ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA	Docket No. E-01933A-07-0402
IN THE MATTER OF THE FILING BY TUCSON ELECTRIC POWER COMPANY TO AMEND DECISION NO. 62103.	Docket No. E-01933A-05-0650

CLOSING BRIEF OF THE RESIDENTIAL UTILITY CONSUMER OFFICE

The Residential Utility Consumer's Office ("RUCO") submits the following closing brief.

INTRODUCTION

Tucson Electric Power's ("TEP" or the "Company") rate application, and the proposed Settlement Agreement ("Settlement") that is the subject of this matter have raised the passions of all the parties involved. It is a compliment to the Commission's process that so many parties with such diverse interests could address and resolve so many different issues within such a short period of time. Many of issues that did arise throughout the course of the proceedings are peripheral and should be given little or no attention. The issues before this Commission are whether the Settlement is truly in the best interests of TEP's residential and commercial ratepayers, and if not, what would be a better alternative.

The parties that signed the Settlement ("signatories") believe that on balance the Settlement is in the best interests of the Company's ratepayers. RUCO is the only party that did not sign the Settlement. RUCO respects the signatories' decisions and their reasons for making those decisions concerning the Settlement. RUCO understands that the Settlement provides a result that will end, once and for all, the question of how TEP will price its generation after December 31, 2008. RUCO further understands that there are other positive provisions of the Settlement which will benefit ratepayers. RUCO lauds the signatories for working so hard to fashion a proposal that they believe balances all of the competing interests.

But RUCO's interests are statutorily defined. RUCO is charged with looking out for the best interests of residential ratepayers. That does not mean that RUCO does not balance the interests of the Company. On the contrary, it is not in ratepayers interests for the Company to be unable to provide adequate service because it is not financially healthy. What it does mean, however, is from RUCO's perspective the Company should have an opportunity to earn a reasonable return, and not one dime more.

The benefits to ratepayers under the Settlement come at too high a cost to ratepayers. After the Company presented its initial position, it was readily apparent to RUCO that the gap between RUCO's filed case and the Company's Settlement proposal was too wide to have held out the reasonable prospect for finding a common "middle ground." RUCO decided it would have not only been pointless, but unfair to the settling parties for RUCO to have actively participated in the settlement negotiations knowing that RUCO could not be a signatory. It came as no surprise to RUCO that the ultimate Settlement recommends a revenue increase that is a multiple of RUCO's position. The Settlement comes at too high a cost to ratepayers and is not in the ratepayers' best interests.

THE SETTLEMENT COMES AT TOO HIGH OF A COST TO RATEPAYERS.

There does not appear to be much disagreement on how much of an increase ratepayer's will see in their bills if the Settlement is approved. What has become the bigger issue in this proceeding is disclosure related - what is the appropriate information to disseminate to ratepayers concerning the amount of the increase ratepayers will see under the Settlement. While interesting, from RUCO's standpoint, it is really the actual amount of the increase ratepayer's will see when they open their bill that RUCO is concerned with.

The actual amount of the increase cannot be determined without first determining whether the fixed competition transition charge ("fixed CTC") should be excluded from consideration. Under the terms of the 1999 Settlement Agreement, the fixed CTC is set to terminate December 31, 2008 or when the Company recovers $450 million of its stranded costs, whichever is earlier. Decision No, 62103 at 5. The Company had recovered $450 million by May 2008. TEP-2 at 28[1]. However, the Commission, in Decision No. 69568[2], continued the fixed CTC charge until the Commission orders otherwise. Decision No. 69568 at 21. The Commissions' Utilities Staff ("Staff") estimates the amount of the fixed CTC revenues ("the fixed CTC true-up revenues") for the period of May 2008 through December 2008 will total $67.9 million. S-4 at 19. The Settlement does not provide a resolution of how the fixed CTC true-up revenues should be calculated and treated. TEP-1 at 15.1.

