

OPEN MEETING ITEM



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COMMISSIONERS
MIKE GLEASON - Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

ARIZONA CORPORATION COMMISSION

DATE: APRIL 24, 2007

DOCKET NO: E-01933A-05-0650

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Jane Rodda. The recommendation has been filed in the form of an Opinion and Order on:

TUCSON ELECTRIC POWER COMPANY
(AMEND DECISION NO. 62103)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

MAY 3, 2007

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

MAY 8, 2007 and MAY 9, 2007

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Secretary's Office at (602) 542-3931.

BRIAN C. McNEIL
EXECUTIVE DIRECTOR

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

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

DOCKET NO. E-01933A-05-0650
DECISION NO. _____

OPINION AND ORDER

DATE OF PUBLIC COMMENT:	January 8, 2007 and February 20, 2007
DATE OF HEARING:	March 6, 2007, through March 9, 2007
PLACE OF HEARING:	Tucson, Arizona
ADMINISTRATIVE LAW JUDGE:	Jane L. Rodda
IN ATTENDANCE:	Mike Gleason, Chairman William A. Mundell, Commissioner Jeff Hatch-Miller, Commissioner Kristin K. Mayes, Commissioner Gary Pierce, Commissioner
APPEARANCES:	Mr. Raymond S. Heyman, Sr. Vice President and General Counsel, and Michelle Livengood, Regulatory Counsel, Tucson Electric Power Company, and Mr. Michael Patten and Mr. J. Matthew Derstine, Roshka, DeWulf & Patten PLC, on behalf of Tucson Electric Power Company; Mr. C. Webb Crockett, Fennemore Craig, PC, on behalf of Arizonans for Electric Choice & Competition, Phelps Dodge Mining Company and Asarco; Mr. Michael M. Grant, Gallagher & Kennedy, PA, on behalf of Arizona Utility Investors Association; Mr. Scott Wakefield, Chief Counsel, on behalf of Residential Utility Consumer Office; Mr. Timothy M. Hogan, Arizona Center for Law in the Public Interest, on behalf of Southwest Energy Efficiency Project and Western Resource Advocates;

Mr. Peter Q. Nyce, Jr., General Attorney, Regulatory Law Office, Office of the Judge Advocate General Department of the Army, on behalf of the Department of Defense;

Mr. Nicholas J. Enoch: Lubin & Enoch, PC, on behalf of International Brotherhood of Electrical Workers Local 1116;

Mr. Lawrence V. Robertson, Jr., on behalf of Mesquite Power, LLC, Southwestern Power Group II, LLC, Bowie Power Station, LLC and Sempra Energy Solutions;

Robert Metli, Snell & Wilmer, LLP, on behalf of Arizona Public Service Company; and

Mr. Christopher Kempley, Chief Counsel, Legal Division, on behalf of the Utilities Division.

BY THE COMMISSION:

* * * * *

Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission (“Commission”) finds, concludes, and orders that:

FINDINGS OF FACT

1. Between 1996 and 1999, the Commission adopted various versions of its Electric Competition Rules (the “Rules”) to transition the electric industry in Arizona from a regulated to a competitive environment.

2. In 1999, Tucson Electric Power Company (“TEP” or “Company”), the Residential Utility Consumer Office (“RUCO”) Arizonans for Electric Choice and Competition (“AECC”) and the Arizona Community Action Association entered into a Settlement Agreement to settle various matters related to TEP, including TEP’s application for stranded cost recovery and the establishment of unbundled tariffs.

3. In Decision No. 62103 (November 30, 1999), the Commission modified and then approved the Settlement Agreement (the “1999 Settlement Agreement”). The 1999 Settlement Agreement provided for the: (i) commencement of competition in TEP’s service territory; (ii) establishment of unbundled rates, with a rate decrease of one percent in 1999, another rate decrease

1 of one percent in 2000, and a rate freeze thereafter until December 31, 2008; (iii) resolution of
2 stranded cost recovery; and (iv) settlement of TEP's Electric Competition litigation. The 1999
3 Settlement Agreement required TEP to transfer its generation assets to a subsidiary by December 31,
4 2002 and to acquire power for Standard Offer customers as required by the Rules. To recover
5 stranded costs, the 1999 Settlement Agreement included a Fixed Competitive Transition Charge
6 ("CTC") and a Floating CTC. The Fixed CTC is a fixed per kWh charge and terminates when it
7 yields a total of \$450 million, or on December 31, 2008, whichever occurs first. The Floating CTC is
8 computed using a Market Generation Credit ("MGC") methodology based on market-index prices.
9 Decision No. 62103 established TEP's rates through 2008, but required TEP to file rate case
10 information in 2004, with the intent to determine if rates should be lowered.

11 4. In 2002, the Commission issued Decision No. 65154 ("Track A Order") modifying
12 portions of Decision No. 62103 by requiring TEP to cancel any plans to divest interests in any of its
13 generation assets.

14 5. In 2003, the Commission adopted Decision No. 65743 ("Track B Order), which
15 established certain requirements for utilities to acquire power for Standard Offer customers from the
16 wholesale market.

17 6. In 2004, the Arizona Court of Appeals issued a decision in *Phelps Dodge Corp. v.*
18 *Arizona Elec. Power Co-op, Inc.*, 207 Ariz. 95, 83 P.3d 573 (Ct. App. 2004) ("*Phelps Dodge*"), in
19 which it invalidated certain of the Rules.

