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Arizona Corporation Commission

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10 **BEFORE THE ARIZONA CORPORATION COMMISSION**

11 **RENZ D. JENNINGS**  
12 **CHAIRMAN**  
13 **MARCIA WEEKS**  
14 **COMMISSIONER**  
15 **CARL J. KUNASEK**  
16 **COMMISSIONER**

17 IN THE MATTER OF COMPETITION )  
18 IN THE PROVISION OF ELECTRIC )  
19 SERVICES THROUGHOUT THE )  
20 STATE OF ARIZONA )

DOCKET NO. U-0000-94-165

21 **COMMENTS OF**  
22 **SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT**  
23 **AND POWER DISTRICT**  
24 **TO THE CORPORATION COMMISSION STAFF**  
25 **PROPOSED ORDER**

26 **DECEMBER 23, 1996**

**PRELIMINARY STATEMENT**

Locally owned and controlled power has been a customer choice in Arizona for many decades. The goal as we move into a competitive marketplace is to preserve and expand choices for customers, including the choice of public power. It is the goal of SRP to bring competition to its service territory in a fair and nondiscriminatory manner. SRP believes that the rules (with the clarifications set forth below) represent a first step in achieving this goal.

1           The solution to accommodating investor owned and public power in a  
2 competitive marketplace is not more regulation. Rather it will involve a cooperative  
3 transitional process. The ultimate goal of giving the customer a broad range of choices will  
4 best be served by this approach. As contemplated by the rules, an intergovernmental  
5 agreement is the appropriate vehicle to permit public power and the regulators to strike an  
6 appropriate balance.

7           COMMENTS

8           1.           An Intergovernmental Agreement is the Appropriate Mechanism to Blend  
9                           Public and Investor Owned Power Into a Competitive Marketplace.

10           Some critics have missed a basic premise. The option of public power has  
11 always been available as an alternative to the investor owned utilities. In a competitive  
12 marketplace, the threat of this alternative will be no greater. In reality, it will be less, as Salt  
13 River Project Agricultural Improvement and Power District ("SRP") and other public power  
14 entities are not motivated to maximize market share and profits presumably taken from the  
15 investor owned utilities. These are publicly-owned entities created to provide a customer  
16 alternative to regulated private power, and to perform other specific public functions as may  
17 individually be the case. To the extent that SRP loses customers and revenue to competition,  
18 SRP will seek only to replace the lost load and income through other sales and to effectively  
19 market its surplus energy, in order to maintain its financial viability and continue to perform  
20 its traditional functions.

21           The mechanism of an intergovernmental agreement can blend the two systems  
22 of public and private power. An intergovernmental agreement might address as appropriate:

- 23                   •       fair and equitable distribution rates
- 24                   •       a fair and impartial complaint resolution mechanism
- 25                   •       reciprocal terms of service and access among all utilities

26           ...

1 This approach is consistent with the recommendation of RUCO<sup>1</sup> and the  
2 recommendation of the Irrigation and Electrical Districts' Association<sup>2</sup>.

3 It appears that APS and TEP have used this opportunity to launch a frontal  
4 attack on the very option of public power. Using the rhetoric of a "level playing field", APS  
5 advocates the elimination of SRP's "legal preferences and other advantages."<sup>3</sup> TEP suggests  
6 that SRP customers should be surcharged to subsidize investor owned utilities<sup>4</sup>.

7 These points have been made by TEP and APS:

8 *Point One: SRP has an unfair advantage because of tax exempt*  
9 *financing and different tax treatment.*

10 As SRP has discussed elsewhere, and as has been long debated in the electric  
11 industry, while there are differences between public and investor owned power, these  
12 differences offset each other, and there is no inherent advantage or disadvantage to one sector  
13 of the industry or the other. Each has pluses and minuses, pros and cons, and respective  
14

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15 <sup>1</sup> On page seven of its November 27 comments RUCO asserts:

16 RUCO believes that the reciprocity provisions are unrealistic in that they require unanimous  
17 consent from Affected Utilities before SRP can participate in the market.

18 SRP and other public entities must -- sooner rather than later -- be able to compete, and their  
19 customers should have the right to choose their own suppliers.