The Settlement provides for a $136.8 million increase over TEP's adjusted current base rates excluding the fixed CTC from the calculation. TEP-1 at 6. This increase translates to a 19.8% increase over adjusted current base rates. RUCO-2 at 7. When adjusted for the actual estimated fuel costs, short-term sales, SO2 allowances and the credit for wholesale revenues,

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[1] For ease of reference, trial exhibits will be identified similar to their identification in the Transcript of Proceedings. The Transcript page number will identify references to the Transcript.
[2] Decision No. 69568 was docketed on May 21, 2007.

RUCO estimates that the Settlement provides for a total yearly increase of $146,248,098 or 21.15%[3] over adjusted current base rates. RUCO-2, Exhibit WAR-1.

By comparison, RUCO in its underlying case, has recommended an increase over adjusted base year revenues of $36,254,000. The difference, $109,994,098 ($146,248,098 - $36,254,000) is the annual increase that the Settlement provides for beyond RUCO's underlying position[4]. RUCO weighed all of the benefits that the Settlement provides against the additional $110 million that it will cost ratepayers per year and determined that the benefits do not justify the additional costs. Ratepayers would be better off under RUCO's underlying recommendation.

THE SIGNATORIES MADE TOO MANY, AND TOO LARGE CONCESSIONS IN EXCHANGE FOR THE SETTLEMENT.

The Signatories made too many and too large concessions in exchange for the Settlement. The concessions that Staff made from its direct case are detailed in a chart attached to the Settlement. TEP-1, Settlement Exhibit No. 2. The largest rate base concession that Staff made is the reinstatement of $99 million related to a FAS 143 write-off of accumulated depreciation. Id. at 1, RUCO -2 at 10. RUCO's position on this issue is similar to

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[3] The Settlement also describes the increase in terms that include the fixed CTC in the calculation. TEP-1 at 6. Including the fixed CTC in the calculation, the Settlement provides for an increase of approximately $47.1 million or 6.03%. TEP-1 at 6. Since the fixed CTC has been recovered, under the terms of the 1999 Settlement Agreement the fixed CTC revenues terminate. Any monies recovered beyond what was agreed to should be returned to ratepayers. Moreover, since the fixed CTC terminates it would be misleading to represent to the public a percentage increase figure that includes the fixed CTC. At the time rates go into effect, barring a contrary decision by the Commission, adjusted base revenues will not include the fixed CTC.

[4] Staff's underlying direct case recommended an increase of $9,753,000. RUCO-1, Exhibit WAR-1. Staff's Director, Ernest Johnson testified on cross-examination that its surrebuttal position would have been approximately $60-70 million. Transcript at 493.

Staff's with the exception of the amount of the adjustment[5]. RUCO-2 at 10. The issue is straight forward - utilities have historically recognized the cost of asset retirement through annual depreciation accruals. RUCO-2 at 11. Prior to Statement No. 143, these retirement costs were placed in TEP's Accumulated Depreciation account. Id. The effect of these accruals is a reduction to ratebase because the accruals represent the portion of TEP's plant investment that has been paid for by ratepayers and recovered by the Company through depreciation expense. Id. Statement No. 143 requires TEP to write-off a portion of the accumulated depreciation balance that ratepayers have already paid for. This write-off decreases the Accumulated Depreciation balance, which in turn increases rate base. The overall result is that ratepayers pay a return on portions of the Company's plant investment that ratepayers have already paid for through their utility rates. Id.

From a ratemaking perspective, the inequity is obvious, and Statement No. 143 is inappropriate for regulatory accounting. Statement No. 143 was designed for non-regulatory accounting where its consequences are intended. In regulatory accounting, the application of FAS 143 will result in the double recovery of the previously accrued asset retirement costs. Id. RUCO believes that its litigation position on this issue is well grounded and likely to point to ways in which the Commissioners can amend this Settlement to yield a more equitable result.

