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Arizona Corporation Commission
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BEFORE THE ARIZONA CORPORATION COMMISSION

10 IN THE MATTER OF THE
 11 APPLICATION OF TUCSON ELECTRIC
 12 POWER COMPANY FOR THE
 13 ESTABLISHMENT OF JUST AND
 14 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

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

DOCKET NO. E-01933A-05-0650

**POST HEARING BRIEF OF PHELPS
 DODGE MINING COMPANY AND
 ARIZONANS FOR ELECTRIC
 CHOICE AND COMPETITION**

19 Phelps Dodge Mining Company and Arizonans for Electric Choice and
 20 Competition (hereafter collectively "AECC") hereby submit their Post- Hearing Brief in
 21 connection with the above referenced matters.

I. INTRODUCTION

22 This proceeding arose out of an Order of the Arizona Corporation Commission
 23 ("Commission") dated May 21, 2007 (Decision No. 69568) in which Tucson Electric
 24 Power Company ("TEP") was ordered by the Commission to file a rate case by July 2,
 25 2007.
 26

1 On July 2, 2007, TEP filed an Application with the Commission for a rate increase
2 to become effective January 1, 2009. The Commission consolidated the Rate Case Docket
3 (Docket No. E-01933A-07-0402) with the Docket in which the Commission re-opened
4 Decision No. 62103 (Docket No. E-01933A-05-0650)

5 On October 5, 2007, the Commission set the matter for Hearing, to commence on
6 May 12, 2008, and provided a schedule for filing pre-filed Testimony. On April 18, 2008,
7 the Commission Utilities Division ("Staff") reported that the parties had engaged in
8 settlement discussions and were making sufficient progress and Staff, therefore, requested
9 that the date for the filing of Surrebuttal Testimony be vacated.

10 On April 23, 2008, TEP filed a Notice in the Docket indicating that TEP and Staff
11 had reached an agreement in principal on the terms of settlement and were engaged in
12 preparing a written agreement. Based on their knowledge and participation in settlement
13 discussions, many of the parties believed that, depending on specific details of the
14 ultimate agreement, they would be able to support the proposed settlement. Only two
15 parties, the Residential Utility Consumer Office ("RUCO") and Southwest Energy
16 Efficiency Project ("SWEEP") expressed a belief they would likely not be supporting the
17 forthcoming agreement.¹

18 Hearing on the proposed settlement agreement commenced on July 9, 2008, at the
19 Commission's offices in Tucson, Arizona, and concluded on July 17, 2008.

20 II. DISCUSSION

21 AECC is a signatory to the Settlement Agreement and recommended that the
22 Settlement Agreement be approved by the Commission because it produces just and
23 reasonable rates and is in the public interest. All signatories to the Settlement Agreement
24 agreed the settlement is fair, balanced and in the public interest. As stated by Staff
25

26 ¹ SWEEP later reached an agreement concerning certain provisions of the settlement, although SWEEP did not sign the Settlement Agreement.

1 Witness Ernest G. Johnson, Director of the Commission Utilities Division:

2 "The Settlement Agreement is in the public interest in that it is fair to
3 ratepayers because it results in just and reasonable rates. It's fair to the
4 utility because it provides revenues necessary for the utility to provide
5 reliable electric service, along with an opportunity for a reasonable profit.

6 "It promotes rate stability by establishing a four-year base rate
7 increase moratorium. It balances many diverse interests, including those of
8 low income, residential, commercial, and industrial customers, merchant
9 generators, retail energy marketers, and shareholders" (Tr. at p. 336, ll. 12-
10 23²) (emphasis added).

11 The settlement agreement resolved liability issues, contentious issues and many
12 other issues related to the 1999 Settlement Agreement.³ Settlement discussions were open
13 to all parties who chose to participate. The discussions involved compromises, write-offs,
14 and give-and-take situations. The parties did not receive all of which they advocated for
15 in any given situation; however, it was with an understanding that a settlement agreement
16 agreed to by the parties would be approved in its entirety. As stated by TEP Witness
17 James S. Pignatelli: "The Settlement Agreement as it is presented is a product of a
18 balancing of interests. And it must be adopted in its entirety." (Tr. p 105, ll. 8-10.)

