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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE FILING BY TUCSON ELECTRIC POWER COMPANY TO AMEND DECISION NO. 62103.	DOCKET NO. E-01933A-05-0650
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

Arizona Corporation Commission
DOCKETED
AUG 29 2008
DOCKETED BY

POST-HEARING BRIEF

OF TUCSON ELECTRIC POWER COMPANY

August 29, 2008

TABLE OF CONTENTS

I. Introduction 1

II. The Record establishes that Settlement Negotiations were Open and Transparent and Fair to all Parties 3

III. The Evidence in the Record Demonstrates that the Settlement Agreement is in the Public Interest and should be approved 4

A. The Settlement Agreement is in the public interest because it resolves all issues arising out of the 1999 Settlement Agreement 5

B. The Settlement Agreement is in the public interest because it resolves TEP's rate increase request in a way that is just and reasonable 6

C. Base Rates 7

D. Generation Assets 9

1. Luna Generating Station 9
2. Springerville Unit 1 10

E. Cost of Capital 11

F. Depreciation and Cost of Removal 12

G. Implementation Cost Recovery Asset 13

H. The PPFAC 13

1. Benefits and Protections 14
2. There is no evidence in the record to support a modification to the PPFAC 17
3. The PPFAC supports the accounting deferral of unrealized gains (losses) on fuel, purchased power, and hedging agreement 18

I. Renewable Energy Adjustor 20

J. Demand-Side Management Programs and Adjustor 20

K. Base Rate Increase Moratorium and Emergency Clause 21

L. Certificate of Convenience and Necessity 22

M. Returning Customer Direct Access Charge 22

N. Rate Design 22

1. TEP's inverted block rate structure will help customers save on their electric bills 23
2. TEP's Time-of-Use Tariffs provide incentives for customers to use energy when it is least costly 23

3. Low-Income customer will be held harmless from the 6 percent base rate increase and additional PPFAC charges 24

O. Rules and Regulations....24

P. Additional Tariff Filings....24

Q. Fuel Audit 25

IV. TEP should Retain the Fixed CTC True-Up Revenues 26

A. Customers' rates were not raised from just and reasonable levels in 1999 to fund the Fixed CTC Recovery 26

B. TEP is currently under-earning 27

C. Any refund or credit of the Fixed CTC True-up Revenues would be inequitable and confiscatory 28

D. Should the Commission determine that $32.5 million of Fixed CTC True-up Revenue be returned to customers, those revenues should be credited to the PPFAC Balancing Account....30

V. TEP's New Rates should be Implemented as soon as possible 30

VI. RUCO's Opposition to the Settlement Agreement....31

A. RUCO recognizes the many benefits in the Settlement Agreement 31

B. RUCO's criticism of the base rate increase is incorrect 32

C. RUCO simply adhered to its litigation position, failing to address any errors in its revenue requirement....33

VII. The Settlement Agreement Should Be Approved....33

Exhibits:

Exhibit 1 Chronology of Settlement Negotiations.

Appendix In Support of Tucson Electric Power Company's Post Hearing Brief.

Tucson Electric Power Company ("TEP" or "Company"), through undersigned counsel, hereby submits its Post-Hearing Brief in support of the Settlement Agreement dated May 29, 2008 (the "Settlement Agreement").

I. INTRODUCTION.

The record in this case clearly and convincingly establishes that the Settlement Agreement is in the public interest and should be approved in its entirety and without modification by the Arizona Corporation Commission ("Commission"). The Settlement Agreement provides real and significant benefits to TEP's customers, employees and shareholders. For example, the Settlement Agreement provides the following benefits:

- Resolution of all issues relating to the 1999 Settlement Agreement ("1999 Settlement") (Section XIV).
- Resolution of the TEP rate increase request (Section I).
- Determination that TEP's generation rates shall be calculated on a cost-of-service basis (Section II).
- A base rate case moratorium through December 31, 2012 (Sections X and XI).
- Implementation of a Purchased Power and Fuel Adjustment Clause ("PPFAC") which provides recovery of only fuel and purchased power costs acquired for the benefit of customers, which is netted by 100% of the revenues from short term wholesale sales and 50% of the value of sales of SO2 credits (Section VII).
- Inclusion of Springerville Unit 1 and related lease hold improvements in rate base at original cost (Section III).
- Inclusion of the Luna Generating Station in rate base at original cost (Section III).
- Holding low-income customers harmless from the base rate increase and from additional fuel and purchased power costs (Section XVI).
- Providing a lower than requested cost of equity of 10.25% (Section IV).
- Inclusion of an innovative, inverted block rate design to encourage conservation (Section XVI.B).

- Addition of new time of use, partial requirements and demand response options (Sections XVI.C, XVIII).

These benefits were negotiated by the parties in good faith and as an integrated package. TEP's participation in the Settlement Agreement is predicated on the economics of the terms and conditions as agreed to by the parties. No party to the Settlement Agreement has proposed any modification to those terms and conditions and the evidence in the record of this case does not support any such change. The evidence supports approval of the Settlement Agreement as executed.

The parties presented evidence on two issues not resolved definitively in the Settlement Agreement, namely, the disposition of the CTC True-up Revenues and the effective date of the new rates agreed to in the Settlement Agreement. The evidence on these two issues fully supports the conclusion that TEP should retain all CTC True-up Revenues and that the new rates should be effective immediately upon Commission approval.

Finally, one non-signatory party, the Arizona Residential Utility Consumer Office ("RUCO"), expressed opposition to the Settlement Agreement. However, by the end of the settlement hearing, it appeared that RUCO had expressed support for most, if not all, provisions of the Settlement Agreement, except those that provided TEP with a 6% base rate increase and a PPFAC.[1] In other words, RUCO would impose on TEP all of the obligations of the Settlement Agreement without providing the Company the economic means to accomplish them. This position destroys the economic viability of the Settlement Agreement and, if adopted, would force TEP to withdraw from the Settlement Agreement.

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[1] At the end of the settlement hearing, RUCO's official position on the Settlement Agreement was still unclear. Accordingly, throughout this post-hearing brief, TEP will refer to arguments that RUCO raised against terms of the Settlement Agreement. TEP anticipates that RUCO's brief will clarify the confusion surrounding its position in this case.

II. THE RECORD ESTABLISHES THAT SETTLEMENT NEGOTIATIONS WERE OPEN AND TRANSPARENT AND FAIR TO ALL PARTIES.

The testimony and exhibits in the record of this proceeding clearly establish that the settlement negotiations were open and transparent. The open and transparent nature of the settlement negotiations served as a check and balance that ensured that all interested parties had an opportunity to participate and be heard on the terms and conditions of the Settlement Agreement. This process also ensured that the Settlement Agreement is fair, just and reasonable. A chronology of events relative to the Settlement Agreement negotiation process is attached hereto as Exhibit 1.

At the hearing, each party indicated that the negotiation process was fair, open and transparent. Mr. Ernest Johnson, Director of the Utilities Division ("Commission Staff"), testified, it was "the most transparent proceeding that I have ever been aware of and that I have knowledge of."[2] Commission Staff witness Mr. Ralph Smith testified that the settlement discussions were "extremely open and transparent. I have to say that this was probably the most open settlement discussion I have ever been involved in my 28 years or so of doing utility regulatory consulting work."[3]

Even RUCO agreed that the settlement process was open and transparent. RUCO's witness, Mr. William Rigsby acknowledged that even though RUCO openly opposed the settlement, it was able to attend all of the settlement meetings,[4] received all drafts of the settlement agreement,[5] and had access to any materials exchanged during the settlement process.[6] Mr. Rigsby agreed that the settlement process was the most open and transparent one in which RUCO had participated.[7]

The open and transparent nature of the negotiation process provided a forum where parties were able to raise, discuss and resolve a broad range of issues. At the hearing, the parties described

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[2] Tr. (Johnson) at 360.
[3] Tr. (Smith) at 694.
[4] Tr. (Rigsby) at 990.
[5] Tr. (Rigsby) at 990.
[6] Tr. (Rigsby) at 976-77.
[7] Tr. (Rigsby) at 977.

the complexity of the issues involved in this case, and the contentious and highly contested nature of some of those issues.[8] As Arizona Investment Council ("AIC") witness Mr. Gary Yaquinto testified, "we were very surprised [that so many parties could come to an agreement]. I think going into it we put the prospects of reaching a settlement agreement at less than 50/50, and probably closer to zero than 50."[9] The parties further testified that the Settlement Agreement was negotiated in good faith and that there were both compromises and concessions made by the participants.[10]

The Settlement Agreement is the end result of an unprecedented process that fostered significant work by parties with disparate constituencies and interests. The integrated Settlement Agreement's terms and conditions reflect a balanced resolution of the parties' issues and should be approved as presented to the Commission.

III. THE EVIDENCE IN THE RECORD DEMONSTRATES THAT THE SETTLEMENT AGREEMENT IS IN THE PUBLIC INTEREST AND SHOULD BE APPROVED.

The evidence in the record demonstrates that the Settlement Agreement[11] is in the public interest. It resolves complex issues. It provides significant benefits to TEP's customers, employees and shareholders, as well as the Commission. It is innovative. For example, the Arizona Community Action Association's witness, Ms. Cynthia Zwick, testified in support of the groundbreaking protections the Settlement Agreement affords low income customers, and agreed that this is the first time low income customers will have these protections, and that they should serve as a model for future cases.[12] The Settlement Agreement should be approved as soon as possible so that the benefits provided therein can inure to the parties without delay.

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[8] Tr. (Johnson) at 353.
[9] Tr. (Yaquinto) at 483.
[10] Tr. (Johnson) at 353.
[11] Admitted as Ex. TEP-1; *see* Tr. at 101.
[12] Tr. (Zwick) at 454.

A. The Settlement Agreement is in the public interest because it resolves all issues arising out of the 1999 Settlement Agreement.

The Settlement Agreement is in the public interest because it provides a stipulated and comprehensive resolution to the disputes that have arisen out of the 1999 Settlement Agreement.

Those disputes focused on whether TEP would be entitled to charge market based rates for generation service beginning January 1, 2009. Their outcome has far reaching implications. As TEP witness Mr. Pignatelli testified, market based rates could result in a rate increase of approximately 52%.[13] On the other hand, if TEP is entitled to charge market based rates, but is prevented from so doing, resulting in a breach of the 1999 Settlement Agreement, then damages paid to TEP by the other parties to the 1999 Settlement Agreement could reach hundreds of millions of dollars. Further, if a court determined that TEP's generation assets were to be subject to the competitive marketplace, then the Commission could lose ratemaking jurisdiction over those assets.[14]

While parties lined up on opposite sides of these issues, they all agreed that there was substantial risk relating to litigation of the disputes arising out of the 1999 Settlement Agreement. The Settlement Agreement removes that risk, and it avoids the otherwise inevitable expenditure of time and money by all parties in litigating those disputes. The Settlement Agreement provides that any claims or damages arising from, or pertaining to, the 1999 Settlement Agreement are extinguished upon the issuance of a final, non-appealable order of the Commission approving the Settlement Agreement.[15]

Both TEP witness Mr. Pignatelli and Commission Staff witness Mr. Johnson recognized the value in resolving these issues and moving forward.[16] Mr. Johnson not only noted the immediate benefit of resolving the issues in the 1999 Settlement Agreement, he also highlighted that the resolution of that matter, which would otherwise result in a protracted and very complex

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[13] Tr. (Pignatelli) at 268.
[14] Tr. (Johnson) at 341-42; Tr. (Rigsby) at 1050.
[15] Ex. TEP-1 (Settlement Agreement), Sec. XIV.
[16] Ex. TEP-2 (Pignatelli Settlement Direct) at 24; Tr. (Johnson) at 347.

legal process, also provides a significant long-term benefit to TEP's customers.[17] Moreover, resolving these issues aids investor confidence and provides for regulatory certainty.[18]

The Settlement Agreement is in the public interest because it resolves the disputes arising from the 1999 Settlement Agreement in a way that is fair, reasonable and avoids protracted and risky litigation.

B. The Settlement Agreement is in the public interest because it resolves TEP's rate increase request in a way that is just and reasonable.

All parties recognize that TEP needs a rate increase in order to continue to provide safe and reliable service. The evidence in the record established that TEP must make substantial investments in its system in the next five years, and the rates set in this case must be sufficient to allow TEP to attract the capital needed to make those critical investments. The rates and PPFAC proposed in the Settlement Agreement will provide TEP with the cash flow necessary to maintain facilities and keep up with demand, while minimizing the base *and* overall rate impacts to its customers.[19] The Settlement Agreement gives TEP just enough cash flow to fund the estimated $1.2 billion in capital improvements needed for the next four to five years.[20]

Rising inflation levels remain a concern for TEP, even under the Settlement Agreement. As TEP witness Mr. Pignatelli testified, operations and maintenance costs are not likely to decrease from 2006 levels anytime through 2013.[21] This includes pension costs and healthcare costs for TEP's workforce. TEP faces a significant challenge to replace an aging workforce (*e.g.*, linemen and crews that help to restore service after an outage). There is also a need to improve its transmission and distribution facilities.[22] The rate increase in the Settlement Agreement is the minimum needed to maintain TEP's demonstrated quality of service to its customers. Without the increase, TEP would have to scale back crews, projects and capital investments.[23] The Settlement

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[17] Tr. (Johnson) at 341-42, 499.
[18] Tr. (Pignatelli) at 111.
[19] Tr. (Pignatelli) at 169, 292-93.
[20] Tr. (Pignatelli) at 111.
[21] Tr. (Pignatelli) at 262.
[22] Tr. (Pignatelli) at 166-69, 290-91.
[23] Ex. TEP-2 (Pignatelli Settlement Direct) at 26.

Agreement is in the public interest because it allows TEP to continue to provide safe and reliable service to customers.

C. Base Rates.

The Settlement Agreement is in the public interest because it resolves TEP's rate increase request in a way that is just and reasonable. The Settlement Agreement provides for a 6% base rate increase, a base rate increase moratorium until December 31, 2012, the implementation of a PPFAC (which may provide a surcharge or credit to customer bills) and meaningful rate design.

In July 2007, TEP submitted a rate increase request wherein it proposed three alternative rate methodologies: (i) the Market Methodology; (ii) the Cost-of-Service Methodology; and (iii) the Hybrid Methodology. The rate increase requested ranged from 15% to 23% based upon which methodology the Commission approved. The Company's preferred methodology was the Market Methodology. As previously referenced, TEP witness Mr. James Pignatelli testified that if TEP were to charge its customers a market based rate, the increase today would be 52%.[24]

The Company's testimony and exhibits submitted with the rate filing fully supported its requested increase. However, the Commission Staff, RUCO and other intervenors disputed TEP's rate increase request.

The Settlement Agreement resolved the TEP rate case filing by establishing that the Company's rates will be calculated based upon a Cost-of-Service methodology that results in a 6% base rate increase. This is significantly less than the amounts TEP had originally requested. The Settlement Agreement also provides for a rate moratorium until December 31, 2012. TEP had not proposed any rate moratorium in its original request. And, the Settlement Agreement adopts the PPFAC proposed by Commission Staff. This is substantially different from the PPFAC originally proposed by TEP.

To put the 6% base rate increase into a proper context, TEP's last rate increase was effective in 1996. Since then, TEP's rates were reduced by 3%, which is below the rate levels that

[24] Tr. (Pignatelli) at 268.

existed in 1994. TEP presented evidence that its costs have increased significantly since then[25] and that other electric utility rates increased an average of 32%.[26] Under the Settlement Agreement, TEP's new rates will be subject to another rate increase moratorium until December 31, 2012. Thus, under the Settlement Agreement, TEP's customers will be subject to a modest base rate increase and continue to experience rate stability for a numbers of years, just as they have in the past.

RUCO was the only party to oppose the base rate increase. However, RUCO's opposition to the 6% base rate increase lacked financial analysis and factual support. RUCO's stated that the 6% base rate increase is "somewhat high",[27] but could not be more specific when asked to quantify the increase amount it believed appropriate. Rather, RUCO witness Mr. Rigsby testified at the settlement hearing that he could not give an exact dollar figure or percentage, but thought "it would lie somewhere between probably RUCO's original $36 million recommendation and the $136 million that was adopted in the settlement agreement."[28] This is a differential of $100 million! Likewise, when asked whether RUCO had conducted an analysis of the rate increase that would have resulted under TEP's original filings, Mr. Rigsby testified "no, we didn't . . .".[29] RUCO opposition to the 6% base rate increase is without foundation or analysis and should be rejected.

The rates set forth in the Settlement Agreement are also just and reasonable because they were designed in a way that mitigates their impact on residential customers. The Settlement Agreement utilizes an inverted block structure to encourage and reward conservation.[30] By way of example, TEP residential summer consumption (May through October) averages 1100 kWh per month. Thus, under the inverted block rate structure, the customer will buy 500 kWh per month at the first tier price (the lowest priced block), and 600 kWh per month at the second tier price. A

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[25] Ex. TEP-9 (Pignatelli Rebuttal Testimony) at 6-7.
[26] Ex. TEP-9 (Pignatelli Rebuttal Testimony) at 5-6.
[27] Tr. (Rigsby) at 1066.
[28] Tr. (Rigsby) at 1067.
[29] Tr. (Rigsby) at 983.
[30] Ex. TEP-1 (Settlement Agreement), Sec. XVI.B.

customer who keeps his usage low will see a lower percentage increase. TEP residential winter consumption (November through April) averages 700 kWh per month. Thus, under the inverted block rate structure, the customer will buy 500 kWh at the lowest first tier price, and 200 kWh at the second tier price. Again, keeping usage low holds down the overall rate increase.

TEP's average residential customer uses 900 kWh per month.[31] The inverted block rate structure enables the average residential bill, without a DSM surcharge, to increase by only 3.2%, again by way of example, from $84.55 to $87.25 per month. [32] With the DSM surcharge, the bill will increase to $87.81. All parties, including RUCO, support the inverted block rate structure.

The rates set forth in the Settlement Agreement are also just and reasonable because they provide that TEP's low-income customers will be held harmless from the base rate increase and any potential additional charges from the PPFAC. Thus, neither the 6% base rate increase, nor the estimated approximate 3% to 4% PPFAC increase resulting from increased fuel and purchased power costs, will apply to low-income customers. Incremental fuel and purchased power costs that low-income customers would otherwise have paid under the PPFAC will now be recovered from all remaining customers subject to the PPFAC. Again, all parties, including RUCO, support low-income customers being held harmless from the base rate and PPFAC increases.

D. Generation Assets.

1. Luna Generating Station.

The Settlement Agreement is in the public interest because it provides clarity and certainty regarding the rate base treatment for the Luna Generating Station. TEP acquired a one-third interest in the Luna Generating Station in 2004 for approximately $250/kw.[33] The Luna Generating Station was not purchased with ratepayer funds and was not included in TEP's rate base calculation. TEP indicated that it would either keep the Luna Generating Station out of rate base or include it at its current market value, which is approximately $1,000/kw.[34] Commission

[31] Ex. TEP-6 (Dukes Settlement Direct) at 5-6.
[32] Ex. TEP-2 (Pignatelli Settlement Direct) at 14.
[33] Ex. TEP-9 (Pignatelli Rebuttal Testimony) at 20; Tr. (Pignatelli) at 296; Tr. (Hutchens) at 812.
[34] Tr. (Pignatelli) at 107; Tr. (Hutchens) at 812.

Staff argued that the Luna Generating Station should be included in rate base at its net book value as of December 31, 2006.

2. Springerville Unit 1.

The Settlement Agreement provides that the Luna Generating Station will be included in TEP's original cost rate base at net book value as of December 31, 2006. This treatment of the Luna Generating Station provides TEP's ratepayers "a tremendous benefit."[35] Commission Staff witness Mr. Johnson acknowledged that inclusion of the Luna Generating Station in rate base at its original cost was "a bargain" for customers.[36]

The parties to the TEP rate case filing disputed the cost of Springerville Unit 1 non-fuel costs. The Settlement Agreement is in the public interest because it resolves that dispute in a just and reasonable way. The Settlement Agreement provides that Springerville Unit 1, and its leasehold improvements, were to be placed into rates at cost. The Settlement Agreement also provides that Springerville Unit 1's non-fuel costs shall reflect a cost of $25.67 per kW per month, which approximates the levelized cost of Springerville Unit 1 through the remainder of the primary lease term. Commission Staff witness Ralph Smith testified that the use of $25.67 per kW per month as an estimate of levelized cost in conjunction with the use of a cost-of-service methodology is fair and reasonable in this case.[37]

The only party to oppose the use of $25.67 per kW per month as an estimate of cost was RUCO. However, RUCO failed to present any analysis or compelling evidence that suggests the $25.67 figure is unjust or unreasonable. This is evident as RUCO's own testimony states that it believes such cost should fall within the incredibly large range of "$15.00 and $25.67."[38] Clearly RUCO's position cannot be relied upon as it is not specific and it lacks any credible analysis. Even assuming RUCO's position is correct, the $25.67 per kW per month provided in the Settlement Agreement falls within its cited range.

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[35] Tr. (Pignatelli) at 107.
[36] Tr. (Johnson) at 670.
[37] Ex. S-5 (Smith Settlement Rebuttal) at 21.
[38] Tr. (Rigsby) at 1068.

E. Cost of Capital.

The Settlement Agreement is in the public interest because it resolves the parties' dispute regarding TEP's cost of capital for ratemaking purposes. In the TEP Rate Case filing, TEP sought a capital structure of 55% debt and 45% common equity, a return on common equity of 10.75%, and embedded cost of debt of 6.39% and a weighted average cost of capital of 8.35%.[39] Commission Staff, RUCO and other intervenors disputed the Company's cost of capital and fair value return proposals.

The Settlement Agreement provides a capital structure for TEP of 57.50% debt and 42.50% common equity, a return on common equity of 10.25%, an embedded cost of debt of 6.38% and a weighted average cost of capital of 8.03%, resulting in a fair value rate of return of 5.64%.[40] TEP has accepted these percentages only as part of the integrated terms and conditions that comprise the Settlement Agreement.

Only RUCO opposes the Settlement Agreement's cost of equity. It is important to note that the 10.25% cost of equity figure was proposed by Commission Staff. That figure is 50 basis points lower than that requested by TEP and 50 basis points less than the cost of equity approved by the Commission in a recent case involving another investor-owned electric utility in the state.

RUCO's objection to the 10.25% cost of equity is not credible. It did not file an opposition to the cost of equity in its Response Direct Settlement Testimony. Instead, the only substantive comment from RUCO regarding the cost of equity in the Settlement Agreement was in response to questioning during the settlement hearing. There, RUCO witness Mr. Rigsby, merely stated that RUCO believed that TEP's cost of equity "could very well possibly be lower."[41] The sole justification for this was an unquantified belief that the PPFAC, if granted, may help reduce the risk of the Company.[42]

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[39] Ex. TEP-7 (Larson Direct Testimony) at 3.
[40] Ex. TEP-1 (Settlement Agreement), Sec. IV and Exhibit 1 thereto.
[41] Tr. (Rigsby) at 1069.
[42] Tr. (Rigsby) at 1069.

Contrary to RUCO's speculation, the evidence on the record supports the finding that in the context of the Settlement Agreement the stipulated cost of capital percentage are reasonable.

F. Depreciation and Cost of Removal.

The Settlement Agreement is in the public interest because it resolves issues regarding the ratemaking treatment for depreciation and cost of removal. Specifically, the Settlement Agreement resolves the disputes that arose regarding setting depreciation rates going forward – *together with* resolving the cost of removal for TEP's generation assets.

The Settlement Agreement provides that TEP will use depreciation rates for Distribution and General plant as contained in Exhibit 5 to the Settlement Agreement on a forward basis.[43]

The Settlement Agreement also resolved the lingering issue of addressing the cost of removal for TEP's generation assets. The Settlement Agreement provides for an annual accrual for cost of removal for TEP's generation assets (excluding the Luna Generating Station) with TEP's depreciation rates.[44] This will also, in Commission Staff's words, provide for additional buildup for TEP's accumulated depreciation balance related to cost-of-removal accruals on generation plant during the rate moratorium period.[45] Exhibit No. 5 to the Settlement Agreement separately identifies depreciation rates for the Luna Generating Station.[46]

RUCO at one point took issue with this resolution, but does not and cannot state that it is unreasonable. Instead, RUCO merely acknowledges that that this resolution of the issues is different than what the Company originally proposed regarding depreciation rates. Mr. Pignatelli, however, pointed out that both Commission Staff and the Company addressed the issue in subsequent rounds of testimony and that the Settlement Agreement satisfactorily incorporates cost of removal into depreciation rates – including build-up of $21.6 million for cost of removal spread across depreciation rates for all of TEP's generation assets (except the Luna Generating Station) –

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[43] Ex. TEP-1 (Settlement Agreement), Sec. V.

[44] *See* Ex. TEP-2 (Pignatelli Settlement Direct) at 17. Because Luna Generating Station was originally proposed to be set at a market-based amount rather than original cost, it was not included in TEP's originally proposed depreciation rates.

[45] Ex. S-4 (Smith Settlement Direct) at 16-17.

[46] *See* Ex. TEP-2 (Pignatelli Settlement Direct) at 17.

and recognizing this cost of removal in TEP's accumulated depreciation balance going forward.[47] RUCO ignores that addressing depreciation and cost of removal as proposed in the Settlement Agreement is a reasonable way of resolving these issues in unison. RUCO's arguments on these issues should therefore be rejected.

G. Implementation Cost Recovery Asset.

The Settlement Agreement provides that TEP's original cost rate base should include an Implementation Cost Recovery Asset ("ICRA") in the amount of $14,212,843 to reflect the appropriate costs that TEP incurred during its transition to retail electric competition under the 1999 Settlement Agreement. Section VI of the Settlement Agreement further provides that the ICRA will be amortized by TEP over a four-year period and will not be included as rate base or amortization expense in TEP's next rate case. While TEP originally argued it incurred significantly higher costs under that transition, TEP accepted this provision as part of the integrated Settlement Agreement. The reduction from TEP's original position is a clearly defined benefit that is provided to TEP's customers under the Settlement. RUCO is supportive of this provision of the Settlement Agreement.[48]

H. The PPFAC.

The Settlement Agreement is in the public interest because it provides for the implementation of a PPFAC designed to recover the costs of fuel and purchased power used to provide electricity to customers.[49] TEP does not currently have a PPFAC. However, TEP increasingly relies on significant quantities of natural gas and purchased power.[50] These costs have steadily risen since 2006.[51] The PPFAC will allow TEP to recover these costs in a timely manner. Without the protection provided by the PPFAC, TEP could not agree to a 6% base rate increase, but would have negotiated a much higher increase. Also, without the PPFAC, TEP

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[47] Ex. TEP-3 (Pignatelli Settlement Rebuttal) at 8-9.
[48] Tr. (Rigsby) at 1071.
[49] Tr. (Pignatelli) at 216.
[50] Tr. (Pignatelli) at 124.
[51] Tr. (Pignatelli) at 220-21, 258.

would need to frequently file base rate cases.[52] That would be necessary because of the large size of purchase power and fuel costs compounded by "regulatory lag" – the time it naturally takes to process a rate application, have an evidentiary hearing and issue an order. TEP would be constantly forced to play "catch up", placing a substantial burden on all involved.

The PPFAC provided in the Settlement Agreement was designed by Commission Staff. As TEP witness Mr. David Hutchens testified, the Company agreed to Commission Staff's PPFAC, "lock, stock and barrel."[53] Consequently, the PPFAC proposed in the Settlement Agreement has many customer benefits and protections.

RUCO has simply stated that it is opposed to the PPFAC and has adhered to its original position that a different type of fuel clause should be adopted by the Commission.[54] RUCO did not present any evidence at the settlement hearing that suggested that it had actually evaluated the PPFAC proposed in the Settlement Agreement. Further, RUCO did not propose any changes to the proposed PPFAC. Again, RUCO did not provide any testimony or provide any exhibits about the financial effect that its proposed PPFAC would have upon TEP or its customers. RUCO's opposition to the PPFAC is without foundation or support and should be rejected.

1. Benefits and Protections.

The PPFAC benefits TEP's customers by protecting them from spikes in the price of fuel and purchased power. The PPFAC rate is established each year by the Commission.[55] That fixed rate is then charged to consumers each month for the next 12 months. Therefore, intra-year price spikes in fuel costs are not immediately passed though to TEP's customers. For example, if fuel prices were to spike in the month of August in a given year, the fixed PPFAC rate charged to TEP's customers, as established by the Commission, would not change. The costs associated with the August price spike would be absorbed by TEP until a new PPFAC rate was approved by the Commission. Even then, the price spike from the previous month of August, would be spread out

[52] Tr. (Pignatelli) at 174.
[53] Tr. (Hutchens) at 804.
[54] Tr. (Rigsby) at 1071-72.
[55] Tr. (Hutchens) at 845.

over the entire year under the new, Commission-approved PPFAC rate. As TEP witness Mr. Hutchens stated, if there is a price spike during the year, the PPFAC provides a "12-month smoothing mechanism."[56] During the hearing one Commissioner accurately noted that this provision is "very friendly to the ratepayer"[57] as it dampens the effects of a fuel price spike and further observed that the PPFAC is a "hedge plus", because it fixes the price for ratepayers for the year while allowing any over-collections or under-collections to be returned or charged over a subsequent 12-month period.[58]

The PPFAC also provides customers with proper price signals about the real costs of energy consumption. In this regard, a PPFAC is a benefit to customers as it assists them in adjusting their usage based on the total cost of their energy consumption.

The PPFAC further provides a direct economic benefit to customers by creating PPFAC offsets and credits. These include: (i) all Short-Term Wholesale Sales Revenue will be credited to fuel and purchased power costs; (ii) 10% of annual net positive wholesale trading profits will be credited to fuel and purchased power costs annually – and under no circumstances will any annual net loss on wholesale trading incurred by TEP be shared with or borne by ratepayers; and (iii) 50% of the revenues from the sales of sulfur dioxide (SO_2) emission allowances will be credited to fuel and purchased power costs.[59] Further, there is no nexus between the credits and TEP ratepayers. Crediting the PPFAC with revenues from the sale of SO_2 credits is a prime example of a benefit that TEP is providing to customers through the Settlement Agreement. As TEP witness Mr. Pignatelli explained, the capital provided to reduce reductions in sulfur dioxide at the Springerville Generating Station was not paid for by the customers.[60] Nevertheless, under the Settlement Agreement, TEP's customers will receive the benefit of 50% of those revenues in the form of a credit against the PPFAC.

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[56] Tr. (Hutchens) at 845.
[57] Tr. at 846.
[58] Tr. at 847.
[59] *See* Ex. TEP-1 (Settlement Agreement), Sec. 7.2.i-.k.
[60] Tr. (Pignatelli) at 147-49.

The PPFAC also benefits customers by lowering TEP's cost of capital. As previously referenced, the Settlement Agreement reflects: (i) a return on equity that is 50 basis points lower than TEP had requested and 50 basis points lower than the return authorized for APS in Decision No. 69663 (June 28, 2007); and (ii) a capital structure lower than what TEP will likely achieve at the end of the moratorium period.[61] These concessions were justified, in part, by the reduced risk to TEP due to the PPFAC. Without the PPFAC, for instance, the return on equity would have to be higher than 10.25%.[62]

The Settlement Agreement provides the significant safeguard that that any proposed adjustment to the PPFAC rate will be subject to scrutiny by Commission Staff and interested parties. Those parties will be able to provide meaningful input prior to the Commission making any adjustment to the PPFAC rate. Furthermore, the recalculation of the PPFAC rate is not just an automatic occurrence – the PPFAC rate cannot be adjusted up or down unless the Commission approves such a change.[63] In this regard, questions were raised during the hearing regarding the specific nature of the procedure that would be used for the request, review and approval of changes in the PPFAC rate. Several approaches were discussed. TEP witness Mr. Hutchens stated that the Company is amenable to work within any reasonable process that is established by the Commission and Commission Staff.[64]

Finally, the Settlement Agreement further provides that TEP's low income customers will be held harmless from the charges associated with the new PPFAC. The record in this proceeding clearly reflects the need, benefits and protections of the PPFAC. The PPFAC is a critical component of the Settlement Agreement and should be approved as agreed to by the parties without modification.

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[61] Tr. (Pignatelli) at 318.
[62] Tr. (Pignatelli) at 139.
[63] *See* Ex. TEP-1 (Settlement Agreement), Ex. 6 (PPFAC Plan of Administration) at 5.
[64] Tr. (Hutchens) at 863.

2. There is no evidence in the record to support a modification to the PPFAC.

There is no evidence in the record of this proceeding to support any modification to the PPFAC. During the settlement hearing questions were raised about the pros and cons of imposing a cap on the PPFAC. No specific PPFAC cap was proposed. No party to the Settlement Agreement supported such a change to the PPFAC.

Although TEP witness Mr. Pignatelli indicated that in some circumstances an appropriate form of a cap might be acceptable, TEP does not support a cap on PPFAC cost recovery in this case.[65] Based upon the terms and conditions of the Settlement Agreement, TEP cannot financially afford to have its ability to recover these costs capped if the base cost of fuel and purchased power is set at 2006 levels. Further, TEP cannot afford to lose recovery of cost increases for each year from 2009 through 2013 (TEP can file a case after the end of 2012, but it will likely take more than a year to process any such case).[66] TEP simply cannot absorb the rising costs of fuel and purchased power for such a lengthy period. The PPFAC structure proposed in the Settlement Agreement is directly tied to the rate moratorium, and modifications to the PPFAC would leave TEP imprudently exposed for costs that could imperil TEP's finances at the very time that TEP must make substantial investments in its system.

TEP witnesses Mr. Pignatelli[67] and Mr. Hutchens,[68] also testified that a cap could create the following problems:

a. A cap sends an inappropriate price signal to customers.

b. The cost of fuel and purchased power in this case is based on a 2006 test year. Therefore, a cap is inappropriate as it does not take into account the current expected cost of fuel. The use of a cap on costs based on a 2006 test year would not allow TEP to timely recover its costs and would undermine the economics of the settlement. Further, it would exacerbate the issue of sending the proper price signals to customers.

c. There are intergenerational issues associated with a cap as it creates balances that

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[65] Tr. (Pignatelli) at 210, 217.
[66] Tr. (Pignatelli) at 280, 320.
[67] Tr. (Pignatelli) at 210-12.
[68] Tr. (Hutchens) at 848.

are incurred by one set of ratepayers, yet those costs are borne by another set of ratepayers.

d. Any interest owed due to balances created by a cap would ultimately be paid by the ratepayers, thereby increasing their expense.

e. The balances and the financial costs created by a cap will affect TEP's credit and impair its ability to purchase fuel and power at more favorable prices, especially if TEP is only able to collect a Treasury Bill rate on the outstanding balance. This in turn will ultimately increase TEP's customer bills.

Commission Staff testified that the safeguard provisions of the PPFAC make a cap unnecessary and that this PPFAC is superior to other clauses previously adopted by the Commission.[69] For example, as previously referenced PPFAC rate adjustments are not automatic and require Commission review and a Commission order before they go into effect.[70]

3. The PPFAC supports the accounting deferral of unrealized gains (losses) on fuel, purchased power, and hedging agreements.

Upon Commission approval of the Settlement Agreement TEP will apply FAS 71 to its generation operations because generation assets will be included at original cost and subject to the Commission's ratemaking and regulatory review and approval.[71] Consequently, with approval of the PPFAC, TEP would record the changes in fair market value (unrealized gains or losses) of resource acquisition agreements defined as derivatives under *Statement of Financial Accounting Standards ("SFAS") No. 133, Accounting for Derivative Instruments,* as deferred assets or liabilities in FERC Account No. 186, "Miscellaneous Deferred Debits", and FERC No. 253, "Other Deferred Credits," in accordance with *SFAS No. 71, Accounting for the Effects of Certain Types of Regulation.* The Commission previously authorized UNS Electric, Inc. to defer unrealized gains and losses related to resource acquisition agreements in Commission Decision No. 69202 (December 21, 2006).

SFAS No. 133 requires reporting all derivatives at fair market price (mark-to-market). TEP has entered into certain transactions, such as power supply and hedging agreements, that are derivatives. Accordingly, differences between the contract prices and market prices are recorded

[69] Tr. (Johnson) at 652; Tr. (R. Smith) at 706-07.
[70] Tr. (Pignatelli) at 218.
[71] Ex. TEP-1 (Settlement Agreement), Sec. III.

as an unrealized gain or loss affecting TEP's reported earnings and equity. To the extent that derivatives are related to costs that flow through TEP's PPFAC, the associated unrealized gains and losses have no real economic consequence to the Company. As a result, and contrary to the intended purpose of SFAS No. 133, unrealized gains and losses that have no economic consequence cause fluctuations in reported income and equity. The accounting treatment proposed herein counters the undesirable effects of recognizing unrealized gains and losses related to energy acquisitions and related hedging agreements on reported earnings and equity.

An amount equal and opposite to these non-cash accounting entries, which reflects the fair market value of the derivative assets or liabilities, would be recorded in FERC Account No. 175, "Derivative Instrument Assets", or FERC Account No. 244, "Derivative Instrument Liabilities". This is consistent with present accounting practices provided by the FERC Uniform System of Accounts, General Instruction No. 24B. When the obligations related to resource acquisition agreements are settled, any unrealized gain or loss previously recorded would be reversed in accordance with SFAS No. 133 and the offsetting asset or liability would also be reversed. The actual price paid would be recorded through TEP's PPFAC, and subsequently through earnings. This is consistent with accounting for power purchases *not* considered derivatives under SFAS No. 133.

This deferral accounting method will have no effect on the cost of power, nor would there be any impact on the proposed PPFAC mechanism. None of the temporary mark-to-market accounting entries would appear in the PPFAC bank tracking account. Additionally, TEP will neither seek rate base treatment for the requested SFAS No. 133 deferral accounts, nor cost recovery of any amounts temporarily recorded therein, as such amounts represent non-cash items.

This accounting treatment would result in equal and opposite entries in the balance sheet, eliminating the potential earnings and equity volatility caused by SFAS No. 133. Any adverse effect on TEP's reported earnings, ability to comply with debt covenants, financing arrangements, ability to attract capital or credit enhancements required under future resource acquisition agreements would be eliminated. The Company respectfully requests that the Commission order

approving the Settlement Agreement authorize TEP to follow such accounting.

I. Renewable Energy Adjustor.

The Settlement Agreement is in the public interest because it provides that the Renewable Energy Standard Tariff ("REST") adjustor mechanism recommended by Commission Staff in its Direct Rate Design Testimony will be adopted by TEP, upon Commission approval. The initial rate of the adjustor mechanism will be $0.004988 per kWh, with monthly caps of $2.00 for residential customers, $39.00 for non-residential customers and $500.00 for non-residential customers with demands of 3 MW or greater, as approved in Decision No. 70314 (April 28, 2008). RUCO does not oppose the REST adjustor mechanism provided in the Settlement Agreement.[72]

J. Demand-Side Management Programs and Adjustor.

The Settlement Agreement is in the public interest because it provides an initial Demand Side Management ("DSM") adjustor rate of $0.000639 per kWh, applied to all kWh sales, which shall become effective when the new proposed rates become effective.

TEP's DSM Portfolio 2008-2012, including its ten (10) DSM programs, was filed in Docket No. E-01933A-07-0401 on July 2, 2007. To date, nine of TEP's ten proposed DSM programs have been approved;[73] TEP withdrew its Direct Load Control program in July of 2008 in order to take advantage of advances in thermostat technology and metering communication infrastructure, and plans to refile this program shortly. While some DSM programs are already active, TEP anticipates that formal implementation of its new DSM programs will take place between August and November of 2008. RUCO does not oppose TEP's DSM programs or its DSM adjustor mechanism.[74]

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[72] Tr. (Rigsby) at 1072.