Another of the many concessions identified by Staff includes $41.6 million which also relates to TEP's Accumulated Depreciation balance. TEP-1, Settlement Exhibit No. 2. The explanation for this adjustment is simple – since 2004 the Company began depreciating its generation assets at rates that were substantially lower than what the Commission authorized in its last rate case. RUCO-2 at 12. The adjustment trues-up the Accumulated Depreciation balance to the Commission's authorized rates from TEP's last rate case. RUCO

[5] RUCO's adjustment is an increase in the accumulated depreciation balance of $112.8 million. RUCO-2 at 10.

believes that its litigation position on this issue is also well grounded and likely to result in a favorable decision if litigated.

The list of concessions is long and the point is not to itemize them, estimate the likelihood of success if litigated, or to be critical of Staff or any other party for making the concessions. As Staff points out, in reaching a Settlement in a case as complex as this case the parties have to carefully consider their litigation positions and work towards reasonable compromises whenever possible. S-5 at 16. However, it is RUCO's view that after the litigation risks and all other things are considered, if there comes a point when the concessions significantly outweigh the exchanged benefits, then the Settlement is not in the best interests of ratepayers. In this case, the approximate $110 million a year additional that it will cost ratepayers beyond what RUCO is recommending outweighs the benefits the Settlement offers. The Commission should reject and/or modify the Settlement.

THE SETTLEMENT DOES HAVE BENEFITS BUT THOSE BENEFITS NEED TO BE PLACED IN THEIR PROPER PERSPECTIVE.

Before considering the benefits, it is noteworthy that the Settlement does not resolve all of the outstanding issues in this case. The Settlement does not resolve two large issues that could have a substantial impact on ratepayer's bills. The Settlement does not resolve how the fixed CTC true-up payments should be calculated or treated for ratemaking purposes. RUCO-2 at 18. Nor does the Settlement resolve what date any rate increase authorized in this docket will become effective. The signatories have taken different positions on both these issues and both issues involve substantial amounts of money. RUCO-2 at 19. The Settlement does not resolve these issues and only represents a partial resolution of the rate case. The ultimate resolution of these two issues could significantly change the balance between the costs and the benefits of the Settlement.

RUCO acknowledges that there are benefits to the Settlement. Significant elements of the Settlement represented by the signatories to be benefits include:

1) Purports to limit the base rate increase to approximately "6%", or $47.1 million. TEP-1 at 13, S-3 at 8;

2) A moratorium on base rate increases through 2012. TEP-1 at 13, S-3 at 8;

3) Waiver of any claims under the 1999 Settlement Agreement. TEP-1 at 13, S-3 at 7;

4) The implementation of a Purchased Power and Fuel Adjustor Charge ("PPFAC"). TEP-1 at 13.

While the Settlement does provide benefits, these benefits must be placed in perspective. First, ratepayers will experience a rate increase greater than "6%". Even viewed in the perspective the signatories advocate, beginning in 2009 the PPFAC surcharge could add another 3%-4%. TEP-3 at 6. The true rate increase, including the fixed CTC will likely be closer to a 9%-10% increase.

However, the rate increase should exclude the fixed CTC. Ratepayers are already paying rates that are more than what they should be paying. The Commission determined that it would allow the fixed CTC collection to continue beyond its termination date in order to avoid "potential confusion" and to provide rate stability pending the outcome of the rate case. Decision No. 69568 at 16. In reality what the Commission is doing is keeping the rates higher than what they should be, with the effect that it will appear to customers that the final rate increase is less than what it actually is. This type of ratemaking is less confusing but it is also misleading.

The actual rate increase, and what should be marketed to the public, is the amount that the Commission approves excluding the fixed CTC since the fixed CTC terminated. Under the

Settlement, this rate increase will be approximately 21.5% or approximately $146.2 million more per year than test year revenues excluding the fixed CTC. RUCO-2, Exhibit WAR-1.