19 The settlement was intended to resolve many issues associated with the 1999
20 Settlement Agreement, and the TEP Rate Application. It also was intended to eliminate
21 long, complex and contentious litigation.

22 Although RUCO had the opportunity to actively participate in the negotiations,
23 they did not negotiate (Tr. p. 392 ll. 19-24).⁴ RUCO did not endorse even those issues

24

25 ² "Transcript" will be referred to as "Tr." with reference to the page and lines.

26 ³ The 1999 Settlement Agreement was entered into by Tucson Electric Power Company, Arizona Residential Utility
Consumer Office, Arizonans for Electric Choice and Competition, and Arizona Community Action Association.

⁴ As stated by Staff Witness Johnson:

27 "And I want to be clear. My testimony in this proceeding is that RUCO did not negotiate. And I
28 believe that's a fair depiction of what occurred. That's not to say that RUCO did not attend the
29 various settlement discussions, because, to my knowledge, RUCO did attend. And there were
30 points in time when RUCO even offered a comment. RUCO, to my knowledge, never put forward
31 a proposal toward a resolution of any of the issues during the settlement process." (Tr. p 639, ll.
32 12-20.)

1 that would typically be positive for residential ratepayers (Tr. p. 393, ll. 5-8).⁵

2 Although RUCO did not voice support for any of the provisions in the Settlement
3 Agreement during the settlement negotiations, RUCO indicated support at the hearing for
4 many of the provisions.⁶

5 A. Just and Reasonable Rates

6 The Settlement Agreement establishes new base rates that are 6 percent higher than
7 current rates. Current rates include the fixed CTC but exclude DSM related rates. The 6-
8 percent revenue increase is to be effected through a 6.1-percent increase on all rate
9 schedules except low-income residential customers who will receive no increase.

10 The 6-percent increase is over the last authorized increase granted TEP by the
11 Commission which was determined to be just and reasonable. (Tr. p. 180, ll. 16-17.)
12 RUCO disagrees on the amount of the percentage increase. The determination of that
13 figure depends upon the base from which the figure is computed. When computing the
14 percentage on the base, i.e. TEP authorized rates, the figure amounts to 6 percent. As
15 stated by Staff Witness, Mr. Johnson: "We believe that the rates put forward in the
16 settlement agreement represents the lowest reasonable rates that we believe is appropriate
17 based upon the information that we have." (Tr. p. 502, ll. 12-15.)

18
19 ⁵ RUCO Witness William S. Rigsby responded to a question from Mr Crockett concerning RUCO participation in
the settlement negotiations as follows:

20 "Q. (BY MR. CROCKETT) In connection with matters that RUCO has felt would have an impact on
the people they represent, i.e., the residential consumer, are you familiar with any proceeding in which
21 RUCO failed to express their position with reference to the interest of the residential consumer?

22 "A. No. I believe we have always done that. I think in this particular case, though, we just didn't do it
as far as the settlement negotiations." (Tr. p. 960, ll 21-25; p. 961, ll. 1-4.)

23 ⁶ RUCO indicated support for the following:

- 24 1. Expanded time-of-use rates.
- 25 2. Expanded Demand-Side Management Programs and spending.
- 26 3. Four-year base rate moratorium.
4. Equitable rate spread.
5. Rate increase exemption for low-income tariffs.
6. Customer credits for short-term sales revenue.
7. Credit for 10 percent of wholesale trading profits.
8. Customer credit for 50 percent of revenues realized from the sale of SO2 emission allowances.

1 Although RUCO ultimately accepted many of the benefits of the settlement
2 agreement, RUCO continued to oppose the rate increase provided for in the settlement
3 agreement. (Tr. p. 1066, ll. 20-22.)

4 B. Market versus Cost Issue

5 The Settlement Agreement resolves the major dispute between TEP and other
6 parties as to the appropriate basis for establishing Standard Offer Generation Rates for
7 TEP customers. The new proposed rates were derived using conventional cost-of-service
8 principles as opposed to market based pricing. As indicated by AECC Witness, Mr.
9 Higgins, he considered resolving that issue with a 6-percent base rate increase to be "the
10 strongest selling point of the settlement agreement." (Tr. p. 630, ll. 22-25.) Staff's
11 Witness, Mr. Johnson, stated that he and Mr. Higgins were on the same page and that the
12 adoption of cost-of-service was "absolutely critical." (Tr. p. 645, ll. 5-6.)