[73] TEP's approved DSM programs include the Shade Tree Program, the New Home Construction Program, the Low-Income Weatherization Program, the Education and Outreach Program, the CFL Buydown Program, the Residential HVAC Program, the Small and Large Business Programs, and the Commercial New Construction Program.

[74] Tr. (Rigsby) at 1072.

K. Base Rate Increase Moratorium and Emergency Clause.

The Settlement Agreement is in the public interest because it provides for a base rate increase moratorium through December 31, 2012. TEP will not submit a rate application sooner than June 30, 2012 and its rate application will not utilize a test year ending earlier than December 31, 2011.[75]

TEP is not precluded from requesting, or the Commission from approving, changes to specific rate schedules or terms and conditions of service, or the approval of new rates or terms and conditions of service that would have a de minimus impact upon TEP's Arizona jurisdictional earnings. Additionally, TEP is not prevented from requesting certain necessary changes in the event of conditions or circumstances that constitute an emergency. The base rate moratorium promotes rate stability for at least four more years and conserves the resources that both Commission Staff and the Company utilize in filing and litigating a rate case.

The inclusion of an Emergency Clause provision in the Settlement Agreement is also in the public interest. In order for TEP to agree to a base rate increase moratorium, which was a provision that was insisted upon by Commission Staff, TEP needed the ability to petition the Commission to change its base rates, PPFAC mechanism or the DSM and REST adjustor mechanisms in case of an "emergency."[76] TEP believes that it will be to continue to provide safe and reliable electric power to its customers under the terms of the Settlement Agreement. However, the inclusion of an emergency clause to address extraordinary events is prudent in this matter as the Settlement Agreement includes a multi-year base rate increase moratorium. RUCO does not oppose this provision.[77]

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[75] Ex. TEP-1 (Settlement Agreement), Secs. X, XI.
[76] Ex. TEP-2 (Pignatelli Settlement Direct) at 21
[77] Tr. (Rigsby) at 1072-73.

L. Certificate of Convenience & Necessity ("CC&N").

The Settlement Agreement is in the public interest because it provides for the status quo regarding the state of retail electric competition in Arizona. The Settlement Agreement provides that any such change to this statewide, Commission-approved policy is best addressed in a generic docket, rather than a specific rate case. Although TEP had originally requested that its CC&N be returned to exclusivity, it agreed to the status quo in light of other interested parties and stakeholders that are not interveners in this case and pending matters such as the Sempra CC&N proceeding.[78] Although not opposed to this provision, RUCO witness Mr. Rigsby stated that he would prefer that TEP have an exclusive CC&N under traditional ratemaking.[79]

M. Returning Customer Direct Access Charge.

The Settlement Agreement is in the public interest because it provides that TEP will file, as a compliance item, a Returning Customer Direct Access Charge ("RCDAC") that will only apply to customers or aggregated groups of customers with a demand load of 3 MWs or greater who do not provide TEP with one year's advance written notice of intent to return to TEP for generation and Standard Offer service.[80] This provision is just and reasonable as it appropriately apportions the costs attributed to a customer that leaves, and then reestablishes service without providing the proper notice, upon that same customer.[81] The Settlement Agreement further provides that any costs associated with reestablishing service to these customers should be borne by those customers, unless they provide the appropriate written notice. Although RUCO did not oppose this provision, it reiterated its position that it would prefer TEP have an exclusive CC&N.[82]

N. Rate Design.

The Settlement Agreement is in the public interest because it provides rate design that is just and reasonable, that promotes energy conservation and that protects low income customers.

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[78] Ex. TEP-1 (Settlement Agreement), Sec. XII; TEP-2 (Pignatelli Settlement Direct) at 22; Tr. (Pignatelli) at 256.
[79] Tr. (Rigsby) at 1073.
[80] Ex. TEP-1 (Settlement Agreement), Sec. XIII.
[81] Ex. TEP-2 (Pignatelli Settlement Direct) at 22-23.
[82] Tr. (Rigsby) at 1073-74.

1. TEP's inverted block rate structure will help customers save on their electric bills.

The Settlement Agreement recognizes that energy conservation is an important rate design goal. Accordingly, the Settlement Agreement provides an inverted block rate structure for TEP's Residential Rate 01, whereby the unit price of electricity, excluding the customer charge, shall increase as consumption increases. Three blocks shall be seasonally differentiated, with the first block applicable to kWh usage from 0 to 500 kWhs, the second block applicable to kWh usage from 501 kWhs to 3,500 kWhs and the third block applicable to kWh usage above 3,500 kWhs.[83] This rate design should provide an economic incentive for customers to conserve energy. RUCO witness Mr. Rigsby testified at the settlement hearing that the provision of the inverted block rate structure is one of the benefits of the Settlement Agreement.[84]

2. TEP's Time-of-Use Tariffs provide incentives for customers to use energy when it is least costly.

The Settlement Agreement also reflects a consensus that sending customers appropriate time-of-use price signals is an important goal of rate design.[85] Accordingly, the Settlement Agreement contains new Time-of-Use ("TOU") rate schedules. TEP's TOU rates will be available to customers on a voluntary, not mandatory, basis. RUCO not only supports TEP's TOU rates, but would have preferred that the TOU rates become mandatory for new customer connections.[86] RUCO believes that TEP's expanded TOU rates are another benefit of the Settlement Agreement.[87]

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[83] Ex. TEP-1 (Settlement Agreement), Sec. 16.4; Ex. TEP-6 (Dukes Settlement Direct) at 4.
[84] Tr. (Rigsby) at 981.
[85] Ex. TEP-1 (Settlement Agreement), Sec. XVI.C.
[86] Tr. (Rigsby) at 1085.
[87] Tr. (Rigsby) at 981.

3. Low-Income customers will be held harmless from the 6% base rate increase and additional PPFAC charges.

One of the innovative aspects of the Settlement Agreement is the provision that low income customers will not be subject either to the 6% base rate increase or any additional charges attributable to the PPFAC. As previously indicated, the Arizona Community Action Association's witness, Ms. Cynthia Zwick, testified in support of these important protections that the Settlement Agreement affords low income customers, and agreed that this is the first time low income customers will have these protections, and that they should serve as a model for future cases.[88] No party opposed this provision of the Settlement Agreement. Clearly, this provision is in the public interest as it provides rate relief for low income customers.

O. Rules and Regulations.

The Settlement Agreement is in the public interest because it provides for needed changes and modifications to the Company's Rules and Regulations. TEP filed its Rules and Regulations, including changes proposed by both TEP and Commission Staff, on June 11, 2008. During the settlement negotiations the Rules and Regulations were reviewed and agreed to by Commission Staff as well as other parties to the Settlement Agreement. No party has objected to the Rules and Regulations. Among the significant changes proposed for TEP's Rules and Regulations is the elimination of free footage from its line extension tariffs.[89] No party has opposed this modification. RUCO does not oppose the elimination of free footage.[90]

P. Additional Tariff Filings.

The Settlement Agreement is in the public interest because it provides for filing of additional tariffs that address specific areas of need for TEP's customers. For example, the Settlement Agreement provides that TEP will file within ninety (90) days of the effective date of the Commission's approval of the Settlement Agreement: (i) a new Partial Requirements Service ("PRS") Tariff, (ii) an Interruptible Tariff, (iii) a Demand Response Tariff, and (iv) a Bill

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[88] Tr. (Zwick) at 454.
[89] Ex. TEP-1 (Settlement Agreement), Sec. 17.3.
[90] Tr. (Rigsby) at 1086.

Estimation Tariff. The tariffs are to be developed in consultation with Commission Staff and other interested stakeholders.[91]

During the settlement hearing, the Commission requested that TEP work with other interested parties on its proposed PRS Tariff so that a draft tariff would be available for review before the Commission votes on the Settlement Agreement.[92] TEP has already begun working on its PRS Tariff and met with Commission Staff and interested stakeholders on August 4, 2008. Interested stakeholders who attended the meeting included representatives of Commission Staff, the City of Tucson, APS, the Department of Defense, Pima County, AECC, TFS, Raytheon, the Tucson Medical Center, Solar City, Global Solar, Solar Alliance, Sun Edison, Pima County Regional Wastewater Reclamation Department, and Solan America. A follow-up meeting for the participants took place on August 19, 2008, and TEP anticipates filing its PRS Tariff in advance of the Commission's Open Meeting to consider the Settlement Agreement.

Q. Fuel Audit.

The Settlement Agreement is in the public interest because it provides for TEP's implementation of the fuel audit recommendations as delineated by Commission Staff once the PPFAC is implemented.[93] This Settlement Agreement provision provides material benefits to TEP's customers as it creates a process whereby Commission Staff can evaluate the fuel procurement practices of TEP as a further check and balance to ensure that TEP is following prudent fuel procurement practices. No party objected to this provision.

In summary, the record is replete with evidence that fully supports that conclusion that the Settlement Agreement is fair, just and reasonable, resolves many important and complex issues, provides significant benefits to customers and is in the public interest.

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[91] Ex. TEP-1 (Settlement Agreement), Sec. XVIII.
[92] Tr. (Pignatelli) at 228-29.
[93] Ex. TEP-1 (Settlement Agreement), Sec. 19.1.

IV. TEP SHOULD RETAIN THE FIXED CTC TRUE-UP REVENUES.

The treatment of the Fixed CTC True-up Revenues was one of two issues that was not resolved in the Settlement Agreement and was deferred to the Commission for final disposition.[94]

TEP believes that it should retain all Fixed CTC True-up Revenues for several important reasons. First, as set forth in the Settlement Agreement, TEP has been under-earning since at least 2006 -- even if Fixed CTC Revenues are included in the revenue requirement calculation. Second, the Fixed CTC is simply an accounting mechanism that did not increase customer rates. Those rates as a whole, including the Fixed CTC, have been deemed just and reasonable. Third, ratepayers are realizing the benefits of the Fixed CTC because the cost-of-service generation rates under the Settlement Agreement reflect the accelerated write-down of $450 million of generation assets. Given the accounting nature of the Fixed CTC, ratepayers did not pay extra for that benefit. And because TEP's generation rates are now based on cost-of-service, ratepayers will receive that benefit in perpetuity.

The Settlement Agreement does provide that, to the extent the Commission determines that any Fixed CTC True-up revenues are to be credited to customers, up to $32.5 million shall be credited through the PPFAC balancing account. However, that provision should not be interpreted in any way as TEP acquiescing to a customer credit in any amount.

A. Customers' rates were not raised from just and reasonable levels in 1999 to fund the Fixed CTC recovery.

AECC witness Kevin Higgins testified that the Fixed CTC was not an incremental rate increase but merely an accounting "color-coding" of a portion of TEP's overall rate that was in effect in 1999.[95] That overall bundled rate had been determined to be just and reasonable in 1996[96] and that determination was confirmed in 1999 because the unbundled rates were simply an unbundling of TEP's existing rates that were previously approved by the Commission.[97] TEP's

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[94] Ex. TEP-1 (Settlement Agreement), Sec. 15.1.
[95] Tr. (Higgins) at 594; *see* AECC-3 (Higgins Settlement) at 9-10.
[96] *See* Decision No. 59594 (March 29, 1996) at 7.
[97] *See* Decision No. 62103 (November 30, 1999) at 5, 20-21.

overall rates were not raised to collect the Fixed CTC.[98] Rather, the Fixed CTC was one of many unbundled rate elements delineated in 1999 to allow retail electric competition to occur.[99] Specifically, the Fixed CTC was an accounting mechanism to allow TEP to amortize $450 million of generation plant stranded costs between 1999 and the end of 2008 rather than incur the entire write off in a single year.[100] TEP did not collect extra revenue from the Fixed CTC but it did (during the 1999-2008 time period) write down the value of its generation assets by $450 million.[101]

Due to electric use over the past eight years that was higher than forecasted in 1999, the $450 million was amortized before the end of 2008. The Fixed CTC has remained part of TEP's rate since the full amortization in May of 2008 and the Fixed CTC revenues accruing since that time are referred to as Fixed CTC True-up Revenues pursuant to Decision No. 69568. It is estimated that the Fixed CTC True-up Revenues that will accrue by the end of 2008 will total approximately $66 million.[102]

B. TEP is currently under-earning.

The Settlement Agreement rate design is intended to provide TEP with $47.1 million of additional revenue above 2006 test year revenues that include Fixed CTC revenues.[103] Therefore, the Settlement Agreement acknowledges that even if Fixed CTC revenues are treated as traditional revenue, TEP has been under-earning since at least 2006. Therefore, it would be contradictory to the evidence in this case for the Commission to cause the Company to refund revenues at a time that it is not earning its authorized rate of return.

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[98] Ex. TEP-2 (Pignatelli Settlement Direct) at 29-30; Ex. AECC-3 (Higgins Settlement) at 9-10.
[99] *See* Ex. AECC-3 (Higgins Settlement) at 10.
[100] Ex. TEP-3 (Pignatelli Settlement Rebuttal) at 7.
[101] Tr. (Pignatelli) at 103, 112-13.
[102] Ex. TEP-2 (Pignatelli Settlement Direct) at 29.
[103] See Ex. TEP-1 (Settlement Agreement), Sec. 2.3.

C. Any refund or credit of the Fixed CTC True-up Revenues would be inequitable and confiscatory.

Despite the nature and purpose of the Fixed CTC and despite the acknowledgement that the TEP has been under-earning since at least 2006, most Signatories have taken the position that TEP should credit up to $66 million of Fixed True-up Revenues to customers. That position, particularly in combination with parallel requests to delay implementation of the new rates until 2009, would lead to an inequitable and confiscatory result.

First, a credit or refund would simply serve to aggravate the current inability of TEP to earn a just and reasonable return. A credit or refund of Fixed CTC True-up Revenues would effectively confiscate a portion of revenues that TEP collected through rates that were previously determined to be just and reasonable. Because TEP has experienced a revenue deficiency since at least the 2006 test year, it is unnecessary and confiscatory to require any credit or refund of those Revenues.

Second, the Settlement Agreement sets TEP's generation rates based on cost-of-service.[104] In so doing, TEP's generation rates will reflect generation assets that have been reduced on an accelerated basis by $450 million.[105] The customers are now going to benefit from a write down of assets for which they did not have to pay any increased overall rate from 1999 to present. Given that TEP will continue to set rates based on cost-of-service, this write down of generation assets will benefit customers in perpetuity.

This long-term benefit is not something that was contemplated in 1999 due to the previously contemplated shift to market-based pricing and is why blind adherence to the 1999 Settlement Agreement provision regarding termination of the Fixed CTC is not appropriate or equitable. As Mr. Higgins explained at the hearing, the Fixed CTC was set to recover stranded costs in contemplation of the divestiture of TEP's generation assets.[106] It may have made sense to end the Fixed CTC if TEP had in fact divested its generation assets. However, that divestiture did not occur. As a result, TEP potentially is faced with reduced rate base for its new cost-of-service

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[104] Ex. TEP-1 (Settlement Agreement), Sec. 2.2.
[105] Tr. (Pignatelli) at 103.
[106] Tr. (Higgins) at 591.

rates *and* a reduction to its current rates (through a Fixed CTC True-up Revenues credit). Imposing both reductions on TEP effectively double-counts the impact of the $450 million generation asset reduction. And requiring a refund or credit of the Fixed CTC True-up Revenues would constitute an effective decrease of rates that had been deemed just and reasonable -- without any matching benefit to TEP that justifies the rate decrease.

AECC, through Mr. Higgins, acknowledges the dilemma of this change of circumstance and proposes a compromise of sharing the Fixed CTC True-up Revenues between TEP and the ratepayers.[107] However, even that proposal provides an inequitable windfall to TEP's customers. Although AECC had previously supported no credit or refund if a cost-of-service methodology was adopted and TEP dropped its legal claims under the 1999 Settlement Agreement,[108] it did not continue that position in its pre-filed testimony even though a cost-of-service methodology is being adopted and TEP has agreed to drop its claims under the 1999 Settlement Agreement in the new Settlement Agreement. [109]

Finally, none of the other parties have set forth any compelling reason for requiring such a confiscatory credit or refund. They do not dispute that TEP has been under-earning since 2006 or that the Fixed CTC never increased overall rates. They simply point to the termination provision of the 1999 Settlement Agreement – an agreement that will be superseded by the new Settlement Agreement. One of the true benefits of the new Settlement Agreement is to extinguish all issues and claims related to the 1999 Settlement Agreement. Indeed, the Settlement Agreement notes that the 1999 Settlement Agreement was designed to allow a transition to retail electric competition within a specific time period and that time period has passed.[110] Given that the 1999 Settlement Agreement is being superseded by the new Settlement Agreement, it is inequitable to allow a select provision of the 1999 Settlement Agreement to transfer inappropriate economic benefits from TEP to its customers. As noted above, given the lack of divestiture, the customers

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[107] Ex. AECC-3 (Higgins Settlement) at 7-9; Tr. (Higgins) at 588, 592-93.
[108] Ex. AECC-1 (Higgins Direct) at 43; Ex. AECC-3 (Higgins Settlement) at 9.
[109] Ex. TEP-1 (Settlement Agreement), Secs. 2.2, 14.4 – 14.7.
[110] Ex. TEP-1 (Settlement Agreement), Sec. 14.1.

will enjoy the benefit of the $450 million generation asset reduction in perpetuity and the Fixed CTC termination provision in the 1999 Settlement Agreement no longer has legitimate purpose.

D. Should the Commission determine that $32.5 million of Fixed CTC True-up Revenue be returned to customers, those revenues should be credited to the PPFAC balancing account.

The Signatories have agreed that to the extent the Commission desires to return Fixed CTC True-up Revenues to ratepayers, up to $32.5 million of the Revenues should be credited to the PPFAC balancing account. If the amount to be returned exceeds $32.5 million, TEP requests to have the Revenues designated for certain programs or capital improvements (such as solar generation facilities), assuming they would become part of rate base in the future (and not considered contributions). Alternatively, TEP requests that the entire amount be credited to the PPFAC account and that there be no direct refunds.

V. TEP'S NEW RATES SHOULD BE IMPLEMENTED AS SOON AS POSSIBLE.

The second issue that the Settlement Agreement did not resolve is the effective date of the new rates and the other provisions of the Settlement Agreement. TEP believes that rates should go into effect as soon as the Settlement Agreement is approved by the Commission. There is no valid reason for delay other than to cling to a legacy term of the 1999 Settlement Agreement – an agreement that is otherwise fully superseded by the new Settlement Agreement. Blind adherence to the 1999 Settlement rate freeze provision is inequitable and confiscatory, particularly given the changed circumstances concerning retail electric competition. Indeed, there are compelling reasons to implement the new rates as soon as possible.

First, as discussed above, TEP has been under-earning since at least the 2006 test year and delaying implementation of the new rates interferes with TEP's opportunity to earn a just and reasonable return. TEP needs those revenues to continue to operate a safe and reliable electric system and to meet significant capital expenditure requirements in the near future. The initial rate freeze provision was adopted in the context of the move to retail competition. As noted in the Settlement Agreement, that time and context has passed.[111] TEP is moving back to full cost-of-

[111] Ex. TEP-1 (Settlement Agreement), Sec. 14.1.

service rates and there is no reason to cling to a provision tied to the move to retail competition.

Second, any delay in rate relief will exacerbate the scope of the Fixed CTC True-up Revenue dilemma. It would be unfair to unintentionally manipulate TEP's new rates by artificially inflating the Fixed CTC True-up Revenues and then crediting those Revenues against rates that are necessary to allow TEP an opportunity to earn a just and reasonable rate of return.

Finally, there are important rates and programs that should go into effect sooner rather than later. For example, DOD believes that the new rates should go into effect as soon as possible because it believes that it can save significant costs through the new TOU rates.[112]

VI. RUCO's Opposition to the Settlement Agreement.

The record in this case is, at best, confusing regarding RUCO's opposition to the Settlement Agreement. TEP believes that from the record of the settlement hearing it appears that RUCO is now in general support of most of the terms of the Settlement Agreement except those that relate to a rate increase, PPFAC and the status of TEP's CC&N. However, because RUCO's position is not clear, TEP hereby submits for the Presiding Administrative Law Judge's consideration reasons why RUCO's opposition to the Settlement Agreement has been, and to the extent remaining, continues to be without merit.

A. RUCO recognizes the many benefits in the Settlement Agreement.

RUCO admits that there are many provisions in the Settlement Agreement that it supports. For instance, RUCO supports the rate moratorium in the Settlement Agreement.[113] RUCO supports holding low-income customers harmless, as the Settlement Agreement will do.[114] RUCO does not object to the provisions requiring TEP to file Partial Requirements Service and Demand Response tariffs.[115] RUCO supports provisions that resolve disputes from the 1999 Settlement Agreement.[116] RUCO supports including Luna Generating Facility in rate base at original cost.[117]

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[112] Tr. (Neidlinger) at 420-21.
[113] Tr. (Rigsby) at 1060.
[114] Tr. (Rigsby) at 1060.
[115] Tr. (Rigsby) at 1087.
[116] Tr. (Rigsby) at 1071-72.
[117] Tr. (Rigsby) at 982.

RUCO supports all TEP generation costs being determined on a cost-of-service basis, as agreed in the Settlement Agreement.[118] As RUCO witness Mr. Rigsby admitted, the Settlement Agreement avoids exposing TEP ratepayers to market based prices for generation, either by the Commission or by a court.[119] RUCO finds the rate design principles and structure acceptable.[120] RUCO supports the DSM and renewable energy adjustors.[121] Given RUCO's recognition of these many benefits, its opposition to the Settlement Agreement is puzzling. Apparently, RUCO would have TEP accept the obligations to provide all the benefits of the Settlement Agreement without sufficient funds to be able to do so. To impose such a financial hardship on TEP is not in the public interest.

B. RUCO's criticism of the base rate increase is incorrect.

RUCO claimed that the Settlement Agreement results in a 19.8 % base rate increase for TEP's customers rather than the 6% increase presented by the parties.[122] But, as RUCO witness Mr. Rigsby was forced to admit during the settlement hearing, RUCO is wrong and TEP's customers will see only a 6% base rate increase over current rates.[123]

RUCO also has erroneously argued that the treatment of the fixed CTC true-up revenues has been misstated. RUCO argued that the fixed CTC was a temporary surcharge. However, as previously discussed herein: (i) the fixed CTC was simply a carve out from rates determined to be just and reasonable for TEP in 1996 (and that were subsequently decreased 2% since the 1999 Settlement Agreement); and (ii) there was and is no such thing as a "fixed CTC surcharge" as RUCO implies. Moreover, RUCO never raised any concern about the treatment of the fixed CTC true-up revenues during the settlement negotiations.[124] RUCO's argument seems more to be an ad hoc position to oppose the Settlement Agreement rather than a valid point of concern. RUCO's insistence in putting forth its erroneous claim regarding the fixed CTC and true-up revenues is not

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[118] Tr. (Rigsby) at 982-83.
[119] Tr. (Rigsby) at 1045.
[120] Tr. (Rigsby) at 981, 1086.
[121] Tr. (Rigsby) at 1071-72.
[122] Tr. (Rigsby) at 1080; *see also* Ex. RUCO-2 (Rigsby Settlement) at 6-7.
[123] Tr. (Rigsby) at 1013-14.
[124] Tr. (Rigsby) at 996-97.

in the public interest.

C. RUCO simply adhered to its litigation position, failing to address any errors in its revenue requirement.

RUCO witness Mr. Rigsby testified at the hearing that his client continued to argue that the Commission should adopt the revenue requirement set forth in its direct case.[125] RUCO's insistence in pursuing its original position is unfortunate particularly because it made no effort to negotiate in good faith with the parties or to even correct the errors in its revenue requirement that were brought to its attention. Indeed, RUCO failed to respond in any meaningful way to any of the problems with RUCO's revenue requirement that were identified in TEP's Rebuttal Testimony. Had it done so, RUCO may have reached a similar conclusion to Staff that significant adjustments to its initial revenue requirements should be made in light of TEP's Rebuttal Testimony.[126]

VII. THE SETTLEMENT AGREEMENT SHOULD BE APPROVED.

For all the forgoing reasons, TEP respectfully requests that the Presiding Administrative Law Judge issue a Recommended Opinion and Order that finds, concludes and orders that the Settlement Agreement is in the public interest and should be approved in its entirety; that the rates and charges proposed in the Settlement Agreement are just and reasonable and supported by the evidence in the record;[127] that TEP should retain all CTC true-up revenues; and that the Settlement Agreement and the new rates should become effective immediately.

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[125] Tr. (Rigsby) at 984, 1019-20.

[126] *See, e.g.*, S-5 (Smith Settlement Rebuttal) at 19-20.

[127] Evidence in support of fair value, rate base and other cost of service elements is contained in the Exhibits to the Settlement Agreement.

RESPECTFULLY SUBMITTED this 29th day of August 2008.

TUCSON ELECTRIC POWER COMPANY

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By Mary Ippolito

Exhibit 1

CHRONOLOGY OF SETTLEMENT NEGOTIATIONS

On April 3, 2008, TEP sent a letter to all parties in Docket Nos. E-01933A-05-0650 and E-01933A-07-0402, inviting them to attend settlement discussions on April 10, 2008 at the Commission's office in Phoenix.

At the initial meeting, TEP presented the parties with eight (8) rate case settlement concepts. Each participant provided an initial reaction and decided that discussions would continue on April 15, 2008, at which time participants would more fully address the Company's concepts and recommend additional items they wanted to be considered.

On April 15, 2008, the Commission Staff and other participants presented their responses to TEP's concepts. This expanded the rate case concepts from TEP's original eight (8), to more than 17 concepts. Over the next seven (7) days, the number of concepts continued to grow as the participants negotiated the terms of the Settlement Agreement.

On April 18, 2008, the Commission Staff filed a motion with the Commission requesting the postponement of surrebuttal testimony. On April 21, 2008, the Administrative Law Judge granted the request.

On April 23, 2008, TEP filed notice that it had reached an agreement in principle with the Commission Staff. Participants to the settlement process continued to meet in order to refine the details of the agreement, and the supporting data and exhibits that would become part of the Settlement Agreement.

On May 8, 2008 a procedural conference was held in this proceeding. At that time, TEP and Commission Staff provided the Administrative Law Judge with an update on the progress of the finalization of the Settlement Agreement. Thereafter a procedural schedule was issued that required the final Settlement Agreement to be filed with the Commission on May 29, 2008.

Between May 28, 2008 and May 29, 2008, participants continued to work on finalizing the Settlement Agreement, especially regarding the development of appropriate rate design and tariffs. An important aspect of this work was the development of tariffs that would provide frozen rates

for eligible low-income customers, thereby holding those customers harmless from the impacts of the rate increase and the purchased power and fuel adjustment clause ("PPFAC"). All participants, including those who indicated that they would not support the Settlement Agreement, continued to be provided with drafts of the Settlement Agreement and related documents for review and comment.

On May 29, 2008, almost two (2) months after the first notice of settlement discussions was transmitted, the final Settlement Agreement was executed and filed with the Commission. Signatories to the Settlement Agreement include the Arizona Corporation Commission ("Commission") Staff; TEP; Southwestern Power Group II, LLC; the International Brotherhood of Electric Workers, Local 1116 ("IBEW 1116"); Sempra Energy Solutions, LLC; Arizonans for Electric Choice and Competition ("AECC"); Phelps Dodge Mining Company; Bowie Power Station, LLC; The Kroger Company; Mesquite Power, LLC; the U.S. Department of Defense and all other Federal Executive Agencies ("DOD"); the Arizona Investment Council ("AIC"); and Cynthia Zwick of the Arizona Community Action Association ("ACAA"). The Southwest Energy Efficiency Project ("SWEEP") neither opposed nor supported the Settlement Agreement. RUCO was the only party that raised an opposition to the Settlement Agreement.

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
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

APPENDIX

IN SUPPORT OF

TUCSON ELECTRIC POWER COMPANY'S

POST-HEARING BRIEF

VOLUME 1 OF 2

August 29, 2008

1

At the end of the settlement hearing, RUCO's official position on the Settlement Agreement was still unclear. Accordingly, throughout this post-hearing brief, TEP will refer to arguments that RUCO raised against terms of the Settlement Agreement. TEP anticipates that RUCO's brief will clarify the confusion surrounding its position in this case.

2

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

Date: July 10, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 192 through 394, inclusive)

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2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 negotiations, did they actively participate?
2 A. I think the -- I want to work on the phrasing. I
3 think that the people who were present were given the
4 opportunity to actively participate. And there were a
5 number of people who, in fact, did actively participate.
6 Q. And in your opinion, was there a good exchange of
7 information from the company and Commission Staff and the
8 intervenors in order to attempt to resolve various
9 positions in connection with the issues?
10 A. Yes. Without getting into who said what, there
11 were a lot of discussions that took place and documents
12 that were passed back and forth amongst and between the
13 parties. It was given to everyone, signatories to the
14 agreement, as well as non-signatories to the agreement.
15 So everyone had possession of all of the information.
16 I thought that was highly unusual. In fact, in
17 my mind, I wasn't quite sure if that was appropriate. But
18 nonetheless, we undertook it, and we undertook it because
19 we wanted to be able to report to this Commission that it
20 was probably the most transparent proceeding that I have
21 ever been aware of and that I have knowledge of.
22 And it was uncomfortable at times, especially
23 when you found out there were people that weren't going to
24 be supportive, but, nonetheless, they had access to all of
25 the information. They were allowed to ask any questions

3

BEFORE THE ARIZONA CORPORATION COMMISSION

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At: Tucson, Arizona

Date: July 14, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV
(Pages 577 through 794, inclusive.)

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Phoenix, Arizona 85004-1481

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

Prepared for:

ACC

1 represents a 6 percent increase of approximately
2 47.1 million. That compares to TEP's original request
3 of a 23 percent increase under the cost of service
4 methodology.
5 The amount of rate increase has also been
6 presented off a second base, which was test year
7 adjusted revenues excluding fixed CTC. Off of that
8 base, the settlement provides for a base rate increase
9 of 136.8 million, which is approximately 19.8 percent
10 off of the adjusted test year revenues excluding CTC,
11 which were approximately 691 million. That amount
12 compares to TEP's original request of an additional base
13 rate increase of 275 million, or approximately
14 40 percent.
15 Q. Mr. Smith, did you participate in the settlement
16 discussions?
17 A. Not in all of them but in many of them.
18 Q. All right. In your opinion, were the settlement
19 discussions open and fair?
20 A. They were extremely open and transparent. I
21 have to say that this was probably the most open
22 settlement discussion I have ever been involved in in my
23 28 years or so of doing utility regulatory consulting
24 work.
25 MS. WAGNER: All right. Thank you, Mr. Smith.

4

BEFORE THE ARIZONA CORPORATION COMMISSION

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At: Tucson, Arizona

Date: July 15, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME V
(Pages 795 through 1037, inclusive.)

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1 just simply wanted to know whether or not it looked like
2 a settlement agreement was going to actually come to
3 fruition, just, you know, most of our own internal
4 planning purposes, so that we could, you know, properly
5 schedule the workload and so forth.
6 Q. Would you agree that there were several
7 occasions in which RUCO sent representatives to the
8 settlement discussions but those representatives didn't
9 have any authority to negotiate?
10 A. Yes, I believe that's correct. And again, I
11 think this goes back to what I was saying earlier, that,
12 you know, we agreed not to be a party to the settlement
13 negotiations, but we wanted to monitor them. And
14 certainly I don't think it would have been in good faith
15 had we tried to actively negotiate when we made it clear
16 that we only wanted to be there to monitor.
17 Q. You would agree that even after RUCO announced
18 its intention not to actively participate, the parties
19 continued to invite RUCO to the settlement discussions?
20 A. I assume that's true, because to the best of my
21 knowledge, we attended all of the meetings.
22 Q. And you would agree that the parties circulated
23 drafts of the settlement agreement to RUCO?
24 A. I did, I know that for a fact.
25 Q. Can you estimate for me the number of drafts of

5

BEFORE THE ARIZONA CORPORATION COMMISSION

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REPORTER'S TRANSCRIPT OF PROCEEDINGS

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1 included in the cost of capital sample, the capital
2 asset pricing model sample to be more specific.
3 Q. Do you have the Mayes 1 exhibit up there which
4 has the Pinn West Value Line sheet?
5 A. I don't, I don't have that in front of me, no.
6 Q. If I were to tell you that the company's
7 financial strength for Pinn West attached there is A,
8 not C plus plus, would it surprise you?
9 A. That wouldn't surprise me. And I believe the
10 safety ranking for Pinnacle West is 1 if I am not
11 mistaken.
12 Q. Mr. Rigsby, you testified that RUCO monitored
13 all of the settlement negotiations, correct?
14 A. We had representatives there at -- it is my
15 understanding that we had representatives there at each
16 one of the meetings. Like I said, I attended two of
17 them. I wasn't able to attend the very first one.
18 Q. All right. And in your prefiled testimony you
19 have not identified any instance where RUCO was denied
20 access to the settlement negotiations?
21 A. No, RUCO wasn't denied access. And I think I
22 may have said as much in the first couple of pages of my
23 settlement testimony.
24 Q. And you haven't identified any instances where
25 RUCO was denied access to the materials being exchanged

1 between the parties during the settlement process, have
2 you?
3 A. Not to my knowledge, no.
4 Q. You have been here listening to these
5 proceedings, haven't you?
6 A. Yes.
7 Q. And you have heard the signatories testify that
8 the settlement process was the most open and transparent
9 settlement process that they had ever participated in.
10 Do you recall that testimony?
11 A. Yes.
12 Q. From a number of people?
13 A. Yes.
14 Q. And you don't have any reason to disagree with
15 that testimony, do you?
16 A. No.
17 Q. Mr. Rigsby, I want to hand you something that is
18 going to marked as Exhibit TEP-11.
19 A. Thank you.
20 Q. Mr. Rigsby, just for the record, TEP-11 contains
21 several data request responses that RUCO provided to TEP
22 in response to TEP's fourth set of data requests, is
23 that correct?
24 A. Yes.
25 Q. And in particular it contains responses to data

7

BEFORE THE ARIZONA CORPORATION COMMISSION

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At: Tucson, Arizona

Date: July 15, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME V
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At: Tucson, Arizona

Date: July 10, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 192 through 394, inclusive)

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By: MICHELE E. BALMER
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Certificate No. 50489

Prepared for:

1 Q. Okay. And I think you have alluded to this a
2 little bit. You consider that the issues in this case are
3 rather complex?
4 A. That would be correct.
5 Q. And you also consider that the issues involved
6 were rather contentious?
7 A. Yes, sir.
8 Q. In fact, I think you have stated that the issues
9 were rather highly contested; is that right?
10 A. I believe they were.
11 Q. Which I would assume that with reference to the
12 issues there were various positions that were put forth by
13 the participants to the settlement negotiations concerning
14 those issues?
15 A. Yes, sir.
16 Q. And would you suggest that there was give and
17 take in connection with those issues insofar as the
18 various parties were concerned?
19 A. Yes, sir.
20 Q. In fact, I assume in order to bring about a
21 settlement of the agreement there had to be some
22 compromise on parties' positions with reference to the
23 various issues; would that be correct?
24 A. That would be correct.
25 Q. And did you also view concessions -- that there

9

BEFORE THE ARIZONA CORPORATION COMMISSION

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) SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 11, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME III
(Pages 395 through 576, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 A. Yes. I mean, we were very surprised. I think
2 going into it we put the prospects of reaching a
3 settlement agreement at less than 50/50, and probably
4 closer to zero than 50.
5 Q. Do you have knowledge as you sit here today about
6 how TEP's rates compare to other utility rates in the
7 state or the region?
8 A. Judge Rodda, I really haven't examined that
9 recently, so I don't have an opinion on it.
10 ALJ RODDA: All right. Mr. Grant, do you have
11 anything further?
12 MR. GRANT: Nothing, Judge.
13 ALJ RODDA: Does anyone else have any further
14 questions for this witness?
15 MR. POZEFSKY: No, Your Honor.
16 MS. MITCHELL: No.
17 ALJ RODDA: Commissioner Mayes?
18 COM. MAYES: No.
19 ALJ RODDA: Well, thank you very much for being
20 here today.
21 At 1:30 this afternoon we are going to start with
22 the Mesquite Group witnesses, and then I presume
23 Mr. Schlegel. He's scheduled to appear this afternoon
24 also. But I would say that it's time to bring Mr. Johnson
25 back, unless there are any other thoughts on how to

10

BEFORE THE ARIZONA CORPORATION COMMISSION

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At: Tucson, Arizona

Date: July 10, 2008

Filed:

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At: Tucson, Arizona

Date: July 9, 2008

Filed: July 14, 2008

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME I
(Pages 1 through 191, inclusive.)

Prepared for:

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 James S. Pignatelli which was filed on July 7th, 2008.
2 Is this a copy of your rebuttal testimony in this case?
3 A. Yes, it is.
4 Q. And was this prepared under your direction and
5 supervision?
6 A. Yes, it was.
7 Q. And do you have any corrections or additions or
8 deletions to make at this time?
9 A. No, I don't.
10 MR. HEYMAN: Your Honor, I would move for the
11 admission of Exhibits TEP-1, 2 and 3 at this time.
12 ALJ RODDA: Any objections to TEP-1, 2 or 3?
13 MR. GRANT: No.
14 MR. POZEFSKY: No.
15 ALJ RODDA: Then they are admitted.
16 (Exhibits Nos. TEP-1, TEP-2, TEP-3 were admitted
17 into evidence.)
18 MR. HEYMAN: Thank you.
19 Q. (BY MR. HEYMAN) Mr. Pignatelli, would you
20 please provide the Commission and parties here with some
21 of your direct and rebuttal testimonies.
22 A. Yes, I will.
23 By way of background, I came to TEP in 1994.
24 And our prices are 2 percent lower than when I joined
25 the company. I was elected chairman in 1998. So

12

BEFORE THE ARIZONA CORPORATION COMMISSION

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Prepared for:

1 edge of poverty in a manner that would allow those costs
2 to potentially escalate out of control automatically? I
3 mean, that kind of automatic, in my mind, virtually
4 unchecked pass-through to customers?
5 A. I would have a concern about that, certainly.
6 Q. And what -- in terms of how we should be -- let
7 me just say this. As you know, I think this is an
8 important part of this settlement agreement, and will be
9 an important part of my decision-making on it. But it
10 seems to me that this is the first time, unless I'm wrong,
11 unless I'm not thinking of something, that such a
12 provision to completely hold low income customers harmless
13 from a rate increase has been enacted or could potentially
14 be enacted by the Commission; is that right?
15 A. That's my understanding as well, yes.
16 Q. And have you seen it done in other states?
17 A. I have not in recent times seen it done in other
18 states, no.
19 Q. And do you think it's something that the
20 Commission should look at in other rate cases?
21 A. Absolutely. We would definitely support on an
22 ongoing basis holding the low income customers harmless.
23 You know, and I appreciate the pressures that the company
24 is facing and the other utility companies face, but the
25 reality is when low income customers can't pay their

13

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By: MICHELE E. BALMER
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Certificate No. 50489

Prepared for:

1 Q. Okay. I will ask him.
2 A. I have a hard enough time remembering my own
3 numbers, let alone his.
4 Q. And you said at one point in your testimony, you
5 said that TEP, I guess absent this agreement or without
6 this agreement and the things that are contained in it,
7 would see a 52 percent rate increase? Really?
8 A. I said if we went to market for our generation,
9 our current estimate is that would require a 52 percent
10 rate increase. Would I seek it?
11 Q. You wouldn't really want to --
12 A. I have more empathy for my customers than that.
13 Q. That was my question, because I thought that was
14 surprising.
15 A. No. I just wanted to put it in perspective of
16 what my reading of the 1999 settlement produced.
17 Would I ask for that? I would not do that to my
18 customers. That's why we agreed to the 6 percent base
19 with a fuel clause.
20 Q. Okay. Have you had a chance to think about the
21 Renewable Energy Standard rules issue and adoption?
22 A. Mr. Heyman will give you that answer. I didn't
23 have a chance to talk to him.
24 Q. Oh, you didn't?
25 A. No, not on that subject.