20 7. On June 1, 2004, TEP filed with the Commission general rate case information as
21 required by Decision No. 62103 (the "2004 Rate Review Docket" Docket No. E-01933A-04-0408).

22 8. On May 4, 2005, TEP filed a Motion for a Declaratory Order and Request for
23 Procedural Conference in the 2004 Rate Review Docket and in the generic Retail Electric
24 Competition Rules restructuring dockets, Docket Nos. E-00000A-02-0051, E-00000A-01-0630, E-
25 01345A-01-0822 and E-01933A-02-0069. The Motion sought clarification of whether TEP would be
26 entitled to charge market-based Standard Offer generation rates beginning January 1, 2009. After
27 Staff and others filed oppositions to the Motion for Declaratory Order, the Administrative Law Judge
28 issued a Procedural Order suggesting TEP consider requesting that certain dockets be reopened

1 pursuant to A.R.S. §40-252, given that the Motion for Declaratory Order appeared to be a request to
2 clarify Decision No. 62103 which approved the 1999 Settlement Agreement.

3 9. On September 12, 2005, TEP filed a Motion to Amend Decision No. 62103 pursuant
4 to A.R.S. §40-252 ("Motion to Amend"). The Motion to Amend sought resolution of the dispute
5 over whether TEP is entitled to charge market-based rates for generation service under Decision No.
6 62103 and the 1999 Settlement Agreement. At the same time, TEP filed the Direct Testimony of
7 James S. Pignatelli.

8 10. In its Motion to Amend, TEP proposed to amend Decision No. 62103 to provide for:
9 (a) the extension beyond December 31, 2008, of the existing TEP rate freeze at TEP's base rate; (b)
10 the retention of the current CTC amortization schedule; (c) the agreement of TEP not to seek rate
11 treatment for certain generation assets; and (d) the implementation of a mechanism to protect TEP
12 and its customers from energy market volatility to be effective after December 31, 2008. According
13 to TEP, this proposal was a short-term, interim solution in order to give the parties more time to agree
14 upon how TEP's generation rates would be determined in 2009.

15 11. Intervention was granted to the Department of Defense ("DOD"); AECC;
16 International Brotherhood of Electrical Workers AFL-CIO Local Union 1116 ("IBEW Local 1116");
17 the Arizona Utility Investors Association, Inc. ("AUIA"); and RUCO.

18 12. On September 22, 2005, AECC filed a Motion to Suspend Proceedings.

19 13. On September 30, 2005, TEP filed a Response to AECC's Motion to Suspend.

20 14. On October 12, 2005, AECC, RUCO, and Commission Utilities Division Staff
21 ("Staff") filed Responses to TEP's Motion to Amend.

22 15. On October 21, 2005, TEP filed a Reply in Support of its Motion to Amend.

23 16. On October 24, 2005, a procedural conference for the purpose of oral argument on
24 TEP's Motion to Amend was held at the Commission's offices in Phoenix, Arizona.

25 17. On January 30, 2006, the Administrative Law Judge issued a Recommended Opinion
26 and Order, which was considered at an Open Meeting of the Commission on April 2, 2006.

27 18. On April 20, 2006, the Commission issued Decision No. 68669, in which it ordered
28 that a hearing should be held under A.R.S. §40-252 to consider amending Decision No. 62103 and

1 the 1999 Settlement Agreement. It found that the hearing, at a minimum, should address the
2 following issues: (a) the viability of the 1999 Settlement Agreement in light of the Track A Order, the
3 Track B Order, and *Phelps Dodge* (including a discussion and presentation of evidence regarding the
4 individual parties' opinions of whether TEP will be able to charge market-based rates or cost-of-
5 service rates after 2008); (b) the proposals outlined in TEP's original application; and (c) Demand-
6 Side Management ("DSM"), Renewable Energy Standards ("RES"), and Time-of-Use ("TOU")
7 tariffs. Accordingly, the Commission directed the Hearing Division to schedule a hearing to consider
8 amending Decision No. 62103 and establish a procedural schedule in this matter. The schedule was
9 to allow for an expeditious but complete review of these matters.

10 19. On June 1, 2006, the Administrative Law Judge issued a Procedural Order setting a
11 schedule for the hearing directed by Decision No. 68669 and granting Mesquite Power, LLC,
12 Southwestern Power Group II, LLC, Bowie Power Station, LLC and Sempra Energy Solutions'
13 (collectively "M/S/B/S") Application to Intervene. The hearing was set to commence January 8,
14 2007, at the Commission's Tucson offices.

15 20. On June 21, 2006, the Commission granted the intervention of the Arizona
16 Competitive Power Alliance ("Alliance").

17 21. On August 11, 2006, TEP filed an affidavit of public notice and affidavits of
18 publication indicating that public notice was mailed to all TEP customers between July 13, 2006 and
19 August 10, 2006, and published as required by the June 1, 2006, Procedural Order.

20 22. On August 18, 2006, TEP filed the Direct Testimony of James S. Pignatelli. As part
21 of the testimony, TEP presented two proposals for generation rates beginning in 2009: (i) a market
22 phase-in proposal that would move TEP to market-based generation in two steps and (ii) a traditional
23 cost-of-service proposal that included an \$850 million regulatory asset and an adjustor ("ECAC"). In
24 addition, Mr. Pignatelli addressed DSM, TOU and RES.

25 23. On August 25, 2006, the Administrative Law Judge granted the interventions of
26 Arizona Public Service Company ("APS"), Southwest Energy Efficiency Project ("SWEEP") and
27 Western Resource Advocates ("WRA").

