson, Arizona 85702

25 **Original and ten copies of the foregoing**  
26 **filed this 19th day of December, 1996, with:**

27 Docket Control  
28 Arizona Corporation Commission  
29 1200 West Washington  
30 Phoenix, Arizona 85007

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
29  
30

**Copies of the foregoing hand-delivered  
this 19th day of December, 1996, to:**

Renz D. Jennings, Chairman  
Marcia Weeks, Commissioner  
Carl J. Kunasek, Commissioner  
1200 West Washington Street  
Phoenix, Arizona 85007

Gary Yaquinto, Director  
David Berry  
Utilities Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Paul A. Bullis, Chief Counsel  
Bradford A. Borman, Staff Attorney  
Legal Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

By: Sandra E Waters  
Sandra Waters  
Legal Secretary