

ORIGINAL

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0000097082

MEMORANDUM  
RECEIVED

TO: Docket Control

2009 MAY 20 A 9:09

FROM: Ernest G. Johnson  
Director  
Utilities Division

AZ CORP COMMISSION  
DOCKET CONTROL

DATE: May 20, 2009

RE: STAFF REPORT IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR AN EXTENSION OF WAIVERS DOCKET NOS. E-01933A-05-0650 AND E-01933A-07-0402.

Attached is the Staff Report for the application of Tucson Electric Power Company for approval of the extension of waivers. Staff recommends approval of some of the extensions and recommends against some of the waiver extensions.

EGJ:LAJ:red

Originator: Linda A. Jaress

Arizona Corporation Commission

DOCKETED

MAY 20 2009

DOCKETED BY	
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Docket Nos. E-01933A-05-0650 and E-01933A-07-0402

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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

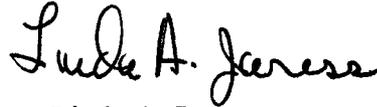
**TUCSON ELECTRIC POWER  
DOCKET NOS. E-01933A-05-0650  
AND  
E-01933A-07-0402**

**IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER  
COMPANY FOR EXTENSION OF WAIVERS**

**MAY 20, 2009**

## STAFF ACKNOWLEDGMENT

The Staff Report for the application of Tucson Electric Power Company for approval of the extension of waivers, Docket Nos. E-01933A-05-0650 and E-01933A-07-0402 was prepared by Linda A. Jaress.

A handwritten signature in black ink that reads "Linda A. Jaress". The signature is written in a cursive style with a large initial "L".

Linda A. Jaress  
Executive Consultant III

## **INTRODUCTION**

Decision No. 70628, dated December 1, 2008, approved a Settlement Agreement (“2008 Settlement Agreement”) entered by Tucson Electric Power Company (“TEP” or “the Company”), Staff and various other parties to resolve a TEP rate case. Paragraph 14.9 of the Settlement Agreement reads as follows:

*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.*

On March 2, 2009, TEP filed this Application for Extension of Waivers in compliance with that Order.

## **TEP**

TEP serves approximately 400,000 customers in Pima and Cochise Counties in Arizona. Exhibit 1 attached shows TEP’s place in the Unisource Energy Corporation (“UniSource”) holding company organization. It can be seen that TEP has three subsidiaries; Escavada Company (“Escavada”), San Carlos Resources, Inc. (“San Carlos”) and Tucsonel, Inc (“Tucsonel”). For the year ending December 31, 2008, TEP’s revenues were \$1.1 billion while Escavada Company reported revenues of \$94,000. Neither San Carlos nor Tucsonel reported revenues for the year. Tucsonel holds an undivided ownership in Springerville Generating Station. San Carlos acquires, constructs, holds and maintains electric power production facilities and Escavada is in the business of owning non-utility real estate in Arizona related to UniSource Energy Corporation’s business.

Exhibit 1, attached, is the organizational chart of UniSource, a public utility holding company and the parent of TEP. This Exhibit illustrates TEP’s place in the organization and its relationship to its affiliates.

## **BACKGROUND**

In the late 1980’s and early 1990’s, TEP’s financial health suffered greatly. As a result of the spin-off of a generator, imprudent fuel contracts and losses from its investment subsidiaries, TEP reached a point where it could not pay its bills. TEP instituted a payment moratorium which eventually led to a filing of an involuntary petition for reorganization of the Company under Chapter 11 of the U.S. Bankruptcy Code. TEP ultimately reached an agreement with its

creditors and shareholders and instituted a restructuring plan which resulted in the heavy dilution of its stock and a capital structure of over 100 percent debt.

About the same time, Pinnacle West Capital Corporation ("Pinnacle West"), parent of Arizona Public Service ("APS"), was suffering from real estate losses and losses from its investment in Merabank, a failed thrift company. As part of its efforts to extricate itself from its financial problems, Pinnacle West used the common stock of APS to secure some of its debt.

The combined circumstances of APS and TEP led the Commission to institute A.A.C. R14-2-801 through 806, the "Public Utility Holding Companies and Affiliated Interests" rules also known as the "Holding Company Rules" or the "Affiliated Interest Rules" (sometimes collectively referred to as "Rules"). The Rules were adopted in Decision No. 56844, March 14, 1990, and are attached as Exhibit 2.

The Commission then stayed the Rules during an extended review and court case brought by the Arizona Attorney General. The stay was partially lifted by Decision No. 58063, dated November 3, 1992. This Decision lifted the stay for all the Rules as of certain dates, except for R14-2-803, to which it limited the requirement to file a notice of intent for certain transactions only for amounts in excess of "exempt amounts". For example, TEP with total utility assets of \$1.5 billion in its last rate case, has the ability to increase or decrease its financial interest in an affiliate by \$25 million per year without Commission approval.