14

BEFORE THE ARIZONA CORPORATION COMMISSION

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By: MICHELE E. BALMER
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Prepared for:

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7 I don't know what RUCO wants. I don't know today
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10 behalf of the very constituency that it represents.
11 I find the RUCO position short-sighted in that
12 RUCO would seem to prefer continued litigation over
13 resolution; would seem to prefer rate instability over
14 rate stability; would potentially expose residential
15 customers to market generation price volatility. And
16 there's some debate here today as to what TEP's exposure
17 is, but the reality of it is there would be exposure. The
18 magnitude is something we can quibble over. I find the
19 RUCO position inconsistent with the interests of
20 residential customers.
21 It seems that the RUCO position would overlook
22 the hold harmless provision in the settlement as it
23 relates to low income customers. It would overlook the
24 rate stability associated with the four-year moratorium.
25 It would overlook the low income exemption for the PPFAC.

1 It would overlook the confirmation of cost of service
2 ratemaking treatment.
3 I find the RUCO position inconsistent with the
4 public interest. It would seem to prefer continued
5 litigation, I might add likely years of litigation,
6 increased litigation costs, which I don't know how that's
7 beneficial to any body of ratepayers, particularly
8 residential ratepayers.
9 It would create the potential for an adverse
10 ruling in an appellate environment, wherein whatever
11 decision this Commission rendered could be determined to
12 be unlawful. It could, in fact, expose TEP's customers to
13 market pricing for generation, which would in all
14 likelihood be higher than that associated with cost of
15 service. I don't think it's in residential customers'
16 best interests to be subject to the volatility of the
17 marketplace. I just don't.
18 You know, the RUCO position would seem to
19 overlook and, in fact, encourage the loss of benefits that
20 this settlement would provide to residential customers.
21 Q. Thank you. I'm going to move away from the RUCO
22 position and just touch upon some other issues that I
23 think there may be some disagreement among the parties,
24 and one of them is the disposition of the fixed CTC
25 true-up.

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

Date: July 16, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI
(Pages 1038 through 1091, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 prices have risen just recently, but I think from a
2 historical standpoint that's probably true.
3 Q. Would you agree that ratepayers would be exposed
4 to that difference if TEP's market rate proposal were to
5 be adopted either by the Commission or a court?
6 A. That's possible. Again, I think that that would
7 also hinge on whether or not TEP could actually do that.
8 Q. The price of power at a gas-fired generating
9 plant is subject to volatility related to the price of
10 natural gas; is that correct?
11 A. Yeah, assuming that you're buying on the spot
12 market.
13 Q. Would you agree that the settlement agreement
14 forecloses the potential risk to ratepayers of the market
15 pricing of TEP's generation assets by adopting cost of
16 service regulation?
17 A. Yes. Certainly, we would be more comfortable
18 with cost of service rates.
19 Q. And so you support cost of service regulation?
20 A. Yes.
21 Q. Mr. Rigsby, if TEP's market-based rate proposal
22 were to have been approved, would you agree with me that
23 there would be no reason for RUCO to oppose retail
24 competition?
25 A. I'm sorry. Would you state that again, please?

15

ORIGINAL

BEFORE THE ARIZONA CORPORATION C

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and 15 copies of the foregoing filed this 29th day of May, 2008 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Arizona Corporation Commission
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c. The RCDAC rate schedule shall identify the individual components of the potential charge, definitions of the components, and a general framework that describes the way in which the RCDAC would be calculated.

d. The RCDAC shall only be established to recover from Direct Access customers the additional costs, both one-time and recurring, that these customers would otherwise impose on other Standard Offer customers if and when the former return to Standard Offer service from their competitive suppliers. The customers shall pay the RCDAC in full within one year of the RCDAC being assessed.

13.2 The Signatories agree that a RCDAC as described above is in the public interest and should be adopted.

XIV. 1999 SETTLEMENT AGREEMENT.

14.1 The Signatories recognize that Decision No. 62103 and the 1999 Settlement Agreement were designed to allow a transition to retail electric competition within a specific time period. Inasmuch as the transition to retail electric competition has thus far not occurred and the time periods applicable to Decision No. 62103 and to the 1999 Settlement Agreement have passed, the Signatories recognize that it is necessary to address the prospective regulatory treatment that is appropriate for TEP under these circumstances.

14.2 To the extent that any party to the 1999 Settlement Agreement or any other party contends that the provisions of this Agreement are inconsistent with Decision No. 62103, the Signatories request that the Commission amend Decision No. 62103 to be consistent with this Agreement.

14.3 Under the circumstances in which TEP currently operates, it is appropriate to determine TEP's rates pursuant to cost-of-service ratemaking principles.

14.4 Upon the Commission's issuance of a final, non-appealable order approving this Agreement, TEP shall forego all claims relating to any alleged breach of contract resulting from or related to the 1999 Settlement Agreement and/or Decision No. 62103.

14.5 Upon the Commission's issuance of a final, non-appealable order approving this Agreement, TEP shall not seek to recover, in this or any subsequent proceeding, any amount that it claims is attributable to its alleged damages allegedly related to setting its rates under cost-of-service ratemaking principles.

14.6 Upon the Commission's issuance of a final, non-appealable order approving this Agreement, TEP shall not seek to recover, in this or any subsequent proceeding, any amount that it claims is attributable to any alleged damages allegedly related to the rate freeze adopted by the Commission in Decision No. 62103.

14.7 Upon the Commission's issuance of a final, non-appealable order approving this Agreement, TEP shall forego any and all claims related in any way to Decision No. 62103 or the 1999 Settlement Agreement.

14.8 Upon the Commission's issuance of a final, non-appealable order approving this Agreement, each Signatory hereby releases and forever discharges each other Signatory and the Commission from any and all claims, actions, and demands, of any nature whatsoever, past or present, whether arising out of any Commission order, statute, regulation, breach of contract, or any other theory, whether legal or equitable, including any claims, losses, costs or damages, in each case whether known or unknown, which such other Signatory or the Commission ever had, now have, or may in the future claim to have,

arising from or pertaining to the 1999 Settlement Agreement and Decision No. 62103.

14.9 The Signatories recognize that certain waivers were provided to TEP under the 1999 Settlement Agreement. As these waivers were previously evaluated in the context of the then-contemplated transition to competition, they may not continue to be in the public interest. The Signatories agree that TEP shall file an application with the Commission addressing all of these waivers within ninety (90) days of the issuance of a Commission order approving this Agreement. In that proceeding, the Commission shall evaluate whether these waivers remain appropriate.

XV. FIXED CTC TRUE-UP REVENUES.

15.1 Certain issues related to the Fixed CTC True-up revenues remain unresolved by this Agreement, and the Signatories agree to present their respective positions in the hearing scheduled in this proceeding. Specifically, the Signatories shall present to the Commission their respective positions as to when TEP's new rates may go into effect and how TEP's Fixed CTC True-up revenues, as defined in Decision No. 69568, should be calculated and treated. The Signatories may present evidence to the Commission in the hearings scheduled in these consolidated dockets regarding these issues. This provision is not intended to limit any party's ability to present its position on these issues.

15.2 To the extent that the Commission determines that any Fixed CTC True-up revenues are to be credited to customers, then TEP agrees that an amount equal to any such Fixed CTC True-up revenues, up to $32.5 million, shall be credited to customers in the PPFAC balancing account.

15.3 The Commission shall determine the disposition of additional Fixed CTC True-up revenues, if any, to be credited to customers.

16

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
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Direct Testimony in Support of the Settlement Agreement

James S. Pignatelli

On Behalf of

Tucson Electric Power Company

June 11, 2008

Also, upon issuance of a final non-appealable order approving the settlement agreement the signatories thereto will release each other from any claims arising under the 1999 Settlement Agreement and Decision No. 62103. Finally, TEP will file within 90 days of the decision approving the settlement agreement an application to update the waivers that were set forth in Decision No. 62103.

This provision addresses claims and litigation under the 1999 Settlement Agreement and allows TEP, the Commission and the parties to move beyond the 1999 Settlement Agreement and into the future

L. Rate Design.

Q. Mr. Pignatelli, please provide an overview of the rate design provisions of the settlement agreement.

A. Mr. Dukes' testimony provides support and detail regarding the individual rate design provisions in the settlement agreement. Let me say that rate design was a significant part of the settlement agreement negotiations. From TEP's standpoint, we were looking to implement rate design concepts that are conservation-oriented and customer friendly. We believe that we will be able to accomplish those goals through provisions of the settlement agreement that establish: (i) an inclining block structure for residential and smaller general service customers (normally under 200 kW) whereby the incremental price increases with usage; (ii) three new optional residential time-of-use programs whereby customers can save money by conserving energy and shifting usage to the off-peak period; (iii) a time-of-use education program designed and administered by TEP; (iv) low-income residential programs that hold low-income customers harmless from the rate increase and exempt from the PPFAC; (v) expanded time-of-use programs for larger commercial and industrial customers; (vi) increased demand charges for larger

BEFORE THE ARIZONA CORPORATION COMMISSION

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By: MICHELE E. BALMER
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Certificate No. 50489

Prepared for:

1 approval by the Commission.
2 So I want to make sure the record is clear there
3 as well, because I know it's been confusing between APS,
4 UNS Electric, and TEP.
5 Q. Mr. Johnson, do you have anything else that you
6 wish to add?
7 A. Yes, I do. By way of final comments before I'm
8 thrown to the lions, I would just like to say a couple of
9 things, and I want to state this with all sincerity. I am
10 pleased to be here today, even in this relatively short
11 chair, even too short for me, in support of the settlement
12 agreement.
13 Staff supports this agreement because this
14 agreement provides opportunity; opportunity to move
15 forward; opportunity to resolve highly contested issues;
16 opportunity to protect those who are most in need;
17 opportunity to stabilize rates for TEP's customers in a
18 fair and reasonable manner; an opportunity to balance many
19 diverse interests, including those of TEP in its need for
20 additional revenues; an opportunity for customers to have
21 additional options such as additional time-of-use options;
22 an opportunity for power marketers to seek to compete in
23 TEP's service territory.
24 I cannot state how strongly we urge adoption of
25 the settlement agreement. That would be the conclusion of

17

BEFORE THE ARIZONA CORPORATION COMMISSION

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16 there's some debate here today as to what TEP's exposure
17 is, but the reality of it is there would be exposure. The
18 magnitude is something we can quibble over. I find the
19 RUCO position inconsistent with the interests of
20 residential customers.
21 It seems that the RUCO position would overlook
22 the hold harmless provision in the settlement as it
23 relates to low income customers. It would overlook the
24 rate stability associated with the four-year moratorium.
25 It would overlook the low income exemption for the PPFAC.

1 It would overlook the confirmation of cost of service
2 ratemaking treatment.
3 I find the RUCO position inconsistent with the
4 public interest. It would seem to prefer continued
5 litigation, I might add likely years of litigation,
6 increased litigation costs, which I don't know how that's
7 beneficial to any body of ratepayers, particularly
8 residential ratepayers.
9 It would create the potential for an adverse
10 ruling in an appellate environment, wherein whatever
11 decision this Commission rendered could be determined to
12 be unlawful. It could, in fact, expose TEP's customers to
13 market pricing for generation, which would in all
14 likelihood be higher than that associated with cost of
15 service. I don't think it's in residential customers'
16 best interests to be subject to the volatility of the
17 marketplace. I just don't.
18 You know, the RUCO position would seem to
19 overlook and, in fact, encourage the loss of benefits that
20 this settlement would provide to residential customers.
21 Q. Thank you. I'm going to move away from the RUCO
22 position and just touch upon some other issues that I
23 think there may be some disagreement among the parties,
24 and one of them is the disposition of the fixed CTC
25 true-up.

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 11, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME III
(Pages 395 through 576, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 don't know where you get your $78 million, but I will be
2 referring to a number of approximately $66 million.
3 And I think the question that you're posing to
4 me, you're asking me can I apply some percentage to how
5 much of that would be directly associated with the threat
6 of litigation. And the answer would be no, because I'm
7 not able to -- the settlement agreement was not simply
8 based upon the threat of litigation.
9 It was also associated with the benefits that we
10 believe inure to the customers such as a four-year rate
11 moratorium, which equates to rate stabilization, such as a
12 limited increase, such as the exemption for low income
13 customers from any ill effects of this rate increase, but
14 for DSM and the REST rules.
15 It's interesting that that also includes an
16 exemption for those same low income customers that you
17 represent from the effects of the PPFAC.
18 Q. Let me be clear So you're aware. When I was
19 talking about the $78 million, I took the 136.7 and I
20 subtracted the 60 million, which was the lower end, and I
21 did get 78. I guess it would be 76.7. But for the sake
22 of argument, we can use either the 66 or the 76. I don't
23 care.
24 If I were to ask you to apply that same question
25 to the issue of the rate moratorium, would your answer be

18

BEFORE THE ARIZONA CORPORATION COMMISSION

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At: Tucson, Arizona

Date: July 9, 2008

Filed: July 14, 2008

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VOLUME I
(Pages 1 through 191, inclusive.)

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Suite 502
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By: COLETTE E. ROSS
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1 can we do that? Well, probably the way we did it since
2 1999. Our customers will still have the ability to go
3 to alternative providers. But I believe, after looking
4 at what we need, that this will provide the cash flow
5 and the revenues which we need to fairly treat our
6 customers, to fairly treat our employees, to attract and
7 retain the best qualified employees, to replace all
8 these linemen that we are going to need to replace over
9 the next five to ten years. This industry is going to
10 see a real turnover in qualified people. And we need to
11 have wages that we can attract these people. Otherwise
12 we will all suffer.
13 My shareholder will see benefits. They will see
14 a benefit because we will avoid costly, time consuming
15 litigation and risk. They will see more regulatory
16 certainty, and that provides predictability and gives
17 investor confidence. It facilitates investment. We all
18 should be happy when we have regulatory certainty
19 because then all of us will be able to do our jobs in a
20 much easier fashion.
21 It provides a fuel clause without which we could
22 not settle. It provides reasonable base rates which is
23 important to us as a company. It provides adequate cash
24 flow for us to embark on, over the next four years
25 capital expenditures of $1.2 billion. Our cap ex is up

19

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1 welfare of the community.
2 Q. In my opening statement I referred to the
3 portion of the Arizona State Constitution which refers
4 to the task of this Commission to, amongst other things,
5 help ensure the safety of the employees of public
6 service corporations. Can you describe for the
7 Corporation Commission how the requested rate relief
8 would have that residual effect, which is to help ensure
9 the safety of the employees of Tucson Electric?
10 A. Well, we will always and have always operated
11 this system with the safety of our employees paramount.
12 We will not let an employee work in an unsafe
13 environment. I am very proud of our safety record.
14 But there is a constant need for improvement in
15 aging transmission and distribution facilities that have
16 to be upgraded so that it preserves that safe working
17 environment. And our system is, with the additional
18 power demands of existing customers as well as infill,
19 our system is getting harder and harder to operate in a
20 safe and reliable manner. And this settlement will give
21 us the cash flow to ensure that we can put the necessary
22 modification into the system to continue that safe and
23 reliable operation.
24 Also it is incumbent upon us to always provide
25 our employees with the tools which allow them to work in

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By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 but we will have challenges integrating renewables into
2 the system. They have a different challenge in operating
3 the system. So it's really maintaining a flexible
4 operating system with trained people.
5 Those are the challenges that I see.
6 Q. Okay. And so at the beginning of your testimony
7 yesterday, you were making comments about RUCO's position,
8 and so I got the impression from your comments that this
9 was -- the settlement agreement was sort of a bare bones.
10 It was like the minimum that you think that you need to
11 manage in the next five years.
12 Is that an accurate description?
13 A. That is very accurate. I'm sitting here and
14 saying that to the best to my knowledge, to the best of my
15 experience, 45 years in the business, I, at a minimum,
16 need the 6 percent, plus the fuel costs, to operate, to
17 expand, to run a safe, reliable system that the public
18 here desires.
19 Q. But you think that you can do it with this, that
20 the settlement agreement will let you meet all of these
21 challenges for the next five years?
22 A. The settlement agreement provides me with the
23 minimum necessary to accomplish it. And I'm here saying
24 that based on 45 years and my knowledge of this system, I
25 can accomplish that with this settlement agreement. An

1 adjustment downward, I cannot accomplish that. And you
2 might say, you mean a million dollars and you can't do it?
3 I'm just telling you I'm at the bottom.
4 Q. Questions that I have about the low income
5 tariff, is that Mr. Dukes or --
6 A. I can talk philosophically about low income
7 tariffs.
8 Q. These are more in terms of the revenue that you
9 would be losing from low income, how much revenue that you
10 were giving up from the low income or being shifted to the
11 other users.
12 A. How much is being shifted. I would prefer that
13 you ask Dallas Dukes that. Because it's not just the low
14 income, it's the Lifeline, and it's at what point does
15 anybody that's not getting the 6 percent rate increase
16 plus the fuel clause, or what is the shift point that
17 you're -- I can tell you on 17,000 customers, that's the
18 5 percent that are low income. It's probably not a big
19 number, but I think your question is broader. How much of
20 a revenue shift to the inverted blocks are we doing in
21 this rate design.
22 Q. Okay. And so then part of this agreement has a
23 cost recovery asset of $14.2 million. Are you familiar
24 with that?
25 A. Yes, ma'am.

20

BEFORE THE ARIZONA CORPORATION COMMISSION

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5 and the revenues which we need to fairly treat our
6 customers, to fairly treat our employees, to attract and
7 retain the best qualified employees, to replace all
8 these linemen that we are going to need to replace over
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10 see a real turnover in qualified people. And we need to
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13 My shareholder will see benefits. They will see
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15 litigation and risk. They will see more regulatory
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19 because then all of us will be able to do our jobs in a
20 much easier fashion.
21 It provides a fuel clause without which we could
22 not settle. It provides reasonable base rates which is
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Certificate No. 50489

Prepared for:

1 A. Well, the settlement contemplates the answer to
2 that would be no.
3 Q. Okay. But in a normal environment, okay, let's
4 take the years 2013 to 2016. The adjustor mechanism is in
5 place and you're passing through all costs associated with
6 fuel and purchased power.
7 Does the Commission have an opportunity, unless
8 you come in for a rate case, to look at your other costs?
9 A. If we don't come in for a rate case, the
10 Commission can always order us in for a rate case. I'm
11 just saying that there's no requirement under the
12 settlement agreement for us to file a rate case.
13 Q. So the answer is no?
14 A. Well, I think you would probably -- we would
15 probably come in, because I don't see a diminution of our
16 costs going forward. I don't see O&M decreasing between
17 2006, which we're setting this on, and 2013. I don't see
18 my interest costs going down between 2006 and 2013. I
19 don't see my pension costs going down. So more than
20 likely we'll be in, unless we're damn good stewards and
21 can figure out some way to reduce costs.
22 Q. Okay. Well, let's say it takes a year or two for
23 the Commission to process. Let's say you're right and you
24 do come in. You might not be right, though, correct? You
25 might not come in for a couple of years. Is that

22

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Prepared for:

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1 just a minute and go to Mr. Enoch to make sure I get him
2 in today.
3 MR. ENOCH: That's fine.
4 ALJ RODDA: He knows I will come back to him.
5 MR. ENOCH: Thank you, Judge Rodda, members of
6 the Commission.
7
8 CROSS-EXAMINATION
9
10 Q. (BY MR. ENOCH) Good afternoon, Mr. Pignatelli.
11 A. Good afternoon.
12 Q. I have a few questions for you today. We have
13 spent a lot of time today discussing and you have -- or
14 actually I haven't but you have -- various costs that
15 are projected to increase for Tucson Electric moving
16 forward, namely fuel and methods of generation. But you
17 have other costs that are also going up in the years to
18 come, right, other ones?
19 A. That's correct.
20 Q. And namely, if I recall when you testified last
21 at the Commission, you had a nice chart moving up that
22 showed projections of such costs, including benefits for
23 employees including healthcare expense. Do you recall
24 that?
25 A. Yes.

1 Q. And should I assume that since you last
2 testified there hasn't been any downward projection in
3 where those expenses are moving forward?
4 A. There have not been any downward projection in
5 the cost of benefits.
6 Q. Okay. And, likewise, during the period of the
7 moratorium period moving forward, those healthcare
8 expenses, those are not going to be flat lined by any
9 means, are they?
10 A. No.
11 Q. Can you describe for the Commission how the
12 requested rate relief set forth in the settlement
13 agreement will enhance Tucson Electric's ability to
14 attract and retain highly skilled employees?
15 A. Yes, the increased revenue, the 6 percent as
16 well as the protections for cash flow provided by a fuel
17 clause. And that's the, you know, major component of
18 expenses. To the extent that we have those, we feel
19 that we will be able to meet market prices for new
20 labor.
21 Our philosophy, as you well know, is to pay a
22 market rate. And our employees have been very
23 responsive to understanding and working with us. Our
24 employees have not received an increase in over 15 years
25 of more than 3 percent during the year, maybe 3 and a

1 half percent, but the majority have been 3 percent.
2 They have been very cooperative and they understood and
3 understand everything that we have to do to act in the
4 public interest.
5 And I would expect that the market rates for
6 qualified employees in this segment of the industry is
7 going to go up. We have a drastic need for, not only
8 us, the entire industry, for trained linemen, you know,
9 journeymen linemen. And there is just a shortage. And
10 I would anticipate that the market price for these
11 individuals is going to go up and is going to put upward
12 pressure, but we feel that with the 6 percent increase
13 and the protection on the fuel that we will be able to
14 accommodate those demands.
15 Q. Along those lines, can you describe to the
16 Commission how the patrons of Tucson Electric, and I had
17 focused on the residential customers as ratepayers, how
18 do they benefit from Tucson Electric's ability to
19 attract and maintain a highly skilled work force?
20 A. Come out with me about midnight in the driving
21 rain and you will answer that question for yourself.
22 A highly skilled work force is more efficient.
23 It is more dedicated. They become a part of the
24 community. They provide an essential service to the
25 community. And they are fundamental to the health and

1 welfare of the community.
2 Q. In my opening statement I referred to the
3 portion of the Arizona State Constitution which refers
4 to the task of this Commission to, amongst other things,
5 help ensure the safety of the employees of public
6 service corporations. Can you describe for the
7 Corporation Commission how the requested rate relief
8 would have that residual effect, which is to help ensure
9 the safety of the employees of Tucson Electric?
10 A. Well, we will always and have always operated
11 this system with the safety of our employees paramount.
12 We will not let an employee work in an unsafe
13 environment. I am very proud of our safety record.
14 But there is a constant need for improvement in
15 aging transmission and distribution facilities that have
16 to be upgraded so that it preserves that safe working
17 environment. And our system is, with the additional
18 power demands of existing customers as well as infill,
19 our system is getting harder and harder to operate in a
20 safe and reliable manner. And this settlement will give
21 us the cash flow to ensure that we can put the necessary
22 modification into the system to continue that safe and
23 reliable operation.
24 Also it is incumbent upon us to always provide
25 our employees with the tools which allow them to work in

BEFORE THE ARIZONA CORPORATION COMMISSION

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Certificate No. 50489

Prepared for:

1 adequate to meet our capital needs and to provide any
2 short-term funding that's required for shortfalls in
3 our -- any shortfalls in our balancing accounts.
4 I think we have a great need in the next five
5 years to replace an aging workforce. We have a challenge
6 currently and it will continue over the next five years of
7 continuing to operate this system as effectively as we
8 have. It's an aging distribution system, an aging
9 transmission system.
10 We are at the limits of our flexibility to switch
11 between circuits, so we have to have extensive investment
12 in plant and equipment just to continue to be able to
13 operate the system as we currently do. We have aging
14 transformers that we have programmed to replace, but
15 frankly, the large transformers are very hard to obtain.
16 They're a long lead time, and we've had two failures of
17 brand new transformers when they came in. These are
18 $5 million transformers. We're facing much similar demand
19 as other utilities, so there's a huge competition for
20 people, resources and for equipment.
21 I don't see a big pressure caused by the new
22 hook-ups. Our projection of new customer growth is in the
23 2 percent range, and I think that's manageable. What
24 aggravates it is because we're such a spiky peak. It's
25 really the extra one and a half percent growth that's in

1 per customer usage, and that's what is putting an
2 inordinate strain on the existing system. It's not so
3 much the new people coming on. It's the more usage by the
4 existing customers.
5 There's going to be a huge issue with getting
6 permits to build the appropriate transmission that's
7 needed. It's not going to be a pleasant thing in this
8 community.
9 So I'm not concerned about the acquisition of
10 generation. I'm not concerned, I mean, being able to buy
11 it in the marketplace. I think we do still have a little
12 bit of a surplus from the merchants in the marketplace.
13 But I'm more concerned with the transmission and
14 distribution of that, the replacement of people, the
15 replacement of aging infrastructure. And then when you
16 get to outside the five-year horizon, then you start
17 talking about generation. We need new generation.
18 To the extent we have to modify -- I shouldn't
19 say it that way. Well, to the extent that we economically
20 are encouraged to change generation mix because of
21 government policies, that will be a challenge also. And
22 what is the right solution to that, we all have different
23 opinions on that.
24 I think we will have challenges -- and this is
25 not to say that I don't think we should be pursuing them,

23

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
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Direct Testimony in Support of the Settlement Agreement

James S. Pignatelli

On Behalf of

Tucson Electric Power Company

June 11, 2008

risk, helping to ensure that the Company's financial condition is not jeopardized, which also can be beneficial to our customers. Further, the uncertainty regarding the disposition of the 1999 Settlement Agreement is resolved through the settlement agreement. This will avoid the costly expense of time and money in litigating disputed issues surrounding the 1999 Settlement Agreement and eliminate the risk to TEP's customers that generation service rates would be determined through a more expensive market methodology.

And. finally, a financially improved TEP will mean that the Company will have adequate cash flows and will be able to continue to provide its customers with a high level of service and plan for the future by investing in distribution, transmission and generation facilities.

Q. Mr. Pignatelli, please explain the benefits that the settlement agreement provides for TEP's employees.

A. In order for TEP to be able to attract and retain the best qualified employees, we must be able to afford to pay them competitively. In order for the employees to be able to perform at a high level and safely, they must have proper manpower, training and equipment. As I have repeatedly stated, without rate relief TEP would not be able to maintain current levels of service. While we would never jeopardize the safety of our employees, we would have to scale back crews, projects and capital investments. With the rate relief provided in the settlement agreement, we believe that we can maintain our high standards of service and continue to be a safe and desirable Company that attracts and keeps the best employees.

24

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Prepared for:

1 Q. Okay. I will ask him.
2 A. I have a hard enough time remembering my own
3 numbers, let alone his.
4 Q. And you said at one point in your testimony, you
5 said that TEP, I guess absent this agreement or without
6 this agreement and the things that are contained in it,
7 would see a 52 percent rate increase? Really?
8 A. I said if we went to market for our generation,
9 our current estimate is that would require a 52 percent
10 rate increase. Would I seek it?
11 Q. You wouldn't really want to --
12 A. I have more empathy for my customers than that.
13 Q. That was my question, because I thought that was
14 surprising.
15 A. No. I just wanted to put it in perspective of
16 what my reading of the 1999 settlement produced.
17 Would I ask for that? I would not do that to my
18 customers. That's why we agreed to the 6 percent base
19 with a fuel clause.
20 Q. Okay. Have you had a chance to think about the
21 Renewable Energy Standard rules issue and adoption?
22 A. Mr. Heyman will give you that answer. I didn't
23 have a chance to talk to him.
24 Q. Oh, you didn't?
25 A. No, not on that subject.

25

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
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

Rebuttal Testimony of

James S. Pignatelli

on Behalf of

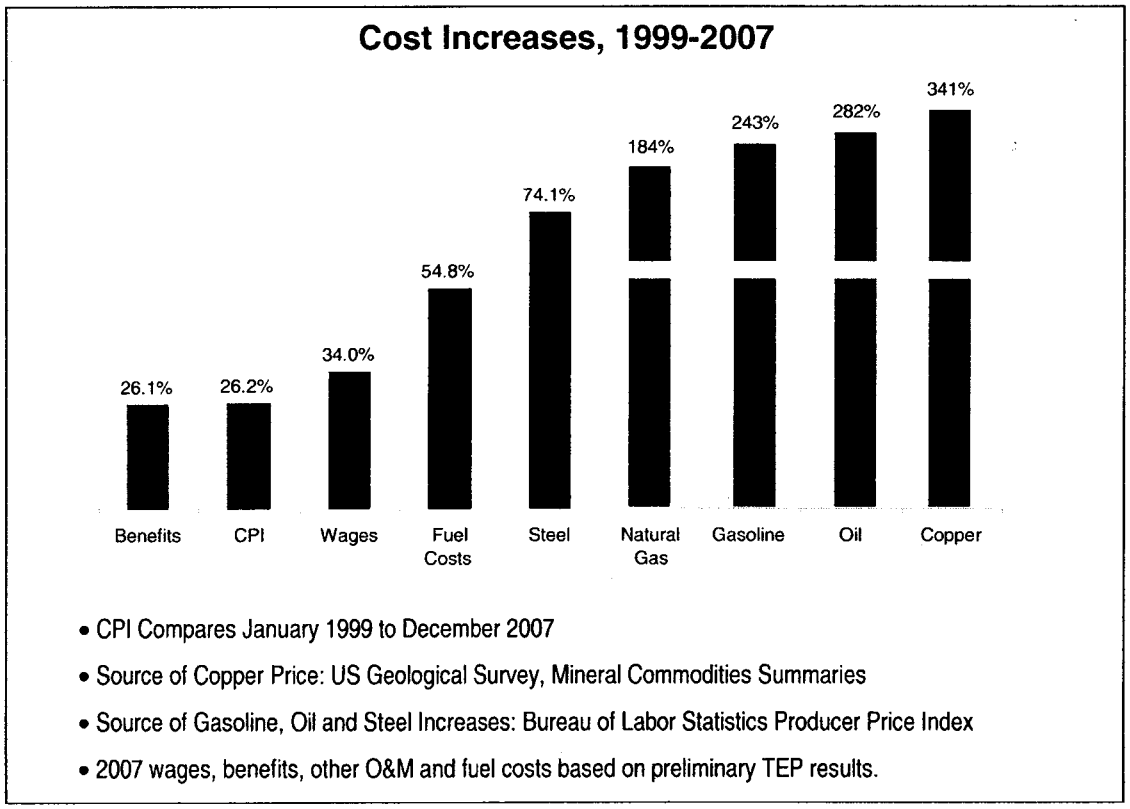
Tucson Electric Power Company

April 1, 2008

While TEP's rates have been frozen, the average retail rates charged by Arizona Public Service ("APS") increased 14 percent. The rates charged by Salt River Project ("SRP") increased 25 percent during that period, while the average U.S. investor-owned electric utility increased rates nearly 32 percent. TEP's residential rates, meanwhile, were 11 percent lower than those of APS and 2 percent lower than those of SRP at the end of 2007. If TEP does not receive adequate rate relief, this disparity is set to increase even further. APS has recently sought an additional 8 percent increase, while SRP's Board of Directors recently approved an average 3.9 percent rate increase that will take effect May 1.

Q. Has TEP faced similar cost increases to those experienced by APS and SRP?

A. Yes. While I cannot speak to specific expenses incurred by APS and SRP, all three utilities have faced rising market costs for wages and benefits, fuel, materials and other business needs since the 1999 Settlement Agreement was signed, as is generally shown in the following table:



In light of these rising costs, and the rate increases granted to other electric utilities to address them, I do not see how anyone could conclude that a reduction of TEP's long-frozen base rates would be either just or reasonable.

Q. How might a decision to accept the recommendations of Commission Staff and Intervenors be received by the financial and investment communities?

A. A decision to rescind the 1999 Settlement Agreement without any compensation to the Company – as the Commission Staff and Intervenors have recommended – would likely lead potential investors or lenders to view any authorization or commitment by the Commission or other agency of the State of Arizona to be illusory. Such disregard for a prior contractual commitment would serve to discourage investors or lenders from doing business with TEP and other Arizona utilities or companies, thus hampering the state's

26

BEFORE THE ARIZONA CORPORATION COMMISSION

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Rebuttal Testimony of

James S. Pignatelli

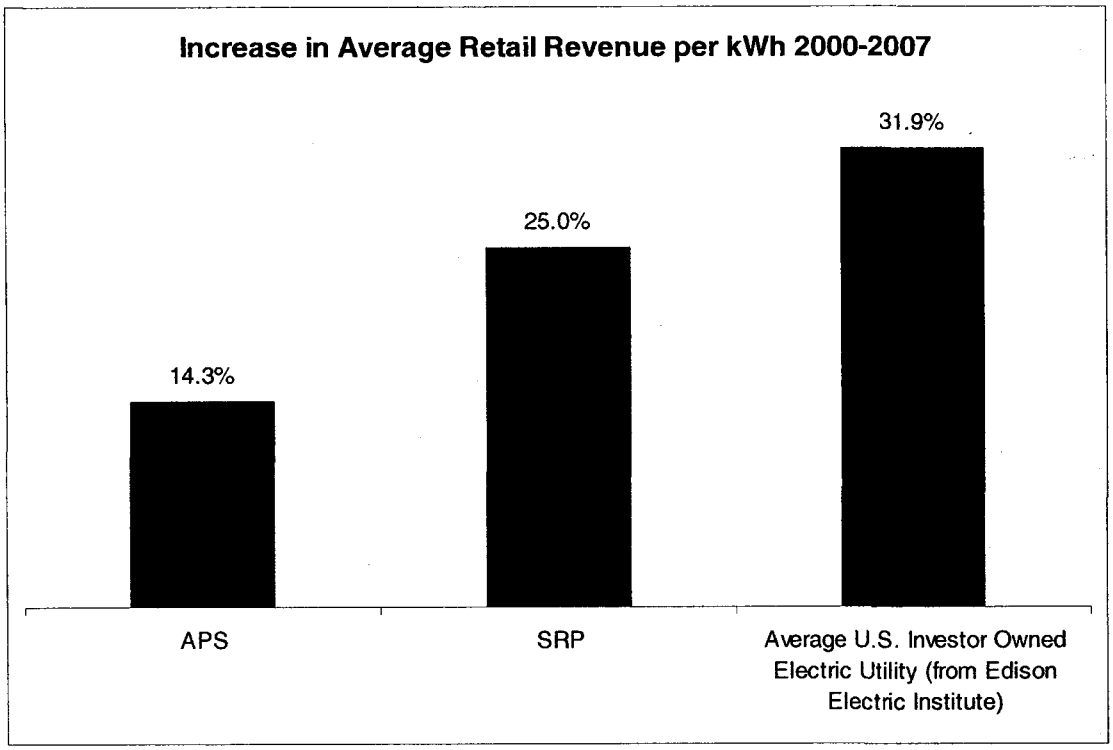
on Behalf of

Tucson Electric Power Company

April 1, 2008

If TEP is not allowed to charge a market rate for generation or if significant rate relief does not occur, then these plans will have to be scaled back, operating expenses will have to be further reduced and the reliability of TEP's service will undoubtedly suffer. The Company's credit ratings for its unsecured debt, which are currently rated as speculative or below investment grade by Standard and Poor's and Fitch Ratings, Inc., could face further reductions due to weaker financial indicators. This would drive up TEP's borrowing costs at the very time that a lack of adequate cash flow would force the Company to make heavier use of debt to fund its most dire capital needs. A rate reduction would serve only to exacerbate these problems, further eroding the significant value that TEP customers derive from the reliability of their service.

I think it is informative to look at the rate relief that Arizona's two other major electric utilities received from 2000 through 2007:



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27

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 16, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI
(Pages 1038 through 1091, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 Q. All right. Do you have a copy of the settlement
2 agreement in front of you?
3 A. Yes, I do.
4 Q. I would like you to turn to the table of contents
5 on the settlement agreement, which appears to be the
6 second physical page. And what I'm trying to do with my
7 series of questions, Mr. Rigsby, is to see if I can pull
8 together so I understand exactly what RUCO's position is
9 at this point in the proceeding and what it's asking Judge
10 Rodda and the Commission to do.
11 So looking at the table of contents, I'm going to
12 take you down each of the indicated subjects which refer
13 to different sections of the settlement agreement, and ask
14 you what RUCO's position is with regard to that subject.
15 Background really isn't relevant, so let's start
16 with Section 2. What is RUCO's position on the rate
17 increase proposed by the settlement agreement?
18 A. Well, as I have said, I think that our -- well,
19 our position is that we think it's somewhat high.
20 Q. And does RUCO then oppose the proposed rate
21 increase provided for in the settlement agreement?
22 A. Yes.
23 Q. And can you quantify in terms of dollars what the
24 amount difference is between the increase in revenues that
25 RUCO would support versus what the settlement agreement

28

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 proposes?
2 A. I don't know that I can give you an exact dollar
3 figure or percentage, but I think it would lie somewhere
4 between probably RUCO's original $36 million
5 recommendation and the 136 million that was adopted in the
6 settlement agreement.
7 Q. So that's a differential of approximately
8 $100 million?
9 A. Yes.
10 Q. Okay. Let's move to Section 3, ratemaking
11 treatment of TEP's generation assets and fuel costs. What
12 is RUCO's position with regard to what is provided for in
13 Section 3?
14 A. Well, of course, we would like to see those
15 placed in at original cost. And we've already had the
16 discussion on the Springerville unit.
17 Q. Well, Section 3 appears to provide for original
18 cost and cost of service ratemaking treatment, doesn't it?
19 A. Yes.
20 Q. Does RUCO support Section 3?
21 A. We would support original cost ratemaking
22 treatment.
23 Q. Are there any aspects of the provisions of
24 Section 3 that RUCO opposes?
25 A. Well, I already had the discussion with Judge

29

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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	SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 15, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME V
(Pages 795 through 1037, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 Q. And has RUCO investigated what rate increase
2 would have resulted if TEP's generation rates were to be
3 set at market rates starting January 2009?
4 A. No, we didn't, because I think there is some
5 debate on that point. And I think a lot of it goes back
6 to the Phelps Dodge court decision, which basically
7 stated that the Commission cannot abdicate its
8 constitutional responsibility to set rates on a finding
9 of fair value, that they can't leave that, they can't
10 leave that to the free market.
11 Q. Mr. Rigsby, you corrected the cover page of your
12 testimony to eliminate the phrase in opposition to?
13 A. Yes.
14 Q. Why did you do that? I haven't heard an
15 explanation yet.
16 A. At the time -- at the time we thought that would
17 be a more appropriate description of the testimony
18 because, as we have just discussed here, you know, there
19 are what we believe to be some benefits that are being
20 offered in this settlement agreement. And so if the
21 Commission were to make a, make a decision to make
22 changes to the settlement agreement, certainly there
23 were things in there that we wouldn't want them to,
24 wouldn't want them to eliminate.
25 So I guess what we were just simply trying to do

30

ORIGINAL

BEFORE THE ARIZONA CORPORATION CC

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and 15 copies of the foregoing filed this 29th day of May, 2008 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Arizona Corporation Commission
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MAY 29 2008
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XVI. RATE DESIGN.

A. Rate Spread.

16.1 Except as set forth in Paragraph 16.28, the base revenue increase is to be spread across all customers such that each rate schedule shall reflect the same increase of 6.1% in adjusted base revenues as shown on Exhibit 7. The 6.1% increase is the result of holding low-income customers harmless from the rate increase. Selected rate schedules are attached as Exhibit 8.

