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BEFORE THE ARIZONA CORPORATION COMMISSION

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NOV -6 P 3:10
AZ CORP COMMISSION
DOCKET CONTROL

EXCEPTION

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

**TUCSON ELECTRIC POWER
COMPANY'S EXCEPTION TO
RECOMMENDED OPINION AND
ORDER**

Tucson Electric Power Company ("TEP" or the "Company"), through undersigned counsel, respectfully submits its Exception to the Recommended Opinion and Order ("ROO") issued in this docket approving the TEP Proposed Rate Settlement Agreement dated May 29, 2008 (the "2008 Settlement Agreement").

TEP supports the ROO's findings and conclusions that the 2008 Settlement Agreement is in the public interest, produces rates that are just and reasonable and should be adopted in its entirety. TEP acknowledges the ROO's comprehensive analysis of the 2008 Settlement Agreement and the evidence in the record that fully supports its approval by the Arizona Corporation Commission.

Arizona Corporation Commission

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1 The one area that TEP still disputes is the ROO's recommendation that all Fixed CTC
2 True-Up Revenue ("True-Up Revenue") should be credited to TEP's customers. The ROO states,
3 in part:

4 "We believe that the Fixed CTC True-up Revenues should be credited in their
5 entirety to the ratepayers by means of a credit to the PPFAC...Our concern in
6 Decision No. 69568 was to balance the Company's concern about its financial
7 condition while protecting ratepayers. By adopting the 2008 Settlement
8 Agreement, which provides TEP with increased base rates and a PPFAC, and
9 returning the Fixed CTC True-up revenues to the ratepayers, we believe we are
10 accomplishing both goals of Decision No. 69568. Furthermore, when the
11 Commission found TEP's current rates in Decision No. 62103 to be just and
12 reasonable, it made that determination with the knowledge that the Fixed CTC
13 would terminate after it collected \$450 million. Thus, contrary to the arguments
14 of TEP and AIC, the current rates that have been found to be just and reasonable
15 include the termination of the Fixed CTC component, and we do not find it
16 determinative that the Fixed CTC was not an "add on" to the previously existing
17 rates."¹

18 TEP believes that the evidence in this case is contrary to the ROO's analysis regarding the proper
19 treatment of the True-Up Revenue. In fact, the evidence in this matter supports TEP's position
20 that it should retain the True-Up Revenue.

21 TEP should retain the True-Up Revenue for three reasons. First, the record is clear and the
22 2008 Settlement Agreement acknowledges that even if the True-Up Revenue is treated as
23 traditional revenue, TEP has been under-earning since at least 2006. It would be contradictory to
24 the evidence, unjust and unreasonable for the Commission to cause the Company to refund
25 revenue at a time that it is not earning its authorized rate of return. Crediting back a portion of
26 revenue based on a rate that has been determined to be just and reasonable is inequitable and
27 would increase TEP's revenue shortfall.

Second, ratepayers are realizing the benefits of the Fixed CTC because the cost-of-service
generation rates recommended in the ROO reflect the accelerated write-down of \$450 million of
generation assets. That is a benefit that was not originally contemplated in 1999 because at that
time it was expected that generation assets would be divested before the Fixed CTC terminated.

¹ ROO at page 40.

1 Further, given the accounting nature of the Fixed CTC, ratepayers did not pay for that extra
2 benefit. Because TEP's generation rates will be based on cost-of-service, ratepayers will receive
3 that extra benefit in perpetuity. As a result, TEP potentially is faced with reduced rate base for its
4 new cost-of-service rates *and* a reduction to its current rates (through a True-Up Revenue credit) --
5 without any matching benefit to TEP that justifies the rate decrease. In essence, imposing both
6 reductions on TEP effectively double-counts the impact of the \$450 million generation asset
7 reduction.

8 Third, the Fixed CTC is simply an accounting mechanism that did not increase customer
9 rates. It is important to note that those rates, including the Fixed CTC, were deemed just and
10 reasonable in 1996 and again in 1999. Any credit would effectively disregard the rationale of the
11 Commission's prior decisions and deny TEP a portion of revenue that it collected through rates
12 that were previously determined to be just and reasonable.

13 Accordingly, TEP requests that the ROO be amended to provide that the True-Up Revenue
14 should *not* be refunded. This exception includes TEP's proposed amendment to the ROO,
15 attached hereto as Exhibit A.

