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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF
TUCSON ELECTRIC POWER COMPANY
FOR THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES
DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE
OF ITS OPERATIONS THROUGHOUT THE
STATE OF ARIZONA.

DOCKET NO. E-01933A-07-0402

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

DOCKET NO. E-01933A-05-0650

NOTICE OF FILING

Staff of the Arizona Corporation Commission hereby provides notice of filing the summaries of witnesses' Barbara Keene, Ralph Smith, Ernest Johnson and Frank Radigan in the above-captioned matter.

RESPECTFULLY SUBMITTED this 8th day of July, 2008.

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Barbara Keene
Witness Summary
Tucson Electric Power Company
Docket Nos. E-01933A-07-0402 & E-01933A-05-0650

Ms. Keene's testimony will provide support for the Settlement Agreement filed on May 29, 2008, by addressing the following sections of the Settlement Agreement:

Section VIII. Renewable Energy Adjustor;
Section IX. Demand-Side Management Programs and Adjustor;
Section XVII. Rules and Regulations; and
Section XVIII. Additional Tariff Filings (including partial requirements service tariffs, interruptible tariff, demand response, and bill estimation).

Her testimony also responds to Commissioner Mayes' letter of May 20, 2008, in regard to the topics of partial requirements service tariffs, demand response, and demand-side management for Tucson Electric Power.

Additionally, Ms. Keene will address Staff's response to the direct testimony of Mr. Jeff Schlegel of the Southwest Energy Efficiency Project in regard to DSM program spending increases and a Performance Incentive.

Ralph C. Smith
Witness Summary
Tucson Electric Power Company
Docket Nos. E-01933A-07-0402 & E-01933A-05-0650

Mr. Smith's testimony in support of the Settlement addresses the following sections of the Settlement Agreement:

- II. Rate Increase
- III. Ratemaking Treatment of TEP's Generation Assets and Fuel Costs
- IV. Cost of Capital
- V. Depreciation and Cost of Removal
- VI. Implementation Cost Recovery Asset
- VII. Purchased Power and Fuel Adjustment Clause
- XV. Fixed CTC True-Up Revenues
- XIX. Fuel Audit

The findings and recommendations for each of these areas are as follows:

II. Rate Increase. For Settlement purposes, Staff, TEP, and a number of other parties to this rate case have agreed to a rate increase that would provide TEP with approximately \$828.2 million of base rate revenue per year. As shown on Settlement Exhibit 3, page 1, this \$828.2 million is approximately a 6 percent increase over TEP's current revenue of \$781.1 million. In dollar terms, the base rate increase over TEP's current revenue is approximately \$47.1 million. This is also addressed in Paragraph 2.3 of the Settlement. As shown on Settlement Exhibit No. 2, page 2 of 5, TEP's current revenues include approximately \$89.6 million for Fixed CTC.

As described in Paragraph 2.1 of the Settlement, the parties agreed to an Arizona jurisdictional fair value rate base for the test year ending December 31, 2006, of approximately \$1.452 billion, and a fair value rate of return of 5.64 percent. Settlement Exhibit No. 1 summarizes the fair value rate base, adjusted operating income, and fair value rate of return that the signing parties used for Settlement purposes to derive a base rate increase amount of approximately \$136.8 million.

Settlement Exhibit No. 2 presents the Signatories' approach of reconciling the amount of base rate increase that is provided for in the Settlement. It has columns for TEP's original filing, Staff's direct filing, and the Settlement. It shows how the adjustments originally filed by TEP and Staff were ultimately resolved, for Settlement purposes, in deriving the base rate increase of \$136.8 million.

Attachment RCS-7 presents a reconciliation of the jurisdictional revenue deficiency of approximately \$9.8 million on original cost rate base ("OCRB") filed with my direct testimony to the \$136.8 million increase provided for in the Settlement Agreement. My testimony in support of the Settlement describes the resolution, for Settlement purposes, of a number of major impact items, including Springerville Unit 1, Accumulated Depreciation and prospective depreciation rates, and items such as Short Term Sales Revenue and Gain on Sale of SO₂ Allowances. Attachment RCS-8 presents the transcript of my deposition in this proceeding which was taken by TEP on March 10,

Ralph C. Smith
Witness Summary
Tucson Electric Power Company
Docket Nos. E-01933A-07-0402 & E-01933A-05-0650

2008. In that deposition, a number of the more important issues pertaining to this case were discussed in additional detail

III. Ratemaking Treatment of TEP's Generation Assets and Fuel Costs

Section III of the Settlement Agreement resolves the disputes between the parties concerning the ratemaking treatment of TEP's generation assets. Paragraph 3.1 of the Settlement Agreement provides, for ratemaking purposes, that Springerville Unit 1 and the Luna Generating Station shall be included in TEP's rate base at their respective original costs. Moreover, all other generation assets acquired by TEP after December 31, 2006, but before December 31, 2012, shall be included in TEP's rate base at their respective original costs, subject to the Commission's subsequent regulatory and ratemaking review and approval.