28 24. On August 29, 2006, the Administrative Law Judge issued a Procedural Order stating

1 that the proposals found in Mr. Pignatelli's August 18, 2006, Direct Testimony appeared to deviate
2 from TEP's initial proposal as described in its Motion to Amend, and finding that the testimony
3 "raises the question whether the timeline and scope of the proceeding as described in the June 1, 2006
4 Procedural Order remain realistic," and further inquiring whether the public notice was adequate in
5 light of the new testimony.

6 25. A Procedural Conference convened on September 21, 2006, and by Procedural Order
7 dated October 6, 2006, the Commission issued a modified procedural schedule and directed TEP to
8 publish a revised notice which extended the date for intervention. The hearing was rescheduled to
9 commence February 20, 2007.

10 26. On October 20, 2006, Staff filed a request for an extension of the procedural schedule
11 pointing to the involvement of senior Staff members in the APS rate case proceedings.

12 27. On October 30, 2006, TEP filed a response urging that the current proceeding not be
13 unduly delayed and requesting that the case move forward under the procedural schedule established
14 in the October 6, 2006 Procedural Order.

15 28. On November 1, 2006, the Administrative Law Judge issued a modified procedural
16 schedule which allowed Staff and Intervenors additional time to file direct testimony, but retained the
17 February 20, 2007 hearing date.

18 29. As required by the October 6, 2006, Procedural Order, on November 15, 2006, TEP
19 filed the affidavits of publication for the Second Revised Notice.

20 30. On December 6, 2006, intervention was granted to Sulphur Springs Valley Electric
21 Cooperative, Inc. ("SSVEC").

22 31. On January 8, 2007, the Direct Testimony of Dr. Michael Ileo and Ms. Barbara Keene
23 on behalf of Commission Staff, Mr. Kevin Higgins on behalf of AECC, Ms. Marylee Diaz Cortez on
24 behalf of RUCO, and Mr. Jeff Schlegel on behalf of SWEEP was filed.

25 32. On January 29, 2007, TEP filed the Rebuttal Testimony of James S. Pignatelli and
26 James R. Pyers.

27 33. On February 6, 2007, TEP and Staff jointly filed a letter requesting a continuance of
28 the hearing to allow parties to participate in settlement discussions.

1 34. By Procedural Order dated February 6, 2007, the Administrative Law Judge requested
2 objections and comments to the request for a continuance by February 12, 2007.

3 35. On February 8, 2007, Staff, AECC, RUCO, IBEW Local 1116 and SWEEP filed
4 Surrebuttal Testimony.

5 36. On February 15, 2007, TEP filed the rejoinder testimony of Mr. James Pignatelli.

6 37. On February 15, 2007, a procedural conference was held to consider the joint request
7 of TEP and Staff to continue the scheduled start of the hearing to allow the parties to participate in
8 settlement discussions. On February 16, 2007, the Administrative Law Judge issued a Procedural
9 Order that, among other things, ordered the hearing to convene on February 20, 2006 for the purpose
10 of taking Public Comment only, and provided that following the Public Comment, the hearing would
11 be recessed until March 6, 2007. The Procedural Order also provided that the parties would meet
12 during the period February 20-23, 2007, for the purpose of discussing settlement.

13 38. On February 26, 2007, the parties appeared for a procedural conference and advised
14 the Administrative Law Judge that no settlement had been reached.

15 39. On March 6, 2007, the hearing was reconvened. At that time, the Administrative Law
16 Judge took administrative notice in this Docket of the 1999 Settlement Agreement Docket (Docket
17 No. E-01933A-98-0471 et al.) and the 2004 TEP Rate Review Docket (Docket No. E-01933A-04-
18 0408).

19 40. The hearing continued over four days. Testimony was presented by James S.
20 Pignatelli and James R. Pyers on behalf of TEP; Ryle J. Carl III on behalf of IBEW Local 1116;
21 Kevin Higgins on behalf of AECC; Dan L. Neidlinger on behalf of DOD; MaryLee Diaz-Cortez on
22 behalf of RUCO; Jeff Schlegel on behalf of SWEEP; and Michael J. Ileo and Barbara Keene on
23 behalf of Commission Staff.

24 41. During the course of testimony by Mr. Pignatelli, TEP indicated that it had formulated
25 an additional proposal for amending the 1999 Settlement Agreement and Decision No. 62103 that
26 Mr. Pignatelli termed a "hybrid proposal." Under TEP's "hybrid proposal," rates would be
27 established by cost-of-service methodology but certain generation assets would be removed from
28 TEP's cost-of-service rate base and would be dedicated to wholesale market transactions. In

1 addition, Mr. Pignatelli explained, the "hybrid proposal" would include a purchased power and fuel
2 adjustor clause and a greatly reduced regulatory asset from that proposed in the Company's cost-of-
3 service proposal.

4 42. During the course of the hearing, it became apparent that the Commission did not have
5 adequate information in this docket to allow it to determine if any of TEP's alternative proposals
6 would result in just and reasonable rates. At a minimum, to make such evaluation would require TEP
7 to file the information required in a general rate case.

