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ARIZONA CORPORATION COMMISSION  
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Arizona Corporation Commission

DOCKETED

AUG 29 2008

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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

**CLOSING BRIEF OF THE  
ARIZONA INVESTMENT  
COUNCIL**

The Arizona Investment Council ("AIC") files this Closing Brief in support of the Tucson Electric Power Company ("TEP" or the "Company") Settlement Agreement dated as of May 29, 2008 (the "Settlement Agreement"). The AIC is a signatory and urges the Commission promptly to (1) approve the Settlement Agreement, (2) authorize institution of the new rates at the earliest possible date prior to January 1, 2009 and (3) authorize TEP to retain the fixed CTC True-Up Revenues which were created by Decision No. 69568.

**The Settlement Agreement is in the Public Interest**

The Settlement Agreement is the product of a several-weeks-long, thoroughly noticed, publicly conducted, fair, open and transparent settlement process. At the conclusion of that process, 13 parties to this proceeding, including, but not limited to, the Commission's Utilities

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1 Division Staff, the Arizona Community Action Association, the AIC, merchant generators and  
2 several consumer stakeholders signed on to the Agreement.

3 Staff Director Ernest Johnson described the negotiation process which led to the  
4 Settlement Agreement this way:

5 I would characterize the discussions as candid but professional. I am extremely  
6 pleased with the desire and effort put forth by all parties. While acknowledging  
7 that not all parties executed the Agreement, I must note that all parties had the  
8 opportunity to be heard and to have their issues fairly considered.<sup>1</sup>

8 As with any Settlement Agreement, this one reflects a compromise of the signatories' positions  
9 on the myriad issues presented in these consolidated dockets.

10 The evidence, however, is overwhelming that the Settlement Agreement is in the public  
11 interest. It not only balances, but affirmatively advances the interests of both customers and  
12 shareholders.

13 The AIC will not walk point-by-point through the Settlement Agreement's multiple  
14 provisions, but it does emphasize the following:

- 15 • From the customers' standpoint, after 14 years of stable/declining rates, the  
16 Settlement Agreement provides a modest 6% base rate increase, followed by a  
17 more than four-year rate increase moratorium. That rate increase does not apply  
18 to eligible low-income consumers. The projected average residential user impact  
19 is actually only slightly more than 3% due to the inclining block rate structure  
20 proposed by TEP. Other positive consumer features include new time-of-use  
21 tariffs which give customers additional opportunities to adjust their usage and  
22 reduce their bills even further as well as rate designs and tariffs which facilitate

23 \_\_\_\_\_  
24 <sup>1</sup> S-3, p. 5, l. 25-p. 6, l. 2.

1 additional demand-side management and energy efficiency programs and  
2 initiatives.

- 3 • From the shareholders' standpoint, a key positive of the Settlement Agreement is  
4 the implementation of the Purchased Power and Fuel Adjustment Clause  
5 ("PPFAC"). As the Commission is aware, the ability of a utility like TEP to  
6 timely recover prudently-incurred energy costs is a critical factor to capital  
7 markets in evaluating the risks of investing in or lending money to TEP. Also, the  
8 Settlement Agreement's adoption of a cost of equity of 10.25% and a capital  
9 structure of 57.5% debt and 42.5% equity should also send a positive signal to the  
10 investment community.

11 The Settlement Agreement also resolves in a positive and constructive fashion a series of  
12 uncertainties currently existing. Right now (and for the past several years), the investment  
13 community doesn't know how TEP will be rate regulated, what the value of its plant will be and  
14 precisely what its service territory's status is. The Settlement Agreement not only resolves each  
15 of those matters, but also settles without the necessity of prolonged litigation the considerable  
16 uncertainty surrounding the 1999 Settlement Agreement.

17 As Company CEO James Pignatelli explained, the regulatory certainty the Settlement  
18 Agreement brings benefits not only investors, but consumers as well:

19 Regulatory certainty is important in that it provides predictability, gives investors  
20 confidence and reduces the return premium they might otherwise require. This is  
21 also beneficial to customers because they ultimately bear the prudent financing  
22 costs associated with the construction of projects. If investors do not require an  
23 additional premium, because the regulatory environment is responsive, then the  
24 overall cost to the consumer is lower.<sup>2</sup>

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<sup>2</sup> TEP-2, p. 27, ll. 8-13.