16 EXCEPTIONS

17 I. TEP SHOULD RETAIN THE TRUE-UP REVENUE.

18 **A. Even if the Fixed CTC Revenue is treated as traditional revenue, TEP has**
19 **been under earning since 2006.**

20 The ROO recommends approval of the rate design agreed to in the 2008 Settlement
21 Agreement that is intended to provide TEP with \$47.1 million of additional revenue above 2006
22 test year revenue that include Fixed CTC revenue.² Therefore, TEP argues that even if the True-
23 Up Revenue is treated as traditional revenue, TEP has been under-earning since at least 2006.
24 Therefore, it would be contradictory to the evidence in this case for the Commission to cause the
25 Company to refund revenue at a time that it is not earning its authorized rate of return.

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² See Ex. TEP-1 (Settlement Agreement), Sec. 2.3.

1 Issuing a credit or refund would simply serve to aggravate the current inability of TEP to
2 earn a just and reasonable return. A credit or refund of the True-Up Revenue would effectively
3 deny TEP a portion of revenue that it collected through rates that were previously determined to be
4 just and reasonable. Because TEP has experienced a revenue deficiency since at least the 2006 test
5 year, it is unnecessary to require any credit or refund of that revenue.

6 **B. Ratepayers have already realized a benefit of \$450 million due to the Fixed**
7 **CTC.**

8 TEP's ratepayers are realizing the benefits of the Fixed CTC because the cost-of-service
9 generation rates, as recommended in the ROO, reflect the accelerated write-down of \$450 million
10 of generation assets. The ROO agrees that TEP's generation rates should be based on cost-of-
11 service.³ If the ROO's recommendation is approved, then TEP's generation rates will reflect
12 generation assets that have been reduced on an accelerated basis by \$450 million.⁴ Customers will
13 benefit from a write down of assets for which they did not have to pay any increased overall rate
14 from 1999 to present. Given that TEP will continue to set rates based on cost-of-service, this write
15 down of generation assets will benefit customers in perpetuity.

16 This long-term benefit is not something that was contemplated in 1999 due to the
17 previously contemplated shift to market-based pricing and is why blind adherence to the 1999
18 Settlement Agreement provision regarding termination of the Fixed CTC is not appropriate or
19 equitable. As Arizonans for Electric Choice and Competition witness, Mr. Kevin Higgins,
20 explained at the hearing, the Fixed CTC was set to recover stranded costs in contemplation of the
21 divestiture of TEP's generation assets.⁵ It may have made sense to end the Fixed CTC if TEP had
22 in fact divested its generation assets. However, that divestiture did not occur. As a result, TEP
23 potentially is faced with reduced rate base for its new cost-of-service rates *and* a reduction to its
24 current rates (through a True-Up Revenue credit). Imposing both reductions on TEP effectively
25 double-counts the impact of the \$450 million generation asset reduction. And requiring a refund

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27 ³ Ex. TEP-1 (Settlement Agreement), Sec. 2.2.

⁴ Tr. (Pignatelli) at 103.

⁵ Tr. (Higgins) at 591.

1 or credit of the True-Up Revenue would constitute an effective decrease of rates that had been
2 deemed just and reasonable -- without any matching benefit to TEP that justifies the rate decrease.

3 **C. Customers' rates were not raised from just and reasonable levels in**
4 **1999 to fund the Fixed CTC recovery.**

5 As Mr. Higgins testified, the Fixed CTC was not an incremental rate increase but merely an
6 accounting "color-coding" of a portion of TEP's overall rates that were in effect in 1999.⁶ That
7 overall bundled rate had first been determined to be just and reasonable in 1996 -- without any
8 anticipation that a portion of the rate would terminate in the future.⁷ In 1999, those just and
9 reasonable rates were simply unbundled to allow for retail electric competition.⁸ TEP's overall
10 rates were not raised to collect the Fixed CTC.⁹ Rather, the Fixed CTC was one of many
11 unbundled rate elements delineated in 1999 to allow retail electric competition to occur.¹⁰
12 Specifically, the Fixed CTC was an accounting mechanism to allow TEP to amortize \$450 million
13 of generation plant stranded costs between 1999 and the end of 2008 rather than incur the entire
14 write off in a single year.¹¹ TEP did not collect extra revenue from the Fixed CTC but it did
15 (during the 1999-2008 time period) write down the value of its generation assets by \$450
16 million.¹²

17 **D. The 2008 Settlement Agreement provides several mechanisms to protect**
18 **customers.**

19 The ROO also suggests that the concern of Decision No. 69568, specifically balancing the
20 Company's financial condition while also protecting ratepayers, is met because the rate relief and
21 the PPFAC in the 2008 Settlement Agreement provide adequate balance against the True-Up
22 Revenue credit.¹³ However, at the time of Decision No. 69568, it was not contemplated that there

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24 ⁶ Hearing Transcript ("Tr.") (Higgins) at 594; see Hearing Exhibit ("Ex.") AECC-3 (Higgins Settlement) at 9-10.