8 43. TEP was concerned, however, that by filing a rate case, it might not be able to
9 preserve all of its rights under the 1999 Settlement Agreement. In addition, TEP advised the
10 Commission and parties that a key consideration in agreeing to provide full general rate case
11 information on its various proposals and going through the cost and expense of a companion rate case
12 proceeding, would be holding its Standard Offer generation rates at current levels pending the
13 outcome of the rate case proceeding rather than having its Standard Offer generation rates reduced
14 when the Fixed CTC expires in or about May 2008.¹ According to TEP, it would make no sense to
15 have customers experience a rate reduction resulting from the expiration of the Fixed CTC only to
16 have rates immediately rebound to higher levels as the result of the rate case. Mr. Pignatelli also
17 testified that the termination of the Fixed CTC would have a serious adverse impact on TEP's cash
18 flow. (Tr at 583)

19 44. At the conclusion of the evidentiary hearing, it was agreed by the parties that TEP
20 would propose procedures which would provide a framework for: (i) TEP to file rate case
21 information in support of each of its alternative rate proposals; (ii) TEP and others to reserve their
22 rights under Decision No. 62103 and the 1999 Settlement Agreement; (iii) deferring the termination
23 of the Fixed CTC, pending resolution of the rate case and subject to refund to consumers, with
24 interest, and (iv) implementation of DSM, TOU and RES tariffs. Under the agreed process, parties
25 would have an opportunity to comment on TEP's proposed procedures, and the Administrative Law
26 Judge would prepare a Recommended Opinion and Order with the goal to have the Commission
27

28 ¹ The Fixed CTC expires when it has collected \$450 million or December 31, 2008, whichever is earlier.

1 consider the proposal as soon as possible. The intent was to allow the Commission to act quickly so
2 that new rates could be approved and in place by January 1, 2009, if possible. It was further agreed
3 that in the event the Commission does not adopt the proposal, the parties would brief the issues raised
4 in the hearing on TEP's Motion to Amend, and the Administrative Law Judge would prepare a
5 Recommended Opinion and Order in this docket.

6 45. The parties understood that TEP would file the rate case information by July 2, 2007,
7 based on a December 31, 2006, Test Year. As in any rate case, a procedural schedule and guidelines
8 would be established that allow for discovery and the filing of testimony. Under the proposal, any
9 party can offer additional rate approaches or variations on any of TEP's alternative approaches. The
10 forthcoming rate case filing would be consolidated with the current docket; however, the focus of the
11 consolidated proceeding would be directed towards a resolution of the rate issues, and not the legal
12 issues arising from the interpretation of the 1999 Settlement Agreement and Decision No. 62103.

13 46. On March 16, 2007, TEP filed a Proposed Recommended Opinion and Order ("TEP's
14 Proposed ROO"), which was accompanied by an "Explanation and Comment."

15 47. On March 28, 2007, Staff, RUCO, IBEW Local 1116, AECC, AUIA, SWEEP, and
16 M/S/B/S filed Comments to TEP's Proposed ROO.

17 48. On April 4, 2007, TEP, Staff, M/S/B/S and SWEEP filed Comments on other parties'
18 Comments.

19 49. On April 9, 2007, AECC filed a Response to TEP's April 4, 2007 Comments.

20 Responses to TEP's Proposed ROO

21 50. AUIA supports TEP's Proposed ROO and urges Commission adoption.

22 51. IBEW has no substantive problems with TEP's proposed procedures and its Proposed
23 ROO, but suggests several modifications.

24 52. RUCO recommends that the Commission reject TEP's proposed procedural
25 framework and instead address the "Core Question" of the March 2007 hearing of whether Decision
26 No. 62103 and the 1999 Settlement Agreement permit TEP to charge market-based generation rates
27 for Standard Offer customers. In the alternative, if the Commission desires to proceed as suggested
28 by TEP, RUCO recommends several modifications to the Proposed ROO. RUCO was most

1 concerned about TEP's proposed methodology for maintaining current rates and refunding the
2 foregone rate decrease if the Fixed CTC does not terminate as scheduled pursuant to the 1999
3 Settlement Agreement.

4 53. Staff expressed a willingness to proceed as suggested by TEP, but had concerns that
5 TEP's Proposed ROO set a tone and tenor that suggest other parties agree with TEP's positions, and
6 is not sufficiently clear about the nature of the forthcoming rate filing. Staff made several suggested
7 revisions to the ROO to clarify the treatment of the revenue collected after the Fixed CTC expires and
8 how DSM, TOU and RES tariffs can be adopted.

9 54. AECC does not object to participating in settlement discussions but objects to several
10 specifics of TEP's Proposed ROO, focusing on TEP's characterization of the other parties' positions,
11 and how revenues from the Fixed CTC will be refunded.

12 55. DOD also finds that TEP's Proposed ROO is deficient with respect to describing the
13 opinions and recommendations of the other parties. DOD generally agrees with the stable rate
14 proposal, but makes specific objections with how TEP proposed to implement such rates upon
15 expiration of the Fixed CTC, and how TEP proposed to implement a refund of the foregone revenue
16 decrease.

17 56. M/S/B/S generally supports TEP's Proposed ROO with the exception of certain
18 language, which M/S/B/S believed could prejudice and pre-judge the outcome of the issue of the
19 restoration of the exclusivity of TEP's CC&N, TEP's rate structure, and status of retail electric
20 competition.

21 **TEP's Proposals for Establishing Standard Offer Generation Rates**

22 57. While TEP asserts that it is entitled to charge market-based generation rates under the
23 1999 Settlement Agreement, TEP made two alternative proposals for amending the 1999 Settlement
24 Agreement through the prehearing testimony of James S. Pignatelli: a Market-Rate Phase-In Proposal
25 and a Cost-of-Service (including Regulatory Asset and ECAC) Proposal. Under both proposals, TEP
26 proposed modifications and additions to its existing DSM, TOU and Renewable Energy tariffs.