20 <sup>2</sup> On page ten its November 29 comments the Association recognizes that the intergovernmental agreement  
21 should be available as an option:

22 We realize that SRP has suggested a negotiated approach using intergovernmental agreements  
23 to address issues that have been raised in this proceeding about non-jurisdictional entities. Our  
24 approach would not preclude using that tool. However, the elements and provisions of  
25 intergovernmental agreements on this subject would have some common yardstick and not be  
26 negotiated on an ad hoc basis. Getting there will require some considerable effort. In the  
27 meantime, this provision could be put in place at once, pending the outcome of the various  
28 working group determinations and further negotiation on the subject of intergovernmental  
29 agreements.

<sup>3</sup> APS comments, page ten.

<sup>4</sup> TEP first set of comments, page 19 - 20.

1 liabilities and limitations that, taken together, clearly and unambiguously indicate there is no  
2 differential advantage enjoyed by anyone. SRP rejects any assertion otherwise. SRP will be  
3 more than happy to address this complex issue in more depth if necessary, but believes this  
4 argument is raised by others only as a delaying and counterproductive tactic.

5 It should be noted that even if public power enjoyed certain advantages in  
6 financing and taxation, the advantages would be immaterial to retail competition. On the  
7 generation side prices will be set by the market, not by embedded costs.

8 TEP's arguments are particularly ironic. On one hand TEP wants to insure  
9 "equal treatment of all participants" by, apparently, eliminating the advantages of the public  
10 power choice. On the other hand, TEP trumpets its advantageous use of tax exempt financing  
11 through the Pima and Apache County Industrial Development Authorities (which has issued  
12 approximately \$673 million of outstanding tax-exempt "local furnishing" bonds) and the Pima  
13 County Industrial Development Authority (which has issued bonds in conjunction with TEP's  
14 sale and leaseback of Irvington Unit 4)<sup>5</sup>, and through the 200MW, five year purchase of firm  
15 capacity from Bonneville Power Administration.<sup>6</sup>

16 *Point Two: SRP is not subject to the same regulation as are the investor*  
17 *owned utilities.*

18 SRP has proposed, and would so agree, that if it markets outside its current  
19 service territory as aforementioned, it will do so through an affiliate. This affiliate would be  
20 entirely subject to ACC regulation and normal corporate taxation. The affiliate will be no  
21 different than any other competitor which might seek to enter the market, except for one  
22 important difference: the affiliate will only seek to market displaced and surplus load  
23 representative of SRP's existing generation capacity.

24 . . .

25 \_\_\_\_\_  
26 <sup>5</sup> See TEP's first set of comments filed on November 7, pages 35 - 41.

<sup>6</sup> See the excerpt from TEP's third quarter report to shareholders, attached hereto

1                    Point Three: *SRP can engage in a protectionist strategy within its current*  
2 *service territory while freely competing elsewhere.*

3                    An apparent fear is that SRP would set discriminatory distribution rates within  
4 its service territory, in order to hinder competition. This argument is invalid. SRP will agree  
5 in its intergovernmental agreement to charge fair and nondiscriminatory distribution rates.

6                    Unless it is the goal of the investor owned utilities to eliminate the public  
7 power option, we cannot see that "basic fairness" requires more than the mechanisms  
8 available through an intergovernmental agreement.

9                    **2.                    Sections Contemplating Legislation Should be Deleted.**

10                    In at least two places the rules contemplate legislation dealing with public  
11 power. These sections of the rules predate the amendment contemplating intergovernmental  
12 agreements with political subdivisions and municipal corporations. Now that this mechanism  
13 is in the rules, the sections regarding legislative change are no longer necessary or  
14 appropriate.

15                    In any event, suggestions of legislative change are inappropriate to  
16 administrative rules.

17                    Specifically the rules provide:

18                    R14-2-1611(C) The Commission shall pursue, on  
19 its own or in cooperation with the Joint  
20 Legislative Study Committee on Electric Industry  
21 competition established by House Bill 2504  
22 (1996), legislation to address the role of electric  
23 utilities of Arizona political subdivisions or  
24 municipal corporations in a competitive market.  
The Commission shall further make available, as  
appropriate, Staff assistance to the Legislature if  
the Legislature request such assistance for the  
purpose of determining the proper role of electric  
utilities of Arizona political subdivisions or  
municipal corporations in a competitive market.