1 All of these elements confirm the public interest is served by approval of the Settlement  
2 Agreement.

3 Several other factors support the conclusion that the Settlement Agreement is an excellent  
4 result. For example, last October, in a special Open Meeting presentation on a national view of  
5 electric competition, Ken Rose, senior fellow at Michigan State's Institute of Public Utilities,  
6 discussed what was happening to rates in six states which, like TEP, were just coming out of rate  
7 freezes. Increases in those states ranged from 12% to more than 70%. In sharp contrast, not  
8 only is the base rate change involved here substantially lower than those, but this 6% adjustment  
9 will immediately be followed by yet another rate increase moratorium to 2013. TEP's rates  
10 today are actually 2% lower than they were in 1995. The result is that electric rates for Tucson  
11 area consumers will have gone up only 4% in almost 20 years when the moratorium expires.

12 Finally, as Mr. Pignatelli testified, the cost of providing service has increased  
13 dramatically over the life of the rate moratorium period—certainly far greater than the proposed  
14 base rate increase. Since 1999, prices for steel and copper have gone up 71% and 323%  
15 respectively. Employee wages and benefits have increased 26% and 43%, while fuel costs have  
16 shot up 34%.<sup>3</sup> Contrast those numbers to 6%. Simply stated, the Settlement Agreement is an  
17 excellent deal for TEP customers.

18 Only the Residential Utility Consumer Office offered testimony in opposition to the  
19 Settlement Agreement.<sup>4</sup> Staff Witness Ralph Smith provided a thorough rebuttal to the issues  
20 raised by RUCO. His conclusion was that the Settlement Agreement delivers fair and reasonable  
21 rates:

22 <sup>3</sup> Pignatelli Direct, p. 27 and Exhibit JSP-1.

23 <sup>4</sup> At hearing, SWEEP's Jeff Schlegel stated that SWEEP's failure to sign the Settlement Agreement did not  
24 necessarily reflect its opposition, but rather the fact that SWEEP did not have the necessary resources to adequately  
analyze all issues involved in the Settlement Agreement.

1 While I have focused my efforts [in responding to RUCO's points] primarily on  
2 certain aspects of the Settlement Agreement, including the reconciliation of the  
3 revenue requirement and the PPFAC, it represents significant compromises by  
4 both Staff and TEP in terms of the agreed-upon base rate revenue level of \$828.2  
5 million. Moreover, the Settlement Agreement has other beneficial provisions  
6 such as a four-year rate moratorium, specificity concerning the use of a cost-of-  
7 service based methodology and a waiver of potential litigation related to the 1999  
8 Settlement Agreement. Overall, the Settlement Agreement resolves a wide range  
9 of contested issues in a fair and reasonable manner that would eliminate  
10 potentially lengthy and costly future litigation.<sup>5</sup>

11 In criticizing the Settlement Agreement, RUCO focused on a few of the settled issues which  
12 favored TEP, while ignoring the numerous items the Company conceded. RUCO offered no  
13 affirmative solutions—only criticisms. What RUCO feels is the right answer in the more than  
14 three-year-old regulatory history of these consolidated dockets remains a mystery.

15 From the beginning of this open, fair and transparent negotiation process, RUCO elected  
16 not to participate. The agency is certainly entitled to choose its course of action and form its  
17 opinions, but they don't change the fact that the Settlement Agreement before the Commission is  
18 in the public interest and should be approved.

19 **The Commission Should Authorize Implementation of the New Rates at the Earliest**  
20 **Possible Date and Allow TEP to Retain the Fixed CTC True-Up Revenues**

21 The parties to the Settlement Agreement were unable to agree on two issues: (1) the  
22 effective date for implementation of the new rates and (2) how the fixed CTC True-Up Revenues  
23 (“CTC Revenues”) created by Decision No. 69568 should be treated,<sup>6</sup> i.e., should they be  
24 retained by the Company, credited to consumers or retained and credited in part. For a number

<sup>5</sup> S-5, p. 22, ll. 3-11. (Citations omitted.)

<sup>6</sup> The Company estimates approximately \$66 million of CTC Revenues will be collected between May and December 31, 2008. TEP-2, p. 29.

1 of reasons, the AIC urges the Commission to authorize institution of the new rates at the earliest  
2 possible date prior to January 1, 2009 and allow TEP to retain all of the CTC Revenues.