27 58. TEP claims under the 1999 Settlement Agreement, that when the Floating CTC
28 expires, the MGC alone would determine generation rates. TEP proposed its Market-Rate Phase-In

1 Proposal in an attempt to moderate the rate increase that Standard Offer customers would experience
2 when rates are set solely by the MGC. Thus, TEP proposed to amend the 1999 Settlement
3 Agreement by imposing a cap on the rate established by the MGC such that no customer class would
4 realize an initial rate increase in excess of 12 percent. Under TEP's proposal, the phase-in period
5 would last approximately four years; therefore, it would be mid-2012 before Standard Offer
6 generation rates would be based solely on the MGC, and fully market-based.

7 59. TEP's proposed Cost-of-Service (including Regulatory Asset and ECAC) Proposal is
8 based on traditional cost-of-service ratemaking, with the creation of a regulatory asset as a
9 mechanism for addressing the financial impacts to TEP of the 1999 Settlement Agreement. The
10 Cost-of-Service Proposal would also implement an ECAC, which TEP asserts would protect the
11 Company and its customers from market volatility. Under this proposal, TEP would immediately file
12 a rate case in 2007 so that the rates would be in effect upon expiration of the Fixed CTC in May
13 2008. TEP proposed that the exclusivity of its CC&N would be restored under this proposal.

14 60. According to Mr. Pignatelli's testimony, the projected rate impact of market rates,
15 using a projected cost of \$7.00 per mmBtu for natural gas, would be an increase of approximately 23
16 percent in 2009. TEP projected a 12 percent increase in rates under its Market Rate Phase-In
17 Proposal in 2009. TEP projects the rate impact of the Cost-of-Service (including Regulatory Asset
18 and ECAC) Proposal would be an approximately 26 percent increase in 2009.

19 61. During the course of the hearing, Mr. Pignatelli presented a "hybrid" proposal for
20 amending the 1999 Settlement Agreement. Under the "hybrid proposal," TEP's rates would be
21 established under traditional cost-of-service methodology, but certain generation assets would be
22 removed from TEP's cost-of-service rate base and these assets would be dedicated to wholesale
23 market transactions. In addition, the "hybrid proposal" would also include a purchased power and
24 fuel adjustor clause and a greatly reduced regulatory asset, based on TEP's actual transition costs.
25 The projected rate impact of the "hybrid proposal" would depend on the assets dedicated to the
26 wholesale market.

27 62. Staff, RUCO, AECC and DOD dispute that Decision No. 62103 and the 1999
28 Settlement Agreement give TEP the authority to charge market-based generation rates for Standard

1 Offer service commencing January 1, 2009. Contrary to TEP's position, these parties argue that the
2 MGC was not intended to establish Standard Offer generation rates, but is a mechanism used to
3 calculate stranded costs.

4 63. TEP has argued that by adopting the 1999 Settlement Agreement as modified in
5 Decision No. 62103, the Commission became a party to the Settlement Agreement. One of the issues
6 in this case has been TEP's position that any rate treatment commencing in January 1, 2009 that
7 deviates from TEP's interpretation that Decision No. 62103 and the 1999 Settlement Agreement
8 provide for the implementation of market-based generation rates, would constitute a breach of the
9 Settlement Agreement. TEP apparently believes that it cannot propose alternative rate proposals
10 without breaching the 1999 Settlement Agreement except in the context of settlement negotiations
11 among the various parties. If the Commission were to order TEP to file a rate case, TEP believes the
12 Commission would have breached the 1999 Settlement Agreement and TEP would be required to file
13 a lawsuit to preserve its rights under that Agreement.

14 64. No other party has argued that the Commission is a party to the 1999 Settlement
15 Agreement. Staff has argued specifically that the Commission is not a party.

16 Process for Considering TEP's Proposals

17 **A. General Rate Information.**

18 65. In order to provide the Commission with additional information necessary to fully
19 assess TEP's alternative rate proposals for amending the 1999 Settlement Agreement and Decision
20 No. 62103, TEP proposes to file documentation and information, including Schedules A through H
21 required by A.A.C. R14-2-103, to support TEP's three proposals for amending the 1999 Settlement
22 Agreement: (i) Market-Rate Phase-In Proposal; (ii) Cost-of-Service (with Regulatory Asset and
23 ECAC); (iii) and Hybrid Proposal. TEP also proposes to present similar information regarding
24 Transmission and Distribution rates alone in the event TEP's Standard Offer generation service
25 would be set by the MGC beginning January 1, 2009. TEP states its Rate Proposals will be based on
26 a test year ending December 31, 2006. TEP further proposes that the Rate Proposals will be filed in a
27 separate, but companion, docket ("Rate Proposal Docket") that would be consolidated with this
28 proceeding. TEP stated it would file the Rate Proposals on or before July 2, 2007.

1 66. Staff believes that in addition to the rate case information required under Commission
2 Rules, market studies illustrating a sufficiently robust market to support TEP's competitive proposals
3 are essential. (See Staff March 28, 2007 Comments at p 2) Staff further wants to clarify that however
4 TEP characterizes the Rate Proposal Docket, it is a rate case.