25 ⁷ See Decision No. 59594 (March 29, 1996) at 7.

26 ⁸ See Decision No. 62103 (November 30, 1999).

27 ⁹ Ex. TEP-2 (Pignatelli Settlement Direct) at 29-30; Ex. AECC-3 (Higgins Settlement) at 9-10.

¹⁰ See Ex. AECC-3 (Higgins Settlement) at 10.

¹¹ Ex. TEP-3 (Pignatelli Settlement Rebuttal) at 7.

¹² Tr. (Pignatelli) at 103, 8-12.

¹³ ROO at page 40.

1 would be a settlement of the numerous issues surrounding TEP's rates. Nor was it certain that
2 TEP's generation rates would be based on cost-of-service.

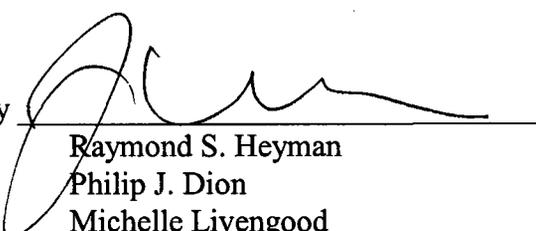
3 A settlement of the contentious issues was reached and the resulting 2008 Settlement
4 Agreement provides numerous mechanisms that protect customers. In fact, the ROO
5 acknowledges that:

6 "[t]he benefits of the 2008 Settlement Agreement are numerous and some would
7 likely have been difficult to obtain without a consensual resolution. In particular,
8 the provision that protects low income ratepayers for both the increase in base
9 rates and the effect of the PPFAC is innovative and unprecedented in Arizona."¹⁴

9 Other examples of the benefits that will enure to our customers include TEP's agreement to a rate
10 freeze until 2012, TEP's generation rates will now be subject to cost-of-service ratemaking and
11 customers will not be exposed to market rates for generation in the future. Therefore, it is
12 unnecessary and inequitable to credit the True-Up Revenue against the PPFAC given TEP's
13 historical under-earning, the effect it would have in exacerbating TEP's financial condition and the
14 numerous other customer benefits provided by the 2008 Settlement Agreement and recommended
15 in the ROO.

16 RESPECTFULLY SUBMITTED this 6th day of November 2008.

17 TUCSON ELECTRIC POWER COMPANY

18
19 By 

20 Raymond S. Heyman

21 Philip J. Dion

22 Michelle Livengood

23 Tucson Electric Power Company

24 One South Church Avenue, Ste 200

25 Tucson, Arizona 85701

26 and

27 _____
¹⁴ ROO at page 38.

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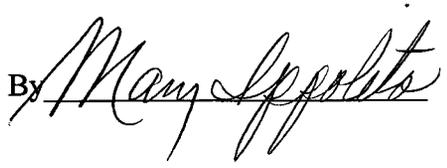
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Exhibit A

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Proposed Amendment

Page 40, Line 10: **DELETE** the first sentence.

Page 40, Line 19: **After** “By adopting the 2008 Settlement Agreement,” **DELETE** the remainder of the paragraph and **INSERT**: “it is unnecessary to require TEP to refund or credit the Fixed CTC True-up Revenues back to rate payers because, as discussed above, the 2008 Settlement Agreement provides numerous customer benefits, such as a four-year rate moratorium and low-income customer protections, while providing TEP with sufficient financial resources to continue to provide reliable electric service.”

Page 47, line 3: **After** “and reasonable” **DELETE** the remainder of the sentence and **INSERT**: “to allow TEP to retain the Fixed CTC True-up Revenues.”

Page 48, lines 11-12: **DELETE** and **INSERT**: “IT IS FURTHER ORDERED that Tucson Electric Power Company shall retain the Fixed CTC True-up Revenues resulting from Decision No. 68568.