25                    . . .

26                    . . .

1 This provision should be deleted. Also unnecessary is the last sentence of R14-2-1601:

2 In the event that modifications are made to  
3 existing law that would allow the application of  
4 this Article to the Salt River Project Agricultural  
5 Improvement and Power District ("SRP"), then  
6 Affected Utilities shall also include SRP.

7 **3. The Wording of the In-State Reciprocity Section Should be Clarified.**

8 As is often the case when different suggestions are incorporated into a single  
9 document, the subparagraphs in the In-State Reciprocity section do not mesh. The wording  
10 needs to be clarified to reflect the intent of the staff in drafting these sections.

11 Particularly subsections (D) and (E) of R14-2-1611 are confusing.<sup>7</sup> Utilities  
12 director Gary Yaquinto has explained that parts (D) and (E) are intended to be options. This  
13 is a logical interpretation of the language. By law, SRP cannot comply with paragraph (D).  
14 (See legal discussion set forth in SRP's first set of comments. If read cumulatively, paragraph  
15 (E) would be unusable.

16 

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<sup>7</sup> Subsection (D) provides:

17 An Arizona electric utility, not subject to the jurisdiction of the Commission, may submit a  
18 statement to the Commission that it voluntarily opens its service territory for competing sellers  
19 in a manner similar to the provisions of this Article. Such statement shall be accompanied by  
20 the electric utility's nondiscriminatory Standard Offer Tariff, electric supply tariffs, Unbundled  
21 Services rates, Stranded Cost charges, System Benefits charges, Distribution Services charges  
22 and any other applicable tariffs and policies for services the electric utility offers, for which  
23 these Rules otherwise require compliance by Affected utilities or Electric Service Providers.  
24 Such filings shall serve as authorization for such electric utility to utilize the Commission's  
25 Rules of Practice and Procedure and other applicable Rules concerning any complaint that an  
26 Affected Utility or Electric Service Provider is violating any provision of this Article or is  
otherwise discriminating against the filing electric utility or failing to provide just and  
reasonable rates in tariffs filed under this Article.

Subsection (E) provides:

If an electric utility making a filing under R14-2-161(D) is an Arizona political subdivision or  
municipal corporation, then the existing service territory of such electric utility shall be deemed  
open to competition of the political subdivision or municipality has entered into an  
intergovernmental agreement with the Commission that established nondiscriminatory terms and  
conditions for Distribution Services and other Unbundled Services, provides a procedure for  
complaints arising therefrom, and provides for reciprocity with Affected Utilities.

1           The wording of subsection (E) should be changed to clearly reflect the stated  
2 intention of the Staff, by deleting the reference to paragraph (D) which is contained in  
3 paragraph (E):

4           If an electric utility ~~making a filing under R14-2-~~  
5           ~~1611(D)~~ is an Arizona political subdivision or  
6           municipal corporation, then the existing service  
7           territory of such electric utility shall be deemed  
8           open to competition if the political subdivision or  
9           municipality has entered into an intergovernmental  
10          agreement with the Commission that establishes  
11          nondiscriminatory terms and conditions for  
12          Distribution Services and other Unbundled  
13          Services, provides a procedure for complaints  
14          arising therefrom, and provides for reciprocity  
15          with Affected Utilities.

16           Additionally part (A) of R14-2-1611 should be modified with this introductory  
17 clause: "Except as otherwise provided in these Rules. . . ."

18           **4.           Conclusion**

19           With the changes noted, SRP supports the rules, and recognizes that much  
20 work remains to be done. SRP is prepared to meet the challenge, and work cooperatively  
21 with the Commission and other industry participants to quickly bring competition to Arizona  
22 in a manner which is competitively fair and neutral to all participants, and in the interests of  
23 all customers.