5 67. TEP acknowledges that the forthcoming Rate Proposal Docket will be a rate case.
6 (TEP April 4, 2007 Comments at 4). TEP wants to confirm, however, that submission of several
7 generation rate proposals is intended to reach a "regulatory solution" to the dispute over the 1999
8 Settlement Agreement and Decision 62103, and does not constitute a waiver of TEP's rights and
9 claims. TEP states it has no objection to filing market studies in conjunction with its market-related
10 proposals, but is concerned that without an established format under Commission rules, they should
11 not be subject to sufficiency review.

12 68. In response to M/S/E/S, TEP agrees that the issue of exclusivity of its CC&N territory
13 remains to be considered and addressed in the forthcoming rate case docket. (TEP April 4, 2007
14 Comments at 8)

15 69. We find that the procedures discussed during the hearing designed to provide a
16 consensual mechanism to present rate proposals for Commission consideration, and to defer a
17 decision on the interpretation of the 1999 Settlement Agreement are reasonable and in the public
18 interest. The approach as set forth herein avoids litigation (at least at this time) which would be a
19 distraction and drain on resources of all parties, and would allow all interested parties to focus on
20 establishing fair and reasonable rates. In establishing the procedures set forth herein, it is our intent
21 that no party waive any right or claim under the 1999 Settlement Agreement or Decision No. 62103.
22 The rate filing should be considered sufficient when TEP has provided all information required by
23 A.A.C. R14-2-103. However, TEP evidently will be filing alternative rate proposals which will
24 present a far more complex analysis than is required under a traditional cost-of service rate case. To
25 the extent the time clock of R14-2-103 would apply to this forthcoming rate case, the complexities of
26 the proceeding warrant a tolling of the time-clock. We understand, however, that it is in the public
27 interest to evaluate and approve new rates for TEP as quickly as is practical with the goal of having
28 new rates in place by January 1, 2009, if possible.

1 **B. Treatment of Existing Rates Pending Decision.**

2 70. TEP notes that the expiration of the Fixed CTC may result in a temporary reduction of
3 rates that TEP believes will sharply increase shortly thereafter due to the resolution of the Rate
4 Proposal Docket. TEP asserts that such an effect could adversely impact both TEP and its customers,
5 and argues that it is in the public interest to preserve the status quo of TEP's current rate levels and
6 prevent a potential temporary fluctuation of rates.

7 71. TEP proposes to keep Standard Offer rates at their current levels by modifying the
8 MGC to adjust for the effect of the termination of the Fixed CTC. TEP notes that the Commission
9 previously approved modifications to the MGC in Decision No. 65751 (March 20, 2003), and is now
10 faced with additional circumstances that justify modifying the MGC as proposed by TEP.

11 72. Staff and DOD do not oppose the concept of holding rates stable pending resolution of
12 final rates.

13 73. Staff, RUCO, AECC and DOD argue that the MGC is not a mechanism that
14 determines rates, but is rather a mechanism intended to collect Stranded Costs. RUCO and DOD
15 object to the concept of adjusting the MGC as a way to keep Standard Offer rates unchanged because
16 of the implications such adjustment would have on the ultimate resolution of the intent of the 1999
17 Settlement Agreement on how rates would be set in January 1, 2009.

18 74. Staff argues that the MGC should not be used as means of tracking revenue recovery
19 after the Fixed CTC is fully recovered, unless it is made clear that the sole purpose is to trace
20 revenues related to the Fixed CTC for possible refund. (Staff April 4, 2007 Comments at 4) Staff
21 believes it should be made clear the MGC is not a "rate," and any revenue collected by this device is
22 specifically tracked and accrues interest at the "rate equal to weighted average cost of capital as
23 established in the last rate proceeding, computed monthly on compounded basis." (Staff March 28,
24 2007 Comments p 6) Staff did not oppose a 24 month refund period, but believes that when and how
25 refunds should occur should be decided in connection with the forthcoming rate case.

26 75. RUCO opposes holding rates at current levels when the Fixed CTC expires. (RUCO
27 Comments at p 7) In addition, RUCO believes the true-up mechanism as set forth in TEP's proposed
28

1 ROO is inadequate to protect customers, as RUCO believes that TEP defined "true-up Revenue" too
2 narrowly and failed to provide for interest.

3 76. AECC believes that the proposal to hold rates stable as proposed by TEP does not
4 provide a benefit to customers. (AECC March 28, 2007 Comments at p 2; AECC 4/9/07 Comments
5 at 1) AECC states that if Standard Offer rates are retained after the Fixed CTC expires, the full
6 amount of the foregone rate reduction between the time the Fixed CTC expires and January 1, 2009
7 must be tracked with the express intention of fully crediting this amount to customers (with interest)
8 when new rates are established, irrespective of the method chosen for setting new rates and
9 irrespective of the level of new rates.

10 77. M/S/B/S does not have a position with regard to the Fixed CTC income. (M/S/B/S
11 April 4, 2007 Comments at 4)

12 78. During the course of the hearing, Mr. Pignatelli testified that TEP believes that the
13 termination of the Fixed CTC would have a significant adverse affect on TEP's cash flow.

14 79. Because of the uncertainty of the impact of the forthcoming rate case, and to avoid the
15 potential confusion or disruption that may arise if rates decline for six months and then increase, we
16 find that it is in the public interest to provide stability of rates pending the outcome of the rate case.
17 We find further that TEP customers should be protected by providing for a mechanism to refund the
18 revenues, plus interest, that will continue to be collected pursuant to the modification of the Fixed
19 CTC until final rates are approved. We will determine the specifics of interest rate and how and
20 when customers may receive a refund in the forthcoming rate case. Accordingly, we will allow
21 TEP's Standard Offer rates to remain unchanged and at current levels, pending our determination of
22 any refund, until the Rate Proposal Docket is resolved.