16.2 This increase also applies to TEP's existing time-of-use schedules, which will be frozen to new subscription.

B. Inclining Block Rate Structure.

16.3 The Signatories agree that rate design can be used as an important energy conservation incentive. To accomplish this goal for the Residential Rate 01 service classification, the rate structure shall be redesigned as an inclining block rate, meaning that the unit price of electricity, excluding the customer charge, shall increase as consumption increases.

16.4 Residential Rate 01 shall have three blocks and shall be seasonally (summer/winter) differentiated with the first block applicable to kWh usage from 0 to 500 kWhs. The second block will be for usage of the next 3,000 kWhs or 501 kWhs to 3,500 kWhs. The third block will be for usage above 3,500 kWhs.

16.5 This rate structure recognizes that there are a large percentage of users that have relatively small usage, while also recognizing that a relatively small amount of users use a relatively large amount of energy. For example, during the Summer Period for Residential Rate 01, 27% of all bills are for usage under 500 kWhs per month. For those customers, the average usage is only 280 kWhs per

month. In contrast, only 1.4% of all Residential Rate 01 bills contain usage above 3,500 kWhs. For these customers, the average usage is 4,766 kWhs per month.

16.6 General Service Rate 10 shall be redesigned to have an inclining block structure with two rates. The first rate shall apply to the first 500 kWhs per month, and the second rate for usage above 500 kWhs. Similar to Residential Rate 01, many General Service Rate customers are small users with 30% of the usage in this rate class falling under 500 kWhs. For these customers, average usage is approximately 200 kWhs.

C. Time-of-Use.

16.7 The Signatories agree that sending price signals to customers as to how TEP's cost to serve may change in different times of the year and times of the day provides an important energy conservation incentive. The Signatories therefore agree that expanding the availability of time-of-use rate schedules is in the public interest. All time-of-use rate schedules shall be available on an optional basis. Time-of-use will not be mandatory for any customer.

16.8 TEP will implement new time-of-use schedules that will be open for new subscription. Under newly implemented time-of-use rates, all residential, general service, large general service, and large light and power customers will be offered a time-of-use option.

16.9 TEP commits to design a program to educate customers on the potential for load shifting and bill reduction under time-of-use rates, and will make a good faith effort to promote time-of-use so as to increase subscription thereto.

16.10 TEP shall offer three new optional residential time-of-use schedules to replace the current (to-be-frozen) Rate 70. The customer charges under the three new rates will be $8.00 per month.

31

BEFORE THE ARIZONA CORPORATION COMMISSION

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Direct Testimony in Support of the Settlement Agreement

Dallas J. Dukes

on Behalf of

Tucson Electric Power Company

June 11, 2008

The attached Exhibit DJD-5 shows the potential bill impacts for customers with varying usage. Given the inclining block rate structure, the impact of the base rate increase agreed to in the settlement agreement will actually be less than 6.1% for residential customers with lower usage. The cost recovery charges for the DSM adjustor and the PPFAC adjustor will further increase the bill impact beyond the base rate increase. The DSM charge proposed in the settlement agreement is $0.000639 per kWh. The PPFAC rate will actually be set at zero until April 1, 2009. At that time, it will be adjusted pursuant to the PPFAC Plan of Administration. Using my hypothetical PPFAC rate of $0.004 (the actual PPFAC rate to be set in April 2009 (i) will depend on the Commission's resolution of this docket, (ii) may increase or decrease depending on the actual fuel and purchased power markets at the time the PPFAC rate is requested, and (iii) must be approved by the Commission prior to going into effect) and the proposed DSM charge, many lower usage residential customers will still see an overall bill impact of less than 6.1%, even including those cost recovery charges. However, given the inclining block rate structure, higher usage customers will see a bill impact greater than 6.1%. As shown in Exhibit DJD-5, the actual increase for a particular customer depends on actual usage.

In Exhibit DJD-5, the data is subdivided into ten deciles. Each decile represents 10% of bills issued to customers. The lowest decile represents the 10% of bills with the lowest usage. The highest decile represents the 10% of bills with the highest usage. As can be seen from the exhibit, over 50% of the bills are for customers with average usage below 705 kWh (the median usage for the residential class). Those customers' bills would increase by only 0.4% due to the increase in base rates. The residential customer base

has an average monthly usage of approximately 900 kWh. The bill of a customer using this average amount would increase 3.2% due to the base rate increase. Those residential customers would incur an additional amount to be determined by the Commission for the DSM and PPFAC charges. Using my hypothetical PPFAC charge and the proposed DSM charge, a median residential customer and an average customer would also have bill increases of 4.9% due to the payment of those cost recovery charges.

Q. Does TEP have substantial numbers of low-use customers?

A. Yes. The Exhibit DJD-5 shows that there are a few residential customers consuming disproportionate levels of kWh, and large numbers of customers consuming smaller quantities. That last 10% of customers alone account for almost 27% of residential usage. By encouraging the higher usage customers to conserve or pay a premium, we are able to keep over 50% of the customer base at or below the 6% increase level inclusive of the REST, DSM and an assumed PPFAC.

Q. Based on the data, how many residential customers use more than 3,500 kWh per month, on average?

A. Less than 2% of bills exceed this threshold. Under the settlement agreement, these customers will see increases of substantially more than the average 6% residential increase. While these customers are not required to reduce usage, the inverted block rate structure will send clear price signals that encourage conservation.

EXHIBIT

DJD-4

Potential Consumption at 500 kWh

Item	Usage Pattern or Information Source	Monthly kWh
19 cf top-freeze refrigerator - automatic defrost	1992 Refrigerator Guide (905 kWh/average plus 50% degradation due to age)	113
25 " color solid-state television	165 watts - 8 hours/day	40
Lighting	6 - 60 watts - 4 hours/day	43
4000 cfm evaporative cooler (high speed)	352 watts - 12 hours/day	127
4000 cfm evaporative cooler (low speed)	180 watts - 12 hours/day	65
Clock radio	10 watts - 8 hours/day	2
Microwave Oven	1500 watts - 10 minutes/day	8
Toaster	900 watts - 5 minutes/day	2
Vacuum Cleaner	1140 watts - 30 minutes/week	2
Electric Oven	3100 watts - 3 hours/week	40
Electric Range	1350 watts - 1 hour/day	41
Dishwasher	1180 watts - 3 hours/week	15
	Total Monthly Consumption	498

EXHIBIT

DJD-5

Exhibit DJD - 5

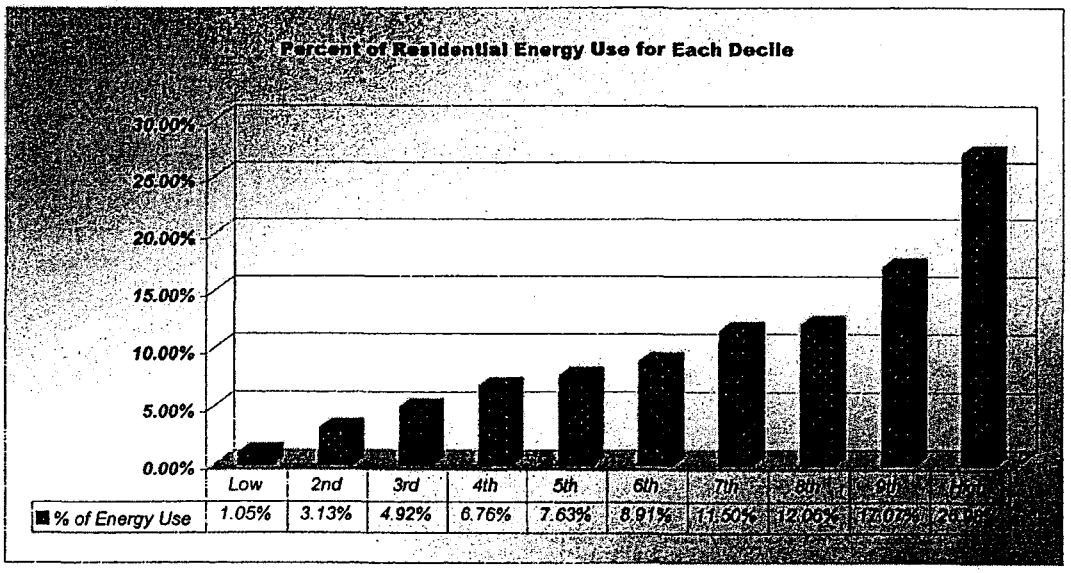
Tucson Electric Power Company
Residential Bill Impact Analysis
Test Year Ended December 31, 2006

	Decile	Percent of Bills	% of Energy Use	Cumulative	Average kWh for Decile (upper bound)	% Increase in Annual Bills
Lowest Decile (10%) of Bills	Low	10.00%	1.05%	1.05%	189	6.0%
2nd Decile (10 %) of Bills	2nd	10.00%	3.13%	4.17%	332	2.0%
3rd Decile (10 %) of Bills	3rd	10.00%	4.92%	9.09%	451	1.4%
4th Decile (10 %) of Bills	4th	10.00%	6.76%	15.85%	573	3.1%
5th Decile (10 %) of Bills	5th	10.00%	7.63%	23.48%	705	5.3%
6th Decile (10 %) of Bills	6th	10.00%	8.91%	32.39%	860	7.7%
7th Decile (10 %) of Bills	7th	10.00%	11.50%	43.89%	1,059	9.7%
8th Decile (10 %) of Bills	8th	10.00%	12.06%	55.95%	1,277	11.3%
9th Decile (10 %) of Bills	9th	10.00%	17.07%	73.02%	1,712	13.3%
Highest Decile (10 %) of Bills	High	10.00%	26.98%	100.00%	4,455	22.2%

Note: The upper bound on the highest decile is set at the upper bound on the 99.75 percentile (only 25 bills in every 10,000 are higher.

When residential bills are sorted by energy use, one sees that there are significant differences in usage between the bill deciles.

* *Bills in the Highest Usage decile account for 25 time more usage than bills in the lowest decile.*
* *56% of residential usage is in highest 3 deciles; 44 % is in the remaining 7 deciles.*
* *The highest decile (10% of bills) accounts for more usage than the 1st 5 deciles combined.*



32

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
MIKE GLEASON- CHAIRMAN
WILLIAM A. MUNDELL
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IN THE MATTER OF THE FILING BY TUCSON ELECTRIC POWER COMPANY TO AMEND DECISION NO. 62103.	DOCKET NO. E-01933A-05-0650
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Direct Testimony in Support of the Settlement Agreement

James S. Pignatelli

On Behalf of

Tucson Electric Power Company

June 11, 2008

Q. Please describe how the rate increase in the settlement agreement will impact an average residential customer bill.

A. Mr. Dukes will testify to this in more detail in his Direct Testimony, but the electric bill of a residential customer with average use (900 kWhs/month) will increase from $84.55 to $87.23 (3.2%) due to the proposed base rate increase. This increase is lower than six percent (6%) due to the impact of the proposed inclining block rate structure.

Upon the effective date of the rates and charges approved in this matter, in addition to the base rate increase, residential customers will incur other charges attributable to the adjuster provisions referenced in the settlement agreement and approved by the Commission. In my Rebuttal Testimony, I will present the Company's estimates of what those additional charges may be, based on TEP's and other parties' positions.

Q. Please describe how low income customers will be affected by the rates in the settlement agreement.

A. As set forth in Paragraphs 16.28 through 16.31 of the settlement, qualified low-income customers' rates will not increase due to the agreed upon 6% increase in base rates or the PPFAC. As part of the settlement agreement, the 6% increase in base rates will not apply to the Company's existing low-income programs. The rates of current low-income customers will be frozen. TEP will also implement a single Lifeline (low-income) schedule with a monthly discount of $8.00 (or the monthly bill if the billed amount is less than $8.00) and a single Medical Life Support Schedule. Both of these new low-income tariffs will be open to new subscription and will not be subject to the 6% base rate increase. Further, low-income customers, both under frozen low-income tariffs and unfrozen low-income tariffs, will not be subject to the PPFAC. Incremental fuel and purchased power costs that these low-income customers would have otherwise paid under the PPFAC will be recovered from all remaining customers through the PPFAC.

33

BEFORE THE ARIZONA CORPORATION COMMISSION

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Rebuttal Testimony of

James S. Pignatelli

on Behalf of

Tucson Electric Power Company

April 1, 2008

Rates should be set with, at a minimum, the average equity anticipated over the period the rates are in effect. TEP will be increasing its equity as it reinvests its earnings in new plant and equipment. A 45 percent equity ratio will help the Company continue to make gradual improvements in its capital structure and position TEP to access the capital markets on more favorable terms. TEP witness Mr. Larson will address this issue in more detail in his rebuttal testimony.

I further believe that Commission Staff's return on equity recommendation is too low. TEP has demonstrated that the appropriate return on equity level should not be less than 10.75 percent on the pro forma 45-percent equity ratio. Commission Staff's recommendation of 10.25 percent substantially understates the realistic return required for TEP's equity. I note that the Commission recently approved a return on equity of 10.75 percent for APS. See Decision No. 69663. I see no reason why TEP's return on equity should be set lower than that of APS. TEP witness Mr. Hadaway will address this issue in more detail in his testimony. If the Commission adopts the Company's proposed pro forma capital structure and weighted average cost of capital and applies this to Commission Staff's proposed rate base, then the Staff's revenue requirement will increase by $6.1 million on an ACC jurisdictional basis.

Q. Please address the Commission Staff's and Intervenors' recommendations regarding the treatment of the Luna Energy Facility.

A. TEP acquired a one-third interest in the then-unfinished Luna Energy Facility (also referred to as the "Luna plant") in November 2004. The 570-MW combined cycle natural gas-fired plant has been in commercial operation since April 2006. The Luna plant is not in the Company's rate base, and TEP has not proposed any such inclusion in this proceeding. Rather, as detailed in my Direct Testimony, TEP is requesting that the cost of this facility be recovered through a demand charge of $7 per kW-month, a significant

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 10, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 192 through 394, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 or we can have Mr. Dukes answer that one.
2 ALJ RODDA: Well, Mr. Dukes will be fine.
3 Q. (BY ALJ RODDA) All right. Also, as part of your
4 testimony you talk a little bit about the Luna generating
5 station.
6 A. Yes, ma'am.
7 Q. And you call it -- I think that's what you -- I
8 think in your mind you see one of the great benefits to
9 ratepayers in this case is inclusion of the Luna
10 generating station on original cost, but give me some
11 background on that, why you think -- I think you call
12 it -- well, you called it an important part of the
13 generation portfolio, but tell me a little bit about it.
14 A. I'm trying to think what year it was. At a point
15 in time when our generation was deregulated and we were
16 operating under a rate freeze, and in the anticipation
17 that our generation would never go back under cost of
18 service, we acquired from Duke Power a one-third interest
19 in the Luna power project. Our total cost for that is
20 $250 a kW. We use that to -- it's a much more efficient
21 gas-fired plant than our older gas-fired plants, so we use
22 that quite a bit. It's 200 megawatts.
23 At the time we acquired our interest in that and
24 we completed that buy, I went to the Commissioners, as I
25 generally do, and we talked about it. And I said that we

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

Date: July 15, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME V
(Pages 795 through 1037, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 The other 50 percent was coal. It is almost split right
2 down the middle in 2007.
3 Q. And that's one of the major reasons why TEP
4 needs a PPFAC, and for that matter a PPFAC is in the
5 best interest of both the company and its customers?
6 A. Yes.
7 Q. One final question on the Luna generating
8 station. There has been a fair amount of discussion
9 about that. I wanted, Mr. Hutchens, to ask you, do you
10 have reasonably current information or a current
11 estimate of what the present market cost of the Luna
12 assets would be?
13 A. If we were to build a combined cycle facility
14 like Luna today, it would cost approximately a thousand
15 dollars a kW. That compares to what we purchased it for
16 about 50 percent complete and completed ourselves for an
17 all in cost of $250 a kW, or basically 25 cents on the
18 dollar if you were comparing it to today's replacement
19 costs.
20 Q. And am I correct that TEP's share of Luna is
21 about 190 megawatts?
22 A. Yes, it is 190.
23 Q. So under the settlement agreement, ratepayers
24 are saving the rate of return of 5.64 percent on that
25 difference between the $250 cost number and the $1,000

34

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

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2 Arizona Corporation Commission, which was not the case
3 under the '99 settlement.
4 The rights and obligations under the 1999
5 settlement are waived. The settlement agreement
6 includes a provided power agreement, fuel and purchased
7 power. I believe that that is an important way to
8 recover fuel cost. It will add, Commissioner Mayes, 3
9 to 4 percent increase. That is why I am saying that the
10 total increase is 9 to 10 percent since 1994. And,
11 actually, it is 2 percent less than that because we are
12 already 2 percent below 1994.
13 It also provides for DSM and REST adjusters. It
14 updates the treatment of Springerville 1. And it brings
15 Luna into rate base at cost, $250 of kilowatt. The
16 value of Luna today is over $1,000 of kilowatt. That is
17 a shareholder asset which we have put back into rate
18 base at one fourth of its value, a tremendous benefit to
19 the customers.
20 Also, it updates rate design. And I think that
21 we need to focus on rate design going forward, but this
22 rate design, which was a combined effort of the
23 signatories to this, protects the customer.
24 This settlement was open and transparent. It
25 was comprehensive. It was a give and take. And,

BEFORE THE ARIZONA CORPORATION COMMISSION

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BEFORE THE ARIZONA CORPORATION COMMISSION

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BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 14, 2008

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REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV
(Pages 577 through 794, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

Prepared for:

ACC

1 provision. But my view would be that we were concerned
2 with TEP's actions. I think you find that Mr. Smith
3 filed very strong testimony on that point and gave his
4 views as to the responsibilities of TEP in that regard.
5 And he can speak to it more directly.
6 Q. Mr. Pignatelli said that Luna is worth $1,000
7 per megawatt hour at market rates and it is getting rate
8 based at, I think, $250 per megawatt hour. Does Staff
9 agree with his characterization of the value of that
10 plant?
11 A. I am not familiar with those amounts that he
12 would attribute or the market cost of service. I can
13 tell you Mr. Smith would have a greater grasp of those
14 issues.
15 But let's just cut to the bottom line. Luna is
16 a bargain, generally speaking, in terms of an asset that
17 will, if this agreement is approved, will be an asset
18 available to TEP's customers. And we think that's an
19 important consideration.
20 I think there is a, believe me, there was a
21 struggle with trying to get Luna in at cost of service.
22 The company, with all due respect, they didn't want to
23 give that up. They truly did not. And I can understand
24 and appreciate that. But it was, it was crucial to
25 resolution of the issues.

37

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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 TUSCON ELECTRIC POWER COMPANY TO AMEND DECISION NO. 62103.	)	DOCKET NO. E-01933A-05-0650

REBUTTAL TESTIMONY SUPPORTING THE SETTLEMENT AGREEMENT

OF

RALPH C. SMITH

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

JULY 08, 2008

Q. At page 14, lines 12-19, of his responsive testimony, Mr. Rigsby appears to have a problem with describing the Springerville Unit 1 settlement provisions as "cost based recovery." Please respond.

A. While the $25.67 per kilowatt month was originally presented by TEP an estimated market price; as explained above, the settling parties have used this amount as an approximation of the levelized cost. The use of an estimate of levelized cost for settlement purposes in conjunction with the use of a cost-of-service revenue requirement methodology is fair and reasonable under the circumstances.

Overall Settlement

Q. As evidenced by Mr. Rigsby's testimony and his Exhibit WAR-1, one of RUCO's main concerns appears to be that the Settlement Agreement provides for an amount of base rate increase that was agreed to by the signing parties and also includes a PPFAC that could result in further rate increases. Is that a valid reason for rejecting the settlement?

A. I don't believe so. As explained above, the Settlement Agreement specifies the amount of base rate increase from two different bases: (1) a $47.1 million increase from TEP's current rates including Fixed CTC/True-Up Revenue and (2) a $136.8 million increase from TEP's current base rates without Fixed CTC of $691.5 million. This is presented in paragraphs 2.3 and 2.4, respectively. The Settlement Agreement is also clear that the base cost of fuel and purchased power is $0.0028896 per kWh, and that there is a PPFAC, which is presented in detail in Exhibit 6. Consequently, to me, the fact that the Settlement Agreement provides for a base rate increase and a PPFAC that would result in subsequent rate changes does not appear to be a reason for rejecting it.

38

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

Date: July 16, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI
(Pages 1038 through 1091, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 Rodda on Section 3.2, which is the recovery of the
2 Springerville Unit No. 1 non-fuel costs. And as I said
3 earlier, the settlement agreement adopts the $25.67 per
4 kilowatt month. And I stand corrected. I think I said
5 megawatt earlier. So I stand corrected on that. It was
6 per kilowatt month.
7 But certainly, as I had mentioned, we're not so
8 sure that that's the number, and that we heard in this
9 proceeding and also seen the direct testimony that was
10 filed by Mr. Higgins that there could have been another
11 cost --
12 Q. Is there uncertainty -- I didn't mean to
13 interrupt you. Had you concluded your response?
14 A. Yeah. I just was saying that I think that there
15 is enough evidence, enough evidence that's been presented
16 here in the proceeding that could raise some doubt as to
17 whether or not that number should fall somewhere between
18 $15 and $25.67.
19 Q. Is RUCO's position with regard to the uncertainty
20 of that number so strong that it would oppose Commission
21 adoption of the number provided for by the settlement
22 agreement?
23 A. Well, we're already opposed to the agreement
24 overall. All I can say is I would certainly hope that the
25 Commissioners take that into consideration in a final

39

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
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Direct Testimony of

Kevin P. Larson

on Behalf of

Tucson Electric Power Company

July 2, 2007

steps that would raise those ratings to investment grade. TEP believes that its proposed rate request will (i) enable the Company to continue to improve its financial condition, (ii) be viewed positively by the rating agencies and (iii) position the Company so that it can favorably access the capital markets.

I recommend an overall rate of return (ROR or weighted average cost of capital) of 8.35%. This ROR is based on a 10.75% cost of common equity capital, a 6.39% cost of long-term debt and a pro forma capital structure consisting of 45.00% common equity and 55.00% long-term debt.

Following the historical Commission approach for each of its proposals, the Company applied its proposed ROR to original cost rate base ("OCRB"), which results in operating income of $82.1 million. Operating income was then divided by the Commission's definition of FVRB, which is the average of OCRB and RCND.

II. FINANCIAL CONDITION OF TEP.

Q. Has TEP's financial condition improved since it last filed a general rate case?

A. Yes. Since the end of 1994, TEP has reduced debt and capital lease obligations by $1 billion and, improved its common equity by $595 million. The Company has taken steady steps to improve its balance sheet, such as (i) using excess cash flow to make significant debt retirements and to purchase debt securities underlying its capital leases, (ii) amortizing capital lease obligations through scheduled payments, (iii) retaining earnings, (iv) managing and controlling its costs, and (v) receiving capital contributions from its parent company, UniSource Energy.

The following table illustrates the improvements made to TEP's consolidated balance sheet

40

ORIGINAL

BEFORE THE ARIZONA CORPORATION CC

57

COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
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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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

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DOCKET CONTROL

Original and 15 copies of the foregoing filed this 29th day of May, 2008 with:

Arizona Corporation Commission
DOCKETED
MAY 29 2008
DOCKETED BY nR

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

included in TEP's rate base at their respective original costs, subject to the Commission's subsequent regulatory and ratemaking review and approval. This provision is not intended to create a presumption in favor of generation, and the Signatories acknowledge that TEP is obligated to consider all reasonable alternatives when evaluating how to meet its service obligations to its customers.

3.2 Recovery of Springerville Unit 1 non-fuel costs shall reflect a cost of $25.67 per kW per month which approximates the levelized cost of Springerville Unit 1 through the remainder of the primary lease term for this generating facility. In addition, Springerville Unit 1 leasehold improvements shall be included in TEP's original cost rate base at net book value as of December 31, 2006.

3.3 The Luna Generating Station shall be included in TEP's original cost rate base at net book value as of December 31, 2006.

3.4 The average base cost of fuel and purchased power reflected in base rates shall be set at $0.028896/kWh, as calculated in Exhibit 4.

IV. COST OF CAPITAL.

4.1 The Signatories agree that a capital structure comprised of 57.50% debt and 42.50% common equity shall be adopted for ratemaking purposes in these consolidated dockets.

4.2 The Signatories agree that a return on common equity of 10.25% and an embedded cost of debt of 6.38% are appropriate and shall be adopted for ratemaking purposes in these consolidated dockets.

4.3 The Signatories agree to a fair value rate of return of 5.64%, as shown on Exhibit 1.

Settlement Exhibit No. 1

Tucson Electric Power Company
Computation of Increase in Gross Revenue Requirements
Test Year Ended December 31, 2006
(Thousands of Dollars)

Line No.	Description	ACC Jurisdiction			Line No.
		Original Cost	RCND	Fair Value	
1	Adjusted Rate Base	$1,020,207	$1,882,910	$1,451,558	1
2	Adjusted Operating Income	($516)	($516)	($516)	2
3	Current Rate of Return (2/1)	-0.05%	-0.03%	-0.04%	3
4	Required Operating Income	$81,879	$81,879	$81,879	4
5	Required Rate of Return (4/1)	8.03%	4.35%	5.64%	5
6	Operating Income Deficiency	$82,395	$82,395	$82,395	6
7	Gross Revenue Conversion Factor	1.6598	1.6598	1.6598	7
8	Increase in Gross Revenue Requirement	$136,758	$136,758	$136,758	8

41

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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By: MICHELE E. BALMER
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Prepared for:

1 decision.
2 Q. Okay. Let's move to Section 4, cost of capital.
3 A. Yes.
4 Q. What is RUCO's position with regard to the cost
5 of capital provided for for TEP in the settlement
6 agreement?
7 A. Well, given the amount of revenue increase that
8 the settlement is proposing, and the PPFAC which has no
9 cap, no 90/10 sharing arrangement, I think a very strong
10 argument could be made that the return on equity could be
11 lower because those flow-through mechanisms help to reduce
12 the risk of the company.
13 Q. Is RUCO's position one of opposition to the cost
14 of capital for TEP provided for in the settlement
15 agreement?
16 A. I think that that figure could very well possibly
17 be lower. I think I recommended a 9.44 percent cost of
18 common equity.
19 Q. I understand the arguments that you're
20 identifying. I'm trying to ascertain RUCO's position. As
21 of this point, is it one of opposition to the cost of
22 capital for TEP provided for in the settlement agreement?
23 A. Well, I would have to say yes, because I think
24 that there's evidence in the record that would support a
25 lower cost of equity figure.

42

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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43

ORIGINAL

BEFORE THE ARIZONA CORPORATION CC

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

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AZ CORP COMMISSION
DOCKET CONTROL

Original and 15 copies of the foregoing filed this 29th day of May, 2008 with:

Arizona Corporation Commission
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Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

V. DEPRECIATION AND COST OF REMOVAL.

5.1 For ratemaking purposes, upon the effective date of a Commission order approving this Agreement, TEP shall use the depreciation rates for Distribution and General plant contained in the attached Exhibit 5 and incorporated herein.

5.2 For local and non-local generation plant, upon the effective date of the new base rates authorized in the Commission's order approving this Agreement, TEP shall use the depreciation rates attached hereto as Exhibit 5. These generation depreciation rates include an annual accrual of $21,626,296 on an ACC jurisdictional basis as negative net salvage (cost of removal) for "Generation," excluding the Luna Generating Station. The Luna Generating Station has separately identified depreciation rates included in Exhibit 5.

VI. IMPLEMENTATION COST RECOVERY ASSET.

6.1 TEP's original cost rate base shall include an Implementation Cost Recovery Asset ("ICRA") in the amount of $14,212,843 to reflect the following costs of TEP's transition to retail electric competition under the 1999 Settlement Agreement:

Account	Sub	Component	ICRA per Settlement	
18190	1508	Deferred Direct Access Costs	$	11,153,016
18190	1509	Deferred Divesiture Costs	$	1,193,003
18190	1510	Deferred GenCo Separation Costs	$	164,026
		Deferred Desert Star and West Connect Funding	$	1,702,798
		Total	$	14,212,843

6.2 For ratemaking purposes, the ICRA will be amortized by TEP over a four-year period commencing with the effective date of new rates from this proceeding and shall not be included in rate base or as an amortization expense in TEP's next rate case, pursuant to the Rate Moratorium provision of Paragraphs 10.1 and 10.2 herein.

44

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
MIKE GLEASON- CHAIRMAN
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Direct Testimony in Support of the Settlement Agreement

James S. Pignatelli

On Behalf of

Tucson Electric Power Company

June 11, 2008

Q. Are there any other significant financial or accounting issues resolved in this settlement?

A. Yes. For ratemaking purposes, upon the effective date of a Commission order approving the settlement agreement, TEP will use the depreciation rates for Distribution and General plant contained in Exhibit 5 to the settlement agreement. For local and non-local generation plant, TEP will use the depreciation rates in Exhibit 5 to the settlement agreement. These generation depreciation rates also include an annual accrual of $21,626,296 on an ACC jurisdictional basis as negative net salvage (cost of removal) for "Generation," excluding the Luna generating station. This resolves a lingering issue about the impact of the 1999 Settlement Agreement on decommissioning/removal costs for the Company's generation assets. Further, the Luna generating station has separately identified depreciation rates included in Exhibit 5 to the settlement agreement.

E. Implementation Recovery Costs.

Q. Please explain the settlement agreement's treatment of the Implementation Cost Recovery Asset ("ICRA").

A. The settlement agreement provides that TEP's original cost rate base will include an Implementation Cost Recovery Asset ("ICRA") in the amount of $14,212,843 to reflect the following costs of TEP's transition to retail electric competition under the 1999 Settlement Agreement:

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45

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Commissioner

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
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DIRECT TESTIMONY

SUPPORTING THE SETTLEMENT AGREEMENT

OF

RALPH C. SMITH

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

JUNE 11, 2008

V. DEPRECIATION AND COST OF REMOVAL

Q. What does the Settlement Agreement provide for depreciation rates?

A. Section V of the Settlement Agreement addresses depreciation rates. It provides that TEP shall use the depreciation rates contained in Settlement Exhibit No. 5.

Q. How were those depreciation rates derived?

A. 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. As such, the additional depreciation accruals provided for in Settlement Paragraph 5.2 contain an element of future benefit to TEP's ratepayers.

Q. Why does TEP's Luna Generating Station have separately identified depreciation rates, as specified in Settlement Paragraph 5.2, and listed on Settlement Exhibit No. 5?

A. Actually, each of TEP's generating units, including Luna, have separately identified depreciation rates on Settlement Exhibit No. 5. A detailed calculation process was used to spread the $21.6 million annual accrual for cost of removal among TEP's generating plants in deriving the depreciation rates shown on Settlement Exhibit No. 5. TEP had

originally proposed to treat the Luna Generating Station, for ratemaking purposes, at a "market" based amount, rather than at original cost. Accordingly, TEP had not included Luna in its originally proposed depreciation rates. The Settlement Agreement provides that the Luna Generating Station is being treated on a cost basis for ratemaking purposes. Consequently, depreciation rates for Luna needed to be specified. The Luna depreciation rates were added to the generation depreciation rates after the $21.6 million Settlement amount annual accrual for cost of removal had been spread to TEP's other generating units. Consequently, Settlement Paragraph 5.2 indicates that none of that $21.6 million Settlement amount annual accrual for cost of removal was allocated to Luna.

VI. IMPLEMENTATION COST RECOVERY ASSET

Q. How does the Settlement Agreement treat the Implementation Cost Recovery Asset?

A. 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.

46

BEFORE THE ARIZONA CORPORATION COMMISSION

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Direct Testimony in Support of the Settlement Agreement

James S. Pignatelli

On Behalf of

Tucson Electric Power Company

June 11, 2008

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Rebuttal Testimony in Support of the Settlement Agreement

James S. Pignatelli

On Behalf of

Tucson Electric Power Company

July 7, 2008

fictional amount that RUCO has attempted to introduce. RUCO's attempt to overstate the rate increase by imputing a lower existing customer rate is simply unfounded. As stated in the Settlement Agreement, base rates will increase approximately 6%. TEP customers will see only an average 6% increase in their bills – the first increase they have seen since the mid-1990s.

Q: Mr. Pignatelli, please discuss other errors in the Rigsby testimony.

A: Let me briefly address the three rate-related issues that the Rigsby testimony refers to as "concessions" and then criticizes as being unsupported by the record. I will first point out that contrary to the erroneous assertion that there is no basis for the acceptance of the Company's position on these issues, the justification for each of the adjustments is found and documented in testimony that was filed in connection with the TEP rate case application. I will refer to that testimony for background purposes.

First, Mr. Rigsby refers to the $99 million adjustment that was made to rate base by Commission Staff to reflect the impact of FAS 143. As TEP witness Ms. Karen Kissinger indicated in her April 1, 2008 Rebuttal Testimony (pages 14-18), the adoption of FAS 143 in January of 2003 had different financial statement implications for TEP than it would have for a company allowed to follow FAS 71 for its generation assets. Because the Company was precluded from establishing a regulatory liability for amounts formerly included in the reserve for accumulated depreciation for cost of removal of generation assets, the amount was recognized in income in 2003.

Such amount is not refundable to customers and will not be "double collected" on a going forward basis as it was already included, as a benefit to customers, in the determination of the $450 million stranded cost in 1999. No cost of removal amounts have been accrued as a part of generation depreciation expense since 2002 as a result of FAS 143. Only

companies eligible to follow FAS 71 may accrue cost of removal as an element of depreciation expense.

In questioning the related $21.6 million adjustment to increase depreciation expense for cost of removal on an on-going basis, the Rigsby testimony asserts that no party discussed prior to the settlement negotiations a need to begin accruing such an amount of additional depreciation expense for cost of removal. In fact, Commission Staff witness Mr. Ralph Smith proposed an adjustment (adjustment C-15) and Ms. Kissinger countered with a different proposed rate for cost of removal in her Rebuttal Testimony (pages 53-54). The Settlement Agreement provides a reconciliation of the parties' positions.

Second, the Rigsby testimony questions the $41.6 million adjustment to Commission Staff's rate base calculation related to accumulated depreciation. Again, as supported by Ms. Kissinger's Rebuttal Testimony (pages 18-23), in addition to no longer accruing cost of removal as an element of depreciation expense, the Company made other changes to depreciation rates. The Company added new generation assets which had no depreciation rates previously authorized by the Commission. The Company also extended the lives of some of its generation assets, based on new information regarding the economic useful lives of these assets. The changes made were the same changes the Company would have made under cost-based regulation. Such depreciation rates were and are just and reasonable. The Company did not seek Commission authorization of such changes because the generation assets had been effectively deregulated and such authorization was irrelevant because TEP's generation rates were to be competitive and market-based, not cost-based. The linkage of costs and revenues was no longer applicable to generation under the 1999 Settlement Agreement.

48

BEFORE THE ARIZONA CORPORATION COMMISSION

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At: Tucson, Arizona

Date: July 16, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI
(Pages 1038 through 1091, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 Q. (BY MR. ROBERTSON) What is RUCO's position with
2 regard to Section 6, which relates to implementation cost
3 recovery asset?
4 A. Can I just check something here for a moment?
5 Q. Certainly.
6 A. Okay. Thanks for bearing with me there. I just
7 wanted to make sure that I'm clear on this.
8 I believe RUCO and Staff came to similar
9 conclusions on the ICRA. And so as far as the
10 implementation cost recovery asset issue, I don't think we
11 have a problem with that. So the answer would be, yes, I
12 guess we would support that.
13 Q. So you do not object to that; is that correct?
14 A. Yes, that's correct. I just wanted to get clear
15 on that. For some reason or another I thought there was a
16 point that we had made with that, but apparently not.
17 Perhaps I'm confusing that with the TCRA.
18 Q. Let's move to Section 7, which is the purchased
19 power and fuel adjustment clause. What is RUCO's position
20 with regard to the form of PPFAC that has been proposed in
21 the settlement agreement?
22 A. Well, again, as I had explained with Judge Rodda,
23 we had recommended an alternative mechanism that mirrored
24 the company's ECAC proposal during the rate review
25 proceeding, so certainly we would much rather see that

49

BEFORE THE ARIZONA CORPORATION COMMISSION

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At: Tucson, Arizona

Date: July 10, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 192 through 394, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 is more gradual in nature and puts more of that onus on
2 the shareholders who do have greater ability to absorb the
3 impact? I mean, you would agree with that. Take someone
4 who is living on the edge of poverty, or the shareholders
5 that we're going to talk about in a second. Who has the
6 greater ability to absorb the spike in the short term?
7 A. You and I will have a fundamental disagreement
8 philosophically. Shareholders, you come to the conclusion
9 that all shareholders are wealthy. 90-some percent of our
10 stock is owned by funds. Funds are basically pension
11 funds that are investing the pension of working America.
12 Q. And hedge funds.
13 A. Hedge funds. Some are hedge funds.
14 Q. You and I have had lots of conversations about
15 the hedge funds, who are probably listening to us right
16 now, right? A lot of hedge funds own your stock.
17 A. And hedge funds are also investing pension funds
18 and U of A funds and other funds, but --
19 Q. Who is making money at those hedge funds?
20 A. But Commissioner, the shareholder is not
21 consuming that product. The shareholder is making that
22 product available for the customer. If you continue to
23 shield the customer from that outrageous spike that you
24 hypothecate, the consumer is going to continue to consume
25 based on that outrageous fuel cost and is not going to

50

BEFORE THE ARIZONA CORPORATION COMMISSION

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Date: July 9, 2008

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Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 A. Beginning at line, pardon me?
2 Q. Yes. It is line 8 on page 9 of Mr. Hutchens'
3 testimony. The question begins there and it continues
4 through with the answer which concludes on line 15 on
5 page 9.
6 A. So, okay, just to be clear, you want me just to
7 read the first paragraph, the answer?
8 Q. Just for the moment I want you to read that
9 first paragraph. Then I am going to ask you one or two
10 questions against that background.
11 A. Okay. Is the fluctuating volatile nature of
12 these markets the principal reason TEP needs the
13 proposed PPFAC, cap P-P-F-A-C?
14 Yes. Answer: Yes. This is because TEP relies
15 on significant quantities of natural gas and purchased
16 power to meet its retail load. Although TEP has served
17 the majority of its load with company owned generating
18 resources, it relies more and more on natural gas and
19 power that is purchased at market prices to meet its
20 ever growing customer demand. In other words, there is
21 increased dependence on the natural gas and purchased
22 power markets to provide for TEP's growing load.
23 Q. I didn't want to interrupt you. I really meant
24 you just to read it and I was going to ask you a
25 question rather than burden you reading. But that's

51

BEFORE THE ARIZONA CORPORATION COMMISSION

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Prepared for:

1 surprised at my vote. And I certainly wouldn't have voted
2 for it if it had no cap.
3 A. Well, I'm certainly willing to work with the
4 Commission to come up with something that hopefully we get
5 your vote for. Because without a PPFAC, appropriately
6 designed, this doesn't happen. None of this happens.
7 Q. Right.
8 A. I want to talk to you about your 90/10 for a
9 minute.
10 Q. Okay. That was my next question.
11 A. I'm a firm believer in incentives as long as
12 incentives are -- you have an equal opportunity to win or
13 lose on them. And if you put a 90/10 based off 2006
14 costs, and all I see is 10 percent of my fuel costs above
15 the 2006 rate lost through 2013, I can tell you I can't --
16 that's not a mechanism that works.
17 If you say that there's an equal chance of
18 winning and losing by focusing on incentives off of what
19 the future price is, i.e., the price 2009, 2010, 2011,
20 then there might be something to work with.
21 But I like incentives. I don't think they are
22 necessary. And I'm going to tell you -- we had this
23 discussion yesterday -- you don't -- I know that you trust
24 me. I'm not going to be pejorative on this, but you seem
25 to feel that an organization won't always try to get the

1 lowest possible cost.
2 I can tell you when I look at it, I have fuel
3 costs, I have O&M costs, I have capital investments, and I
4 have a return to my shareholder. And if I have to raise
5 or you have to permit me to raise my rates 10 percent for
6 fuel costs, I'm going to pay hell getting a base rate
7 increase for what is really necessary for my O&M and my
8 shareholder. I know that it isn't the market setting my
9 prices. It's you setting my prices. And you take into
10 consideration market, but you also take into consideration
11 political issues, i.e., what can the consumer afford?
12 I can tell you that the product we supply to the
13 consumer is much more valuable than they pay -- than what
14 they're paying for it. The marginal utility exceeds the
15 marginal cost. But it's a politicized product, and I
16 understand that.
17 But in back of every one of my employee's minds,
18 not only is they are going to do the absolute best job
19 they can, but they know that their salary is competing
20 with fuel costs. If fuel costs go up too much and you
21 increase rates, I'm going to have a hard time increasing
22 their salary because I'm not going to be able to recover
23 it in increasing rates. This is a constant balance that
24 we go through.
25 Q. But to this point, Mr. Pignatelli, with the

1 continuously up unless you can somehow come in very
2 rapidly and get relief.
3 The earnings component of our bill is so small
4 that you quickly eat up all of your earnings. If
5 50 percent of your expenses rise 5 percent in a year, you
6 have a devastating impact on your earnings components. It
7 all falls to the bottom. So unless you have continuous
8 base rate changes, you can't absorb changes in one
9 component which is 50 percent of your expenses.
10 Now, the amount that it's going to change with
11 gas right now is higher, but I can tell you that my total
12 fuel bill -- and we have a small amount of gas -- for the
13 last six years has gone up about an average of 5 percent a
14 year.
15 Q. Okay. But Wall Street is saying your earnings
16 are going to rise by 6 percent this year without an
17 adjustor clause, right?
18 A. Well, Wall Street and Value Line, and I'm not
19 sure if that's correct.
20 Q. But are your earnings going to rise this year?
21 A. Are you going to give me 65 million?
22 Q. Not if it's January 1, 2009.
23 A. My earnings without the 65 million true-up will
24 be less than a dollar. That's not an increase.
25 Q. So Value Line is wrong.