13 The resolution of this issue was a significant event as the "Market versus Cost"
14 dispute had already been the subject of a fully litigated Docket before the Commission.⁷
15 Because that issue had not been resolved in the prior Docket, the dispute had been carried
16 forward into this proceeding and had the potential for continuing beyond this proceeding
17 to the courts. The outcome of such a proceeding was uncertain, but the consequences
18 could be great to the parties. RUCO did not believe that the resolution of this issue had
19 much value to the parties, although, acknowledging that there was the possibility of some
20 exposure to ratepayers if TEP's position regarding market rates for generation were to be
21 adopted either by the Commission or as the result of an appeal. (Tr. p. 1045, ll. 19-23.)

22 RUCO's Witness, Mr. Rigsby, did agree that the Settlement Agreement foreclosed
23 the potential risk to ratepayers of the market pricing of TEP's generation assets by
24 adopting cost-of-service regulation. (Tr. p. 1050, ll. 13-17.)

25
26

⁷ Docket No. E-01933A-05-0650.

1 C. Rate Stability

2 The Settlement Agreement provides for base rates stability over the next 4 years.
3 Under the terms of the Settlement Agreement, the new base rates are to remain fixed with
4 some exceptions until January 1, 2013. This extends the period of rate stability for TEP
5 customers from the date of the 1999 Settlement Agreement to 2013, a period of 13 years.⁸

6 D. Purchase Power Fuel-Adjustor Clause

7 Without the PPFAC, TEP would not have agreed to the rate moratorium (Tr. p.
8 138, ll. 14-16). Commissioner Mayes expressed some concern about the lack of a cap in
9 the Adjustor Clause, especially in light of the fact the Arizona Public Service Company
10 ("APS") mechanism contains such a cap (Tr. p. 614, ll. 19-22).

11 AECC Witness, Mr. Higgins, responded to Commissioner Mayes's concern by
12 pointing out that you have to weigh the short-term benefit of a cap versus the fact that the
13 dollars ultimately have to be repaid with interest. (Tr. p. 615, ll. 8-10.) Mr. Higgins also
14 stated that ". . . it is important that the Settlement Agreement be viewed as a package" (Tr.
15 p. 617, ll. 7-8.) and that the proposed TEP PPFAC includes a customer credit for 50
16 percent of the revenues realized from the sale of SO2 emission allowances, a provision
17 that is not included in APS's power cost adjustor mechanism. Although Mr. Higgins did
18 not agree with everything that's been put into the fuel-adjustor mechanism, he believes
19 that "on balance it is reasonable and in the context of the entire package that it's
20 reasonable." (Tr. p. 627, ll. 5-7.)

21 Although RUCO did not agree with the structure of the PPFAC included in the
22 settlement agreement, RUCO did agree with the inclusion in the PPFAC of customer
23 credits for short-term sales revenue, credit for 10 percent of wholesale trading profits, and
24 credit for 50 percent of revenues realized from the sale of SO2 emission allowances.

25
26 _____
⁸ RUCO did not object to this provision in the Settlement Agreement.

1 E. Rate Spread Issues

2 The Settlement Agreement resolves, in an equitable and reasonable manner,
3 numerous rate spread issues. The parties were able to reach agreement concerning the
4 method of spreading the revenue increase among the various rate classifications.⁹

5 F. Rate Design Issues

6 For non-residential consumers, the Settlement Agreement properly aligns energy
7 related costs with energy charges and demand related costs with demand charges. The
8 rate design also minimizes cross-subsidies among non-residential customers who are on
9 the same rate schedules.

10 The rate design also provides for fully unbundled rates that can accommodate
11 direct access service consistent with the requirements of the Commission's Electric
12 Competition Rules (Tr. p. 587, ll. 2-6.)

13 G. Optional Time-of-Use Rates

14 The Settlement Agreement provides for optional time-of-use rates for both
15 residential and non-residential customers. This gives the customer the opportunity to be
16 more responsive to price signals.

17 H. Development of New Tariffs

18 The Settlement Agreement provides for the development of new partial
19 requirement rate schedules, new interruptible rate schedules, and new demand response
20 rate schedules within 90 days of the approval of the Settlement Agreement.