24           DATED this 20th day of December, 1996.

25           JENNINGS, STROUSS & SALMON, P.L.C.

26           By \_\_\_\_\_

  
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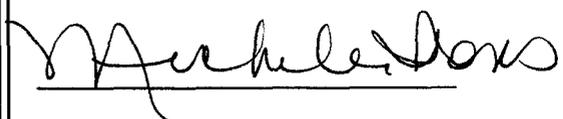
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## THIRD QUARTER REPORT 1996

### Dear Shareholder:

#### TEP Reports Strong Third Quarter Results

Tucson Electric Power Company's (TEP) net income was \$102.5 million or \$3.19 per average share of common stock for the quarter ending September 30, 1996, as compared to \$60.7 million or \$1.89 per average share of common stock for the same period in 1995.

Consistent with the Company's continuing improvement in profitability, TEP recognized tax benefits associated with losses generated in prior periods. These tax benefits offset future taxable income and reduce future taxes payable. For the third quarter of 1996, these benefits totaled \$70.3 million and were partially offset by \$22.1 million of current period income tax expense for a net income tax benefit of \$48.2 million, or \$1.50 per share.

Earnings for the five months ending September 30, 1996 were \$100.0 million or \$3.71 per share, as compared to \$39.0 million or \$1.21 per share for the same period in 1995. Net income tax benefits included in the most recent 12-month results were \$84.3 million or \$2.62 per share.

Excluding various one-time items, the Company's pre-tax operating income for the 12-month period increased \$21.1 million or 18% over pre-tax operating income for the same period in 1995. Similarly, related operating margins (adjusted operating income as a percent of total revenue) for the two comparable 12-month periods increased from 18% for 1995 to 21% for 1996.

This improvement in earnings is attributable to, among other things, the following:

- 3% growth in number of customers served;
- 1.6% increase in electricity usage per customer; and
- 1.1% retail rate increase implemented March 31, 1996.

#### Arizona Moving Towards Competition

On October 9, 1996 the Arizona Corporation Commission (ACC) proposed rules that would "phase-in" competition by giving customers a choice of electric service providers.

This framework for a more competitive structure remains subject to public comment and ACC approval prior to becoming effective. The ACC has scheduled public comment meetings on the rules throughout Arizona in early December and may vote to approve the Proposed Rule.

The Proposed Rule would begin phasing in retail competition in January 1999 when TEP, along with certain other Arizona utilities, would be required to give a percentage of its customers a choice of their electric service provider. Beginning January 1, 1999, customers representing 20% of TEP's 1996 peak demand would be eligible to choose their electric supplier.

On January 1, 2001, electric service provider choice would be given to customers representing 50% of TEP's 1996 peak demand. And, by January 1, 2003, all retail customers would be eligible to choose their electric service provider.

Overall, TEP believes that competition is the appropriate path and that certain regulatory reforms are necessary to make it a reality in Arizona. On November 7, 1996, TEP filed its first set of comments to the previously described Proposed Rule. In its filing TEP recommends that the ACC should resolve the many complicated issues of deregulation prior to adoption, including recovery of stranded investment, insuring equal treatment of all participants and maintaining a safe and reliable system.

#### Forging Ahead

In recent years initiatives to deregulate the energy market and introduce competition have altered the manner in which utilities approach their business. TEP has embraced these changes and has taken steps to "forge ahead" in the increasingly competitive energy environment.

TEP intends to continue taking advantage of emerging opportunities in the energy markets to the benefit of both shareholders and customers. TEP is involved with three notable energy-related ventures:

- Nations Energy Corp.;
- New Energy Ventures; and
- Global Solar Energy, L.L.C.

New Energy Ventures (NEV), based in California, serves as a buyer's agent for companies and other entities seeking to lower their electricity costs. TEP has an option to purchase a 50% stake in NEV, and we believe our association with NEV positions TEP as a key participant in the deregulated energy markets.

During the recent quarter, NEV signed additional contracts to provide energy services to large groups of customers beginning January 1, 1998, when California begins to "phase-in" retail competition. NEV also announced a purchase power agreement with Bonneville Power Administration for 200 MW of firm capacity and options for additional amounts for five years, commencing on January 1, 1998. This agreement represents a positive step for NEV in securing competitive, low-cost electric power for its customers.

For more information regarding NEV, please visit their website at <http://www.NewEnergy.com>.