52

BEFORE THE ARIZONA CORPORATION COMMISSION

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Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 THE WITNESS: Well, because the median customer
2 and the average customer, one has Lifeline and because
3 of the inverted blocks on --
4 ALJ RODDA: Okay. So the average customer is
5 still getting the benefit of the Lifeline and the
6 inverted blocks?
7 THE WITNESS: Correct.
8 ALJ RODDA: Okay.
9 THE WITNESS: And that was --
10 ALJ RODDA: But Mr. Crockett's customers, who
11 are large commercial, would see --
12 THE WITNESS: They would see, if there was zero
13 in the ECAC, they would see, I think it is, about 6.02
14 or 6.1 percent increase.
15 ALJ RODDA: Okay.
16 THE WITNESS: Depending on their use of TOU
17 also, so, which is --
18 ALJ RODDA: Thank you.
19 THE WITNESS: This is very comprehensive.
20 Q. (BY MS. MITCHELL) In the event that there were
21 no PPFAC associated with this settlement agreement,
22 would TEP be required to file more rate cases in that
23 event?
24 A. If there was no PPFAC with this rate case? We
25 would file a rate case every six months.

53

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 15, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME V
(Pages 795 through 1037, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 public interest due to its benefits to both the company
2 and its customers. These benefits include getting price
3 signals to our customers; prompt reconciliation of fuel
4 and purchased power costs; avoiding deferrals, which
5 ultimately leads to cheaper power supply costs; also the
6 credits provided to the customers, the wholesale trading
7 credits, short-term wholesale revenue and SO2 credits to
8 the PPFAC bank. And, finally, inclusion of this PPFAC
9 has allowed TEP a base rate moratorium which is a key
10 component to this integrated settlement agreement.
11 I would like to make a couple comments on things
12 that have been said thus far related to the PPFAC. The
13 topic has come up once or twice. This is an integrated
14 settlement agreement. It addresses many issues.
15 (Phone rings.)
16 (An off-the-record discussion ensued.)
17 THE WITNESS: As I was stating, this is an
18 integrated agreement addressing many issues and which
19 results in a fair and balanced outcome. One of the key
20 components of this settlement agreement is the PPFAC.
21 The company proposed a slightly different mechanism in
22 its direct testimony and, through the settlement
23 negotiation process, has accepted Staff's proposed PPFAC
24 as put forth in their direct testimony. We accepted
25 that lock, stock, and barrel.

54

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

Date: July 16, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI
(Pages 1038 through 1091, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 Q. (BY MR. ROBERTSON) What is RUCO's position with
2 regard to Section 6, which relates to implementation cost
3 recovery asset?
4 A. Can I just check something here for a moment?
5 Q. Certainly.
6 A. Okay. Thanks for bearing with me there. I just
7 wanted to make sure that I'm clear on this.
8 I believe RUCO and Staff came to similar
9 conclusions on the ICRA. And so as far as the
10 implementation cost recovery asset issue, I don't think we
11 have a problem with that. So the answer would be, yes, I
12 guess we would support that.
13 Q. So you do not object to that; is that correct?
14 A. Yes, that's correct. I just wanted to get clear
15 on that. For some reason or another I thought there was a
16 point that we had made with that, but apparently not.
17 Perhaps I'm confusing that with the TCRA.
18 Q. Let's move to Section 7, which is the purchased
19 power and fuel adjustment clause. What is RUCO's position
20 with regard to the form of PPFAC that has been proposed in
21 the settlement agreement?
22 A. Well, again, as I had explained with Judge Rodda,
23 we had recommended an alternative mechanism that mirrored
24 the company's ECAC proposal during the rate review
25 proceeding, so certainly we would much rather see that

1 adopted.
2 Q. Would I be correct in concluding that at this
3 posture, with regard to the form of PPFAC provided for in
4 the settlement agreement, RUCO opposes it?
5 A. I think that's -- yes, I would say that.
6 Q. Let's move to Section 8, which is the renewable
7 energy adjustor. What is RUCO's position on that?
8 A. RUCO has no opposition to that.
9 Q. Okay. Let's move to Section 9, which is the
10 demand-side management programs and adjustor. What is
11 RUCO's position on that?
12 A. We're not opposed to that.
13 Q. Let's move to Section 10, which is the rate case
14 moratorium. What is RUCO's position on that?
15 A. Again, as I mentioned in my opening statement,
16 that's one of the aspects of the agreement that we like.
17 Q. So RUCO supports that; is that correct?
18 A. Yes.
19 Q. Let's move to Section 11, which is the emergency
20 clause. What is RUCO's position on that?
21 A. Well, we certainly couldn't oppose that, because
22 no one knows what can happen in the future.
23 Q. So do I understand your testimony to be that you
24 don't oppose Section 11?
25 A. No. And it wouldn't matter if it was in the

55

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

Date: July 15, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME V
(Pages 795 through 1037, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 I actually have some charts and graphs in front of me as
2 well. And the two spikes that you are speaking of
3 occurred in late 2000 as well as -- which was due to the
4 California energy crisis which had some effect of
5 bringing up gas prices across the U.S. That was
6 specifically in the west, which those prices dropped
7 down significantly shortly thereafter.
8 And then in 2005 with the Hurricanes Katrina and
9 Rita going through the gulf, that was the other peak
10 that you were referencing it. And those prices again
11 dropped in early 2006.
12 Q. Okay. Thank you.
13 We have heard a lot of conversation in the last
14 few days about spike in gas prices. And I wanted to
15 establish that a spike is usually of short duration.
16 Now, the PPFAC, the price that is established in
17 April is a 12-month price, is that right?
18 A. Yes, Chairman Gleason, that is correct. The
19 PPFAC rate that is established each year is for a
20 12-month period. So intra-year spikes do not get
21 immediately passed through to the customers. It does
22 provide a 12-month smoothing mechanism.
23 Q. Yes. And, well, I have got another question.
24 A. Okay.
25 Q. But if you, if the company needs to buy gas or

56

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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BEFORE THE ARIZONA CORPORATION COMMISSION

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Phoenix, Arizona 85004-1481

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 buy power during that spike, that's for the company's
2 account. In other words, the company absorbs those
3 costs, right?
4 A. Those costs during that period, while the PPFAC
5 rate is fixed, those costs are deferred by the company
6 for future recovery in the next PPFAC rate calculation.
7 Q. Yes. This is my -- because the way this is set
8 up is that there is a true-up component in next April,
9 and that is when the costs will be back to the
10 ratepayer. But again, those costs are usually over a
11 12-month period on the true-up mechanism, is that right?
12 A. Yes, that is correct. And those, while those
13 costs are deferred, and we build up a deferred bank
14 balance, it is at that low interest rate that I had
15 previously mentioned.
16 Q. Yes. Well, would you agree with me that this
17 PPFAC is very friendly to the ratepayer in that it
18 ameliorates the cost, the spikes, and that is why it is
19 friendly to the ratepayer?
20 A. I do agree that it does dampen those effects of
21 price spikes during the PPFAC year, and that that is one
22 of the benefits to the ratepayers as well as the other
23 ones that we enumerated before, that there is also
24 benefits to both the company and the customers and the
25 other aspects of this mechanism.

58

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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	SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 15, 2008

Filed:

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Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 Q. I will go on a little bit longer, further. This
2 PPFAC is really somewhat of a ratepayer hedge against
3 prices? In other words, the ratepayer has the hedge in
4 that there is a fixed price for the year, isn't that
5 correct?
6 A. Yes, it does have the effect of fixing that
7 price for the year. But any over or undercollection
8 associated with that fixed price does get returned or
9 recovered from those customers in subsequent periods.
10 Q. Yes, that's what I would term a hedge plus, in
11 other words, you have a hedge, but you have no risk in
12 it, because at some time within the next few months
13 those are -- the true-up takes care of that cost, right?
14 A. Yes.
15 Q. Okay. Now, let's go back to, there has been
16 several conversations about the APS settlement. And if
17 I recall that APS, because I was talking to
18 Mr. Pignatelli, that APS base rate or base cost was very
19 generous. In other words, that was -- I had said that
20 before. I voted for the 4 mil cap, and there was some
21 conversation at that time that six months there would be
22 an overcollection and six months there would be an
23 undercollection, so that the 4 mil annual cap had no
24 effect in the first year. Isn't this true with the
25 PPFAC as you set the base rate?

59

ORIGINAL

BEFORE THE ARIZONA CORPORATION C

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and 15 copies of the foregoing filed this 29th day of May, 2008 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

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applicable rate) will be from April 1, 2009, through March 31, 2010. The first True-up Component will include the period of January 1, 2009, through March 31, 2009.

f. The Forward Component will be updated on April 1st of each year, beginning April 1, 2009, and will be the forecasted fuel and purchased costs for the year commencing on April 1st and ending on March 31st of each individual PPFAC Year less the average Base Cost of Fuel and Purchased Power reflected in base rates ($0.028896 per kWh).

g. The True-up Component will reconcile any over-recovered or under-recovered amounts from the preceding PPFAC Year which will be credited to or recovered from customers in the next PPFAC Year.

h. TEP will file the PPFAC Rate with all component calculations for the PPFAC Year (that begins on the following April 1st), including all supporting data, with the Commission on or before October 31st of each year. TEP will update the October 31st filing by February 1st of the next year.

i. TEP has the ability to request an adjustment to the Forward Component at any time during a PPFAC Year should an extraordinary event occur that causes a drastic change in forecasted fuel and purchased power prices.

j. All Short-Term Wholesale Sales Revenue will be credited to fuel and purchased power costs.

k. Ten percent (10%) of annual net positive wholesale trading profits will be credited to fuel and purchased power costs annually. Under no circumstances will any annual net loss on wholesale trading incurred by TEP be shared with or borne by ratepayers.

60

BEFORE THE ARIZONA CORPORATION COMMISSION

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At: Tucson, Arizona

Date: July 9, 2008

Filed: July 14, 2008

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME I
(Pages 1 through 191, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 COM. MAYS: Given the likelihood of a cap and
2 trade regime or a carbon tax, doesn't it make sense for
3 any utility to escalate their efforts to get away from
4 carbon?
5 THE WITNESS: Yes.
6 COM. MAYS: Okay. And that's your plan?
7 THE WITNESS: Yes. It always has been my
8 desire.
9 COM. MAYS: Okay.
10 ALJ RODDA: Commissioner Pierce.
11 COM. PIERCE: Thank you, madam -- thank you,
12 Your Honor.
13 And, Mr. Pignatelli, this issue with carbon
14 emissions brings up the SO2 emission. And I have a
15 question, too, about that. And then I want to talk
16 about the carbon emissions because I don't necessarily
17 agree that just because of what the two presidential
18 candidates say what will actually happen, because the
19 cost of this is so much more than I think they consider,
20 have considered, just as we have seen talk lately from
21 the democrats about exploring for oil just in the last
22 day or two. So I think as the economy worsens, and it
23 has to do with fuel of all kinds and unrest with the
24 public, I think that certain things will change. But I
25 want to talk about the SO2 for a moment.

1 Who paid for TEP's SO2 emission allowances? Who
2 actually paid for that?
3 THE WITNESS: The emission allowances were
4 provided based on the amount that the plants emitted
5 in -- and I might give, you know, this is in 1990. So
6 you put in a power plant and then they came along with
7 SO2. And they said you are allowed to emit a certain
8 amount of tons. And that was based on what you were
9 emitting from those plants in 1990. And that's what set
10 the amount you can emit.
11 To the extent you reduce those amounts, you get
12 emission credits that you can sell. The majority,
13 actually all of the SO2 allowances which we sell now
14 were created when we put in $100 million worth of new
15 and additional scrubbing equipment at Springerville.
16 That is not in rate base. That was paid for by, by the
17 owner of Springerville 3.
18 We made modifications to Springerville 1 and 2
19 so that Springerville 3 and 4 could be built. And the
20 owner of Unit 3 and the future owner of Unit 4 will have
21 paid for about, it is not quite a 100 million, about
22 75 million worth of new scrubbing equipment at
23 Springerville 1 and 2. And that's where those credits
24 come from that we sell.
25 COM. PIERCE: Who were, who are the major

1 players in Unit 3 and Unit 4?
2 THE WITNESS: It is Tri-States, Tri-States owns
3 Unit 3. Salt River owns Unit 4. But when we developed
4 the right to build those plants, they agreed to put in
5 the additional equipment which produced the emissions
6 reduction at Units 1 and 2. About 3,000 of those
7 Tri-States gets. And the rest of the emission
8 reductions TEP gets and that's what we are selling.
9 COM. PIERCE: I am trying to figure out how you
10 justify 50 percent instead of all of it actually
11 returning to whatever ratepayers that actually paid for
12 this. Because ratepayers somewhere paid for this, isn't
13 that correct?
14 THE WITNESS: Well, if it, if anybody paid for
15 it, the equipment to produce.
16 COM. PIERCE: That's an interesting start, if
17 anybody paid for it. I am sure there is --
18 THE WITNESS: Well --
19 COM. PIERCE: -- the free gods out there.
20 THE WITNESS: Your premise was that some
21 ratepayer paid for it. What I am saying is that that,
22 that capital that was used that produces these
23 reductions was paid for by Tri-States. If Tri-States
24 is, and in the future SRP will pay some to Tri-States,
25 if -- I don't know if Tri-States charged their customer

61

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

Date: July 10, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 192 through 394, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 With a PPFAC, it's true that there will be a
2 shift of risk from the shareholders to the ratepayers,
3 correct?
4 A. In an increasing market, a fuel clause shifts the
5 risk of regulatory lag with the establishment of fuel
6 prices from the company to the consumer. In a declining
7 market, the regulatory lag associated fuel risk is shifted
8 from the company -- the risk is borne by the company and
9 shifted to the consumer.
10 Q. And Mr. Pignatelli, if more than 50 percent of
11 the company's expenses are guaranteed to be recovered
12 before they are even incurred, shouldn't there be an
13 offset to the company's return on equity to reflect the
14 reduction in risk?
15 A. That's one element of determining what the market
16 will require as an appropriate return. And that is, as I
17 indicated in my answer to one of the Commissioners, the
18 reason that we accepted a significant lower return on
19 equity than that allowed to APS, which also has a fuel
20 clause, as well as accepting a capital structure including
21 equity below which I think we will ultimately achieve over
22 the period of the rate freeze.
23 Q. And so is it your opinion that that cost of
24 equity that's in the settlement agreement reflects that
25 reduction in risk?

62

BEFORE THE ARIZONA CORPORATION COMMISSION

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Date: July 9, 2008

Filed: July 14, 2008

REPORTER'S TRANSCRIPT OF PROCEEDINGS

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ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 THE WITNESS: I don't know if I could come up
2 with that. I can't come up with it today and I don't
3 know whether I could come up with that in a week and
4 answer. I am being honest with you.
5 CHMN. GLEASON: I am not asking you to guess,
6 but it would be higher?
7 THE WITNESS: Yes. The return requirement
8 without a PPFAC is much higher than 10.25, much higher.
9 CHMN. GLEASON: Care to guess?
10 THE WITNESS: APS got 10.75 with a PPFAC. We
11 agreed to 10.25 here. The PPFAC is, the PPFAC
12 essentially, it is not only a return. Why I am
13 hesitating is I could not accept fuel costs based on
14 2006 costs without a PPFAC. I wouldn't be sitting here.
15 My costs net of the wholesale sales, net of
16 50 percent of credit for SO2 allowances, my cost is at
17 least the 3.3 cents. That's why I am saying 2.9,
18 looking at 3 to 4 percent increase to bring it to
19 current fuel costs. So if the agreement was a
20 10 percent base rate increase without a PPFAC, I would
21 still hesitate on that because I think the fuel costs
22 are going to rise. I am not negotiating here. I am
23 just saying facts. Without a PPFAC, we would be here at
24 a minimum of a 10 to 12 percent requirement for base
25 rate increase, plus a higher return on equity, plus,

63

ORIGINAL

BEFORE THE ARIZONA CORPORATION CO

57

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
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RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
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Original and 15 copies of the foregoing filed this 29th day of May, 2008 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
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Arizona Corporation Commission
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Tucson Electric Power Company
Purchased Power and Fuel Adjustment Clause
Plan of Administration

Table of Contents

1. General Description.....1
2. Definitions.....1
3. PPFAC Components.....3
4. Calculation of the PPFAC.....5
5. Filing and Procedural Deadlines.....5
6. Verification and Audit.....6
7. Schedules.....6
8. Compliance Reports.....7
9. Allowable Costs.....9

This recalculation shall replace estimated monthly balances with those actual monthly balances that have become available since the October 31 filing.

The October 31 filing's use of estimated balances for October through March (with supporting workpapers) is required to allow the PPFAC review process to begin in a way that will support its completion and a Commission decision before April 1. The February 1 updating will allow for the use of the most current balance information available. In addition to the February 1 update filing, TEP's monthly filings (for the months of September through December) of Forward Component Tracking Account balance information and True-Up Component Tracking Account balance information will include a recalculation (replacing estimated balances with actual balances as they become known) of the projected True-Up Component unit rate required for the next PPFAC Year.

The True-Up Component Tracking Account will measure the changes each month in the True-Up Component balance used to establish the current True-Up Component as a result of collections under the True-Up Component in effect. It will subtract each month's True-Up Component collections from the True-Up Component balance. The True-Up Component Account will also include Applicable Interest on any balances. TEP shall file the amounts and supporting calculations and workpapers for this account each month.

4. CALCULATION OF THE PPFAC RATE

The PPFAC rate is the sum of the two components; i.e., Forward Component and True-Up Component. The PPFAC rate shall be applicable to TEP's retail electric rate schedules (except those specifically exempted) and is adjusted annually. The PPFAC Rate shall be applied to the customer's bill as a monthly kilowatt-hour ("kWh") charge that is the same for all customer classes.

The PPFAC rate shall be reset on April 1 of each year, and shall be effective with the first April billing cycle only after approval by the Commission. It is not prorated. The first True-Up Component will include costs and revenues from January 1, 2009 through March 31, 2009.

5. FILING AND PROCEDURAL DEADLINES

A. October 31 Filing

TEP shall file the PPFAC rate with all Component calculations for the PPFAC year beginning on the next April 1, including all supporting data, with the Commission on or before October 31 of each year. That calculation shall use a forecast of kWh sales and of fuel and purchased power costs for the coming PPFAC year, with all inputs and assumptions being the most current available for the Forward Component. The filing will also include the True-Up Component calculation for the year beginning on the next April 1, with all supporting data. That calculation will use the same forecast of sales used for the Forward Component calculation.

64

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 15, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME V
(Pages 795 through 1037, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 know, since you haven't had a PPFAC yet I am not sure
2 you know how it all works, but how notice gets out to
3 interested parties that you made the filing?
4 A. No, I do not know that. I would venture to say
5 that however the Commission wanted to handle that when
6 we file that information with Staff, how they would get
7 notice out would be obviously, I would guess, notice to
8 all the people in this docket. But again, there may be
9 other interested parties that we won't know until they
10 show up at the first or sign up onto that docket.
11 Q. Okay. But whatever the process is, Tucson
12 Electric is okay?
13 A. Yes, that's the process to be determined by
14 Staff for whatever works with them and their staffing
15 requirements.
16 ALJ RODDA: Okay. I appreciate that.
17 Mr. Patten, did anything further?
18 MR. PATTEN: I have nothing further, Your Honor.
19 ALJ RODDA: Is there any other party that has
20 any other questions for this witness?
21 (No response.)
22 ALJ RODDA: All right. Well, thank you very
23 much, Mr. Hutchens. It was very informative.
24 THE WITNESS: Thank you.
25 ALJ RODDA: We need to take a break for 10

65

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

Date: July 10, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 192 through 394, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 our budget?
2 THE WITNESS: Can I do what? I never hear myself
3 so -- but I hope you would consider that in the future.
4 ALJ RODDA: It's a good idea.
5 Commissioner Mayes.
6 COM. MAYES: Okay. I'll go ahead.
7
8 EXAMINATION
9
10 Q. (BY COM. MAYES) Mr. Pignatelli, let's start with
11 the PPFAC. As I said yesterday, I'm concerned about the
12 design of it, and maybe you can allay some of those
13 concerns.
14 But let's start with the fact that it doesn't
15 have a cap, apparently. Am I wrong about that?
16 A. This PPFAC, you're correct on that. This PPFAC
17 does not have a cap. I actually believe that caps are
18 inappropriate, to be honest with you.
19 Caps have a result of failing to send the
20 appropriate price signals immediately. They do have the
21 impact of challenging intergenerational. You start to
22 move costs from one group of ratepayers to another group
23 of ratepayers.
24 I can tell you that caps, as I had the discussion
25 with Mr. Robertson yesterday, can cause difficulties in

1 adjust his consumption.
2 I will just say that if you put caps on, it
3 should not be a cap on the ultimate recovery of that cost.
4 If you use it to ameliorate current, if it's properly
5 designed might be appropriate, but give us the opportunity
6 to earn what it costs us to carry that balance, and it's
7 not Treasury bill.
8 Q. Well, again, would you be opposed to an annual
9 cap akin to the one that APS has? I'm not letting you go
10 until you answer this question.
11 A. Well, I wish -- can you give me what APS's cap
12 is? Is it 4 mils? Is it -- I don't know.
13 Q. I believe it's a 4-mil annual cap. Yeah. It
14 used to be lifetime, which is why we wound up with all of
15 those surcharges. But if I'm not mistaken, it's a 4-mil
16 annual. I can check that at a break.
17 A. Are you saying could I take an agreement that
18 allows us to at maximum raise it 4? Or considering that
19 this is a 2006 fuel rate, it was 4 percent for 2007,
20 4 percent for 2008, 4 percent for 2009, 4 percent max, and
21 it accumulates so that right now I could raise it 8 or
22 12 percent? Because the fuel cost has obviously gone up
23 since 2006.
24 Q. Well --
25 A. What is my starting point?

66

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 over 2006 fuel rates, there's no opportunity to win. It
2 would only be a penalty, and it is uncalled for, an
3 unacceptable result. Because if I'm going to lose the
4 difference between 2000 -- 10 percent of the difference
5 between fuel costs based on 2006 rates, fuel, all the way
6 through 2013, that's not a sharing mechanism. That's a
7 penalty.
8 Like I say, if you're going to make a sharing
9 mechanism, make it so that the company has an equal chance
10 to win or lose. You have to make it on the forward
11 component of the purchases, not on the embedded cost of
12 the energy, especially not when it's already two years
13 old.
14 CHMN. GLEASON: Thank you.
15 ALJ RODDA: Thank you, Commissioner Gleason.
16 What I would like to do now is take a break for
17 lunch. So I thought I could get you off before lunch, but
18 I don't think so.
19 Commissioner Hatch-Miller, are you still there?
20 (No response.)
21 ALJ RODDA: Anyway, so let's come back at 1:30.
22 (A recess was taken from 12:07 p.m. to 1:35 p.m.)
23 ALJ RODDA: So let's go back on the record. And
24 Mr. Pignatelli is still on the stand.
25 And Mr. Heyman, I think we have some

1 A. Because it's too long of a freeze. 2009 to 2013
2 is too long a period to absorb a 10 percent loss on fuel
3 increases.
4 Q. But didn't I understand --
5 A. What I said was -- and I will repeat this -- that
6 a sharing mechanism which is equally balanced, equal
7 opportunity to profit and an equal opportunity to lose,
8 would be something we would consider. But not a penalty,
9 and that is a penalty that you just described.
10 Q. What fuel cost price would you consider equally
11 balanced?
12 A. I would look at the additional power necessary to
13 meet new load during a particular year based off the
14 forward curve of supplying that power for that year.
15 Q. So that's not a number that you could provide for
16 us today, correct?
17 A. No, I couldn't tell you a number that I could
18 agree to in 2011. I don't know what the number is going
19 to be then. I can only tell you that you need to look at
20 an appropriate mechanism that looks at what the market is
21 there and gives you an equal opportunity of beating or
22 losing to that market.
23 Q. So that number would change every year, correct?
24 A. That's correct.
25 Q. With regard to the required revenue increase,

67

BEFORE THE ARIZONA CORPORATION COMMISSION

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By: MICHELE E. BALMER
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Certificate No. 50489

Prepared for:

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6 COM. MAYES: Okay. I'll go ahead.
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8 EXAMINATION
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10 Q. (BY COM. MAYES) Mr. Pignatelli, let's start with
11 the PPFAC. As I said yesterday, I'm concerned about the
12 design of it, and maybe you can allay some of those
13 concerns.
14 But let's start with the fact that it doesn't
15 have a cap, apparently. Am I wrong about that?
16 A. This PPFAC, you're correct on that. This PPFAC
17 does not have a cap. I actually believe that caps are
18 inappropriate, to be honest with you.
19 Caps have a result of failing to send the
20 appropriate price signals immediately. They do have the
21 impact of challenging intergenerational. You start to
22 move costs from one group of ratepayers to another group
23 of ratepayers.
24 I can tell you that caps, as I had the discussion
25 with Mr. Robertson yesterday, can cause difficulties in

1 credit in the marketplace.
2 Q. Well, really? I mean, really?
3 A. They can.
4 Q. You're making that argument when you don't have
5 an adjustor mechanism at all right now?
6 A. I know what we struggle with at UNS Electric.
7 Q. We're talking about TEP right now.
8 A. No. I understand that. I'm talking about caps
9 in general. And honestly, if a cap is used to cause a
10 higher and higher balance when you're only allowed
11 Treasury bill rates on it, it is a penalty to the
12 shareholders of the company. And if a cap had a return on
13 rate base, equal to the return on rate base, then maybe I
14 could finance them easier.
15 Q. Then let's talk about the APS adjustor mechanism,
16 which as far as I can tell is about the most generous
17 adjustor mechanism in the country, and even it has a cap
18 on it. It's got an annual cap. It started out with a
19 lifetime cap. And that's what got us into this situation
20 of having to do multiple surcharges, although one could
21 argue in that situation that was because they are much
22 more heavily dependent on natural gas than TEP is, which
23 is an empirical truth.
24 What is wrong with having an annual cap on an
25 adjustor mechanism that is forward-looking and has no

1 90/10 sharing agreement? We'll get to that issue. What
2 is wrong with that?
3 A. A cap on a forward-looking. If it's properly
4 structured, if it's adequate, it would be appropriate.
5 Q. Do you think that the APS adjustor mechanism is
6 appropriate?
7 A. I honestly -- Mr. Hutchens can respond to the APS
8 adjustor mechanism, because I am not that close to it,
9 honestly.
10 But I can tell you that over the period that I
11 looked at, which I believe there's some testimony on, our
12 fuel, total fuel costs went up about 5 percent a year.
13 Now, if you do it on the forward -- and we're
14 looking right now at TEP, the rate that is being
15 established in the base rate is 2006. You know that
16 there's been increases since 2006, so you have to take all
17 of this into consideration.
18 I am not a proponent of caps. I'm willing to
19 work with you on an appropriate cap, knowing that I am
20 opposed to caps.
21 Q. Okay. Well, I appreciate that. Because I have
22 to be honest with you, I cannot vote for an adjustor
23 mechanism that has no cap. It's unconscionable because --
24 and let me get you to respond to this.
25 If there was a run-up in the price of gas to,

68

BEFORE THE ARIZONA CORPORATION COMMISSION

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At: Tucson, Arizona

Date: July 15, 2008

Filed:

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VOLUME V
(Pages 795 through 1037, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 A. Would that be true for TEP's PPFAC rate?
2 Q. Yes, because you set the rate in April, you
3 know, on your forward hedge, forward projections.
4 A. No. Because the first year, if there is a cap
5 in the first year, we are working off a three-year old
6 2006 test year. So that's one of the problems with
7 trying to define a cap in our PPFAC, is we don't have a
8 current, as you put it, generous base cost. We have a
9 low cost.
10 That 2.9 cents we expect to be significantly or
11 somewhat lower than what the projections are in 2009,
12 and so to design a cap accurately for TEP, we have to
13 take that into consideration, that a 4 mil cap in the
14 first year is -- wouldn't be the same to us using a
15 three-year-old stale old test year versus a 4 mil cap on
16 APS's PPFAC, which had a base cost much closer to the
17 expected expenses in that first year.
18 Q. Okay. Well, just for the record at this time I
19 don't favor caps. But didn't I just hear you say that
20 in April '09 we will establish another base cost, base
21 rate?
22 A. No. No, we do not establish another base cost.
23 That is one of the primary pushbacks from trying to
24 apply a cap or trying to accurately design a cap, is we
25 are talking about a 2006 base cost of gas and fuel and

69

BEFORE THE ARIZONA CORPORATION COMMISSION

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	)	SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 14, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV
(Pages 577 through 794, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

Prepared for:

ACC

1 Q. Okay. But, well, let me ask you this: Is that
2 the methodology that we used with the APS adjuster
3 mechanism?
4 A. In this case, this adjuster I think further
5 reflects that refining of the adjuster mechanisms,
6 because to my knowledge, the provision I just quoted to
7 you, and that is that no PPFAC ratio shall become
8 effective without Commission approval, my Staff can
9 correct me but I don't think that's present in the APS
10 adjuster mechanism.
11 Q. I don't think it is either. But the problem
12 that I have with what you just described is I don't know
13 how we go about making a decision about what portion
14 ought to be implemented and what portion shouldn't be
15 implemented. If there is a hurricane and the price of
16 gas goes to $26 mmBTU, are we supposed to just lop it in
17 half, well, we think only part of this hurricane run up
18 in gas should be passed on to the consumers and the
19 company comes back and sues us for being arbitrary?
20 A. No, I don't think you can be arbitrary but I do
21 think that creates an opportunity for dialogue between
22 the Commission and company to figure out how does the
23 Commission and the company jointly best manage this
24 situation, because I do think there is a shared
25 responsibility.

BEFORE THE ARIZONA CORPORATION COMMISSION

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By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

Prepared for:

ACC

1 A. Yes, I would definitely say it does. And I am
2 referring to page 5 of the PPFAC under section 4. The
3 PPFAC rate shall be reset on April 1st of each year and
4 shall be effective with the first April billing cycle
5 only after approval by the Commission.
6 And I would like to point out that that is
7 considerably different from the APS power supply
8 adjustment mechanism which, in section 3 of the APS PSA
9 mechanism, it provides that the APS PSA rate shall be
10 reset on February 1st of each year and shall be
11 effective with the first February billing cycle unless
12 suspended by the Commission.
13 So the TEP PPFAC specifically provides that new
14 PPFAC rates only become effective after approval by the
15 Commission. And Staff insisted on that language being
16 in this PPFAC as we thought it was an appropriate
17 safeguard and in some respects compensated for some of
18 the other potential safeguards to ratepayers not being
19 included.
20 Q. Do you perceive that difference between the APS
21 PPFAC and the proposed PPFAC for TEP which you have just
22 described to be a positive attribute and improvement
23 over the APS approach?
24 A. Well, it depends on your perspective. For
25 ratepayers, yes, it is an additional safeguard. It

1 requires Commission action. From TEP's perspective,
2 they didn't like this particular phrase in there and
3 they tried to have it changed a number of times during
4 the process.
5 But for ratepayers it is a definite. For TEP it
6 is an additional hurdle that they need to overcome in
7 order to have a new PPFAC rate become effective.
8 COM. MAYS: Mr. Robertson, can I interject here?
9 MR. ROBERTSON: Certainly, Commissioner Mayes.
10
11 EXAMINATION
12
13 Q. (BY COM. MAYES) But, Mr. Smith, wouldn't an
14 even stronger ratepayer protection be a cap? Is this,
15 are these two things -- it sounds like Staff used this
16 as the replacement for the cap. Is that correct?
17 A. We didn't really use it as a replacement for the
18 cap directly. This particular language was included in
19 the original Staff proposed PPFAC which was filed with
20 my direct testimony.
21 Q. Right.
22 A. And Staff thought it was quite important so
23 Staff did insist that it remain in the settlement PPFAC.
24 Q. Why?
25 A. The cap is, I think, a different issue.

70

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

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VOLUME II
(Pages 192 through 394, inclusive)

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Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 Q. Well, it's going to be forward looking.
2 A. So you're saying that -- you're saying that the
3 current fuel cost, whatever it is, plus the PPFAC. So in
4 2010, we can't raise that more than 4 percent?
5 Q. 4-mil. It's a 4-mil adjustor.
6 A. A mil is about a percent to us. It just happens
7 that way.
8 Q. Uh-huh.
9 A. See, I don't --
10 Q. You know, I think that we had very similar
11 circumstances with the APS case where they were starting
12 with a lower -- you know, a distant test year, a
13 relatively distant test year.
14 I mean, maybe I'll give you some time on a break
15 to talk to -- and I'll talk to my advisory team about
16 this, but I just don't understand. Let me ask it to you
17 this way.
18 How can TEP expect to get an adjustor mechanism
19 that is more generous than APS's when TEP is less exposed
20 to natural gas than APS is?
21 A. Well, our adjustor mechanism has different
22 provisions which I think mitigate some of the concerns
23 that you have about APS's. It's not an automatic. It
24 requires your approval each year. It requires us to file
25 our expenses and subject them to a three-month prudency

71

ORIGINAL

BEFORE THE ARIZONA CORPORATION C

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and 15 copies of the foregoing filed this 29th day of May, 2008 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Arizona Corporation Commission
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MAY 29 2008
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2008 MAY 29 P 3 31
AZ CORP COMMISSION
DOCKET CONTROL

2.3 The Signatories agree to an annual base rate increase for TEP of approximately six percent (6%) over the current average rate of 8.4 cents per kWh. This approximate six percent (6%) increase does not include the adjustors for Purchased Power and Fuel, Demand-Side Management, and Renewable Energy. The new average retail base rate will be 8.9 cents per kWh. The approximate six percent (6%) increase, calculated on TEP's existing base rates which include revenue for Fixed CTC, is approximately $47.1 million, and increases TEP's existing base revenue from approximately $781.1 million to $828.2 million. The effect of designing rates to recover $828.2 million is a 6.03% increase.

2.4 The Signatories agree that this increase is just and reasonable. This rate increase is based on the fair value rate base and fair value rate of return set forth on Exhibit 1 and upon the original cost rate base, operating revenue, and operating expenses and adjustments thereto shown on Exhibit 2. As shown on Exhibits 1 and 2, the settlement provides for base rate revenues of approximately $828.2 million, which is a base rate increase of approximately $136.8 million over TEP's adjusted current base rates without Fixed CTC of $691.5 million.

2.5 The rates set forth in the Proof of Revenue, attached hereto as Exhibit 3 and incorporated herein, are designed to permit TEP to recover an additional $47.1 million in base revenues as compared to existing test year base revenues (including Fixed CTC but excluding DSM) of $781.1 million.

III. RATEMAKING TREATMENT OF TEP'S GENERATION ASSETS AND FUEL COSTS.

3.1 For ratemaking purposes, Springerville Unit 1 and the Luna Generating Station shall be included in TEP's rate base at their respective original costs. 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. This provision is not intended to create a presumption in favor of generation, and the Signatories acknowledge that TEP is obligated to consider all reasonable alternatives when evaluating how to meet its service obligations to its customers.

3.2 Recovery of Springerville Unit 1 non-fuel costs shall reflect a cost of $25.67 per kW per month which approximates the levelized cost of Springerville Unit 1 through the remainder of the primary lease term for this generating facility. In addition, Springerville Unit 1 leasehold improvements shall be included in TEP's original cost rate base at net book value as of December 31, 2006.

3.3 The Luna Generating Station shall be included in TEP's original cost rate base at net book value as of December 31, 2006.

3.4 The average base cost of fuel and purchased power reflected in base rates shall be set at $0.028896/kWh, as calculated in Exhibit 4.

IV. COST OF CAPITAL.

4.1 The Signatories agree that a capital structure comprised of 57.50% debt and 42.50% common equity shall be adopted for ratemaking purposes in these consolidated dockets.

4.2 The Signatories agree that a return on common equity of 10.25% and an embedded cost of debt of 6.38% are appropriate and shall be adopted for ratemaking purposes in these consolidated dockets.

4.3 The Signatories agree to a fair value rate of return of 5.64%, as shown on Exhibit 1.

72

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 16, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI
(Pages 1038 through 1091, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

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7 energy adjustor. What is RUCO's position on that?
8 A. RUCO has no opposition to that.
9 Q. Okay. Let's move to Section 9, which is the
10 demand-side management programs and adjustor. What is
11 RUCO's position on that?
12 A. We're not opposed to that.
13 Q. Let's move to Section 10, which is the rate case
14 moratorium. What is RUCO's position on that?
15 A. Again, as I mentioned in my opening statement,
16 that's one of the aspects of the agreement that we like.
17 Q. So RUCO supports that; is that correct?
18 A. Yes.
19 Q. Let's move to Section 11, which is the emergency
20 clause. What is RUCO's position on that?
21 A. Well, we certainly couldn't oppose that, because
22 no one knows what can happen in the future.
23 Q. So do I understand your testimony to be that you
24 don't oppose Section 11?
25 A. No. And it wouldn't matter if it was in the

73

TEP's approved DSM programs include the Shade Tree Program, the New Home Construction Program, the Low-Income Weatherization Program, the Education and Outreach Program, the CFL Buydown Program, the Residential HVAC Program, the Small and Large Business Programs, and the Commercial New Construction Program.