3 First, the only reason these issues are even being debated is because of the rate freeze in  
4 the 1999 Settlement Agreement and its provision that fixed CTC recovery would cease when the  
5 amount collected reached \$450 million. As a global matter, the Settlement Agreement's  
6 Section XIV contains nine different provisions that recognize the intended purpose of the 1999  
7 Settlement Agreement—"to allow a transition to retail electric competition"—has been  
8 frustrated. Those provisions collectively terminate the 1999 Settlement Agreement. Because the  
9 parties have agreed to call the whole thing off, it is abundantly unfair to resuscitate only these  
10 two aspects of the otherwise dead 1999 Settlement Agreement to delay the rates' effective date  
11 to January 1, 2009 and cause a refund of the CTC Revenues—particularly when the parties have  
12 also agreed that the Company's current rates are not adequate.

13 Second, as to the CTC Revenues, their sole purpose was to position the Company so it  
14 could compete in the wholesale market on January 1, 2009. Clearly, that's not going to happen.  
15 Instead, given the Company's return to cost-of-service rate regulation, the CTC-related plant  
16 value write-offs are instead reducing customers' costs and, correspondingly, their rates now and  
17 for years to come. Under these significantly changed circumstances, there's absolutely no reason  
18 for yet another credit to customers on top of these savings they will realize resulting from the  
19 rate base write-offs the CTC Revenues financed.

20 Similarly, it's important to recall that customer rates were not increased to fund the CTC  
21 Revenues in 1999. Mr. Higgins, on behalf of Arizonans for Electric Choice and Competition,  
22 explains:

1           It is useful to bear in mind that when the Fixed CTC was established in  
2 1999, it was not a new cost that was added to TEP's existing rates, but a "carve-  
3 out" of then-existing rates which was designated for Fixed CTC recovery. Thus,  
4 when the Fixed CTC expires, removing this charge would not remove something  
5 that was "added on" to rates, but rather removal would strip out a pre-existing  
6 portion of rates.<sup>7</sup>

7           Consistent with that, Mr. Pignatelli noted that RUCO admitted during discovery that  
8 "TEP's existing rates [including the fixed CTC component] are those last determined by the  
9 Commission to be just and reasonable."<sup>8</sup> There simply is no rationale for, and certainly no  
10 equity in, returning to customers a portion of the rates which the Commission has ordered are  
11 TEP's because of a competitive market expectation which no longer applies and which TEP will  
12 not be allowed to participate in.

13           As to prompt rate efficacy, for a number of reasons, the rates and tariffs agreed to by the  
14 signatories should take effect quickly—before January 1. The Commission stated in last year's  
15 Decision No. 69568 that "it is in the public interest to evaluate and approve new rates for TEP as  
16 quickly as is practical..."<sup>9</sup> While there was concern last year as to whether the Commission  
17 could accomplish that before January 1, another benefit of the Settlement Agreement is it has  
18 positioned the matter for action "as quickly as is practical."

19           Another critical consideration is that all the signatories, including Staff, agree that TEP is  
20 currently, and since the 2006 rate year has been, under-earning by millions of dollars. Finally, as  
21 both SWEEP and the Department of Defense note, the Settlement Agreement provides many  
22 benefits, including new tariffs and programs that should be made effective as quickly as possible.

23 <sup>7</sup> AECC-3, p. 9, l. 19-p. 10, l. 2.

24 <sup>8</sup> TEP-3, p. 7, ll. 13-14.

<sup>9</sup> Decision No. 69568, p. 14, ll. 17-18. (Emphasis supplied.)

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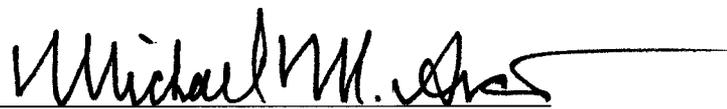
Conclusion

This Settlement Agreement is comprehensive. It is fair to the Company, its investors and its shareholders. It addresses and resolves a myriad of issues in a positive and productive way. And, it stands in remarkable and very positive contrast to the experience of many other states which have had a staggering exit from their retail electric competition exercises.

The AIC urges the Commission promptly to (1) approve the Settlement Agreement, (2) authorize the new rates at the earliest possible date and (3) allow TEP to retain the fixed CTC True-Up Revenues. Each of those actions is markedly in the public's interest.

RESPECTFULLY SUBMITTED this 29<sup>th</sup> day of August, 2008.

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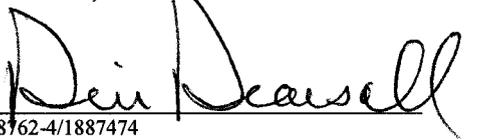
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