During the mid- and late-nineties, the Commission and Arizona's electric utilities took efforts toward instituting electric competition. TEP was in the forefront of these efforts and planned to divest its generation assets. Some of the Holding Company Rules would have limited TEP's flexibility in this undertaking. Thus, the Commission issued a series of orders over several years partially approving or denying TEP's applications for waivers to the Holding Company Rules.

Among these decisions was Decision No. 62103, November 30, 1999, which approved the 1999 Settlement Agreement which is the subject of this application. The 1999 Settlement Agreement modified some of TEP's previous waivers of the Holding Company Rules and "waived" compliance with some previous Commission decisions as well.

## **THE APPLICATION**

TEP's current application directly responds to the 2008 Settlement Agreement's requirement to address only the waivers granted through the 1999 Settlement Agreement. In this application, TEP is requesting that the Commission approve continuation of most of the waivers addressed in the 1999 Settlement Agreement but that the partial waivers of R14-2-803 and R14-2-804.A. not be continued. The Company's basic arguments for continuing the waivers are that if the waivers are not extended, the reporting requirements would be burdensome and unnecessary and that the waivers have been in effect for over ten years with no ill effects.

Some of the 1999 Settlement Agreement waivers which TEP would like continued are waivers of requirements set forth in Commission Decisions and some are waivers of portions of the Commission's Holding Company Rules. Staff has attached as Exhibit 1 the organizational chart of Unisource Energy Corporation, TEP's parent, which illustrates TEP's relationship to its affiliates. Exhibit 2 to this report is a copy of the Holding Company Rules. Exhibit 3 is the portion of the 1999 Settlement Agreement which granted the waivers at issue. Exhibit 4 lists the 28 conditions to TEP's formation of a holding company granted by Decision No. 60480.

Staff's discussion and analysis will address the waivers by looking to the circumstances under which they were first granted and whether or not it is currently in the public interest to maintain the waivers.

#### **DECISION NO. 57586**

Decision No. 57586 was issued on October 11, 1991, in the midst of TEP's financial crisis. This rate case was resolved with a settlement agreement ("the 1991 Settlement Agreement"). However, the Decision went beyond the settlement agreement by adding language which addressed the Commission's concerns about consulting contracts and contracts for goods and services between TEP and current and former members of the TEP Board of Directors and their family members, and between TEP and current and former officers and managers of TEP.

The Decision and Settlement Agreement required TEP to submit a report at the appointment of each new member to the TEP Board of Directors which would disclose the new member's current and prior associations with TEP, its affiliates and subsidiaries for the past ten years. The 1999 Settlement Agreement granted a waiver of this requirement and TEP is requesting that the waiver be continued.

TEP has had at least two rate cases since this requirement was put in place. Staff is not aware of any improprieties or alleged improprieties regarding TEP's or its parent's Board of Directors contracts with the Unisource subsidiaries. Staff is also not aware of any similar requirement of other Arizona utilities. Therefore, Staff recommends that the waiver of this requirement be continued.

#### **DECISION NO. 58316**

Decision No. 58316, dated June 9, 1993, approved a waiver of compliance with A.A.C. R14-2-804.B. for certain transactions subject to five conditions. The transactions at issue were the liquidation of TEP's investment in two subsidiaries: Tucson Resources, Inc. and Sierrita Resources, Inc. The conditions required the filing of information regarding the book value, sales price, security, broker identity, accounting treatment of the liquidation, the parties to the transactions and the relationship of the parties to TEP and its officers and directors. By the time of the 1999 Settlement Agreement, the subsidiaries had been liquidated and the requirement was irrelevant. Thus, the 1999 Settlement Agreement waived this requirement.

TEP requests that the waiver of these filing requirements be extended. Staff agrees because the liquidation of the subsidiaries has long been accomplished. Staff recommends that TEP receive a continuation of this waiver.

#### **DECISION NO. 59594**

Decision No. 59594 approved the 1995 Settlement Agreement in a TEP rate case. The focus of this rate case was cost containment. The Decision required TEP to "provide Staff with an annual report providing a description and quantification of the effects of TEP's ongoing cost containment efforts" and to file such a report no later than April 15<sup>th</sup> of each year.

This requirement is contained within a section of the 1995 Settlement Agreement entitled "Moratorium Period" which sets forth the period of a base rate case moratorium from March 1995 to January 1, 2000. The section also discusses the possibility of rate case settlements and mergers during the moratorium period. Thus, it could be deduced that the cost containment reports may have only been required during the moratorium period to keep the Commission informed of TEP's efforts to contain costs between rate cases.