74

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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75

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BEFORE THE ARIZONA CORPORATION C

57

COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
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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
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RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
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Phoenix, Arizona 85007
(602) 542-3402

Original and 15 copies of the foregoing filed this 29th day of May, 2008 with:

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Phoenix, Arizona 85007

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performance incentive. The total amount to be recovered would be divided by the appropriate projected retail sales (kWh) for the next year to calculate the per/kWh rate.

9.6 TEP shall file semi-annual DSM reports in Docket No. E-01933A-07-0401 (TEP's DSM Portfolio docket) by March 1st (for period ending December 31st) and September 1st (for period ending June 30th) of each year. The reports should contain the information set forth in Staff's DSM Testimony.

9.7 TEP may continue to propose new DSM programs for Commission review and approval. TEP may recover the reasonable and prudent costs of such Commission-approved programs through its DSM adjustor.

X. RATE CASE MORATORIUM.

10.1 Except as otherwise expressly provided herein, TEP's base rates, as authorized in the Commission order approving this Agreement, shall remain frozen through December 31, 2012, and no Signatory will seek any change to TEP's base rates that would take effect before January 1, 2013.

10.2 TEP shall not submit a rate application sooner than June 30, 2012. On or after June 30, 2012, TEP may not submit a rate application that uses a test year ending earlier than December 31, 2011. The Signatories agree to use their best efforts to have post-moratorium rates in place no later than thirteen months after TEP's rate application is filed with the Commission. For purposes of this paragraph, Staff will be deemed to have used its "best efforts" if it endeavors to process TEP's rate application within the timeframes set forth in A.A.C. R14-2-103. The Signatories recognize that Staff cannot ensure that the Commission will act on a rate application by any date certain.

10.3 The rate moratorium contained herein shall not preclude TEP from requesting, or the Commission from approving, changes to specific rate schedules or terms and conditions of service, or the approval of new rates or terms and conditions of service, that would have a de minimus impact upon TEP's Arizona jurisdictional earnings. For purposes of this Agreement, "de minimus impact" is defined as the lessor of (i) 0.04 percent (0.0004) of the agreed-upon Arizona jurisdictional fair value rate base of $1,451,558,000, as set forth in Exhibit 1, or (ii) a $600,000 annual impact on TEP's calendar year recorded net operating income during the years of the rate moratorium period. Nothing contained in this Agreement is intended to preclude the Commission from approving changes to TEP's tariffs or terms and conditions of service which are consistent with this Agreement.

XI. EMERGENCY CLAUSE.

11.1 Notwithstanding anything contained herein to the contrary, TEP shall not be prevented from requesting a change to its base rates, or necessary changes to the PPFAC mechanism, the DSM adjustor mechanism, or the REST adjustor mechanism, as may be applicable, that would take effect prior to January 1, 2013, in the event of conditions or circumstances that constitute an emergency. For the purposes of this Agreement, the term "emergency" is limited to an extraordinary event that is beyond TEP's control and that, in the Commission's judgment, requires rate relief in order to protect the public interest. This provision is not intended to preclude TEP from seeking rate relief pursuant to this paragraph in the event of the imposition of a federal carbon tax or related federal "cap and trade" system. This provision is not intended to preclude any party from opposing an application for rate relief filed by TEP pursuant to this paragraph.

XII. CERTIFICATE OF CONVENIENCE & NECESSITY.

12.1 The Signatories agree that a generic docket is an appropriate means by which the Commission could address the issue of exclusivity

BEFORE THE ARIZONA CORPORATION COMMISSION

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APPENDIX

IN SUPPORT OF

TUCSON ELECTRIC POWER COMPANY'S

POST-HEARING BRIEF

VOLUME 2 OF 2

August 29, 2008

76

BEFORE THE ARIZONA CORPORATION COMMISSION

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MIKE GLEASON- CHAIRMAN
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James S. Pignatelli

On Behalf of

Tucson Electric Power Company

June 11, 2008

Adjustor rates will be set at $0.000639 per kWh for all kWh sales. The settlement agreement also provides that TEP shall file an application by April 1st of each year for Commission approval to reset the DSM Adjustor rates, and that rates would be reset on June 1 of each year.

I. Rate Moratorium and Emergency Clause

Q. Please explain the rate moratorium provision of the settlement agreement.

A. The settlement agreement provides that TEP will not file a general rate case before June 30, 2012. New rates (except for those initiated pursuant to the emergency clause which I will discuss below), will not go into effect prior to January 1, 2013. TEP has agreed not to use a test year earlier than the 12 months ending December 31, 2011 for its next general rate case filing. TEP believes that the rate moratorium will provide customers with certainty and stability in the future as well as be a means to mitigate the impact of the rate increase over the next 5 years.

Q. Is TEP concerned about agreeing to a rate moratorium for such an extended period of time?

A. Yes, we are. We believe that we can adequately operate the Company during the rate moratorium but are concerned about the negative financial impact of an event that may occur that is beyond our control. Accordingly, the settlement agreement provides an emergency clause (Paragraph 11.1) that would permit TEP to request a change to its base rates, or necessary changes to the PPFAC mechanism, the DSM adjustment mechanism, or the REST adjustment mechanism, as may be applicable, that would take effect prior to January 1, 2013 in the event of an emergency. It was particularly important to TEP that the emergency clause recognize the potential imposition of a carbon tax or "cap and trade" system as a circumstance which might require TEP to seek additional relief. TEP

77

BEFORE THE ARIZONA CORPORATION COMMISSION

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20 clause. What is RUCO's position on that?
21 A. Well, we certainly couldn't oppose that, because
22 no one knows what can happen in the future.
23 Q. So do I understand your testimony to be that you
24 don't oppose Section 11?
25 A. No. And it wouldn't matter if it was in the

1 context of the settlement agreement or anything else. If
2 a utility was distressed and had to come in and apply for
3 emergency rates, we recognize that that is an option for
4 them.
5 Q. Okay. Now, your previous testimony would
6 indicate or suggest that RUCO opposes Section 12; is that
7 correct?
8 A. Well, as I said, we're not a supporter of an
9 unregulated electric market or a deregulated electric
10 market in the state. So I guess our way of viewing
11 this -- can I review this?
12 Q. Certainly.
13 A. Can I have a minute?
14 Okay. I guess our only problem would be from the
15 standpoint that it does leave open some questions as to
16 whether or not Arizona has made up its mind not to pursue
17 electric deregulation or not. And so I suppose from a
18 residential ratepayer standpoint, we probably would just
19 as well see an exclusive CC&N that one would find under
20 traditional ratemaking.
21 Q. Okay. Let's move to Section 13, which is
22 returning customer direct access charge. What is RUCO's
23 position with regard to that?
24 A. Right. Well, again, this goes back to the
25 previous section, of course.

78

ORIGINAL

BEFORE THE ARIZONA CORPORATION CO

57

COMMISSIONERS

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WILLIAM A. MUNDELL
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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
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Janet Wagner

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VII. PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE.

7.1 The Signatories agree that it is in the public interest for TEP to recover its purchased power and fuel expenses through the use of a Purchased Power and Fuel Adjustment Clause ("PPFAC").

7.2 TEP shall be authorized to recover its purchased power and fuel expenses through the PPFAC as described herein. The following is a description of the major features of the PPFAC, details of which are included in the PPFAC Plan of Administration ("POA"), attached hereto as Exhibit 6 and incorporated herein:

a. The allowable PPFAC costs include fuel and purchased power costs incurred to provide service to retail customers. Additionally, the prudent direct costs of contracts used for hedging system fuel and purchased power will be recovered under the PPFAC. The allowable cost components include the following Federal Energy Regulatory Commission ("FERC") accounts: 501 Fuel (Steam), 547 Fuel (Other production), 555 Purchased Power, and 565 Wheeling (Transmission of Electricity by Others). These accounts are subject to change if FERC alters its accounting requirements or definitions.

b. The PPFAC shall allow for recovery of demand charges and costs of contracts used for hedging fuel and purchased power costs.

c. The average retail Base Cost of Fuel and Purchased Power embedded in base rates is set at $0.028896 per kWh.

d. The PPFAC rate will consist of two components, the Forward Component and the True-up Component.

e. The PPFAC Mechanism will be effective starting January 1, 2009. The PPFAC rate will be initially set at zero from January 1, 2009, through March 31, 2009. The first PPFAC Year (and

applicable rate) will be from April 1, 2009, through March 31, 2010. The first True-up Component will include the period of January 1, 2009, through March 31, 2009.

f. The Forward Component will be updated on April 1st of each year, beginning April 1, 2009, and will be the forecasted fuel and purchased costs for the year commencing on April 1st and ending on March 31st of each individual PPFAC Year less the average Base Cost of Fuel and Purchased Power reflected in base rates ($0.028896 per kWh).

g. The True-up Component will reconcile any over-recovered or under-recovered amounts from the preceding PPFAC Year which will be credited to or recovered from customers in the next PPFAC Year.

h. TEP will file the PPFAC Rate with all component calculations for the PPFAC Year (that begins on the following April 1st), including all supporting data, with the Commission on or before October 31st of each year. TEP will update the October 31st filing by February 1st of the next year.

i. TEP has the ability to request an adjustment to the Forward Component at any time during a PPFAC Year should an extraordinary event occur that causes a drastic change in forecasted fuel and purchased power prices.

j. All Short-Term Wholesale Sales Revenue will be credited to fuel and purchased power costs.

k. Ten percent (10%) of annual net positive wholesale trading profits will be credited to fuel and purchased power costs annually. Under no circumstances will any annual net loss on wholesale trading incurred by TEP be shared with or borne by ratepayers.

l. Fifty percent (50%) of the revenues from sales of sulfur dioxide (SO_2) emission allowances will be credited to fuel and purchased power costs.

m. The Company will file monthly reports to Staff's Compliance Section and to RUCO detailing all calculations related to the PPFAC in a form and substance suitable to Staff and as detailed in the POA.

n. The Commission or Staff may review the prudence of fuel and power purchases at any time.

o. The Commission or Staff may review any calculation associated with the PPFAC at any time.

p. No change to the PPFAC rate shall become effective without Commission approval.

q. The balancing account shall accrue interest based on the one-year Nominal Treasury Constant Maturities rate. This rate is contained in the Federal Reserve Statistical Release, H-15, or its successor publication. The interest rate is adjusted annually on the first business day of the calendar year.

VIII. RENEWABLE ENERGY ADJUSTOR.

8.1 The Signatories agree that the REST adjustor mechanism recommended by Staff in its Direct Rate Design Testimony shall be adopted.

8.2 The initial rates of the REST Adjustor Mechanism will be the same as the REST Tariff charges approved in Decision No. 70314.

8.3 Subsequent changes to the REST Adjustor rates will be set in connection with the annual Renewable Energy Implementation Plan

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
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James S. Pignatelli

On Behalf of

Tucson Electric Power Company

June 11, 2008

relies heavily upon coal-fired generation, that is very beneficial to its customers, and the imposition of new legislation, regulations or taxes related to thereto could require the Company to seek emergency relief. Of course the determination of whether emergency relief will be approved remains with the Commission. I am comfortable that in the event of an emergency situation, the Commission will approve the appropriate rate relief to protect TEP and its customers.

J. TEP's CC&N.

Q. Please explain the settlement agreement's treatment of the exclusivity of TEP's Certificate of Convenience and Necessity ("CC&N").

A. The settlement agreement does not change the status quo of TEP's CC&N. The settlement agreement (Paragraph 12.1) indicates that a generic docket is an appropriate means by which the Commission could address the issue of exclusivity of the CC&Ns of the "Affected Utilities" as defined in A.A.C. R14-2-1601.1, should the Commission choose to do so. The settlement agreement (Paragraph13.1) further provides for a Returning Customer Direct Access Charge ("RCDAC") tariff as a means to protect TEP and its customers from the costs of large load customers (above 3MW) leaving and then returning to TEP's system. Moreover, in conjunction with maintaining the status quo, TEP will continue to have unbundled rates for all of its services.

Q. Please explain the settlement agreement provision related to the RCDAC.

A. As I indicated, in recognition of the fact that there may be customers who take direct access service and then desire to return to TEP for electric service, the settlement agreement provides that TEP will file, as a compliance item, a Returning Customer Direct Access Charge ("RCDAC") tariff within ninety (90) days of the effective date of the Commission's order approving the settlement agreement. The settlement agreement

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ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
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By: MICHELE E. BALMER
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Prepared for:

1 agreed, we would have agreed. And I'm not just singling
2 out Mr. Johnson. The rest of the participants may be at a
3 different agreement. That's part of the give and take.
4 I can only say that this is a comprehensive
5 thing, and I was willing to exclude those two items from
6 finality. But I consider the 6 percent and the fuel
7 clause finality. I can't take adjustments in those.
8 ALJ RODDA: As well as there's another open
9 issue, which is the retail competition in your service
10 area. That's another issue that you're willing to leave
11 open.
12 THE WITNESS: Yes. And that's actually the one I
13 thought was the other one. We backed off on exclusivity,
14 giving exclusivity back to our service territory. This
15 provides that our customer can still have an alternate
16 provider of power.
17 Q. (BY COM. MAYES) Let's turn to the cost of gas in
18 the PPFAC. And again, I'll ask Mr. Hutchens this if you
19 would like me to, but -- and first let me ask a question
20 before I get to that.
21 Does TEP believe that the fuel portfolio of a
22 company should be a factor in designing a PPFAC or in
23 whether a company is given an adjustor clause?
24 A. I'm sorry. You better ask Mr. Hutchens on
25 that --

79

BEFORE THE ARIZONA CORPORATION COMMISSION

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Certificate No. 50489

Prepared for:

1 context of the settlement agreement or anything else. If
2 a utility was distressed and had to come in and apply for
3 emergency rates, we recognize that that is an option for
4 them.
5 Q. Okay. Now, your previous testimony would
6 indicate or suggest that RUCO opposes Section 12; is that
7 correct?
8 A. Well, as I said, we're not a supporter of an
9 unregulated electric market or a deregulated electric
10 market in the state. So I guess our way of viewing
11 this -- can I review this?
12 Q. Certainly.
13 A. Can I have a minute?
14 Okay. I guess our only problem would be from the
15 standpoint that it does leave open some questions as to
16 whether or not Arizona has made up its mind not to pursue
17 electric deregulation or not. And so I suppose from a
18 residential ratepayer standpoint, we probably would just
19 as well see an exclusive CC&N that one would find under
20 traditional ratemaking.
21 Q. Okay. Let's move to Section 13, which is
22 returning customer direct access charge. What is RUCO's
23 position with regard to that?
24 A. Right. Well, again, this goes back to the
25 previous section, of course.

80

ORIGINAL

BEFORE THE ARIZONA CORPORATION CC

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

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of the Certificates of Convenience and Necessity ("CC&N") of the "Affected Utilities" as defined in A.A.C. R14-2-1601.1, should the Commission choose to do so.

12.2 The Signatories acknowledge that TEP has the obligation to plan for and to serve all customers in its certificated service area, irrespective of size, and to recognize, in its planning, the existence of any Commission direct access program and the potential for future direct access customers. This Agreement does not bar any Party from seeking to amend TEP's obligation to serve or the Commission's prospective ratemaking treatment of TEP.

12.3 This Agreement is not intended to create, confirm, diminish, or expand an exclusive right for TEP to provide electric service within its certificated area where others may legally also provide such service, to diminish or expand any of TEP's rights to serve customers within its certificated area, or to prevent the Commission or any other governmental entity from amending the laws and regulations relative to public service corporations.

XIII. RETURNING CUSTOMER DIRECT ACCESS CHARGE.

13.1 TEP will file, as a compliance item, a Returning Customer Direct Access Charge ("RCDAC") tariff within ninety (90) days of the effective date of the Commission's order approving this Agreement. The RCDAC tariff will contain the following features:

a. The RCDAC shall apply only to individual customers or aggregated groups of customers with demand load of 3 MWs or greater.

b. The RCDAC shall not apply to a customer who provides TEP with one year's advance written notice of intent to return to TEP generation service and to take TEP Standard Offer service.

c. The RCDAC rate schedule shall identify the individual components of the potential charge, definitions of the components, and a general framework that describes the way in which the RCDAC would be calculated.

d. The RCDAC shall only be established to recover from Direct Access customers the additional costs, both one-time and recurring, that these customers would otherwise impose on other Standard Offer customers if and when the former return to Standard Offer service from their competitive suppliers. The customers shall pay the RCDAC in full within one year of the RCDAC being assessed.

13.2 The Signatories agree that a RCDAC as described above is in the public interest and should be adopted.

XIV. 1999 SETTLEMENT AGREEMENT.

14.1 The Signatories recognize that Decision No. 62103 and the 1999 Settlement Agreement were designed to allow a transition to retail electric competition within a specific time period. Inasmuch as the transition to retail electric competition has thus far not occurred and the time periods applicable to Decision No. 62103 and to the 1999 Settlement Agreement have passed, the Signatories recognize that it is necessary to address the prospective regulatory treatment that is appropriate for TEP under these circumstances.

14.2 To the extent that any party to the 1999 Settlement Agreement or any other party contends that the provisions of this Agreement are inconsistent with Decision No. 62103, the Signatories request that the Commission amend Decision No. 62103 to be consistent with this Agreement.

81

BEFORE THE ARIZONA CORPORATION COMMISSION

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Direct Testimony in Support of the Settlement Agreement

James S. Pignatelli

On Behalf of

Tucson Electric Power Company

June 11, 2008

relies heavily upon coal-fired generation, that is very beneficial to its customers, and the imposition of new legislation, regulations or taxes related to thereto could require the Company to seek emergency relief. Of course the determination of whether emergency relief will be approved remains with the Commission. I am comfortable that in the event of an emergency situation, the Commission will approve the appropriate rate relief to protect TEP and its customers.

J. TEP's CC&N.

Q. Please explain the settlement agreement's treatment of the exclusivity of TEP's Certificate of Convenience and Necessity ("CC&N").

A. The settlement agreement does not change the status quo of TEP's CC&N. The settlement agreement (Paragraph 12.1) indicates that a generic docket is an appropriate means by which the Commission could address the issue of exclusivity of the CC&Ns of the "Affected Utilities" as defined in A.A.C. R14-2-1601.1, should the Commission choose to do so. The settlement agreement (Paragraph13.1) further provides for a Returning Customer Direct Access Charge ("RCDAC") tariff as a means to protect TEP and its customers from the costs of large load customers (above 3MW) leaving and then returning to TEP's system. Moreover, in conjunction with maintaining the status quo, TEP will continue to have unbundled rates for all of its services.

Q. Please explain the settlement agreement provision related to the RCDAC.

A. As I indicated, in recognition of the fact that there may be customers who take direct access service and then desire to return to TEP for electric service, the settlement agreement provides that TEP will file, as a compliance item, a Returning Customer Direct Access Charge ("RCDAC") tariff within ninety (90) days of the effective date of the Commission's order approving the settlement agreement. The settlement agreement

specifies the terms of the RCDAC tariff. The settlement agreement states that the RCDAC tariff will (i) apply only to individual customers or aggregated groups of customers with demand load of 3 MW or greater; (ii) not apply to a customer who provides TEP with one year's advance written notice of intent to return to TEP generation service and to take TEP Standard Offer service; (iii) identify the individual components of the potential charge, definitions of the components, and a general framework that describes the way in which the RCDAC would be calculated; and (iv) only be established to recover from Direct Access customers the additional costs, both one-time and recurring, that these customers would otherwise impose on other Standard Offer customers if and when the former return to Standard Offer service from their competitive suppliers. The RCDAC tariff will further provide that customers shall pay the RCDAC in full within one year of the RCDAC being assessed.

K. Treatment of 1999 Settlement Agreement.

Q. Mr. Pignatelli, what does the settlement agreement provide regarding the status of and any claims arising under the 1999 Settlement Agreement?

A. The settlement agreement generally provides that TEP's rates shall be determined based upon cost-of-service ratemaking principles and that upon issuance of a final non-appealable order approving the settlement agreement, TEP shall (i) forgo claims related to a breach of the 1999 Settlement Agreement (and Decision No. 62103); (ii) not seek to recover damages related to the Commission setting its rates under cost-of-service ratemaking principles (as set forth in my testimony in this proceeding); (iii) not seek to recover damages related to the rate freeze adopted in Decision No. 62103; and (iv) forgo claims related to the 1999 Settlement Agreement or Decision No. 62103.

82

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At: Tucson, Arizona

Date: July 16, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI
(Pages 1038 through 1091, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
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19 as well see an exclusive CC&N that one would find under
20 traditional ratemaking.
21 Q. Okay. Let's move to Section 13, which is
22 returning customer direct access charge. What is RUCO's
23 position with regard to that?
24 A. Right. Well, again, this goes back to the
25 previous section, of course.

1 Q. So would RUCO's position be essentially the same
2 as it is with regard to Section 12?
3 A. Yes.
4 Q. Let's move to Section 14, which is the 1999
5 settlement agreement. What is RUCO's position with regard
6 to the provisions of Section 14 and how they deal with the
7 1999 settlement agreement?
8 A. Again, can I review it?
9 Q. Certainly.
10 A. Okay. Again, I think we have talked about this.
11 We certainly wouldn't be opposed to it. But again, there
12 is always the question as to whether or not the company
13 would have prevailed in a lawsuit, I guess.
14 Q. As of this point in the proceeding, is RUCO
15 opposed to the provisions of Section 14, can RUCO support
16 those provisions, or is RUCO indifferent or has no
17 position?
18 A. I believe we could support it.
19 Q. Let's move to Section 15, fixed CTC true-up
20 revenues. What is RUCO's position with regard to how that
21 subject is dealt with in the settlement agreement?
22 A. Right. And there was some discussion on that
23 yesterday, and obviously this was the section that I
24 referred to that the parties, the signatories could not
25 resolve among themselves.

83

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XVI. RATE DESIGN.

A. Rate Spread.

16.1 Except as set forth in Paragraph 16.28, the base revenue increase is to be spread across all customers such that each rate schedule shall reflect the same increase of 6.1% in adjusted base revenues as shown on Exhibit 7. The 6.1% increase is the result of holding low-income customers harmless from the rate increase. Selected rate schedules are attached as Exhibit 8.

16.2 This increase also applies to TEP's existing time-of-use schedules, which will be frozen to new subscription.

B. Inclining Block Rate Structure.

16.3 The Signatories agree that rate design can be used as an important energy conservation incentive. To accomplish this goal for the Residential Rate 01 service classification, the rate structure shall be redesigned as an inclining block rate, meaning that the unit price of electricity, excluding the customer charge, shall increase as consumption increases.

16.4 Residential Rate 01 shall have three blocks and shall be seasonally (summer/winter) differentiated with the first block applicable to kWh usage from 0 to 500 kWhs. The second block will be for usage of the next 3,000 kWhs or 501 kWhs to 3,500 kWhs. The third block will be for usage above 3,500 kWhs.

16.5 This rate structure recognizes that there are a large percentage of users that have relatively small usage, while also recognizing that a relatively small amount of users use a relatively large amount of energy. For example, during the Summer Period for Residential Rate 01, 27% of all bills are for usage under 500 kWhs per month. For those customers, the average usage is only 280 kWhs per

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Dallas J. Dukes

on Behalf of

Tucson Electric Power Company

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DSM and PPFAC charges. Some higher usage customers could see an increase significantly higher than 6.1%, particularly when the DSM and PPFAC charges are included. REST replaced the Environmental Portfolio Surcharges formerly in rates. REST charges are included in the current rate calculations used in Exhibits attached to my Direct Testimony in Support of the Settlement.

1. Inclining Block Rate Structure.

Q. You mentioned an inclining or inverted block structure for Residential and Small General Service Customers. What are the benefits of these schedules?

A. The inclining block rate structure imposes higher incremental prices on higher kWh usage, and therefore will encourage customers to conserve. Moreover, higher prices in the upper block(s) allow the first block price to be lower. This allows service for basic needs to be priced at lower levels. In the proposed residential rates, the first block is 0 to 500 kWh. Exhibit DJD-4 shows an example of potential usage for a hypothetical low-use customer.

Q. Please describe how the inclining block structure is applied to the residential rate design.

A. Under the settlement agreement, Residential Pricing Plan R01N has a seasonal (summer/winter) structure and three rate blocks. The first block applies to kWh usage from 0 through 500 kWh. This is the lowest priced block. The second and third blocks are monthly kWh usage of 501 to 3,500 and over 3,500 kWh, respectively. The inverted block structure results in the smallest increases for lower-use customers, with average usage under 500 kWh.

84

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REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME V
(Pages 795 through 1037, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 response in my opening statement.
2 Q. And there are actually other benefits from the
3 proposed settlement agreement that you haven't
4 identified, aren't there? And let me just give you a
5 couple and see if you agree. One is the use of an
6 inclining block rate structure in the rate design?
7 A. Yes. We didn't note any of the rate design
8 provisions, but, well, as I mentioned, as I actually
9 mentioned here in this data request, that we thought
10 that one of the benefits was expanded time-of-use rates.
11 And I guess in that we were actually kind of referring
12 to the, I guess, the total package of rates that were
13 being offered. In other words, we were, when we said
14 expanded time-of-use rates, we were also agreeing with
15 the inclining rate structure that you just referred to.
16 Q. But that is not a part of only time-of-use
17 rates, it is part of the general R-1 rate as well, isn't
18 it?
19 A. That's my understanding, yes.
20 Q. Okay. That's a real benefit to the residential
21 customers?
22 A. Well, we would agree with that. This is, as I
23 say, we were just trying to make a broad, make a
24 broad -- give you a broad outlook of what we thought of
25 those aspects of the settlement agreement that we

85

ORIGINAL

BEFORE THE ARIZONA CORPORATION C

57

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month. In contrast, only 1.4% of all Residential Rate 01 bills contain usage above 3,500 kWhs. For these customers, the average usage is 4,766 kWhs per month.

16.6 General Service Rate 10 shall be redesigned to have an inclining block structure with two rates. The first rate shall apply to the first 500 kWhs per month, and the second rate for usage above 500 kWhs. Similar to Residential Rate 01, many General Service Rate customers are small users with 30% of the usage in this rate class falling under 500 kWhs. For these customers, average usage is approximately 200 kWhs.

C. Time-of-Use.

16.7 The Signatories agree that sending price signals to customers as to how TEP's cost to serve may change in different times of the year and times of the day provides an important energy conservation incentive. The Signatories therefore agree that expanding the availability of time-of-use rate schedules is in the public interest. All time-of-use rate schedules shall be available on an optional basis. Time-of-use will not be mandatory for any customer.

16.8 TEP will implement new time-of-use schedules that will be open for new subscription. Under newly implemented time-of-use rates, all residential, general service, large general service, and large light and power customers will be offered a time-of-use option.

16.9 TEP commits to design a program to educate customers on the potential for load shifting and bill reduction under time-of-use rates, and will make a good faith effort to promote time-of-use so as to increase subscription thereto.

16.10 TEP shall offer three new optional residential time-of-use schedules to replace the current (to-be-frozen) Rate 70. The customer charges under the three new rates will be $8.00 per month.

16.11 The three new residential options shall be offered to allow a customer to choose a schedule fitting his lifestyle and to result in load shifting that will be beneficial to system operations.

16.12 The three new residential time-of-use schedules shall offer customers flexibility for weekend usage, which should make the new optional rates attractive to potential subscribers.

16.13 In order for customers to clearly see the advantages of shifting power to the off-peak period, there are several key elements of the residential time-of-use schedules as compared to the non-time-of-use schedules:

a) Each time-of-use option will have the same inclining block rate structure as the non-time-of-use schedule.

b) The rate for the shoulder period for the time-of-use schedules will be between the peak and off-peak rate.

c) The rate for the peak periods for the time-of-use schedules will be higher than the rate for the non-time-of-use schedule.

d) The rate for the off-peak periods for the time-of-use schedules will be lower than the rate for the non-time-of-use schedule.

16.14 Time-of-use rates shall be seasonally differentiated. "Summer" shall include the billing months of May through October. "Winter" shall include the billing months of November through April.

16.15 New time-of-use schedules shall include:
Rate 70N-B Residential Time-of-Use – (Weekend Shoulder)
Rate 70N-C Residential Time-of-Use – (Weekend Super-Peak)

Rate 70N-D Residential Time-of-Use – (Weekend Off-Peak)
Rate 201BN Special Residential Time-of-Use (Guarantee Home)
Rate 201CN Special Residential Time-of-Use/Solar (Guarantee Home)
Rate 76N General Service Time-of-Use
Rate 85N Large General Service Time-of-Use
Rate 90N Large Light and Power Time-of-Use

16.16 Under Rate 70N-B (Weekend Shoulder), on summer weekends and selected holidays, the shoulder period will be 2 p.m. - 8 p.m. with no peak period. On winter weekends and selected holidays, there will be only an evening peak from 5 p.m. - 9 p.m. The winter morning peak period (6 a.m. - 10 a.m.), which applies on weekdays, will be treated as off-peak. Weekday hours under Rate 70N-B will be as follows: Summer Peak, 2 p.m. - 6 p.m.; Summer Shoulder, 12:00 noon - 2 p.m. and 6 p.m. - 8 p.m.; and Winter Peak, 6 a.m. – - 10 a.m. and 5 p.m. - 9 p.m.

16.17 Under Rate 70N-C (Weekend Super-Peak), there will be no weekend and holiday shoulder. On summer weekends and selected holidays, there will be a four-hour peak period from 2 p.m. - 6 p.m. All other weekend/holiday hours will be off-peak. On winter weekends and selected holidays, there will be a four-hour peak period from 5 p.m. - 9 p.m. The winter morning peak period (6 a.m. - 10 a.m.), which applies on the weekdays, is treated as off-peak. Weekday hours under Rate 70N-C match 70N-B. The hours differ only on weekends.

16.18 Under Rate 70N-D (Weekends Off-Peak), all weekend and selected holiday hours will be off-peak. Weekday hours under Rate 70N-C match 70N-B. The hours differ only on weekends.

16.19 The new non-residential time-of-use rates shall apply to each day of the year, with no distinction for weekdays, weekend days, or

holidays. Peak demand charges, where they exist, will apply to periods designated as shoulder, in addition to peak periods.

16.20 The non-residential time-of-use schedules will have a summer on-peak period from 2 p.m. - 6 p.m., and two shoulder periods from 12 noon - 2 p.m. and 6 p.m. - 8 p.m. Other summer hours will be off-peak. The winter peak period shall run from 6 a.m. - 10 a.m. and 5 p.m. - 9 p.m. Other winter hours shall be off-peak.

16.21 Current residential time-of-use rate schedules shall be frozen to new subscription. Frozen rate schedules shall remain in place for existing customers at existing sites or delivery points. New customers will not be eligible for service under frozen schedules.

16.22 Frozen time-of-use schedules shall include:

Rate 21 Residential Time-of-Use
Rate 70 Residential Time-of-Use (with shoulder)
Rate 201B Special Residential Time-of-Use (Guarantee Home)
Rate 201C Special Residential Time-of-Use/Solar (Guarantee Home)
Rate 76 General Service Time-of-Use
Rate 85A Large General Service Time-of-Use
Rate 85F Large General Service Time-of-Use
Rate 90A Large Light and Power Time-of-Use
Rate 90F Large Light and Power Time-of-Use

16.23 TEP agrees to publicize in a manner agreeable to Staff the current Residential TOU Rate 70 so as to give customers a final opportunity to subscribe before the schedule is closed to all new subscription.

86

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By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 Q. Okay. And that's what TEP estimates, in RUCO's
2 understanding, the base fuel cost will be when rates go
3 into effect in 2009, correct?
4 A. Yes.
5 MR. POZEFSKY: Nothing else. Thank you, Your
6 Honor.
7 ALJ RODDA: Okay. I'm sorry, Mr. Pozefsky. You
8 reminded me just to ask him something else.
9
10 FURTHER EXAMINATION
11
12 Q. (BY ALJ RODDA) When you were going through that
13 exercise with Mr. Robertson, he sort of stopped at a
14 certain point, but after that comes rate design, and
15 that's Section 16.
16 So except for the amount of revenue that's being
17 collected, does RUCO have issues with the rate designs
18 that have been proposed here?
19 A. No. And as a matter of fact, I think I mentioned
20 yesterday as far as time-of-use, RUCO would have actually
21 have liked to have seen time-of-use become mandatory for
22 new customer connections. We think that that might help
23 to jump start the program. Because I guess they have an
24 existing time-of-use program out there right now that for
25 whatever reason just simply hasn't caught on with

87

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 15, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME V
(Pages 795 through 1037, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 response in my opening statement.
2 Q. And there are actually other benefits from the
3 proposed settlement agreement that you haven't
4 identified, aren't there? And let me just give you a
5 couple and see if you agree. One is the use of an
6 inclining block rate structure in the rate design?
7 A. Yes. We didn't note any of the rate design
8 provisions, but, well, as I mentioned, as I actually
9 mentioned here in this data request, that we thought
10 that one of the benefits was expanded time-of-use rates.
11 And I guess in that we were actually kind of referring
12 to the, I guess, the total package of rates that were
13 being offered. In other words, we were, when we said
14 expanded time-of-use rates, we were also agreeing with
15 the inclining rate structure that you just referred to.
16 Q. But that is not a part of only time-of-use
17 rates, it is part of the general R-1 rate as well, isn't
18 it?
19 A. That's my understanding, yes.
20 Q. Okay. That's a real benefit to the residential
21 customers?
22 A. Well, we would agree with that. This is, as I
23 say, we were just trying to make a broad, make a
24 broad -- give you a broad outlook of what we thought of
25 those aspects of the settlement agreement that we

88

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 11, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME III
(Pages 395 through 576, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 edge of poverty in a manner that would allow those costs
2 to potentially escalate out of control automatically? I
3 mean, that kind of automatic, in my mind, virtually
4 unchecked pass-through to customers?
5 A. I would have a concern about that, certainly.
6 Q. And what -- in terms of how we should be -- let
7 me just say this. As you know, I think this is an
8 important part of this settlement agreement, and will be
9 an important part of my decision-making on it. But it
10 seems to me that this is the first time, unless I'm wrong,
11 unless I'm not thinking of something, that such a
12 provision to completely hold low income customers harmless
13 from a rate increase has been enacted or could potentially
14 be enacted by the Commission; is that right?
15 A. That's my understanding as well, yes.
16 Q. And have you seen it done in other states?
17 A. I have not in recent times seen it done in other
18 states, no.
19 Q. And do you think it's something that the
20 Commission should look at in other rate cases?
21 A. Absolutely. We would definitely support on an
22 ongoing basis holding the low income customers harmless.
23 You know, and I appreciate the pressures that the company
24 is facing and the other utility companies face, but the
25 reality is when low income customers can't pay their

89

ORIGINAL

BEFORE THE ARIZONA CORPORATION C.

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

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Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

05201AF - FROZEN, R-05201BF - FROZEN, and R-0621F - FROZEN, R-0821F – FROZEN. In the naming convention, the first two numbers correspond to the current low-income rider. The last numbers correspond to the existing rate to which the discount is applied. Therefore, R-0401F indicates existing low-income Rider 4 combined with existing Residential Rate 1.

16.30 The following low-income tariffs will remain open to new subscription: R-0601, R-0670, R-06201A, R-06201B, R-0801, R-0870, R-08201A, and R-08201B, R-08201C, and R-06201C.

16.31 Low income customers, both under frozen low-income tariffs and unfrozen low-income tariffs, will not be subject to the PPFAC. Incremental fuel and purchased power costs that these low-income customers would have otherwise paid under the PPFAC will be recovered from all remaining customers subject to the PPFAC.

XVII. RULES AND REGULATIONS.

17.1 TEP shall file its Rules and Regulations, including the changes proposed by TEP in its rate application and the changes thereto proposed by Staff, no later than June 11, 2008. It is the Signatories' understanding that the changes to TEP's Rules and Regulations shall not be inconsistent with the provisions of this Agreement.

17.2 Any Signatory to this Agreement shall raise in the hearing any contentions as to whether the Rules and Regulations proposed pursuant to Paragraph 17.1 are inconsistent with the terms of this Agreement or are otherwise inappropriate.

17.3 Among the significant changes to TEP's rules and regulations is the elimination of free footage from TEP's line extension tariffs.

90

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 16, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI
(Pages 1038 through 1091, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 customers.
2 Q. Right. But the design of the time-of-use, the
3 specific ones that are proposed here, RUCO doesn't have a
4 problem with them except for maybe the revenue they would
5 collect?
6 A. Yes. Yes, that's correct.
7 Q. And how about the rules and regulations that the
8 company has filed? Do you have --
9 A. Oh, you mean the tariffs?
10 Q. Well, under Section 17, RUCO is to file its rules
11 and regulations. I think they eliminate -- is that where
12 they eliminate the free footage? Do you have a problem
13 with the elimination of the free footage?
14 A. No, we have no problem with that.
15 Q. And do you -- I can't remember from your -- I
16 remember that you didn't like -- in your testimony that
17 you thought some of the deferral of the CTC and the issue
18 of retail access you thought were problematic.
19 A. Yes.
20 Q. But there are some other things that, according
21 to the settlement agreement, that's going to be decided
22 later, some partial requirements tariffs and interruptible
23 tariff and the demand response program.
24 Do you have a position on any of those, or do you
25 think that's problematic as well?

91

ORIGINAL

BEFORE THE ARIZONA CORPORATION C

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

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Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

XVIII. ADDITIONAL TARIFF FILINGS.

18.1 TEP agrees to file within ninety (90) days of the effective date of the Commission's approval of this Agreement the following tariffs, to be developed in consultation with Staff and interested stakeholders, as compliance items for Commission approval:

a. New Partial Requirements Tariffs that both protect TEP's ability to recover fixed costs and facilitate the development of renewable energy projects and environmentally friendly self-generation. These tariffs will be designed so as to not inhibit the installation of large scale solar or other renewable projects. The new Partial Requirement Tariffs shall provide for supplemental, standby, and maintenance services. Supplemental service shall be based on the unbundled delivery price components applicable to full requirements customers. Maintenance service shall be provided at a rate that recognizes that usage may be scheduled at times with lower cost-to-serve. Standby service shall be priced at such a level that balances the cost recovery needs of TEP with the desires of stakeholders to promote economically viable self-generation.

b. An Interruptible Tariff that provides a range of options with respect to notice requirements, duration, and frequency, and that will provide credits to participating customers based on avoided capacity costs. The interruptible program could also have options for "economic interruptions" as well as interruptions based on capacity or transmission constraints.

c. A Demand Response Program Tariff that establishes a voluntary program whereby customers reduce demand levels for specified durations upon notification by TEP that a critical situation exists. TEP will focus on enrolling interested commercial and industrial customers whose operations permit them to commit to specific load reduction targets during critical periods. The

program will be designed so as to balance TEP's need to reduce peak demand with the customers' desire to maintain viable operations. TEP and stakeholders will also explore the potential advantages of a program through which interested parties could receive bill credits for verifiable demand reduction over expanded hours with high incremental costs. The bill credit program would be in addition to, not in place of, a voluntary program with no payments. Finally, TEP will explore notification methods whereby smaller customers, such as residential customers and smaller general service customers, can contribute to critical period load reduction.

d. A Bill Estimation Tariff that reflects the terms and procedures contained in TEP's Rules and Regulations, and additionally addresses specific permutations of demand and energy estimation for situations with varying history (e.g., at least twelve (12) months, less than twelve (12) months, or no history), status of customer at premise (new customer or existing customer), and status of premise (at least twelve (12) months premise history, less than twelve (12) months of premise history, or new premise).

XIX. FUEL AUDIT.

19.1 TEP agrees to implement the fuel audit recommendations set forth by Staff in its Direct Testimony, except that the fuel audit recommendations need not be completed prior to the implementation of the PPFAC. TEP should file an implementation plan within ninety (90) days of the effective date of the Commission's order approving this Agreement.