IV. Cost of Capital

The Settlement Agreement provides for an overall cost of capital of 8.03 percent and a 5.64 percent fair value rate of return ("FVROR"). It provides for a return on equity of 10.25 percent, which was the Staff recommendation.

V. Depreciation and Cost of Removal

Section V of the Settlement Agreement addresses depreciation rates. It provides that TEP shall use the depreciation rates contained in Settlement Exhibit No. 5. In general, the depreciation rates for Distribution and General Plant are consistent with TEP's originally filed depreciation study. Additionally, for generation plant, the remaining lives and cost recovery rates are consistent with TEP's revised depreciation study that was filed with TEP witness Kissinger's rebuttal testimony. As a result of Settlement negotiations, an additional provision for increased accruals for cost of removal on TEP's generation plant has been included in the depreciation rates provided for in the Settlement Agreement. This provision is closely related to the compromises the parties reached concerning the amount of Accumulated Depreciation reflected in rate base. It provides for additional build-up for TEP's Accumulated Depreciation balance related to cost-of-removal accruals on generation plant during the rate moratorium period.

VI. Implementation Cost Recovery Asset

Section VI of the Settlement Agreement addresses the ratemaking treatment of the Implementation Cost Recovery Asset ("ICRA"). Consistent with Staff's recommendation, \$14.2 million is included in rate base. That amount is amortized over a four-year period, which is also consistent with Staff's recommendation. Amounts in excess of the \$14.2 million that were originally requested by TEP have been removed from rate base and from amortization expense. Additionally, Paragraph 6.2 of the Settlement Agreement specifies that the ICRA shall not be included in rate base or as an amortization expense in TEP's next rate case. The timing of when TEP can file its next rate case is addressed in Section X of the Settlement Agreement, which provides for a rate case moratorium.

Ralph C. Smith
Witness Summary
Tucson Electric Power Company
Docket Nos. E-01933A-07-0402 & E-01933A-05-0650

VII. Purchased Power and Fuel Adjustment Clause

Section VII of the Settlement Agreement addresses the provisions of the PPFAC that has been agreed to by the parties through the process of negotiation. The plan of administration for the PPFAC is provided in Settlement Exhibit No. 6. It is reasonable to provide for the recovery of TEP's fuel and purchased power costs through a PPFAC. TEP does not currently have a PPFAC. However, TEP does have significant fuel and purchased power costs. For the reasons described in my direct testimony that was filed on February 29, 2008 in this proceeding, it is reasonable to provide for the recovery of TEP's fuel and purchased power costs through a PPFAC.

XV. Fixed CTC True-Up Revenues

Other Staff witnesses are presenting Staff's position concerning the disposition of Fixed CTC True-Up Revenue. I have been asked to provide the estimated amounts of such revenue. Based on the information provided by TEP in response to Staff data request LA-25-1, I have summarized these estimated amounts, by month and cumulatively, in a table on page **Error! Bookmark not defined.** of my testimony.

XIX. Fuel Audit.

Section XIX of the Settlement Agreement addresses TEP's implementation of the fuel audit recommendations set forth in Staff's direct testimony. TEP has agreed to implement Staff's recommendations. TEP need not complete its implementation of such recommendations prior to implementing the PPFAC. Section XIX provides that TEP should file an implementation plan within 90 days of the effective date of the Commission's order approving the Settlement Agreement.

Additionally, Mr. Smith will respond to the testimony of RUCO witness William A. Rigsby. Specifically, he will address the aspects of the settlement agreement to which RUCO has taken issue:

- Reconciliation of Staff direct filing with Settlement Agreement
- The amounts of Fixed CTC True-Up Revenues and the presentation of the base rate increase in the Settlement Agreement
- The Base Cost of Fuel and Purchased Power
- The Purchased Power and Fuel Adjustment Clause
- Depreciation and Cost of Removal Related Issues
- Springerville Unit 1 related issues

Mr. Smith will also address a technical correction to Section 7 of TEP's Rules and Regulations concerning Line Extensions that Staff believes should be made.

