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BEFORE THE ARIZONA CORPORATION COMMISSION
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IN THE MATTER OF THE APPLICATION OF
UNS ELECTRIC, INC. FOR APPROVAL OF
THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES
DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE
OF THE PROPERTIES OF UNS ELECTRIC,
INC.

DOCKET NO. E-04204A-06-0783

**STAFF'S NOTICE OF FILING PROPOSED
PPFAC CAP LANGUAGE**

Staff of the Arizona Corporation Commission ("Staff") hereby files its proposal with respect to a PPFAC cap which the Staff recommends to address the potential rate shock issues raised by the Company's Exhibit A-43 in the above-referenced matter.

RESPECTFULLY SUBMITTED this 28th day of September 2007.

Maureen A. Scott, Senior Staff Counsel
Kevin O. Torrey, Attorney
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and thirteen (13) copies
of the foregoing filed this 28th day
of September 2007 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85003

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Arizona Corporation Commission
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SEP 28 2007

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1 Copies of the foregoing e-mailed and/or
mailed this 28th day of September 2007 to:

2
3 Michael W. Patten
Roshka DeWulf & Patten, PLC
One Arizona Center
4 400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

5
6 Raymond S. Heyman
Michelle Livengood
UniSource Energy Services
7 One South Church Avenue
Tucson, Arizona 85702

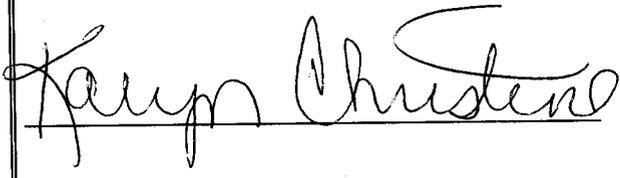
8
9 Marshall Magruder
Post Office Box 1267
Tubac, Arizona 85646

10
11 Scott W. Wakefield, Chief Counsel
RUCO
1110 West Washington, Suite 200
12 Phoenix, Arizona 85007

13 Thomas L. Mumaw
Deborah A. Scott
14 Pinnacle West Capital Corp.
P.O. Box 53999, Mail Station 8695
15 Phoenix, Arizona 85072-3999

16 Barbara A. Clemstine
Arizona Public Service Company
17 P.O. Box 53999, Mail Station 9708
Phoenix, Arizona 85072-3999

18
19 Robert J. Metli
Snell & Wilmer, LLP
One Arizona Center
20 400 East Van Buren Street
Phoenix, Arizona 85004-2202

21
22 
23
24
25
26
27
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UNS Electric PPFAC provisions to prevent a rate shock situation from occurring

Exhibit UNSE 43 illustrates how UNS Electric projects that its purchased power and fuel cost for the period June 2008 through May 2009 is projected to vary, depending upon the price level of natural gas. That exhibit shows the Company's estimated total rates, including the PPFAC forward component rates, at natural gas prices of \$6.00, \$7.50 and \$9.00 per MMBtu, respectively. It shows the Company's forecast of a PPFAC forward component of 0.48 cents/kWh at \$6.00/MMBtu natural gas prices, and 1.73 cents and 2.98 cents at \$7.50 and \$9.00 natural gas prices. The total percentage increases from present rates (including UNS Electric's proposed base rate increase) range from 8.8% at \$6.00 natural gas, and were projected by the Company to be 21.5% and 34.2% at \$7.50 and \$9.00 natural gas prices, respectively.

Staff believes this information raises concerns about the potential for customer rate shock, especially if natural gas prices move significantly higher than the \$7.50/MMBtu that UNS Electric used as the basis for its bill impact estimates in Exhibit UNSE 44. Because natural gas prices can be very volatile, no one currently knows with accuracy what natural gas prices, and, by reference, what UNS Electric's power costs will be, for the period June 2008 through May 2009 when the first PPFAC forward component would be in effect.

After receiving the information contained in Exhibits UNSE 43 and 44, Staff therefore wanted to highlight for the Commission the potential PPFAC rate shock issue, and to offer a recommendation for addressing such a situation, should it occur.

Staff recommends that the Commission impose an annual cap to address the potential of PPFAC rate shock given new information presented by UNSE. The PSA that the Commission approved for APS contains an annual cap of 4 mills which limits the amount by which the new annual rate can change from the current annual rate.¹ That level of annual cap would not be appropriate for UNSE because UNSE does not own any base load generation power costs and its power costs are subject to a higher degree of volatility than are APS'. During cross examination by Staff and under Commission questioning, UNSE witness DeConcini suggested that, if a cap were to be imposed on the UNSE PPFAC, it would need to reflect a wider range than the 4 mill cap contained in the APS PSA. Mr. DeConcini suggested that one way of determining a cap for the UNSE PPFAC would be to examine the volatility of the PPFAC rates under a range of natural gas prices. That type of analysis, including information on customer bill impacts, is essentially what UNSE provided in Exhibits UNSE 43 and 44.² Using the information provided in Exhibits UNSE 43 and 44, an annual cap for UNSE's PPFAC could be developed that would be tailored to UNSE's unique circumstances and exposure to power

¹ APS' 4 mill cap, as it came out of the most recent rate case decision, is a limit on the amount of change that can occur from the current annual rate to the new annual rate. The annual rate is the sum of the Forward, Historical, and Transition components.

² UNS Electric also provided additional bill impacts in Exhibit UNSE 45, assuming "solid fuel resources," i.e., a coal plant; however, Staff views that scenario as speculative, and accordingly, does not accord it any weight in evaluating what an annual cap on the UNSE PPFAC could be.

cost price volatility. For example, if the Commission wanted to use UNSE's "base forecast" of power costs (which are based on natural gas at \$7.50 per MMBtu), an annual PPFAC cap could be developed using such information. Based on the information shown in Exhibit UNSE 43, for example, if an annual cap were set at 1.73 cents per kWh for the PPFAC forward component, the total rate increase under UNSE's projection would be limited to approximately the 21.5% shown on that exhibit.³ If the cap for the UNSE PPFAC were established in this manner, the 1.73 cents per kWh would be a "hard cap" that could not be exceeded.⁴ (This would differ from APS' cap which is a limit on change.)

In summary, the Staff recommends an annual PPFAC cap as discussed herein to prevent the potential for rate shock in this case.⁵

³ The 21.5% increase assumes that UNSE's full base rate increase request and its requested ratemaking treatment of Black Mountain Generating Station (BMGS) would be approved. If the Commission approves something less than UNSE's full base rate request, the total increase would be lower. With respect to the impact of BMGS, UNSE witness Grant testified under cross examination by Staff that the rate impacts shown on Ex. UNSE 43 would be similar with and without the Company's requested ratemaking treatment for BMGS.

⁴ In this illustrative example, based on Ex UNSE 43, the 1.73 cents/kWh cap would apply to the PPFAC forward component only and could be viewed as a "hard cap" on the forward component. If the 1.73 cent PPFAC forward component produced an under-collection of cost, the under collection would be addressed in the PPFAC true-up component for the next period. If gas prices and power costs increase substantially in UNSE's PPFAC filing for the forward component beyond what they are expected to be currently (i.e., beyond the 1.73 cents per kWh shown on Ex UNSE 43), the application of this cap on the PPFAC forward component would essentially result in a deferral of cost recovery in order to avoid a rate shock situation.

⁵ Staff's initial PPFAC recommendation did not include a cap. However, , after seeing the potential for a rate shock situation in UNSE's projections in Exhibit UNSE 43 that assumed higher gas and power prices, Staff now supports the implementation of a PPFAC cap for UNSE.