

ORIGINAL



0000071695

MEMORANDUM

30

TO: Docket Control

FROM: Ernest G. Johnson
EGJ
Director
Utilities Division

DATE: April 23, 2007

RE: TUCSON ELECTRIC POWER COMPANY-APPLICATION FOR APPROVAL
OF AN ELECTRIC SERVICE AGREEMENT WITH ASARCO LLC AND
SILVER BELL MINING, LLC DOCKET NO. E-01933A-06-0801

Attached is the Staff Report for Tucson Electric Power Company's application for approval of an electric service agreement with Asarco, LLC and Silver Bell Mining, LLC. Staff recommends approval of the agreement.

EGJ:BEK:tdp

Originator: Barbara Keene

Attachment: Original and Sixteen Copies

Arizona Corporation Commission
DOCKETED

APR 23 2007

DOCKETED BY *ne*

AZ CORP COMMISSION
DOCUMENT CONTROL

2007 APR 23 P 4: 31

RECEIVED

SERVICE LIST FOR: Tucson Electric Power Company Asarco, LLC and
Silver Bell Mining, LLC
DOCKET NO. E-01933A-06-0801

Mr. Michael Patten
Roshka DeWulf & Patten, PLC
One Arizona Center
400 East Van Buren Street
Suite 800
Phoenix, Arizona 85004

Mr. John D. Low
ASARCO LLC
1150 North 7th Avenue
Tucson, Arizona 85705

Mr. Ernest G. Johnson
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Mr. Christopher C. Kempley
Chief, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Lyn Farmer
Chief, Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

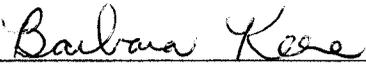
STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY
FOR APPROVAL OF AN ELECTRIC SERVICE AGREEMENT WITH ASARCO LLC AND
SILVER BELL MINING LLC
DOCKET NO. E-01933A-06-0801

April 23, 2007

STAFF ACKNOWLEDGEMENT

The Staff Report for the application of Tucson electric Power Company for approval of an electric service agreement with Asarco, LLC and Silver Bell Mining LLC, Docket No. E-01933A-06-0801 was the responsibility of the staff member listed below. Barbara Keene was responsible for the review and analysis of the application.

A handwritten signature in cursive script that reads "Barbara Keene". The signature is written in black ink and is positioned above a horizontal line.

Barbara Keene
Barbara Keene
Public Utilities Analyst Manager

TABLE OF CONTENTS

	<u>PAGE</u>
1. INTRODUCTION	1
2. BACKGROUND	1
3. PROPOSED AGREEMENT	1
4. STAFF ANALYSIS.....	2
5. RECOMMENDATIONS.....	2

1. INTRODUCTION

On December 28, 2006, Tucson Electric Power Company ("TEP") entered into an electric power supply agreement with Asarco Incorporated ("Asarco") and Silver Bell Mining, L.L.C ("Silver Bell"). On February 9, 2007, the proposed agreement was filed confidentially with Staff. Under this agreement, TEP would provide electric power for copper mining operations at both Asarco's Mission Complex (Mission Unit 1 and Mission unit 2) and the Silver Bell Mine. Asarco owns a majority interest in Silver Bell Mine. On March 2, 2007, TEP filed a letter extending the time for the Commission to consider the proposed agreement until April 12, 2007. On April 12, 2007 TEP filed a redacted version of the agreement. A Procedural Order filed April 16, 2007 set a hearing date on this matter for May 14, 2007.

2. BACKGROUND

The Mission Complex and the Silver Bell Mine currently receive electric service under an agreement with TEP. The proposed agreement would replace the existing agreement. The original agreement for the Mission Complex was approved by the Commission on April 6, 1994 (Decision No. 58584). On September 29, 1997 (Decision No. 60429), the Commission approved an amendment to the agreement that increased the maximum demand for the Mission Unit 2 and added an interruptible power option for both Mission units. The original agreement for the Silver Bell Mine was approved on July 31, 1997 (Decision No. 60324). The most recent agreement for the Mission Complex and the Silver Bell Mine was approved on August 5, 1999 (Decision No. 61868). That agreement for the Mission Complex and Silver Bell Mine remained in effect until December 31, 2006.