Frank Radigan
Witness Summary
Tucson Electric Power Company
Docket Nos. E-01933A-07-0402 & E-01933A-05-0650

Mr. Radigan's testimony will address the following areas:

Revenue Allocation - The Settlement Agreement at paragraph 2.3 provides for base rate revenue of \$828.2 million, which is a \$47.1 million increase over TEP's existing base rate revenue of \$781.1 million. Settlement Exhibit 3 presents a Proof of Revenue which shows how the \$828.2 million (inclusive of the \$47.1 million base rate increase) has been spread across the service classifications so that each class receives the same increase except that residential customers who qualify for lifeline programs do not receive a rate increase. The allocation shown on Settlement Exhibit 3 and described in subsection XVI-A of the Settlement Agreement is a reasonable resolution of the various proposals put forth by parties in their testimony.

Inclining Block Rate Structure - The Settlement Agreement, in subsection XVI-B, calls for the introduction of an inclining block rate structure. This is an important measure to encourage energy conservation. As the customer usage increases, the price for each kWh of electricity becomes more expensive. This should give customers the signal to give more consideration in using power. The rates are also seasonally differentiated between summer and winter, with the winter rates lower than the summer. The seasonal differentiation is an additional means to make customers more aware that power costs are higher during the high-usage summer periods. The largest users, though small in number, use a considerable amount of energy. Therefore, tier points were chosen for the blocks that would protect small users from seeing large increases in their bills but, at the same time, give the largest users a signal to conserve.

Time of Use Rates - The Settlement Agreement, in subsection XVI-C, provides for Time-of-Use Rates. Sending price signals to customers regarding TEP's cost to serve at different times of the year and at different times of the day provides an important energy conservation incentive. Thus, the Settlement expands the availability of time-of-use rate schedules and offers them on an optional basis rather than a mandatory basis. Further, the number of time-of-use rate schedules has been expanded in order to give customers maximum flexibility in choosing the rate schedule that best suits their lifestyle. Finally, the rate design for each of the new rate schedules gives a clear price signal that the best way for a customer to take advantage of time-of-use rates is to shift usage to the off-peak period.

Lifeline Rates - The Settlement Agreement, in subsection XVI-E, provides for protection for customers taking electric service from TEP under low-income tariffs. Customers on lifeline rates will keep their current rates, and those rate schedules will be available for new lifeline

Frank Radigan
Witness Summary
Tucson Electric Power Company
Docket Nos. E-01933A-07-0402 & E-01933A-05-0650

customers. Lifeline tariffs will not be subject to the PPFAC. However, lifeline rate customers will be subject to the Renewable Energy Adjustor and the Demand-Side Management Adjustor.

Large General Service and Large Light and Power Rates - The rates for these service classes are seasonally differentiated and have substantial non-fuel cost recovery through demand charges. Shifting cost recovery to demand charges gives an incentive to customers to move usage from the peak period to off-peak periods, thereby helping the Company to control peak demand and reducing costs for all customers.

**WITNESS SUMMARY
ERNEST JOHNSON
TUCSON ELECTRIC POWER COMPANY
DOCKET NOS. E-01933A-07-0402 & E-01933A-05-0650**

Mr. Johnson will provide policy level testimony that summarizes the Settlement process and the reasons why the Settlement is fair, balanced, and in the public interest. Accordingly, the Settlement Agreement is in the public interest:

- It is fair to ratepayers because it results in just and reasonable rates.
- It is fair to the utility because it provides revenues necessary for the utility to provide reliable electric service along with an opportunity for a reasonable profit.
- It promotes rate stability by establishing a four-year base rate increase moratorium.
- It balances many diverse interests, including those of low-income, residential, commercial, and industrial customers, merchant generators, retail energy marketers, and shareholders.
- It will allow the elimination of long, complex litigation by resolving issues associated with prior Commission decisions.
- It promotes the public interest by facilitating the provision of reliable electric service at the lowest reasonable rates.
- It provides for no base rate increase to low-income customers.
- It implements a demand-side management adjustor and performance incentive.
- It provides for expanded time-of-use options to customers.
- It retains cost-of-service-based rate making treatment.

Additionally, Mr. Johnson will testify that the Agreement addresses and resolves all of the main rate case issues, provides sufficient revenues and return for TEP to maintain reliable electric service, and results in rates and charges which Staff believes are just and reasonable.