XX. MISCELLANEOUS PROVISIONS.

20.1 The Signatories agree that all currently filed testimony and exhibits shall be offered into the Commission's record as evidence. The Signatories acknowledge that the filing of testimony was suspended

92

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 10, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 192 through 394, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 Q. We did it in the APS case.
2 A. Okay. Counsel will come back to you on that.
3 Q. Can you come back to me on that at a break?
4 A. Ray will answer that before the end of this
5 proceeding.
6 Q. Well, what would be the problem with that?
7 You're fully supportive of the rules, aren't you?
8 A. Yes. I don't know the implication of why you --
9 of why, unless you believe that you have exceeded your
10 authority in --
11 Q. No.
12 A. -- calling them out.
13 Q. No, we don't believe that we exceeded our
14 authority. We believe that we are on firm ground on that
15 issue.
16 A. Then I don't know why you need it.
17 Q. Well, you know, lawsuits are happening and, you
18 know, this is something that reinforces the notion that
19 the Commission can do this and is doing it in the form of
20 rate cases, because we have the authority to do it as a
21 part of our ratemaking process. So I would -- I need an
22 answer to that.
23 A. You will have an answer to that.
24 Q. Okay. Would you be opposed to formulating the
25 tariffs, the partial requirements tariffs, before the

1 Commission votes on this? When I raised this issue, I was
2 not expecting to see language as vague as I see in the
3 settlement agreement. I thought we were going to have
4 something much more concrete to look at.
5 A. You'll have it.
6 Q. Okay. Thank you.
7 Going to time-of-use tariffs -- and tell me if
8 you want me to ask somebody else this question --
9 Section 16.23 of the settlement agreement, which is
10 Page --
11 A. 23?
12 Q. -- 16.3? There it is, 16.23.
13 Why would TEP leave the old tariff in place? Why
14 shouldn't existing customers be given, let's say, six
15 months to choose one of your three new time-of-use rates
16 and then migrate over to one of those new rates,
17 especially if the new rates are good for customers?
18 Wouldn't that make more sense than leaving the old
19 time-of-use rate in place and leaving customers on it?
20 A. Staff wanted us to maintain that existing TOU
21 rate for a period of time.
22 Q. Okay. Do you think you could get customers
23 migrated? I'll ask Staff about that. Would you oppose
24 that?
25 A. Are you asking Staff that or --

93

ORIGINAL

BEFORE THE ARIZONA CORPORATION CC

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

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1200 West Washington Street
Phoenix, Arizona 85007

program will be designed so as to balance TEP's need to reduce peak demand with the customers' desire to maintain viable operations. TEP and stakeholders will also explore the potential advantages of a program through which interested parties could receive bill credits for verifiable demand reduction over expanded hours with high incremental costs. The bill credit program would be in addition to, not in place of, a voluntary program with no payments. Finally, TEP will explore notification methods whereby smaller customers, such as residential customers and smaller general service customers, can contribute to critical period load reduction.

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ORIGINAL

BEFORE THE ARIZONA CORPORATION CC

57

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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
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Robin Mitchell, Attorney
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arising from or pertaining to the 1999 Settlement Agreement and Decision No. 62103.

14.9 The Signatories recognize that certain waivers were provided to TEP under the 1999 Settlement Agreement. As these waivers were previously evaluated in the context of the then-contemplated transition to competition, they may not continue to be in the public interest. The Signatories agree that TEP shall file an application with the Commission addressing all of these waivers within ninety (90) days of the issuance of a Commission order approving this Agreement. In that proceeding, the Commission shall evaluate whether these waivers remain appropriate.

XV. FIXED CTC TRUE-UP REVENUES.

15.1 Certain issues related to the Fixed CTC True-up revenues remain unresolved by this Agreement, and the Signatories agree to present their respective positions in the hearing scheduled in this proceeding. Specifically, the Signatories shall present to the Commission their respective positions as to when TEP's new rates may go into effect and how TEP's Fixed CTC True-up revenues, as defined in Decision No. 69568, should be calculated and treated. The Signatories may present evidence to the Commission in the hearings scheduled in these consolidated dockets regarding these issues. This provision is not intended to limit any party's ability to present its position on these issues.

15.2 To the extent that the Commission determines that any Fixed CTC True-up revenues are to be credited to customers, then TEP agrees that an amount equal to any such Fixed CTC True-up revenues, up to $32.5 million, shall be credited to customers in the PPFAC balancing account.

15.3 The Commission shall determine the disposition of additional Fixed CTC True-up revenues, if any, to be credited to customers.

95

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 14, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV
(Pages 577 through 794, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

Prepared for:

ACC

1 appropriate and fair because the fixed CTC was
2 originally a carve out of the rate then in effect in
3 1999?
4 A. Yes. I think that's an important contextual
5 issue, Mr. Grant.
6 When we negotiated the 1999 settlement
7 agreement, it was very important to both AECC and RUCO
8 who negotiated that agreement that the stranded cost
9 recovery not be additive to existing rates. And indeed
10 they were not. The fixed CTC was in essence a color
11 coding of existing rates that were deemed to be
12 associated with the fixed CTC costs and, in essence,
13 would be a carve out of existing rates. And I agree
14 that in that context, recognizing that it was a
15 component of existing rates to start with, and again
16 recognizing that we are agreeing that cost of service
17 rates will be applicable starting 1/1/09, which are to
18 be higher than current cost of service rates, the fact
19 that this was not additive but simply a designation of
20 existing rates is relevant in reaching a decision about
21 this, that what I am proposing is reasonable.
22 Q. Mr. Higgins, in other words, the roughly, what,
23 9.3 mils that was the fixed CTC was part of a rate which
24 the Commission previously had found was just and
25 reasonable simply for the provision of electric service,

BEFORE THE ARIZONA CORPORATION COMMISSION

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

Direct Testimony of Kevin C. Higgins

on behalf of

Phelps Dodge Mining Company and

Arizonans for Electric Choice and Competition

2008 Settlement Agreement

June 11, 2008

TEP estimated that approximately $66 million of True-Up Revenues will be collected between May 2008 and December 31, 2008.[2]

The 2008 Settlement Agreement resolves the "market versus cost" dispute in favor of the positions taken by Staff, RUCO, and AECC. It has been AECC's position, as expressed in my direct testimony filed previously in this case, that AECC would be willing to accept a resolution in which True-Up Revenues were retained by TEP under the Cost-of-Service Methodology, <u>if</u>, and <u>only if</u>, this concession were accompanied by TEP's withdrawal of all claims that the Company would be harmed by setting rates at cost-of-service. The 2008 Settlement Agreement results in such a withdrawal of claims. Therefore, I believe that in the context of the overall settlement, a result that splits the True-Up Revenues between customers and the Company is reasonable. For this reason, I am recommending that the greater of $32.5 million or 50 percent of the True-Up Revenues be credited to customers and that TEP be allowed to retain the remainder of the True-Up Revenues as part of the fair resolution of the issues outstanding in this proceeding. The crediting of the customer share of the True-Up revenues to the PPFAC balancing account is the same recommendation I made on page 42 of my direct testimony filed on February 29, 2008.

It is useful to bear in mind that when the Fixed CTC was established in 1999, it was not a new cost that was added to TEP's existing rates, but a "carve-out" of then-existing rates which was designated for Fixed CTC recovery. Thus, when the Fixed CTC expires, removing this charge would not remove something

[2] Direct testimony of Kentton C. Grant, p. 11, line 23 - p. 12, line 1.

that was "added on" to rates, but rather removal would strip out a pre-existing portion of rates. In the context of the 1999 Settlement Agreement, in which it was anticipated that many customers would be shopping in competitive markets, it was reasonable to expect that the Fixed CTC charge would be extinguished when it had served its purpose of collecting $450 million in stranded cost. However, in the context of the 2008 Settlement Agreement, in which the Signatories believe that a revenue requirement increase over current rates (inclusive of the Fixed CTC) is just and reasonable going forward, and in which the "market versus cost" dispute is resolved in favor of customers, a sharing of the True-Up Revenues between the Company and customers is an appropriate outcome.

Response to Staff Request for Procedural Order Dated June 6, 2008

Q. Do you have any comments with respect to Staff's Request for a Procedural Order dated June 6, 2008?

A. Yes. Staff's Request states that the Settlement Agreement provides for an approximate six percent rate increase across all rate schedules with the exception of the life line rates. Staff's Request then goes on to state: "Such an increase would have an impact on the power supply agreements approved by Decision No. 65207 and Decision No. 69873."

Without addressing the legal aspects of Staff's Request, I do not support Staff's Request as a matter of ratemaking policy nor do I believe that Staff's Request is called for by the 2008 Settlement Agreement.

96

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
Chairman
MARCIA WEEKS
Commissioner
CARL J. KUNASEK
Commissioner

IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR A HEARING TO DETERMINE THE EARNINGS OF THE COMPANY, THE FAIR VALUE OF THE COMPANY FOR RATE-MAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON AND TO APPROVE RATE SCHEDULES IN CONNECTION THEREWITH.	DOCKET NO. U-1933-95-317 DECISION NO. 59594 ORDER

Arizona Corporation Commission
DOCKETED
MAR 29 1996
DOCKETED BY

Public Hearing
January 17, 18, 19, 1996
Tucson, Arizona

Open Meeting
March 27, 1996
Tucson, Arizona

FINDINGS OF FACT

1. TUCSON ELECTRIC POWER COMPANY ("TEP" or "the Company") is an Arizona public service corporation engaged in the generation, transmission and distribution of electric power within the State of Arizona, pursuant to Article 15 of the Arizona Constitution.

2. On July 12, 1995, TEP's Application for a Hearing to Determine the Earnings of the Company for Ratemaking Purposes, To Fix a Just and Reasonable Rate of Return Thereon and to Approve Rate Schedules in Connection Therewith ("Application") was found sufficient by Staff, docketed, and assigned docket No. U-1933-95-317. Thereafter, on July 13, 1995, the Commission's Hearing Division issued its Rate Case Procedural Order establishing, inter alia, a procedural schedule for the case. Pursuant to the

reduction of $600,000 to the revenue requirement increase of $9.5 million that is specified in the Agreement.

13. In TEP's last rate filing, the Commission adopted a hypothetical capital structure of 40 percent equity and 60 percent debt to aid TEP's financial condition. It appears from the record in this matter that TEP's financial health has improved. In recognition of this improvement, the Commission will adopt a capital structure of 37.5 percent equity and 62.5 percent debt, which will reduce by 2.5 million the increase contained in the Agreement.

CONCLUSIONS OF LAW

1. TEP is a public service corporation within the meaning of Article 15 of the Arizona Constitution and A.R.S. Sections 40-250, 40-251 and 40-367.

2. The Commission has jurisdiction over TEP, over the subject matter of this proceeding and over the Agreement submitted by the parties.

3. The Agreement resolves all the issues pending in the docket referenced in the caption of this proceeding in a manner which is just and reasonable, and which promotes the public interest.

4. The Commission's acceptance of the Agreement as modified herein is in the public interest.

5. Based on the Agreement of TEP and Staff as modified herein, for purposes of this proceeding, TEP's fair value rate base is $1,359,085,000, and a fair and reasonable rate of return on that fair value rate base is 6.59 percent.

. . . . .

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BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED

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Received

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR APPROVAL OF ITS PLAN FOR STRANDED COST RECOVERY.	DOCKET NO. E-01933A-98-0471
IN THE MATTER OF THE FILING OF TUCSON ELECTRIC POWER COMPANY OF UNBUNDLED TARIFFS PURSUANT TO A.A.C. R14-2-1601 *ET SEQ.*	DOCKET NO. E-01933A-97-0772
IN THE MATTER OF COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.	DOCKET NO. RE-00000C-94-0165 DECISION NO. 62103 **OPINION AND ORDER**

DATES OF HEARING: August 9, 1999 (pre-hearing conference), August 11, 12, and 13, 1999

PLACE OF HEARING: Tucson, Arizona

PRESIDING OFFICER: Jerry L. Rudibaugh

IN ATTENDANCE: William A. Mundell, Commissioner

APPEARANCES: Mr. Bradley S. Carroll on behalf of Tucson Electric Power Company;

Mr. Jay L. Shapiro, FENNEMORE CRAIG, on behalf of Cyprus Climax Metals Co., ASARCO, Inc., and the Arizonans for Electric Choice & Competition;

Mr. Scott S. Wakefield, Chief Counsel, on behalf of the Residential Utility Consumer Office;

Mr. Robert S. Lynch, on behalf of M-S-R and Southern California Public Power Authority;

Mr. Kenneth C. Sundlof, JENNINGS, STROUSS & SALMON, on behalf of New West Energy;

Mr. Douglas C. Nelson, DOUGLAS C. NELSON, P.C., on behalf of Commonwealth Energy Corporation;

Mr. Peter Q. Nyce, Jr., on behalf of the Department of

"public interest" by approving the Settlement and not allow Energy Service Providers ("ESPs") to delay the benefits that competition has to offer.

Legal Issues

In TEP's last general rate case (Decision No. 59594, dated March 29, 1996), the Commission determined a fair value rate base ("FVRB") and a fair value rate of return ("FVROR") that established the bundled rates and charges for TEP. According to TEP, its proposed unbundled distribution rates are simply the unbundling of TEP's approved bundled rates as required by the Commission's Electric Competition Rules. As a result, TEP opined that no new finding of FVRB is necessary in this non-rate case. TEP also argued that there are not constitutional provisions, statutes or regulations that require a rate case filing before the Commission can approve a voluntary rate reduction. TEP indicated the Commission has previously approved Settlement agreements that contained rate decreases/rate moratoriums for public service corporations (See Decision No. 59594, dated March 29, 1996 and Decision No. 61104, dated August 29, 1998).

The Commission made a fair value determination in Decision No. 59594 and found TEP's rates were just and reasonable. TEP's rates were reduced by settlement in Decision No. 61104. Pursuant to the Agreement, TEP's existing rates will be unbundled. Accordingly, we find that no additional financial analysis is legally necessary to justify unbundling of TEP's current rate levels.

Fixed and Floating Competitive Transition Charges

TEP estimated it has stranded costs of approximately $683 million through 2008. Pursuant to the Agreement, TEP would be authorized to collect the stranded cost through a competition transition charge ("CTC") in two components: (i) a "Fixed" CTC; and (ii) a "Floating" CTC. The Fixed CTC would be set at 0.93 cents/kWh which allows TEP to recover regulatory assets in the amount of $200 million and above market generation costs of $250 million or a total of four hundred and fifty million dollars ($450 million). The Fixed CTC will terminate after $450 million has been collected or on December 31, 2008, whichever occurs first. Upon termination, unbundled rates will be reduced by the 0.93 cents/kWh amount.

TEP opined that any market assumptions through 2008 are almost certainly to be wrong. It is for that reason that TEP proposed the floating component of the CTC to ensure that TEP neither over

25. The Fixed CTC would be set at 0.93 cents/kWh which allows TEP to recover regulatory assets in the amount of $200 million and $250 million of above market generation costs.

26. The Fixed CTC will terminate after $450 million has been collected or on December 31, 2008, whichever occurs first.

27. Upon termination of the Fixed CTC, unbundled rates will be decreased by 0.93 cents/kWh.

28. The Floating CTC will allow TEP to collect its stranded costs in excess of $450 million while ensuring that TEP does not over or under-recover stranded costs.

29. The terms and conditions of the Settlement Agreement, when implemented, are not intended to interfere with, prevent or deter the ongoing performance of existing contractual obligations by TEP, including agreements with MSR and SCPPA.

30. RUCO, ACAA, and AECC collectively, represent residential and non-residential customers.

31. The metering and billing credits set forth in the November Settlement Proposal and as recommended by Staff will provide sufficient credits for competitors to compete.

32. A TEP rate case would take a minimum of one year to complete.

33. ESPs that have been certificated have shown more of an interest in serving larger business customers than residential customers.

34. The Settlement will permit competition in a timely and efficient manner and insure all customers benefit during the transition period.

35. TEP's stranded costs on a relative size to APS are much higher.

36. TEP has significantly less shareholder equity relative to APS.

37. TEP's customer bill should include the market generation credit and Adder as a combined shopping credit for generation.

38. In TEP's last general rate case (Decision No. 59594), the Commission determined a FVRB and FVROR that established the bundled rates and charges for TEP.

39. TEP's rates were reduced by Settlement in Decision No. 61104, dated August 28, 1998.

40. TEP's proposed unbundled rates are simply the unbundling of TEP's approved bundled rates.

41. According to TEP and AECC, all customers will be better off under this Agreement than under the Staff Settlement which would have resulted in a "rush to judgment" sale.

42. The Settlement Agreement provides for competitive retail access in TEP's Service Territory, establishes no rate increases for all TEP customers up through 2008, sets a mechanism for stranded cost recovery, and resolves contentious litigation.

43. The terms and conditions of the Settlement Agreement as modified herein are just and reasonable and in the public interest and should be approved.

CONCLUSIONS OF LAW

1. The Affected Utilities are public service corporations within the meaning of the Arizona Constitution, Article XV, under A.R.S. §§ 40-202, -203, -250, -321, -322, -331, -336, -361, -365, -367, and under the Arizona Revised Statutes, Title 40, generally.

2. The Commission has jurisdiction over the Affected Utilities and of the subject matter contained herein.

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

4. The Settlement Agreement as modified herein is just and reasonable and in the public interest and should be approved.

5. TEP should be authorized to implement its Stranded Cost Recovery Plan as set forth in the Settlement Agreement as modified herein.

6. TEP's Certificate should be modified in order to permit competitive retail access in TEP's Certificate service territory.

7. The approval of the Settlement Agreement, including the divestiture of TEP's generation and other assets deemed to be competitive (as defined in the Electric Competition Rules) to a subsidiary of TEP, at market value, is not intended to interfere with, prevent or deter the ongoing performance of existing contractual obligations by TEP.

8. TEP's unbundled rates are an unbundling of TEP's existing bundled rates that were previously approved by the Commission.

98

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
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

Direct Testimony in Support of the Settlement Agreement

James S. Pignatelli

On Behalf of

Tucson Electric Power Company

June 11, 2008

that the collection of funds pursuant to the Fixed CTC be continued until new rates are in effect and that the additional collected funds be subject to credit, refund or other appropriate treatment (the "Fixed CTC True-up Revenues"). The settlement agreement (Paragraph 15.1) provides that parties can present to the Commission their arguments regarding the proper treatment of the Fixed CTC True-up Revenues in this proceeding.

Q. How much do you anticipate the Fixed CTC True-up Revenues will be?

A. Based on the amortization expense recorded to date, as well as forecasted sales in 2007 and 2008, full recovery of the $450 million was expected to occur in May 2008. As a result, a total of approximately $66 million of additional Fixed CTC revenues (the Fixed CTC True-up Revenues) are anticipated between the full recovery date and December 31, 2008.

Q. How does the settlement agreement treat the Fixed CTC True-up Revenues?

A. The settlement agreement provides that to the extent the Commission determines that Fixed CTC True-up Revenues are to be returned to customers, TEP will credit up to $32.5 million as a "credit to customers" in the PPFAC balancing account. Subject to further comment from the parties, the Commission may determine (i) when the Fixed CTC True-up Revenues shall cease to be accounted for; (ii) the proper treatment of any additional Fixed CTC True-up Revenues; and (iii) the timing for the implementation of new rates.

Q. What do you think should happen to the Fixed CTC True-up Revenues?

A. I believe that TEP should retain the Fixed CTC True-up Revenues. Because TEP did not raise its rates in 1999 in order to be able to collect the Fixed CTC Revenues, it should not have to lower its rates now or otherwise return certain revenues it collects under the 1999 rate level to customers. In Decision No. 62103, which approved the 1999 Settlement

Agreement, the Commission did not order a rate increase to collect the Fixed CTC Revenues. To the contrary it ordered rate reductions to TEP's rates that it had previously found to be just and reasonable. Consequently, while from an accounting perspective a portion of TEP's revenues were credited to collection of the Fixed CTC, the Company's rates were never increased to recover the Fixed CTC revenues. To require TEP to refund or credit the Fixed CTC True-up Revenues would be to confiscate a portion of the revenues that the Company collected based upon rates that were determined to be just and reasonable.

Additionally, one of the important benefits of the settlement here is put the 1999 Settlement Agreement behind us. The designation of a portion of TEP's revenues as Fixed CTC Revenues (through an additional "unbundling" of TEP's overall rate at that time) was a provision of the 1999 Settlement Agreement that is being superseded by the settlement agreement. Selected provisions of the 1999 Settlement Agreement should not be preserved to transfer economic benefits from the Company to its customers. The 1999 Settlement Agreement should be superseded as agreed to in the settlement agreement rather than retained in part and superseded in part.

Finally, even if there was a legal basis for claiming that customers had truly paid extra for collection of the Fixed CTC (even though TEP's overall rate never increased), all parties to the settlement agreement concur that TEP is entitled to a base rate increase of 6% based on a 2006 Test Year. The 2006 Test Year and financial data that supports the settlement agreement demonstrates that increased costs comprising a part of the Company's revenue deficiency greatly exceed the $66 million of Fixed CTC True-up Revenues that are expected to be collected up through December 31, 2008. I submit that those additional costs negate any need to refund or credit the Fixed CTC True-up Revenues to TEP's customers.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

Direct Testimony of Kevin C. Higgins

on behalf of

Phelps Dodge Mining Company and

Arizonans for Electric Choice and Competition

2008 Settlement Agreement

June 11, 2008

TEP estimated that approximately $66 million of True-Up Revenues will be collected between May 2008 and December 31, 2008.[2]

The 2008 Settlement Agreement resolves the "market versus cost" dispute in favor of the positions taken by Staff, RUCO, and AECC. It has been AECC's position, as expressed in my direct testimony filed previously in this case, that AECC would be willing to accept a resolution in which True-Up Revenues were retained by TEP under the Cost-of-Service Methodology, if, 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. The 2008 Settlement Agreement results in such a withdrawal of claims. Therefore, I believe that in the context of the overall settlement, a result that splits the True-Up Revenues between customers and the Company is reasonable. For this reason, I am recommending that the greater of $32.5 million or 50 percent of the True-Up Revenues be credited to customers and that TEP be allowed to retain the remainder of the True-Up Revenues as part of the fair resolution of the issues outstanding in this proceeding. The crediting of the customer share of the True-Up revenues to the PPFAC balancing account is the same recommendation I made on page 42 of my direct testimony filed on February 29, 2008.

It is useful to bear in mind that when the Fixed CTC was established in 1999, it was not a new cost that was added to TEP's existing rates, but a "carve-out" of then-existing rates which was designated for Fixed CTC recovery. Thus, when the Fixed CTC expires, removing this charge would not remove something

[2] Direct testimony of Kentton C. Grant, p. 11, line 23 - p. 12, line 1.

that was "added on" to rates, but rather removal would strip out a pre-existing portion of rates. In the context of the 1999 Settlement Agreement, in which it was anticipated that many customers would be shopping in competitive markets, it was reasonable to expect that the Fixed CTC charge would be extinguished when it had served its purpose of collecting $450 million in stranded cost. However, in the context of the 2008 Settlement Agreement, in which the Signatories believe that a revenue requirement increase over current rates (inclusive of the Fixed CTC) is just and reasonable going forward, and in which the "market versus cost" dispute is resolved in favor of customers, a sharing of the True-Up Revenues between the Company and customers is an appropriate outcome.

Response to Staff Request for Procedural Order Dated June 6, 2008

Q. Do you have any comments with respect to Staff's Request for a Procedural Order dated June 6, 2008?

A. Yes. Staff's Request states that the Settlement Agreement provides for an approximate six percent rate increase across all rate schedules with the exception of the life line rates. Staff's Request then goes on to state: "Such an increase would have an impact on the power supply agreements approved by Decision No. 65207 and Decision No. 69873."

Without addressing the legal aspects of Staff's Request, I do not support Staff's Request as a matter of ratemaking policy nor do I believe that Staff's Request is called for by the 2008 Settlement Agreement.

99

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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2008 Settlement Agreement

June 11, 2008

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100

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
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WILLIAM A. MUNDELL
JEFF HATCH-MILLER
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GARY PIERCE

IN THE MATTER OF THE FILING BY TUCSON ELECTRIC POWER COMPANY TO AMEND DECISION NO. 62103.	DOCKET NO. E-01933A-05-0650
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

Rebuttal Testimony in Support of the Settlement Agreement

James S. Pignatelli

On Behalf of

Tucson Electric Power Company

July 7, 2008

> The $47.1 million purported increase of 6% presents a false impression because it is based on the false premise that the fixed CTC is a permanent part of rates rather than a temporary surcharge that was fully recovered earlier this year. The true increase, based on TEP's adjusted current base rates without the fixed CTC equals 19.8%. (Rigsby testimony at 7, lines 3-7)

RUCO's argument is quickly dismissed by the simple facts. The fixed CTC was not a "temporary surcharge." TEP did not raise its rates to recover its stranded costs. TEP did not add a surcharge to recover its stranded costs. In fact, pursuant to the 1999 Settlement Agreement, TEP's rates were twice decreased while the fixed CTC was being recovered. There is simply no basis for reducing TEP's existing rates. RUCO has even admitted during discovery in this case that TEP's existing rates are those last determined by the Commission to be just and reasonable. (RUCO Response to TEP Data Request TEP 4-12.).

The fixed CTC was part of the 1999 Settlement Agreement that was intended to guide TEP into electric competition and market based rates in 2009. In preparation for 2009, TEP agreed to recover $450 million in stranded costs over a 10 year period. In order to avoid a one-time write-off of $450 million in 2000, and pursuant to the advice of the Company's accountants, TEP ascribed a portion of its **then existing rates** to the fixed CTC. When the $450 million of stranded costs were fully recovered, TEP's rates remained the same and only the accounting for the rate components changed. TEP's customers' bills were not impacted by the accounting impact of the fixed CTC.

Under the Settlement Agreement, TEP's customers' bills will be increased over what they are currently charged, based on a stipulated test-year revenue requirement, and not on the

101

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 9, 2008

Filed: July 14, 2008

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME I
(Pages 1 through 191, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 retiring debt. And that saves us about $40 million a
2 year. Our employees gave up a lot. Our O&M cost per
3 customer grows over that period 2.1 percent per year.
4 That's a CPI basis of 2.8 percent a year. Our employees
5 gave up paid time off, some elements of it. They
6 absorbed higher costs of their pension and benefits.
7 They became as efficient as possible.
8 Our shareholders were not immune during that
9 period of time either. They absorbed, and this is a
10 point of contention, they absorbed $450 million of
11 write-off under what is called fixed CTC without a rate
12 increase. Our last adjudicated just and reasonable rate
13 is exactly the rate that we are charging today, 8.4
14 cents. It is not 8.4 cents minus anything. It is 8.4
15 cents. Under the settlement agreement, all of these
16 efficiencies, all of these benefits, lower interest
17 costs, the short-term, the benefit of short-term sales
18 all are reflected as a benefit to the consumer.
19 Additionally, the consumer will bear or receive the
20 benefit of a reduced rate base because of the
21 $450 million that our shareholder ate over the last 10
22 years.
23 That's how we can achieve it. It was a combined
24 give up of millions of dollars, of hundreds of millions
25 of dollars by TEP's employees and shareholders.

1 as was referred to in one of the opening remarks. This
2 provides us cash flow to meet those needs. And finally,
3 like I said, it provides us an opportunity to earn a
4 reasonable return. I think you, the Commission, and the
5 Staff benefits from this. We settle contentious issues
6 without litigation. It is a willful adjudication with
7 an open process of TEP's first rate case in 14 years
8 without a prolonged, time consuming process. It
9 provides a base rate moratorium.
10 As I said, this is a comprehensive settlement.
11 It balances the interests of all the parties. It is a
12 package. It is just and reasonable. The revenue
13 requirement that is the basis for these requests for
14 this, for this request of 6 percent reflects all of the
15 efficiencies, all of the reductions that we have been
16 able to make. It reflects, as I said, a lower rate base
17 by $450 million, which my shareholders wrote off.
18 Let me talk about this CTC true-up. We should
19 not be required to refund or credit any of this.
20 Current estimate this year is $66 million. The CTC was
21 an accounting fiction in 1999 necessary to avoid a
22 current write-off when this Commission determined that
23 it was going to market. But for a separation of our
24 then existing rate to indicate that the $450 million
25 would be recovered, we would have had a write-off. Did

1 we increase rates to collect this 450 million? No, not
2 one cent.
3 The last adjudicated just and reasonable rate
4 did not include a 10-year amortization of this
5 $450 million. There was no surcharge. TEP merely
6 increased its expense and amortized the 450 without
7 increasing rates. And TEP was unable during that period
8 to earn its authorized return, which established its
9 just and reasonable rate of 8.4 cents. It was part of a
10 settlement. It was part of a settlement that
11 contemplated us going to market. And why should you
12 take the CTC that's accruing after that 450 and not
13 provide the company the ability to go to market, which
14 was the integral part of that settlement?
15 Additionally, all parties agree that based on in
16 2006, we are rate deficient by 6 percent. Why should
17 you make us more rate deficient by taking another
18 $66 million? I fail to see the logic in that. Why
19 create an additional underearning situation for us?
20 Let me talk to the timing for a minute. We need
21 rate relief. This settlement supersedes the 1999
22 settlement agreement with the rate moratorium in it
23 until 1/1/09. Adoption of this settlement agreement
24 moots that agreement. There is no reason to hold us
25 until 1/1/09 at our current rate. And when you really

102

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
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

Direct Testimony in Support of the Settlement Agreement

James S. Pignatelli

On Behalf of

Tucson Electric Power Company

June 11, 2008

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Q. How does the settlement agreement treat the Fixed CTC True-up Revenues?

A. The settlement agreement provides that to the extent the Commission determines that Fixed CTC True-up Revenues are to be returned to customers, TEP will credit up to $32.5 million as a "credit to customers" in the PPFAC balancing account. Subject to further comment from the parties, the Commission may determine (i) when the Fixed CTC True-up Revenues shall cease to be accounted for; (ii) the proper treatment of any additional Fixed CTC True-up Revenues; and (iii) the timing for the implementation of new rates.

Q. What do you think should happen to the Fixed CTC True-up Revenues?

A. I believe that TEP should retain the Fixed CTC True-up Revenues. Because TEP did not raise its rates in 1999 in order to be able to collect the Fixed CTC Revenues, it should not have to lower its rates now or otherwise return certain revenues it collects under the 1999 rate level to customers. In Decision No. 62103, which approved the 1999 Settlement

103

ORIGINAL

BEFORE THE ARIZONA CORPORATION CC

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

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2.3 The Signatories agree to an annual base rate increase for TEP of approximately six percent (6%) over the current average rate of 8.4 cents per kWh. This approximate six percent (6%) increase does not include the adjustors for Purchased Power and Fuel, Demand-Side Management, and Renewable Energy. The new average retail base rate will be 8.9 cents per kWh. The approximate six percent (6%) increase, calculated on TEP's existing base rates which include revenue for Fixed CTC, is approximately $47.1 million, and increases TEP's existing base revenue from approximately $781.1 million to $828.2 million. The effect of designing rates to recover $828.2 million is a 6.03% increase.

2.4 The Signatories agree that this increase is just and reasonable. This rate increase is based on the fair value rate base and fair value rate of return set forth on Exhibit 1 and upon the original cost rate base, operating revenue, and operating expenses and adjustments thereto shown on Exhibit 2. As shown on Exhibits 1 and 2, the settlement provides for base rate revenues of approximately $828.2 million, which is a base rate increase of approximately $136.8 million over TEP's adjusted current base rates without Fixed CTC of $691.5 million.

2.5 The rates set forth in the Proof of Revenue, attached hereto as Exhibit 3 and incorporated herein, are designed to permit TEP to recover an additional $47.1 million in base revenues as compared to existing test year base revenues (including Fixed CTC but excluding DSM) of $781.1 million.

III. RATEMAKING TREATMENT OF TEP'S GENERATION ASSETS AND FUEL COSTS.

3.1 For ratemaking purposes, Springerville Unit 1 and the Luna Generating Station shall be included in TEP's rate base at their respective original costs. All other generation assets acquired by TEP after December 31, 2006, but before December 31, 2012, shall be

104

ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
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of TEP; (iii) resolve the issues arising from the consolidated dockets; and (iv) avoid unnecessary litigation expense and delay.

1.15 The Signatories desire that the Commission issue an order (i) finding that the terms and conditions of this Agreement are just and reasonable, together with any and all other necessary findings; (ii) concluding that the Agreement is in the public interest; (iii) granting approval of the Agreement; and (iv) ordering that the Agreement and its terms be effective upon Commission approval.

II. RATE INCREASE.

2.1 For ratemaking purposes, and in accordance with the terms of this Agreement, the Signatories agree that the fair value of TEP's Arizona jurisdictional rate base for the test year ending December 31, 2006 (the "test year") is $1,451,558,000, as set forth on Exhibit 1. For ratemaking purposes and for the purposes of this Agreement, the Signatories agree that a reasonable fair value rate of return is 5.64%, as shown on Exhibit 1. For ratemaking purposes and in accordance with the terms of this Agreement, the Signatories agree that TEP's jurisdictional revenue deficiency is approximately $136.8 million, as shown on Exhibit 1. The Signatories agree that the opportunity to recover the revenue deficiency results in just and reasonable rates for TEP for the period of the rate moratorium described in Paragraph 10.1. The agreements set forth herein regarding the quantification of fair value rate base, fair value rate of return, and the revenue deficiency are made for purposes of settlement only and should not be construed as admissions against interest or waivers of litigation positions related to any other cases.

2.2 TEP's rates, including its generation rates, will be determined using a cost-of-service methodology. Upon the Commission's issuance of a final, non-appealable order approving this Agreement, TEP shall withdraw its proposed market and hybrid rate methodologies.

105

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

Date: July 9, 2008

Filed: July 14, 2008

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME I
(Pages 1 through 191, inclusive.)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 retiring debt. And that saves us about $40 million a
2 year. Our employees gave up a lot. Our O&M cost per
3 customer grows over that period 2.1 percent per year.
4 That's a CPI basis of 2.8 percent a year. Our employees
5 gave up paid time off, some elements of it. They
6 absorbed higher costs of their pension and benefits.
7 They became as efficient as possible.
8 Our shareholders were not immune during that
9 period of time either. They absorbed, and this is a
10 point of contention, they absorbed $450 million of
11 write-off under what is called fixed CTC without a rate
12 increase. Our last adjudicated just and reasonable rate
13 is exactly the rate that we are charging today, 8.4
14 cents. It is not 8.4 cents minus anything. It is 8.4
15 cents. Under the settlement agreement, all of these
16 efficiencies, all of these benefits, lower interest
17 costs, the short-term, the benefit of short-term sales
18 all are reflected as a benefit to the consumer.
19 Additionally, the consumer will bear or receive the
20 benefit of a reduced rate base because of the
21 $450 million that our shareholder ate over the last 10
22 years.
23 That's how we can achieve it. It was a combined
24 give up of millions of dollars, of hundreds of millions
25 of dollars by TEP's employees and shareholders.

106

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REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV
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Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

Prepared for:

ACC

1 When we look at the context of 1999, that was a
2 situation in which it was expected that TEP would have
3 divested its generation assets by now and in 2008 would
4 be purchasing power from the market to meet its standard
5 offer service obligations. It was also expected at that
6 time that customers would be procuring a fair amount of
7 their needs in the marketplace and that TEP, again, for
8 standard offer customers, would be procuring in the
9 marketplace on their behalf.
10 The fixed CTC was established to recover
11 stranded costs. And it was very important to AECC that
12 when those costs were recovered, that shopping customers
13 no longer have any obligation to pay TEP for its fixed
14 generation costs because those customers would have been
15 purchasing from someone else. Similarly, for standard
16 offer customers, it was important to maintain a
17 reciprocity on that principle and that if TEP was
18 purchasing on their behalf in the marketplace, once the
19 stranded cost had been recovered, it was important that
20 that cost be removed from rates, again, in the context
21 of TEP's generation having been divested.
22 Of course, with the Track A decision, TEP's
23 generation has not been divested. And it has been
24 resolved in this case that generation service would be
25 provided on a cost of service basis with those assets

107

BEFORE THE ARIZONA CORPORATION COMMISSION

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Direct Testimony of Kevin C. Higgins

on behalf of

Phelps Dodge Mining Company and

Arizonans for Electric Choice and Competition

2008 Settlement Agreement

June 11, 2008

direct testimony.[1] At the same time, it is $137.1 million less than TEP had recommended in its Cost-of-Service filing in this docket.

(3) The 2008 Settlement Agreement provides a package of results, of which the proposed revenue increase is one component. As described in the overview above, this package includes favorable resolution of the "market versus cost" dispute; a base rate freeze until January 1, 2013; resolution of rate spread issues; improvements to rate design; increased availability of TOU options for customers; and a commitment to develop new partial requirements, interruptible, and demand response rate schedules. Viewed as a whole, the benefits of the settlement package fully justify the compromise on revenue requirement that I am making in reaching agreement with TEP and the other Signatories.

<u>Start of the Rate Effective Period and True-Up Revenues</u>

Q. Section 15.1 of the 2008 Settlement Agreement states that certain issues pertaining to the Fixed CTC True-Up Revenues remain unresolved, and that the Signatories would present their positions with respect to when TEP's new rates may go into effect and how TEP's Fixed CTC True-Up Revenues should be calculated and treated. What is your recommendation on these two points?

A. I recommend that new rates go into effect January 1, 2009. I further recommend that the greater of $32.5 million or 50 percent of the True-Up Revenues be credited to customers in the PPFAC balancing account and that TEP

[1] $47.1 million – $(3.5 million) + $24.0 million = $26.6 million.

be allowed to retain the remainder of the True-Up Revenues as part of the fair resolution of the issues outstanding in this proceeding.

Q. Please explain your recommendation concerning the start of the rate effective period.

A. I believe that January 1, 2009 is the most appropriate date for new rates to go into effect, as it corresponds to the expiration of the rate cap established in the 1999 Settlement Agreement, which extended until December 31, 2008.

Q. Please explain your recommendation concerning the treatment of True-Up Revenues.

A. I am very familiar with the origins of the True-Up Revenues. They derive from a provision in the 1999 Settlement Agreement that requires rates to be reduced by the amount of the Fixed CTC at such time that $450 million in stranded cost is recovered. I was closely involved in negotiating that provision on behalf of AECC.

In Decision No. 69568, the Commission modified this requirement of the 1999 Settlement Agreement, and determined that rates would <u>not</u> be reduced by the amount of the Fixed CTC when $450 million in stranded cost was recovered. Instead, the Decision provided that TEP customers should be protected by providing for a mechanism to refund or credit the revenues, plus interest, that will continue to be collected by the modified treatment of the Fixed CTC, until new rates are approved. These revenues are the True-Up Revenues. In its direct filing,

TEP estimated that approximately $66 million of True-Up Revenues will be collected between May 2008 and December 31, 2008.[2]

The 2008 Settlement Agreement resolves the "market versus cost" dispute in favor of the positions taken by Staff, RUCO, and AECC. It has been AECC's position, as expressed in my direct testimony filed previously in this case, that AECC would be willing to accept a resolution in which True-Up Revenues were retained by TEP under the Cost-of-Service Methodology, if, 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. The 2008 Settlement Agreement results in such a withdrawal of claims. Therefore, I believe that in the context of the overall settlement, a result that splits the True-Up Revenues between customers and the Company is reasonable. For this reason, I am recommending that the greater of $32.5 million or 50 percent of the True-Up Revenues be credited to customers and that TEP be allowed to retain the remainder of the True-Up Revenues as part of the fair resolution of the issues outstanding in this proceeding. The crediting of the customer share of the True-Up revenues to the PPFAC balancing account is the same recommendation I made on page 42 of my direct testimony filed on February 29, 2008.