23 80. We believe the least disruptive and least confusing or prejudicial way to maintain
24 current rates is for the Fixed CTC to continue beyond the time it would otherwise terminate pursuant
25 to the 1999 Settlement Agreement. TEP is already tracking the revenue collected pursuant to this
26 charge and should easily to able to continue tracking this revenue.

27 81. The amount of revenue collected as a result of this modification to the Fixed CTC, is
28 classified hereafter as "True-up Revenue," until a final order is issued in the Rate Proposal Docket.

1 True-up Revenue will be tracked and accrue interest to be refunded at an appropriate rate of interest
2 compounded monthly, and such interest rate and the mechanism for determining how the refund will
3 be made shall be determined as part of the final order in the forthcoming rate case.

4 **C. Demand-Side Management Portfolio, Time-Of-Use Rates And Renewable Energy**
5 **Action Plan.**

6 82. TEP proposes to file a detailed DSM Portfolio, based upon TEP's existing and
7 proposed DSM programs and a Renewable Energy Action Plan ("REAP") with the Commission by
8 July 2, 2007. Under TEP's proposal, the DSM Portfolio, together with information regarding cost
9 recovery thereof, will be filed in a separate docket for review and approval by Staff and the
10 Commission with the objective that the Commission would ultimately approve the DSM Portfolio, as
11 well as full cost recovery for DSM outside of and separate from whatever decision is reached
12 concerning TEP's proposals to amend the 1999 Settlement Agreement. Similarly, TEP proposes to
13 file the REAP and REAP tariff in the same separate docket for review and approval by Staff and the
14 Commission with the objective that the Commission will ultimately approve the REAP and a REAP
15 tariff that permits full recovery of the costs associated with REAP outside of and separate from
16 whatever decision is reached concerning TEP's proposals to amend the 1999 Settlement Agreement.
17 In the alternative, TEP proposes DSM and renewable energy issues can be fully addressed and
18 implemented in connection with the adoption of one of TEP's proposals for amending the 1999
19 Settlement Agreement in this proceeding. TEP proposes that the Time-of-Use rates will be fully
20 addressed and implemented in connection with the adoption of one of TEP's proposals for amending
21 the 1999 Settlement Agreement in this proceeding.

22 83. Staff, RUCO and AECC believe that cost recovery for DSM must occur in connection
23 with a general rate case based on a finding of fair value. Staff states that DSM programs should be
24 approved in an expeditious manner, but that program costs that exceed costs embedded in current
25 rates should be capitalized to be recovered in rates to be determined in the upcoming rate case. (Staff
26 March 28, 2007 Comments p 6)

27 84. SWEEP's objective in this proceeding has been the establishment of cost effective
28 DSM programs in TEPs service territory as soon as possible. SWEEP supports TEP's Proposed

1 ROO with certain specific modifications that clarify that there will be three dockets: one to address
2 the proposals to amend the 1999 Settlement Agreement, another to consider the DSM Portfolio Plan
3 and the last to address the Renewable Energy Action Plan. (SWEEP March 28, 2007 Comments at 2).
4 SWEEP believes that it is important for the Commission to review, address and order DSM cost
5 recovery through a DSM adjustor or other cost recovery mechanism in the separate DSM docket.
6 SWEEP asserts that TEP should receive reasonable assurance of cost recovery for cost-effective
7 DSM programs approved by the Commission, but that the specific cost recovery mechanism or
8 approach can and should be addressed in the DSM Docket. (SWEEP April 4, 2007 Comments at 2)

9 85. Staff does not oppose the proposal to have a comprehensive review of DSM proposals
10 conducted in a separate docket from the rate case docket. Staff has concerns whether a separate
11 docket will facilitate significant increased spending on DSM in the absence of a cost recovery
12 proposal. Staff suggests that the Commission consider authorizing an accounting order or other
13 regulatory order to provide for the capitalization and later recover of DSM costs to the extent that
14 such costs exceed the costs currently provided in base rates. Staff states the mechanism could be
15 discussed and established in conjunction with the separate DSM docket envisioned by SWEEP.
16 (Staff April 4, 2007 Comments at 2)

17 86. Staff argues that RES funding should be addressed by TEP in the same manner and at
18 the same time as other electric utilities upon the REST rules becoming effective.

19 87. TEP believes it is inappropriate and confiscatory to separate the evaluation and
20 approval of a DSM portfolio from the evaluation and approval of cost recovery of such portfolio.
21 (TEP April 4, 2007, Reply Comments at 15)

22 88. The proposal for TEP to file a detailed DSM portfolio in a separate docket for review
23 and approval is reasonable and will permit approval of, and potential implementation of DSM
24 programs as soon as possible. We agree that Staff's suggestion that the cost recovery mechanism for
25 the DSM programs should be discussed in the separate DSM docket, and the Commission can
26 determine in that docket whether an accounting order or other regulatory order would be appropriate
27 to allow those DSM programs to be implemented prior to the resolution of the rate case, or whether it
28 is in the public interest to consider cost recovery in the rate case.