21 I. Demand-Side Management

22 The Settlement Agreement approves an adjustor mechanism to enable the
23 collection of revenues to fund Demand-Side Management projects. This surcharge is to
24 be levied upon all retail rate schedules.

25 _____
26 ⁹ RUCO Witness Rigsby indicated during cross-examination that RUCO agreed with the spread of rates set forth in the Settlement Agreement stating that, "We believe that is one of the provisions in the Settlement Agreement that has value." (Tr. p. 957, ll. 16-17.)

1 J. Sale of SO2 Emission Allowances

2 The Settlement Agreement provides for at least 50 percent of the SO2 sales
3 revenues to be included in the purchase-power fuel-adjustor clause mechanism.

4 **III. REVENUE REQUIREMENT**

5 TEP requested a revenue increase of \$180.7 million over current rates under the
6 Cost-of-Service Methodology Scenario. TEP's proposal included a Termination Cost
7 Regulatory Asset Charge (CTC) revenues and revenues from the Demand Side
8 Management Program. The request would have increased overall revenues 23 percent
9 over current rates.

10 The Settlement Agreement provides for a \$47.1 million increase or a 6-percent
11 increase over current rates. RUCCO differs with this percentage increase contending that
12 the increase is really 19.8 percent because it includes the CTC charge. The 6-percent
13 versus the 19.8-percent differential arises from the starting point for measuring the
14 revenue deficiency (Tr. p. 1010, ll. 9-12). The CTC charge was never an additional
15 charge, but was always part of current rates.

16 The increase in rates agreed to in the Settlement Agreement was a product of
17 negotiation and compromise. RUCO acknowledged in response to a question from the
18 Administrative Law Judge:

19 "Q. (BY JUDGE RODDA) RUCO knows that sometimes you have to trade a
20 little bit of the revenue requirement to get some of the benefits, right?

21 "A. Yes, certainly." (Tr. p. 1061, ll. 10-12.)

22 The Settlement Agreement also provides that customers are credited for 100
23 percent of the margins from short term sales as part of the proposed PPFAC.¹⁰

24 The revenue increase of \$47.1 million is just \$26.6 million greater than what
25 AECC had recommended, but is \$137.1 million less than TEP had recommended in its

26

¹⁰ RUCCO agrees with this provision in the Settlement Agreement.

1 cost-of-service scenario.

2 The proposed revenue increase is one component of a package of results which
3 included favorable resolution of the "market versus cost" issue, base-rate freeze until
4 January 1, 2013, resolution of rate-spread issues, improvement to rate design, increased
5 availability of TOU option for customers, a commitment to develop new partial
6 requirements, interruptible, and demand-response rate schedules and, thus, fully justifies
7 the compromise on revenue requirement.

8 IV. TRUE-UP REVENUES ISSUE

9 AECC recommends that the greater of \$32.5 million or 50 percent of the True-up
10 Revenues be credited to customers in the PPFAC balancing account and that TEP be
11 allowed to retain the remainder of the True-up Revenues. TEP has estimated that
12 approximately \$66 million of True-Up Revenues will be collected between May of 2008
13 and December 31 of 2008.

14 In order to understand AECC's position, it is necessary to review the history behind
15 the establishment of the True-Up Revenues. AECC was very closely involved in the
16 negotiation of the 1999 Settlement Agreement, and in particular, the provisions related to
17 the fixed CTC. The True-Up Revenues derive from a provision in the 1999 Settlement
18 Agreement that required rates to be reduced by the amount of the fixed CTC at such time
19 that \$450 million in stranded costs was recovered.

20 AECC's position on this issue was stated in the Direct Testimony of its Witness,
21 Mr. Higgins which was filed at the outset of this case. In that Testimony, Mr. Higgins
22 stated:

23 "Although the True-Up Revenues properly belong to customers, AECC
24 would be willing to accept a resolution in which the True-Up Revenues
25 were not returned to customers under the Cost-of-Service Methodology, if
26 and only if, this concession were accompanied by TEP's withdrawal of all
claims that the Company would be harmed by setting rates at cost of
service. Absent such action by TEP, the True-Up Revenues should be
returned in full to customers." (AECC Exh. No. 1, p. 43, ll. 6-11.)