It is useful to bear in mind that when the Fixed CTC was established in 1999, it was not a new cost that was added to TEP's existing rates, but a "carve-out" of then-existing rates which was designated for Fixed CTC recovery. Thus, when the Fixed CTC expires, removing this charge would not remove something

[2] Direct testimony of Kentton C. Grant, p. 11, line 23 - p. 12, line 1.

BEFORE THE ARIZONA CORPORATION COMMISSION

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Prepared for:

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1 being contested in this proceeding.
2 Two of the -- there are two unresolved issues
3 among the signatories, and my testimony also provides a
4 recommendation on those issues.
5 One is the effective date for new rates. And in
6 my testimony I recommend an effective date of January 1,
7 2009, which, in my opinion, is consistent with the
8 original intent of the 1999 settlement agreement which
9 established rates through the end of 2008.
10 In addition, there is the matter of the true-up
11 revenues. And I believe a just and reasonable
12 resolution to that issue would be to provide that
13 customers should receive the benefit of the higher of
14 32.5 million or 50 percent of the amount of the true-up
15 revenues including interest to be credited against the
16 purchased power fuel adjustment clause.
17 I believe it would be reasonable for TEP to
18 retain the balance of those true-up revenues in the
19 context of the overall settlement agreement and I would
20 be happy to elaborate upon that if the Commission or the
21 Judge would like me to do so. That completes my
22 summary.
23 MR. CROCKETT: Thank you, Mr. Higgins.
24 Before making Mr. Higgins available for
25 cross-examination, I would move into evidence AECC

1 being retained by the TEP ownership. We have also
2 determined in this proceeding, or at least the parties
3 who are signatory have determined, that it is just and
4 reasonable for rates to be set 6 percent higher than
5 current 2008 rates, including the fixed CTC.
6 Given that divestiture has not occurred and that
7 we are setting rates based on the cost of service which
8 is higher than the, than 2008 rates, including the fixed
9 CTC, I believe it is reasonable to resolve the issue of
10 the true-up revenues by sharing them between customers
11 and the utility.
12 In the interim period between the establishment
13 of the settlement agreement and the resolution in this
14 2008 settlement agreement of the cost of service issue,
15 I maintained that the true-up revenue should be retained
16 by customers so long as TEP maintained that it was
17 entitled to a large regulatory asset to compensate it
18 for agreeing to cost of service rates.
19 So I and AECC, we are very staunch defenders of
20 retaining the true-up revenues for customers so long as
21 TEP made this claim which I felt was unreasonable. But
22 I made it clear in my direct testimony in this case
23 that, if TEP dropped that claim and agreed with AECC and
24 Staff and RUCO that the proper base for rates going
25 forward was cost of service, then in my view that

1 created a basis for allowing the company to retain fixed
2 CTC revenues or the true-up revenues that would accrue
3 for the balance of 2008.
4 So in light of those three different scenarios,
5 how it was established in 1999 and the premise under
6 which it was established, the alignment of issues during
7 the dispute that has been going on for several years as
8 to the establishment of rates going forward and what I
9 believe is the proper resolution of the issue in the
10 settlement agreement, a sharing between the two parties
11 is just and reasonable and really creates a benefit for
12 customers that was an artifact of that 1999 settlement
13 agreement. And, quite frankly, having been involved in
14 negotiating that component, I feel very good personally
15 about the possibility of creating this at least a 32 and
16 a half million dollar benefit to customers from that,
17 from that agreement.
18 So that's a very, I appreciate the Commission's
19 indulgence in that long explanation and your indulgence
20 Mr. Grant, but that really is the fuller explanation as
21 to why I believe that that's a reasonable resolution.
22 Q. Mr. Higgins, thank you. Now, I appreciate the
23 long answer. And I will cycle back to it in just a sec.
24 Is sharing, you touched on this but I want you
25 to go back to it, is sharing, in your opinion, also

108

BEFORE THE ARIZONA CORPORATION COMMISSION

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Phelps Dodge Mining Company and

Arizonans for Electric Choice and Competition

Revenue Requirement

February 29, 2008

These two alternative recommendations assume that TEP's proposed TCRAC is rejected by the Commission. If, for some reason, the TCRAC is adopted in whole or in part, then the True-Up Revenues should be applied against the TCRAC balance.

Q. Do you have any other comments regarding the True-Up Revenues?

A. Although the True-Up Revenues properly belong to customers, AECC would be willing to accept a resolution in which the True-Up Revenues were not returned to customers under the Cost-of-Service Methodology, if, 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.

VII. Hybrid Methodology

Q. What has TEP proposed with respect to the Hybrid Methodology?

A. The Hybrid Methodology is offered by TEP as a middle ground between its Cost-of-Service Methodology and Market Methodology. For the most part, rates would be set in the same manner as in the Cost-of-Service Methodology, except that certain generation assets would be excluded from rate base. Energy from these excluded facilities would be sold to TEP retail customers at market prices. The excluded facilities would be: (1) TEP's interest in the Navajo Generating Stations Units 1, 2, and 3; and (2) TEP's interest in the Four Corners Generating Stations Units 4 and 5. There would be a PPFAC as part of the Hybrid Methodology and TEP is willing to continue direct access service to customers

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2008 Settlement Agreement

June 11, 2008

TEP estimated that approximately $66 million of True-Up Revenues will be collected between May 2008 and December 31, 2008.[2]

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of TEP; (iii) resolve the issues arising from the consolidated dockets; and (iv) avoid unnecessary litigation expense and delay.

1.15 The Signatories desire that the Commission issue an order (i) finding that the terms and conditions of this Agreement are just and reasonable, together with any and all other necessary findings; (ii) concluding that the Agreement is in the public interest; (iii) granting approval of the Agreement; and (iv) ordering that the Agreement and its terms be effective upon Commission approval.

II. RATE INCREASE.

2.1 For ratemaking purposes, and in accordance with the terms of this Agreement, the Signatories agree that the fair value of TEP's Arizona jurisdictional rate base for the test year ending December 31, 2006 (the "test year") is $1,451,558,000, as set forth on Exhibit 1. For ratemaking purposes and for the purposes of this Agreement, the Signatories agree that a reasonable fair value rate of return is 5.64%, as shown on Exhibit 1. For ratemaking purposes and in accordance with the terms of this Agreement, the Signatories agree that TEP's jurisdictional revenue deficiency is approximately $136.8 million, as shown on Exhibit 1. The Signatories agree that the opportunity to recover the revenue deficiency results in just and reasonable rates for TEP for the period of the rate moratorium described in Paragraph 10.1. The agreements set forth herein regarding the quantification of fair value rate base, fair value rate of return, and the revenue deficiency are made for purposes of settlement only and should not be construed as admissions against interest or waivers of litigation positions related to any other cases.

2.2 TEP's rates, including its generation rates, will be determined using a cost-of-service methodology. Upon the Commission's issuance of a final, non-appealable order approving this Agreement, TEP shall withdraw its proposed market and hybrid rate methodologies.

14.3 Under the circumstances in which TEP currently operates, it is appropriate to determine TEP's rates pursuant to cost-of-service ratemaking principles.

14.4 Upon the Commission's issuance of a final, non-appealable order approving this Agreement, TEP shall forego all claims relating to any alleged breach of contract resulting from or related to the 1999 Settlement Agreement and/or Decision No. 62103.

14.5 Upon the Commission's issuance of a final, non-appealable order approving this Agreement, TEP shall not seek to recover, in this or any subsequent proceeding, any amount that it claims is attributable to its alleged damages allegedly related to setting its rates under cost-of-service ratemaking principles.

14.6 Upon the Commission's issuance of a final, non-appealable order approving this Agreement, TEP shall not seek to recover, in this or any subsequent proceeding, any amount that it claims is attributable to any alleged damages allegedly related to the rate freeze adopted by the Commission in Decision No. 62103.

14.7 Upon the Commission's issuance of a final, non-appealable order approving this Agreement, TEP shall forego any and all claims related in any way to Decision No. 62103 or the 1999 Settlement Agreement.

14.8 Upon the Commission's issuance of a final, non-appealable order approving this Agreement, each Signatory hereby releases and forever discharges each other Signatory and the Commission from any and all claims, actions, and demands, of any nature whatsoever, past or present, whether arising out of any Commission order, statute, regulation, breach of contract, or any other theory, whether legal or equitable, including any claims, losses, costs or damages, in each case whether known or unknown, which such other Signatory or the Commission ever had, now have, or may in the future claim to have,

110

ORIGINAL

BEFORE THE ARIZONA CORPORATION CC

57

COMMISSIONERS

MIKE GLEASON, Chairman
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c. The RCDAC rate schedule shall identify the individual components of the potential charge, definitions of the components, and a general framework that describes the way in which the RCDAC would be calculated.

d. The RCDAC shall only be established to recover from Direct Access customers the additional costs, both one-time and recurring, that these customers would otherwise impose on other Standard Offer customers if and when the former return to Standard Offer service from their competitive suppliers. The customers shall pay the RCDAC in full within one year of the RCDAC being assessed.

13.2 The Signatories agree that a RCDAC as described above is in the public interest and should be adopted.

XIV. 1999 SETTLEMENT AGREEMENT.

14.1 The Signatories recognize that Decision No. 62103 and the 1999 Settlement Agreement were designed to allow a transition to retail electric competition within a specific time period. Inasmuch as the transition to retail electric competition has thus far not occurred and the time periods applicable to Decision No. 62103 and to the 1999 Settlement Agreement have passed, the Signatories recognize that it is necessary to address the prospective regulatory treatment that is appropriate for TEP under these circumstances.

14.2 To the extent that any party to the 1999 Settlement Agreement or any other party contends that the provisions of this Agreement are inconsistent with Decision No. 62103, the Signatories request that the Commission amend Decision No. 62103 to be consistent with this Agreement.

111

ORIGINAL

BEFORE THE ARIZONA CORPORATION CC

57

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 Settlement Agreement and Exhibits in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29th day of May, 2008.

Janet Wagner, Assistant Chief Counsel
Robin Mitchell, Attorney
Nancy L. Scott, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and 15 copies of the foregoing filed this 29th day of May, 2008 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Arizona Corporation Commission
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112

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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At: Tucson, Arizona

Date: July 11, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME III
(Pages 395 through 576, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 somehow. There's been some discussion about the structure
2 of the PPFAC in this and that it doesn't include a cap on
3 it. Do you have a feeling about whether a cap on it is
4 beneficial or not?
5 A. No. I didn't address the PPFAC issue in this
6 case, so I really am not prepared to give you an opinion.
7 The only area in which I prepared testimony on that issue
8 was related to line loss adjustors that I felt were
9 important that never got to the settlement agreement,
10 whereby customers were receiving service at higher
11 voltages. Their adjustor would recognize that and it
12 would be lower than customers receiving service at
13 secondary level voltages. That's the only area I touched
14 on as far as the PPFAC was concerned.
15 Q. So you don't have an opinion on either the
16 relative benefits or detriments of a cap, or any 90/10
17 sharing incentive?
18 A. No, I don't.
19 Q. Can you refresh my memory what your
20 recommendation is concerning the effective date of the new
21 rates?
22 A. As far as we're concerned, tomorrow would be not
23 too soon to have these rates. We would like to have an
24 opportunity to -- and admittedly this may be a bit
25 selfish, but I think these time-of-use rates offer us an

1 opportunity -- when I say us, Fort Huachuca and
2 Davis-Monthan -- to start saving some money.
3 Realistically, the soonest that could happen
4 would probably be, I don't know, November of this year.
5 But I don't have any heartburn over the fact that the new
6 rates might be implemented a month or two prior to the end
7 of the '99 settlement agreement.
8 Q. Because you see the structure of the new rates as
9 really presenting an opportunity for people.
10 A. Yes.
11 Q. At least to your clients?
12 A. Yes.
13 Q. All right. And I'm going to ask you this,
14 although I think I know the answer from your previous
15 answers.
16 One of the issues that came up in the case is the
17 process that the Commission will go through in resetting
18 the PPFAC. And there was some talk about it in the plan
19 of administration that's part of the settlement agreement,
20 but it might not be set forth with a lot of detail.
21 Do you have any opinion on what process or what
22 authority the Commission should exercise in resetting that
23 PPFAC?
24 A. Well, I'll just comment in general, based upon
25 other utilities, on the process. I would say that there

113

BEFORE THE ARIZONA CORPORATION COMMISSION

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At: Tucson, Arizona

Date: July 16, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI
(Pages 1038 through 1091, inclusive)

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Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 Q. When I say you, I guess I mean RUCO.
2 A. RUCO has participated in DSM-related meetings in
3 the past. And, of course, as pointed out here earlier, we
4 were very much in support of DSM-type programs in the APS
5 case.
6 Q. But as far as you know, right now you don't have
7 any issue with the proposed DSM budget?
8 A. No. As I say, as long as the programs are cost
9 effective and they're not replacing any natural type of
10 DSM or, as I say, they're just not cost effective, then
11 certainly we could support them. And, of course, the
12 programs are reviewed by Staff so, you know, we feel
13 pretty comfortable that what does get approved and put
14 into place will meet that cost effective standard that
15 we're relying on or that we like to see.
16 Q. Now, you testified earlier yesterday about there
17 are certain things in the settlement agreement that RUCO
18 likes, like the moratorium --
19 A. Yes.
20 Q. -- the low income. There was a list --
21 A. Yes.
22 Q. -- that you went through.
23 And I have heard you say and I have heard your
24 counsel say that the price that the settlement or the
25 value -- well, you put it in terms of the cost of those

114

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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Prepared for:

1 A. No, I don't believe so. I think the partial
2 requirements service facilitates distributed generation,
3 if I'm not mistaken, and RUCO has never had a problem with
4 that.
5 As far as demand response, we had an opportunity
6 to speak with some APS people about that not too long ago,
7 and I think we're kind of fascinated with that, to tell
8 you the truth, some of the opportunities that that might
9 bring about. So at this stage in the game, as far as
10 demand response, we don't see any problems with that.
11 Q. Okay. I just wanted to go through those other
12 provisions, because I thought it was an interesting
13 exercise.
14 A. Sure.
15 ALJ RODDA: Mr. Pozefsky, did that occasion any
16 other questions?
17 MR. POZEFSKY: No, Your Honor.
18 ALJ RODDA: All right. Before he leaves, anyone
19 else, Ms. Wagner?
20 MS. WAGNER: I do have one more question.
21
22 FURTHER RECROSS-EXAMINATION
23
24 Q. (BY MS. WAGNER) Mr. Pozefsky, your counsel asked
25 whether -- I'm sorry. Mr. Rigsby, I beg your pardon.

116

BEFORE THE ARIZONA CORPORATION COMMISSION

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Prepared for:

1 Q. (BY MR. ROBERTSON) What is RUCO's position with
2 regard to Section 6, which relates to implementation cost
3 recovery asset?
4 A. Can I just check something here for a moment?
5 Q. Certainly.
6 A. Okay. Thanks for bearing with me there. I just
7 wanted to make sure that I'm clear on this.
8 I believe RUCO and Staff came to similar
9 conclusions on the ICRA. And so as far as the
10 implementation cost recovery asset issue, I don't think we
11 have a problem with that. So the answer would be, yes, I
12 guess we would support that.
13 Q. So you do not object to that; is that correct?
14 A. Yes, that's correct. I just wanted to get clear
15 on that. For some reason or another I thought there was a
16 point that we had made with that, but apparently not.
17 Perhaps I'm confusing that with the TCRA.
18 Q. Let's move to Section 7, which is the purchased
19 power and fuel adjustment clause. What is RUCO's position
20 with regard to the form of PPFAC that has been proposed in
21 the settlement agreement?
22 A. Well, again, as I had explained with Judge Rodda,
23 we had recommended an alternative mechanism that mirrored
24 the company's ECAC proposal during the rate review
25 proceeding, so certainly we would much rather see that

1 adopted.
2 Q. Would I be correct in concluding that at this
3 posture, with regard to the form of PPFAC provided for in
4 the settlement agreement, RUCO opposes it?
5 A. I think that's -- yes, I would say that.
6 Q. Let's move to Section 8, which is the renewable
7 energy adjustor. What is RUCO's position on that?
8 A. RUCO has no opposition to that.
9 Q. Okay. Let's move to Section 9, which is the
10 demand-side management programs and adjustor. What is
11 RUCO's position on that?
12 A. We're not opposed to that.
13 Q. Let's move to Section 10, which is the rate case
14 moratorium. What is RUCO's position on that?
15 A. Again, as I mentioned in my opening statement,
16 that's one of the aspects of the agreement that we like.
17 Q. So RUCO supports that; is that correct?
18 A. Yes.
19 Q. Let's move to Section 11, which is the emergency
20 clause. What is RUCO's position on that?
21 A. Well, we certainly couldn't oppose that, because
22 no one knows what can happen in the future.
23 Q. So do I understand your testimony to be that you
24 don't oppose Section 11?
25 A. No. And it wouldn't matter if it was in the

117

BEFORE THE ARIZONA CORPORATION COMMISSION

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VOLUME V
(Pages 795 through 1037, inclusive.)

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Court Reporting
Suite 502
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Phoenix, Arizona 85004-1481

Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 thought benefited TEP's residential customers.
2 Q. What about the fact that even though TEP had
3 initially requested one, there is no transmission cost
4 adjuster provided for in the settlement? That's a
5 benefit to residential ratepayers, isn't it?
6 A. Let me think about that. I would prefer not to
7 comment on that, because it is not something I have
8 studied in depth or I have looked at specifically.
9 Q. Okay. The inclusion of the Luna generating
10 facility in rates at cost is a benefit to residential
11 customers, isn't it, given it is in at 25 cents on the
12 dollar?
13 A. I would say so, yes.
14 Q. And the resolution of issues surrounding the '99
15 settlement agreement is a benefit to residential
16 customers, isn't it?
17 A. Well, I think this goes back to the discussion
18 that I had earlier with Mr. Crockett. Again, yes, you
19 can make an argument that that is. But then again, as I
20 say, who is to say who would have actually prevailed if
21 such a lawsuit had actually come about?
22 Q. It is a benefit for the residential customers
23 that it is now clear that TEP's generation rates will be
24 determined by cost of service, isn't it?
25 A. I believe so, yes.

118

BEFORE THE ARIZONA CORPORATION COMMISSION

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21 such a lawsuit had actually come about?
22 Q. It is a benefit for the residential customers
23 that it is now clear that TEP's generation rates will be
24 determined by cost of service, isn't it?
25 A. I believe so, yes.

1 Q. And has RUCO investigated what rate increase
2 would have resulted if TEP's generation rates were to be
3 set at market rates starting January 2009?
4 A. No, we didn't, because I think there is some
5 debate on that point. And I think a lot of it goes back
6 to the Phelps Dodge court decision, which basically
7 stated that the Commission cannot abdicate its
8 constitutional responsibility to set rates on a finding
9 of fair value, that they can't leave that, they can't
10 leave that to the free market.
11 Q. Mr. Rigsby, you corrected the cover page of your
12 testimony to eliminate the phrase in opposition to?
13 A. Yes.
14 Q. Why did you do that? I haven't heard an
15 explanation yet.
16 A. At the time -- at the time we thought that would
17 be a more appropriate description of the testimony
18 because, as we have just discussed here, you know, there
19 are what we believe to be some benefits that are being
20 offered in this settlement agreement. And so if the
21 Commission were to make a, make a decision to make
22 changes to the settlement agreement, certainly there
23 were things in there that we wouldn't want them to,
24 wouldn't want them to eliminate.
25 So I guess what we were just simply trying to do

119

BEFORE THE ARIZONA CORPORATION COMMISSION

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
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Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 A. Yes.
2 Q. Now, as I remember, RUCO actually was a signatory
3 to the 1999 settlement; is that correct?
4 A. Yes.
5 Q. So at that time, RUCO favored retail competition.
6 Would that be a fair statement?
7 A. Yes.
8 Q. All right. But since that time, RUCO has changed
9 its position and reevaluated that?
10 A. Yes, that's true.
11 Q. All right. Now, in your testimony in RUCO-2, you
12 note that the settlement defers consideration of retail
13 competition to a subsequent proceeding; is that correct?
14 A. Yes.
15 Q. And you conclude that this is another reason why
16 RUCO does not support the settlement agreement; is that
17 correct?
18 A. Yes, I think that's fair to say.
19 Q. All right. Now, you would acknowledge that
20 there's some exposure to ratepayers if TEP's position
21 regarding market rates for generation were to be adopted
22 either by the Commission or as the result of an appeal?
23 A. Yes, that would be a possibility.
24 Q. Has RUCO estimated the potential financial
25 exposure to residential ratepayers if TEP's proposal to

120

BEFORE THE ARIZONA CORPORATION COMMISSION

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1 response in my opening statement.
2 Q. And there are actually other benefits from the
3 proposed settlement agreement that you haven't
4 identified, aren't there? And let me just give you a
5 couple and see if you agree. One is the use of an
6 inclining block rate structure in the rate design?
7 A. Yes. We didn't note any of the rate design
8 provisions, but, well, as I mentioned, as I actually
9 mentioned here in this data request, that we thought
10 that one of the benefits was expanded time-of-use rates.
11 And I guess in that we were actually kind of referring
12 to the, I guess, the total package of rates that were
13 being offered. In other words, we were, when we said
14 expanded time-of-use rates, we were also agreeing with
15 the inclining rate structure that you just referred to.
16 Q. But that is not a part of only time-of-use
17 rates, it is part of the general R-1 rate as well, isn't
18 it?
19 A. That's my understanding, yes.
20 Q. Okay. That's a real benefit to the residential
21 customers?
22 A. Well, we would agree with that. This is, as I
23 say, we were just trying to make a broad, make a
24 broad -- give you a broad outlook of what we thought of
25 those aspects of the settlement agreement that we

BEFORE THE ARIZONA CORPORATION COMMISSION

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Certificate No. 50489

Prepared for:

1 customers.
2 Q. Right. But the design of the time-of-use, the
3 specific ones that are proposed here, RUCO doesn't have a
4 problem with them except for maybe the revenue they would
5 collect?
6 A. Yes. Yes, that's correct.
7 Q. And how about the rules and regulations that the
8 company has filed? Do you have --
9 A. Oh, you mean the tariffs?
10 Q. Well, under Section 17, RUCO is to file its rules
11 and regulations. I think they eliminate -- is that where
12 they eliminate the free footage? Do you have a problem
13 with the elimination of the free footage?
14 A. No, we have no problem with that.
15 Q. And do you -- I can't remember from your -- I
16 remember that you didn't like -- in your testimony that
17 you thought some of the deferral of the CTC and the issue
18 of retail access you thought were problematic.
19 A. Yes.
20 Q. But there are some other things that, according
21 to the settlement agreement, that's going to be decided
22 later, some partial requirements tariffs and interruptible
23 tariff and the demand response program.
24 Do you have a position on any of those, or do you
25 think that's problematic as well?

121

BEFORE THE ARIZONA CORPORATION COMMISSION

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) SETTLEMENT AGREEMENT HEARING

At: Tucson, Arizona

Date: July 16, 2008

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI
(Pages 1038 through 1091, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

1 Q. (BY MR. ROBERTSON) What is RUCO's position with
2 regard to Section 6, which relates to implementation cost
3 recovery asset?
4 A. Can I just check something here for a moment?
5 Q. Certainly.
6 A. Okay. Thanks for bearing with me there. I just
7 wanted to make sure that I'm clear on this.
8 I believe RUCO and Staff came to similar
9 conclusions on the ICRA. And so as far as the
10 implementation cost recovery asset issue, I don't think we
11 have a problem with that. So the answer would be, yes, I
12 guess we would support that.
13 Q. So you do not object to that; is that correct?
14 A. Yes, that's correct. I just wanted to get clear
15 on that. For some reason or another I thought there was a
16 point that we had made with that, but apparently not.
17 Perhaps I'm confusing that with the TCRA.
18 Q. Let's move to Section 7, which is the purchased
19 power and fuel adjustment clause. What is RUCO's position
20 with regard to the form of PPFAC that has been proposed in
21 the settlement agreement?
22 A. Well, again, as I had explained with Judge Rodda,
23 we had recommended an alternative mechanism that mirrored
24 the company's ECAC proposal during the rate review
25 proceeding, so certainly we would much rather see that

1 adopted.
2 Q. Would I be correct in concluding that at this
3 posture, with regard to the form of PPFAC provided for in
4 the settlement agreement, RUCO opposes it?
5 A. I think that's -- yes, I would say that.
6 Q. Let's move to Section 8, which is the renewable
7 energy adjustor. What is RUCO's position on that?
8 A. RUCO has no opposition to that.
9 Q. Okay. Let's move to Section 9, which is the
10 demand-side management programs and adjustor. What is
11 RUCO's position on that?
12 A. We're not opposed to that.
13 Q. Let's move to Section 10, which is the rate case
14 moratorium. What is RUCO's position on that?
15 A. Again, as I mentioned in my opening statement,
16 that's one of the aspects of the agreement that we like.
17 Q. So RUCO supports that; is that correct?
18 A. Yes.
19 Q. Let's move to Section 11, which is the emergency
20 clause. What is RUCO's position on that?
21 A. Well, we certainly couldn't oppose that, because
22 no one knows what can happen in the future.
23 Q. So do I understand your testimony to be that you
24 don't oppose Section 11?
25 A. No. And it wouldn't matter if it was in the

122

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1 settlement has been promoted as a 6 percent increase.
2 Again, we just think that that 19 percent number
3 should have been -- that 19.8 percent figure should have
4 been presented in the settlement. Perhaps a better way of
5 presenting it to the public would have been a final
6 increase in rates will be decided on by the Commission,
7 perhaps. I know that sounds vague, but certainly I think
8 you could make an argument that it's not just a 6 percent
9 increase.
10 Q. (BY MS. WAGNER) Mr. Rigsby, you would agree that
11 the settlement agreement is not a press release?
12 A. No, but there have been a number of press
13 releases made.
14 Q. You would agree that the settlement agreement is
15 not a customer education piece?
16 A. Oh, I don't know about that. I mean, this is a
17 public document. You know, we've got a link to it on our
18 website. Any person out there, whether he's a TEP
19 customer or not, who is interested in learning about this,
20 can access it and read it and make up their mind for
21 themselves.
22 We're just simply saying here that -- you know, I
23 think Commissioner Mayes made the same point -- not
24 everybody out there is an accountant or a lawyer or a rate
25 analyst. We just think that, you know, the 19.8 percent

TUCSON ELECTRIC POWER COMPANY

DOCKET NO. E-01933A-07-0402
DOCKET NO. E-01933A-05-0650

RESPONSIVE DIRECT SETTLEMENT TESTIMONY

OF

WILLIAM A. RIGSBY

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JULY 2, 2008

6) Adoption of a cost of equity of 10.25% and an overall weighted cost of capital of 8.03%;

7) Waiver of any claims under the 1999 Settlement Agreement; and

8) Availability of Retail Competitive opportunities.

Q. Have the Settling Parties presented any Exhibits that portray the various parties' original positions as compared to the Settlement Agreement?

A. Yes. TEP witness James S. Pignatelli presents such an Exhibit on page 10 of his direct testimony and the Settlement Agreement itself presents Exhibit 2 demonstrating the differences between TEP's original position, Staff's original position, and the Settlement Agreement. There is also an Exhibit RCS-7, attached to Staff witness Ralph C. Smith's direct testimony which shows the differences between the Staff's original position and the Settlement position.

Q. Do the numbers in these exhibits appear to be accurate?

A. Yes, however the manner in which the Settling Parties have portrayed the overall result of the Settlement Agreement presents a false impression of the reasonableness of the Agreement.

...

THE FALSE IMPRESSION CREATED BY THE SETTLEMENT AGREEMENT

Q. Please explain this false impression.

A. The $47.1 million purported increase of 6% presents a false impression because it is based on the false premise that the fixed CTC is a permanent part of rates rather than a temporary surcharge that was fully recovered earlier this year. The true increase, based on TEP's adjusted current base rates without the fixed CTC equals 19.8%.[5] The Settlement Agreement revenue requirement comparison charts in Mr. Pignatelli's testimony are misleading because they do not represent apples-to-apples comparisons between the terms of the Settlement and the real increases the customers will bear under the Settlement.

Q. Why are they not apples-to-apples comparisons?

A. The Company and RUCO's original revenue requirement positions were based on a base cost of fuel and purchased power of $.033 per kWh. The Staff's original position and the Settlement Agreement include a base cost of gas of only $.028896 per kWh. The delta between the two amounts is approximately $.0041 per kWh, which when multiplied by test year adjusted kWh sales renders a difference of over $38 million. Since the Settlement Agreement contains a PPFAC that will allow TEP to recover its actual cost of fuel and purchased power no matter what it turns out to be,

[5] The actual total increase as set forth in Exhibit WAR-1 is 21.15%. This testimony is explained in further detail below.

123

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Prepared for:

By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 of course, would go down. And then, of course, at some
2 point later on, you know, there may be a rate increase
3 as a result of, you know, TEP's request for a rate
4 increase. And so for some reason or another, they
5 believe that it would be confusing for customers to
6 understand why their rates were going down, then going
7 back up again.
8 I don't personally agree with that. I mean, I
9 think if you can get the word out that we have reached a
10 settlement agreement that's only going to result in a
11 6 percent increase in rates, I think you can certainly
12 get a press release out that explains why your rates are
13 going to be a little bit lower because a certain charge
14 has been eliminated.
15 And, you know, I think what is important about
16 this, and I don't think there has been much discussion
17 on this, but the fact of the matter is is the company
18 fully recovered that $450 million in stranded costs.
19 Why should ratepayers continue to pay that fixed CTC
20 charge?
21 Q. So you disagree with the Commission's decision
22 in which the Commission allowed TEP to continue to
23 collect that fixed CTC after the recovery of the
24 450 million?
25 A. We -- yes. We believe that after the, you know,

1 pursuant to the 1999 settlement agreement, that charge
2 should have dropped off after the $450 million in
3 stranded costs were recovered.
4 Q. Notwithstanding your disagreement, you recognize
5 that the Commission has issued a decision that allows
6 TEP to continue to recover that until further action of
7 the Commission?
8 A. That is a fact.
9 Q. You would also recognize that's the rate that
10 customers are paying now?
11 A. Again, that is a fact.
12 Q. And --
13 A. I am not disputing the Commission's wisdom in
14 this, or the Commission. The Commission made that
15 decision for the reasons that they thought were
16 important to continue it.
17 But the fact of the matter is is that TEP has
18 recovered the $450 million in stranded costs, and where
19 we are at as we speak in this room today, there is a
20 debate among the signatories of this settlement
21 agreement as to how those fixed CTC true-up revenues
22 should essentially be treated. That's a fact, and
23 that's even presented in this settlement agreement.
24 Q. And you would agree with me that the
25 Commission's decision in the motion to amend would lead

124

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1 going to monitor and that we weren't going to take an
2 active role in the settlement discussion. And I think
3 that it would have been disingenuous on our part to try
4 to do that.
5 And I don't know that one of the parties
6 wouldn't have objected had we done so, so I can't really
7 say yes or no on that. What I do know is that after the
8 final draft was filed, we studied it and then formulated
9 our positions on it.
10 Q. So then your testimony today is that you somehow
11 felt precluded by the nature of your role as a monitor
12 from offering the specific comment that in the
13 settlement discussions you were monitoring you thought
14 that the amount of the increase was being depicted in a
15 way that was somehow false or misleading?
16 A. And again, as I said, because we were only
17 acting in the role of monitors, I don't think we would
18 have been acting in good faith if we had tried to
19 interfere with the negotiations that were going on with
20 the other parties in the settlement discussions.
21 Q. Do you think that informing parties that you
22 have concerns that the settlement agreement contains, in
23 your opinion, language that is false and misleading is
24 interfering?
25 A. Well, yes, because again, we don't know what the

1 final draft is going to contain. Who is to say that
2 parties couldn't have gotten together at the last minute
3 and say hey, wait a minute, maybe we ought to change
4 this?
5 Q. Don't you think it would be helpful to the
6 parties to have those concerns pointed out to them if
7 indeed you have those concerns?
8 A. Perhaps. But then again, we didn't want to blur
9 or try -- I guess the better description is we didn't
10 want to have it both ways, I guess. I think it is only
11 fair. We were trying to do this in a good faith
12 fashion.
13 And this is, again, just my opinion on this, I
14 think it was -- we were trying to behave in a good faith
15 fashion. I don't think that RUCO could have had it both
16 ways. I don't think that we could have, honestly, told
17 you from the beginning no, we don't think that there is
18 anything here being offered here that we could come to
19 agreement with but we would like to go ahead and monitor
20 the proceedings, and then tried to inject ourselves,
21 okay, into the settlement discussions, okay, unless, you
22 know, we walked in and told everybody, well, you know,
23 we have had a change of heart on this, our director has
24 made a decision that we do want to actively participate
25 at this point, and we have some concerns about what is

125

BEFORE THE ARIZONA CORPORATION COMMISSION

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By: COLETTE E. ROSS
Certified Reporter
Certificate No. 50658

1 is point out certain facts, mainly the disclosure issue
2 on the level of increase that I spoke about earlier.
3 Q. In your opening summary, though, you stated that
4 what RUCO is now recommending is its litigation position
5 without change?
6 A. Yes.
7 Q. And so it is not your position that -- or is it
8 really your position that the Commission should approve
9 the elements of the settlement agreement that RUCO likes
10 and supports and reject all other elements?
11 A. No. I think it is like any other rate case
12 proceeding, you know. The Commission has broad
13 discretion on what they want to do. And so if they want
14 to adopt our litigated position, say, as a basis for
15 what new rates would be, certainly they are free to
16 include anything else in there that they want. I mean
17 we see this all the time at open meeting when
18 Commissioners file amendments to recommended orders and
19 opinions.
20 MR. PATTEN: Your Honor, that's all I have.
21 ALJ RODDA: Okay. Thank you, Mr. Patten.
22 Ms. Wagner, do you have any questions?
23 MS. WAGNER: I do.
24 ALJ RODDA: Do you have a lot?
25 MS. WAGNER: Thank you, Your Honor. Well, I had

1 agreement out there. And as we have stated, you know,
2 certainly there are parts of it that, you know, RUCO
3 believes is beneficial for residential ratepayers and so
4 forth. Even beneficial to ratepayers who aren't just
5 residential ratepayers.
6 But that being the case, I mean the Commission
7 is pretty much free to do what it wants. I mean, you
8 know, if it wants to look at our litigated position and,
9 you know, work off of that as a base, that's entirely
10 their prerogative.
11 Q. Well, Mr. Rigsby, if I wanted to know what
12 RUCO's position is in this case in terms of what RUCO is
13 asking the Commission to do, what testimony would I
14 refer to?
15 A. Well, I believe you would refer to the documents
16 that we have entered into evidence as RUCO's
17 Exhibit No. 1.
18 Q. So if I were the Commission and I wanted to know
19 what RUCO wanted the Commission to adopt, I would look
20 at RUCO-1, and then that would tell me what RUCO is
21 asking the Commission to do in this case?
22 A. Yes.
23 Q. All right.
24 A. But of course, we have a settlement agreement,
25 excuse me, a proposed settlement agreement in front of

1 the Commissioners also. So I am sure they would want to
2 weigh the information that is contained or the proposals
3 that are contained in that settlement agreement.
4 Q. But RUCO thinks that the Commission should adopt
5 RUCO-1 and not adopt the settlement agreement, that's
6 your position, is that -- have I stated that correctly?
7 A. I think that's fair to say, yes.
8 Q. All right. Would you agree with me that the
9 surrebuttal filing deadline was vacated by the Judge
10 pending the settlement discussions?
11 A. Yes. Yes, there was no surrebuttal testimony
12 filed in the proceeding.
13 Q. By any party, including RUCO?
14 A. That's correct.
15 Q. All right. Now, would you agree that it is
16 possible that if RUCO had filed surrebuttal testimony,
17 it might have adopted various changes to its position?
18 A. Possibly. I can't, I can't say for sure. Let
19 me just speak in generalities on this, because typically
20 when we file surrebuttal there isn't generally a lot of
21 difference between what we recommended in direct and
22 what we recommend in surrebuttal, unless, you know, we
23 uncover something that would have a material impact on
24 what we recommended and so forth.
25 We may make, depending on timing of Value Line

126

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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
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REBUTTAL TESTIMONY SUPPORTING THE SETTLEMENT AGREEMENT

OF

RALPH C. SMITH

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

JULY 08, 2008

Q. At pages 13-14 of his responsive testimony, RUCO witness Rigsby appears to be criticizing Staff for moving from a $15 per kilowatt-month cost to $25.67 per kilowatt-month amount for Springerville Unit 1. Why was Staff willing to accept this adjustment?

A. For two reasons.

First, in Staff's direct filing, I had used a $15 per kilowatt-month fixed cost recovery rate. This was based in large part on my understanding at that time of Decision No. 56659 (October 24, 1989), which had required TEP to adjust the revenue requirement effect of Springerville Unit 1 to reflect a $15 per kilowatt-month fixed cost recovery rate that reflected the cost of long-term generation capacity reasonably available at the time of that prior TEP rate case. The ratemaking treatment of Springerville Unit 1 was an important subject discussed during my deposition (see Attachment RCS-8). At the time of filling my direct testimony, I was not aware of Commission Decision No. 57586, which was issued in 1991 (i.e., after Decision No. 56659), and which provided as follows in Finding of Fact 10.q: "In future rate cases the Commission shall determine the appropriate level of the Century demand charge based upon reasonable market prices, but in no event will the rate be lower than the rate allowed in Decision 56659, or $15 per kilowatt month." Consequently, Staff was already considering a substantial revision in its direct filed position on Springerville Unit 1 when the schedule for filing surrebuttal testimony in this case was suspended.

Second, the Settlement Agreement provides at paragraph 3.2 on page 7 that:

Recovery of Springerville Unit 1 non-fuel costs shall reflect a cost of $25.67 per kW month which approximates the levelized cost of Springerville Unit 1 through the remainder of the primary lease term for this generating facility. In addition,

Springerville Unit 1 leasehold improvements shall be included in TEP's original rate base at net book value as of December 31, 2006.

Consequently, the intent of the settling parties is to provide Springerville Unit 1, including leasehold improvements, in rates at cost. The $25.67 was originally presented by TEP as a market-based rate, but according to the terms of the Settlement Agreement, this number is used as an approximation of the Springerville Unit 1 lease-related non-fuel levelized cost. In my opinion, this result is reasonable in light of TEP's rebuttal testimony and TEP's responses to data requests concerning Springerville Unit 1 cost.

Q. At page 13, line 23, through page 14, line 1, Mr. Rigsby states that: "RUCO's position on this issue was that Springerville Unit 1 should be included in rates at its embedded cost." Please respond.

A. Mr. Rigsby does not appear to acknowledge that RUCO's reflection of Springerville Unit 1 may have been incomplete, and thus not an accurate reflection of cost. He does not appear to acknowledge TEP's rebuttal testimony on Springerville Unit 1 issues. For example, TEP witness Kissinger's rebuttal testimony suggests that the levelized cost of Springerville Unit 1 was higher than had been reflected by RUCO. As noted above, the Settlement agreement attempts to achieve the objective articulated by RUCO of including Springerville Unit 1 in rates at cost. It did this by including the leasehold improvements in rate base and by using an amount for lease-related non-fuel expenses that approximated the levelized cost.

127

Evidence in support of fair value, rate base and other cost of service elements is contained in the Exhibits to the Settlement Agreement.