1 89. The proposed RES rules permit utilities to file tariffs in a separate docket or
2 alternatively as part of a rate case. TEP's proposal to file its REAP and REAP tariff in a separate
3 docket is reasonable. However, as of this Decision, the RES rules are not final, and TEP's ultimate
4 tariff will have to comply with the final RES Rules. As part of the REAP docket, the Commission
5 may determine that the proposed REAP tariff is best considered as part of the forthcoming Rate
6 Proposal Docket, and may consolidate those dockets.

7 90. TOU tariffs will be considered as part of TEP's various rate proposals in the
8 forthcoming rate case.

9 **D. Full Reservation of Rights.**

10 91. TEP states that its agreement to file the Rate Proposals in the Rate Proposal Docket is
11 being made for the purpose of providing the Commission, as well as the Parties and Intervenors,
12 information that has been requested to fully evaluate TEP's Rate Proposals. According to TEP, the
13 Rate Proposals are being presented to further settlement discussions between the parties that may
14 result in a mutually acceptable regulatory solution or agreement to modify the 1999 Settlement
15 Agreement and Decision No. 62103. TEP states that its filing of the Rate Proposals is with full
16 reservation of all its rights and claims, and without waiver of any of its rights or claims, arising out of
17 the 1999 Settlement Agreement and Decision No. 62103.

18 92. Similarly, Staff and Intervenors' participation in the Rate Proposal Docket is with full
19 reservation of their rights and without waiver of any asserted position regarding the proper
20 interpretation of the 1999 Settlement Agreement.

21 93. It is the intent of the Commission to preserve all parties' rights or claims that may
22 exist under the 1999 Settlement Agreement and Decision No. 62103. There is disagreement among
23 the parties concerning the existence and nature of those rights and claims. The Commission
24 acknowledges that TEP, and other parties, have agreed to participate in the forthcoming rate proposal
25 docket voluntarily and in an attempt to avoid litigation while a solution to the disputes that have
26 arisen in this docket are addressed at the Commission.

27 94. Any further proceedings in this Docket are stayed until further Order by the
28 Commission.

1 95. The Rate Proposal Docket will be consolidated with this Docket and proceeding.

2 96. The evidence submitted in connection with the hearing on TEP's Motion to Amend
3 will be held under consideration pending further Order.

4 **CONCLUSIONS OF LAW**

5 1. TEP is a public service corporation within the meaning of the Arizona Constitution,
6 Article XV, and under A.R.S. Title 40, generally.

7 2. The Commission has jurisdiction over TEP and the subject matter contained herein.

8 3. Notice of the proceeding has been given in the matter prescribed by law.

9 4. All existing rights and claims of TEP, Staff and the Intervenors arising out of the 1999
10 Settlement Agreement and Decision No. 62103 will be fully preserved.

11 5. It is in the public interest to preserve the status quo and prevent potentially significant
12 short term fluctuations in TEP's Standard Offer rates.

13 6. It is just and reasonable that TEP's Standard Offer rates shall remain at their current
14 level, and that the revenues that will continue to be collected after the Fixed CTC would otherwise
15 terminate, shall be traced and accrue interest, pending future Commission determination of any
16 refund, until the effective date of the Commission's final Order in the forthcoming Rate Proposal
17 Docket.

18 7. The extension of the operation of the Fixed CTC, as discussed herein, is just and
19 reasonable and should be adopted.

20 **ORDER**

21 IT IS THEREFORE ORDERED that Tucson Electric Power Company shall file the Rate
22 Proposals initiating the Rate Proposal Docket on or before July 2, 2007.

23 IT IS FURTHER ORDERED that Tucson Electric Company shall file a detailed DSM
24 Portfolio based upon Tucson Electric Company's existing and proposed DSM programs and a
25 Renewable Energy Action Plan with the Commission by July 2, 2007. The DSM Portfolio and
26 REAP, together with information regarding cost recovery thereof, shall be filed in separate dockets.

27 IT IS FURTHER ORDERED that all existing rights and claims of Tucson Electric Power
28 Company, Staff and the Intervenors arising out of the 1999 Settlement Agreement and Decision No.

1 62103 are fully preserved.

2 IT IS FURTHER ORDERED that Tucson Electric Power Company's current Standard Offer
3 rates for all retail customers shall remain at their current level, pending Commission determination of
4 any refund, until the effective date of a final order in the Rate Proposal Docket.

5 IT IS FURTHER ORDERED that in order to maintain Tucson Electric Power Company's
6 Standard Offer rates at their current level, the Fixed CTC charge shall continue beyond the time it
7 would otherwise termination under the 1999 Settlement Agreement until further Order of the
8 Commission.

9 IT IS FURTHER ORDERED that the incremental revenue collected as a result of retaining
10 the Fixed CTC and maintaining Standard Offer rates at their current level shall be treated as "True
11 Up Revenue" as discussed herein, and shall accrue interest and may be subject to refund as
12 determined by the Commission in the forthcoming rate case docket.

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1 IT IS FURTHER ORDERED that this Docket shall be stayed until further Order of the
2 Commission.

3 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

5
6
7 CHAIRMAN _____ COMMISSIONER

8
9
10 COMMISSIONER _____ COMMISSIONER _____ COMMISSIONER

11
12 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
13 Director of the Arizona Corporation Commission, have
14 hereunto set my hand and caused the official seal of the
Commission to be affixed at the Capitol, in the City of Phoenix,
this ____ day of _____, 2007.

15
16 _____
BRIAN C. McNEIL
EXECUTIVE DIRECTOR

17
18 DISSENT _____

19
20 DISSENT _____

21 JR:mj

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2	DOCKET NO.:	E-01933A-05-0650
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