**Charles E. Bayless**  
Chairman, President and Chief Executive Officer

#### Operational Information Comparisons of Kilowatt-Hour Sales (Amounts in thousands)

	Quarter ended September 30,			Nine months ended September 30,		
	1996	1995	% Incr (Decr)	1996	1995	% Incr (Decr)
Residential	866,570	869,085	(0.4)	2,014,725	1,878,675	7.4
Commercial	411,385	417,138	(1.4)	1,019,301	992,406	2.7
Industrial & Mining	898,573	887,058	1.3	2,607,590	2,378,048	5.5
Other Retail	64,970	59,352	9.5	178,326	154,344	14.2
Total Retail Sales	2,240,498	2,232,633	0.4	6,718,042	5,401,473	5.9
Wholesale Sales	836,721	633,391	32.1	2,231,072	1,651,537	35.1
Total Sales	3,077,220	2,866,024	7.4	7,949,114	7,053,010	12.7

1 **RENZ D. JENNINGS**  
Chairman  
2 **MARCIA WEEKS**  
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3 **CARL J. KUNASEK**  
Commissioner  
4

5 **BEFORE THE ARIZONA CORPORATION COMMISSION**

6 IN THE MATTER OF COMPETITION ) DOCKET NO. U-0000-94-165  
7 IN THE PROVISION OF ELECTRIC )  
8 SERVICES THROUGHOUT THE )  
9 STATE OF ARIZONA )  
10 \_\_\_\_\_ )  
11

12 **SRP'S PROPOSED AMENDMENT NO. 1**  
13 **TO THE CORPORATION COMMISSION STAFF PROPOSED ORDER**

14 Rule R14-2-1611(C) is deleted in its entirety.

15 ~~The Commission shall pursue, on its own or in cooperation with~~  
16 ~~the Joint Legislative Study Committee on Electric Industry~~  
17 ~~competition established by House Bill 2504 (1996), legislation to~~  
18 ~~address the role of electric utilities of Arizona political subdivisions~~  
19 ~~or municipal corporations in a competitive market. The~~  
20 ~~Commission shall further make available, as appropriate, Staff~~  
21 ~~assistance to the Legislature if the Legislature requests such~~  
22 ~~assistance for the purpose of determining the proper role of electric~~  
23 ~~utilities of Arizona political subdivisions or municipal corporations~~  
24 ~~in a competitive market.~~

25 And:

26 The last sentence of Rule R14-2-1601 is deleted.

~~In the event that modifications are made to existing law that would~~  
~~allow the application of this Article to the Salt River Project~~  
~~Agricultural Improvement and Power District ("SRP"), then~~  
~~Affected Utilities shall also include SRP.~~

1 **RENZ D. JENNINGS**  
Chairman  
2 **MARCIA WEEKS**  
Commissioner  
3 **CARL J. KUNASEK**  
Commissioner  
4

5 **BEFORE THE ARIZONA CORPORATION COMMISSION**

6 IN THE MATTER OF COMPETITION ) DOCKET NO. U-0000-94-165  
7 IN THE PROVISION OF ELECTRIC )  
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10 \_\_\_\_\_ )  
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12 **SRP'S PROPOSED AMENDMENT NO. 2**  
13 **TO THE CORPORATION COMMISSION STAFF PROPOSED ORDER**

14 Rule 14-2-1611(A) is amended as follows:

15 Except as otherwise provided in these Rules, The service territories  
16 of Arizona electric utilities which are not Affected Utilities shall  
17 not be open to competition under the provisions of this Article, nor  
18 shall Arizona electric utilities which are not Affected Utilities be  
19 able to compete for sales in the service territories of the Affected  
20 Utilities.

21 Rule R14-2-1611(E) is revised as follows:

22 If an electric utility ~~making a filing under R14-2-1611(D)~~ is an  
23 Arizona political subdivision or municipal corporation, then the  
24 existing service territory of such electric utility shall be deemed  
25 open to competition if the political subdivision or municipality has  
26 entered into an intergovernmental agreement with the Commission  
that establishes nondiscriminatory terms and conditions for  
Distribution Services and other Unbundled Services, provides a  
procedure for complaints arising therefrom, and provides for  
reciprocity with Affected Utilities.