The second benefit highlighted by the signatories is the four-year rate moratorium. Ratepayers and Commissioners like rate moratoriums - there is no question that ratepayers would like rate stability for the next few years. However, the attractiveness of a rate moratorium is predicated on the assumption that rates are not set too high to begin with. RUCO believes that an approximate 21.15% increase will result in rates that are too high which negates any benefit derived from a rate moratorium.

The third benefit highlighted by the signatories is the elimination of the potential litigation of issues associated with the 1999 Settlement Agreement. The threat of a lawsuit has been a stick that the Company has threatened the Commission with for years. RUCO agrees with TEP that the dispute focuses on one basic issue – how TEP's generation rates will be set after the rate freeze terminates under the 1999 Settlement Agreement at the end of 2008. See Direct Testimony of James S. Pignatelli in TEP's filing to Amend Decision No. 62103, Legal Brief at 1. The 1999 Settlement Agreement did not address what rates would be after 2008. See Direct Testimony of Mary Lee Diaz Cortez in TEP's filing to Amend Decision No. 62103, Legal Brief at 7. Putting aside the different positions taken on this issue, like any prospective litigation it is anybody's guess how the Courts would decide this issue.

RUCO presented its legal position in its Brief attached to its testimony of Marylee Diaz Cortez in TEP's filing to Amend Decision No. 62103. RUCO has updated its Brief and presents further legal argument on this issue and the likelihood of its success in the attached legal brief. RUCO concludes that a lawsuit brought by the Company would lack merit and ultimately be unsuccessful. RUCO's position is similar to the positions advocated by Staff and the AECC. Staff, in the Motion to Amend Decision No. 62103 testified "No basis exists for the $844 million of foregone revenues included therein, which TEP alleges to be part of the economic damages that it has sustained due to Arizona's experiment with electric competition." See Direct Testimony of Michael J. Ileo in TEP's filing to Amend Decision No. 62103 at 6, The AECC concluded that the 1999 Settlement is silent on the type of generation rates to be charged after 2008 and that TEP is not currently authorized to charge market based rates after 2008. See Direct Testimony of Kevin C. Higgins in TEP's filing to Amend Decision No. 62103, Legal Brief at 6.

RUCO recognizes that there is some litigation risk to ratepayers and therefore, some value to ratepayers to have this matter resolved short of litigation. Again, it comes down to a weighing of the value and the potential risks to ratepayers in resolving this matter versus the cost of the Settlement to ratepayers. It is impossible to know exactly how much potential exposure ratepayers would have since the Company has not filed a lawsuit against the Commission. The Commission should weigh the litigation risk premium embodied in the Settlement against the filed cases of the parties in the underlying case to inform their determination of whether the revenue requirement of the Settlement is just and reasonable, or whether it would constitute an unjust enrichment of the Company and would institutionalize an unjustly high rate structure for ratepayers.

Finally, the Settlement provides for an overly generous PPFAC. The overall make-up of TEP's generation is primarily fueled by coal. RUCO-2 at 17. Coal has historically been far less volatile than gas, which makes up a significant portion of APS' generation portfolio. Id. APS has a fuel adjustor that has a 4 mill cap and a 90/10 sharing clause. The PPFAC proposed in the Settlement does not provide for either a cap or a sharing clause. This aspect of the Settlement makes no sense and would result in bad precedent.

RUCO has recommended a fuel adjustor that only applies to incremental sales. Id. Hence, RUCO's adjustor is far more applicable for this company which experiences fuel costs that have historically been less volatile than APS. Ratepayers would be better off under RUCO's recommendation.

CONCLUSION - THE COSTS OF THE SETTLEMENT OUTWEIGH THE BENEFITS

This Brief does not cover an analysis of all of the costs and all of the benefits – that would be overkill. The emphasis has been on the larger costs and benefits. When the costs and the benefits are tallied, RUCO believes there is a large gap that separates the two. The gap is too large in RUCO's opinion for the Settlement to be in ratepayers' bests interests. The Commission should reduce the revenue requirement in this Settlement.

RESPECTFULLY SUBMITTED this 29th day of August 2008

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