On August 9, 2005 Asarco filed for protection under Chapter 11 of the United States Bankruptcy Code (Case Number 05-21207, Southern District of Texas, Corpus Christi Division).

3. PROPOSED AGREEMENT

The proposed agreement, upon Commission approval, would become effective retroactively January 1, 2007 and would end on December 31, 2011. Under the proposed agreement, the Mission Complex and Silver Bell Mine would purchase, at a minimum, the power requirements specified in the agreement from TEP at the energy prices contained in the Time-of-Use ("TOU") Pricing Plan. The Mission Complex and the Silver Bell Mine have been charged the rates under the TOU Pricing Plan of the proposed agreement beginning January 1, 2007.

According to responses to Staff's data requests, the TOU pricing structure being used will facilitate in reducing the costs of electric power for the Mission Complex and Silver Bell Mine, allowing them to shift loads from on-peak to off-peak or shoulder hours.

Section 12.2 of the proposed agreement contains stipulations where Asarco and Silver Bell would not be permitted to participate in discussions contrary to TEP's positions, evidence,

or testimony concerning the Commission's decision (Decision No. 62103) in Docket No. E-01933A-05-0560, TEP's motion to amend this decision.

4. STAFF ANALYSIS

Staff has determined that the revenue to be received under the proposed agreement would cover TEP's marginal costs. Staff has estimated the cost of obtaining electric power under the tariff rates and the proposed agreement rates for the Mission Complex and Silver Bell Mine. In absence of the proposed agreement, Asarco and Silver Bell would be provided service under the rates, terms, and conditions of Tariff Nos. LLP-14 or LLP-90A. Staff has concluded that the rates under the proposed agreement are just and reasonable.

Despite the current high prices of copper, Asarco and Silver Bell anticipate the unavoidable decline of the copper market by aiming to limit the increase of operational expenses. Because electricity is a substantial factor in the cost of production, an increase in this cost could hinder the competitiveness of Asarco's and Silver Bell's mining operations.

On April 18, 2007, Staff issued a data request as to what rate TEP is currently charging Asarco and Silver Bell. In its response to the data request, TEP confirmed that Asarco and Silver Bell have been charged for January and February 2007 in accordance with the terms, rates, and conditions of the proposed agreement. Staff believes that TEP is in violation of Decision No. 61868 because the most recent agreement expired December 31, 2006.

Staff has determined that the limitations set forth in section 12.2 of the proposed agreement are not in the public interest. Staff believes that no company or intervener should be precluded from participating in proceedings which go before the Commission.

Staff also analyzed this application in terms of whether there were fair value implications. Compared to TEP's total revenues, any impact from this agreement would probably be de minimus, and any impact on TEP's fair value rate base and rate of return would also be de minimus.

5. RECOMMENDATIONS

Staff recommends approval of the proposed agreement because Asarco has a possible alternative to buying power from TEP. Without the agreement, TEP would lose net revenues it could otherwise receive. In addition, electricity costs play an important role in the competitiveness of a copper mine.

Staff further recommends that the Commission require TEP to reimburse Asarco and Silver Bell the difference between the rates charged under the most recent Commission approved agreement and the rates charged under the proposed agreement. That agreement expired December 31, 2006. The reimbursement should extend from January 1, 2007, the date which

TEP began charging under the proposed agreement rates. The reimbursement should continue for as long as TEP is charging rates not approved by the Commission.

Staff further recommends that the Commission specify in its Order that the provisions of section 12.2 of the proposed agreement shall become null and void upon approval.

Staff further recommends that the Commission specify in its Order that approval of the agreement at this time does not guarantee any future ratemaking treatment of the agreement Asarco and Silver Bell.