1 In light of the fact that TEP has agreed in the settlement agreement to such a
2 withdrawal of claims and in light of the overall settlement, a result that splits the True-Up
3 Revenues between customers and TEP is fair, equitable, and reasonable.

4 In addition, it should be noted that, when the fixed CTC was established in 1999, it
5 was not a new charge that was added to TEP's existing rates but a "carve-out" of then
6 existing rates which was simply designated for fixed CTC recovery. So, when the fixed
7 CTC expired, removing the charge would not remove something that was "added on" to
8 rates but, rather, the removal would strip out a pre-existing portion of rates that had
9 previously been determined by the Commission to be just and reasonable rates.

10 In view of the settlement of the issues addressed in this proceeding, a sharing of the
11 True-Up Revenues between the Company and customers is an appropriate outcome.

12 **V. RATE EFFECTIVE PERIOD ISSUE**

13 AECC recommends that the new rates go into effect January 1, 2009. This date is
14 the most appropriate date for the new rates to go into effect because it corresponds to the
15 expiration of the rate cap established in the 1999 Settlement Agreement. In addition, as
16 stated by AECC Witness, Mr. Higgins, "Given the absence of an agreement on that point,
17 I am of a strong opinion that January 1, 2009, is the appropriate start date" (Tr. p.
18 597, ll, 20-22.)

19 **VI. EXCLUSIVITY OF TEP'S CERTIFICATE OF** 20 **CONVENIENCE AND NECESSITY ISSUE**

21 This issue was a major issue for AECC and was a particularly important issue to
22 AECC signing the Settlement Agreement (Tr. p. 587, ll 12-13).

23 No change to TEP's Certificate of Convenience and Necessity is proposed in the
24 2008 Settlement Agreement. The parties agreed that if the Commission desires to address
25 the issue of exclusivity of CC&N's, it should be addressed in the context of a generic
26 Docket.

1 The issue of the exclusivity of TEP's CC&N is directly connected to Direct Access
2 and Electric Retail Competition within TEP's certificated electric service area. Direct
3 Access Service refers to a type of service in which a customer purchases generation
4 service from the competitive retail provider which is designated "Electric Service
5 Provider" in Arizona or "ESP." (Tr. p. 601, ll. 2-5.) AECC's Witness, Mr. Higgins,
6 testified that unbundled rates which are provided for in TEP's rate design accommodate
7 Direct Access Service (Tr. p. 601, ll. 6-8). Mr. Higgins further testified as to why the
8 possibility of Direct Access is of interest to customers such as AECC members. He stated
9 that it provides an option for customers to take service from an alternative provider (Tr. p.
10 602, ll. 15-16), it provides the ability for customers to do things that are innovative on a
11 going-forward basis (Tr. p. 602, ll. 20-21), and it provides the right for customers to avail
12 themselves of the transmission system. Prior to the Commission's adoption of the electric
13 competition rules, the use of the Company's transmission system for retail activities was
14 off limits (Tr. p. 602, l. 24 - p. 603, l. 3). Mr. Higgins pointed out that the Direct Access
15 Rules or Electric Retail Competition Rules give customers the right to use the
16 transmission system as a customer or have someone use it on their behalf (Tr. p. 603, ll. 4-
17 7). Mr. Higgins further pointed out that when the Direct Access Rules or Electric Retail
18 Competition Rules were first adopted, people thought entirely about price, but retail
19 customers are now looking at sustainability issues and opportunities for directly availing
20 themselves of renewable energy. Mr. Higgins stated that, "In my view having flexibility
21 with respect to the use of the transmission system is a very important element of what
22 Arizona has put in place." (Tr. p. 603, ll. 21-23.) Mr. Higgins concludes his comments
23 concerning this issue by pointing out that, with the Direct-Access option available to
24 customers, "It does present a bogey that utilities need to keep in mind when they come
25 and ask regulators for rate increases." (Tr. p. 604, ll. 2-4.)

26

1 **VII. CONCLUSION**

2 For all of the reasons set forth above, AECC recommends that the Commission
3 approve the Settlement Agreement as a package because it produces just and reasonable
4 rates and is in the public interest.

5 RESPECTFULLY SUBMITTED this 29th day of August 2008.

6 FENNEMORE CRAIG, P.C.

7
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21 **COPIES of the foregoing HAND DELIVERED**
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this 29th day of August to

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and to the Parties of record:

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