The 1995 Settlement Agreement also required the filing of a Mid-Year demand-side management ("DSM") and Renewables Report. The 1999 Settlement Agreement did not waive this requirement but required the filing only until such time as divestiture occurs. Divestiture has not occurred and TEP does not object to continuation of the requirement.

Staff believes that because a full TEP rate case has been conducted since the initial requirement was put in place, and the Commission has had the opportunity to determine which of TEP's costs were unreasonable, the waiver of the 1995 requirement to file cost containment reports granted in the 1999 Settlement Agreement should be continued.

#### **DECISION NO. 60480**

In Decision No. 60480, dated November 25, 1997, the Commission approved a TEP application to form a public utility holding company, ultimately, UniSource. According to the Decision, at the time, TEP was still on the road to financial recovery but wanted to form a holding company to "allow it to compete on a level playing field in the increasingly competitive electric energy business and to comply with...the Electric Competition rules." The Commission, recognizing TEP's still fragile financial health while at the same time addressing what the Decision called "looming competition", approved the formation of the holding company but with 28 conditions. These conditions included filing requirements (in addition to those required by the Holding Company Rules), and capital structure limitations and addressed cost allocation procedures, marketing standards, etc. These conditions are attached to this report as Exhibit 4.

## **DECISION NO. 62103 – THE 1999 SETTLEMENT AGREEMENT**

Decision No. 62103, dated November 30, 1999, approved a rate case settlement, the 1999 Settlement Agreement, entered by TEP and various other parties. The 1999 Agreement, in anticipation of the implementation of competitive retail access, stranded cost recovery and independent scheduling administrators, granted TEP waivers of the Affiliated Interest Rules, Integrated Resource Planning Rules, certain conditions in Decision No. 60480, and certain Commission decisions. Of the 28 conditions placed in effect by Decision No. 60480, Conditions numbers 2, 12, 13, 17, 26 and 27 were waived or partially waived by the 1999 Settlement Agreement.

**Condition 2:** This condition was waived in full by the 1999 Settlement Agreement. The condition addressed potential subsidies among and between TEP, its subsidiaries and affiliates. It required TEP to charge the higher of fully allocated cost or market price whenever it sold services or goods to affiliates and required affiliates to charge TEP the lower of fully allocated cost or market price.

TEP requests that this condition continue to be waived. Among TEP's arguments are that the condition could disadvantage UNS Gas and UNS Electric, Inc., there have been no ill effects from the 10-year old waiver and that the condition could apply to renewable projects.

How utilities charge affiliates for services provided to affiliates is an important ratemaking issue. Staff also believes that there are some economic advantages to sharing services among sister utilities and if allocation procedures are too complicated or expensive for a utility to accomplish, it may be motivated to not share services where economies of scale can be accomplished.

Staff thoroughly examines allocations of costs and expenses among the Unisource utilities during their rate cases. Staff agrees that placing Condition 2 back into effect would cost TEP considerable time and money and might result in the utilities' loss of mutually beneficial economies of scale. Staff recommends the condition continue to be waived.

**Condition 12:** This condition required the filing of quarterly consolidated and quarterly individual financial statements for TEP and each "sister" company. The 1999 Settlement Agreement waived the filings for sister companies but maintained annual filings by UniSource and quarterly filings by TEP. TEP has requested that the partial waiver remain in effect.

Staff is unaware of any similar requirement imposed on a utility, other than TEP, to file quarterly financial statements of affiliates and is unaware of any current circumstance under which this information would be useful. Staff has not experienced any inconvenience or impediment to the receipt of appropriate information from TEP during the time this waiver has been in effect. Staff recommends the waiver be continued.

**Condition 13:** This condition to Decision No. 62480 required TEP to file an annual report which identified any full-time, non-clerical personnel who were moved from TEP to UniSource or any of its subsidiaries during the year. The 1999 Settlement Agreement gave a complete waiver to this condition. Staff agrees with TEP that this condition would be burdensome. Staff recommends the waiver of the condition be continued.

**Condition 17:** Condition 17 required the total of the debt and equity of the sister companies to not exceed 30 percent of TEP's capitalization unless approved by the Commission. This condition was in place before TEP purchased UNS Gas and UNS Electric from Citizens Utilities Company. If the Commission were to remove the waiver of this condition granted in the 1999 Settlement Agreement, depending on the relative growth rates of the UNS companies and TEP, it may complicate financing for the UNS companies or even impact their ability to raise capital in a timely manner. Staff recommends the waiver of the condition be continued.

**Condition 26:** This condition set accounting and tracking requirements for the cost of the time spent by TEP employees on mergers, acquisitions and business development. If the activities were substantially for the benefit of TEP, the costs would be recorded above the line and if not, below the line. TEP believes the condition to be unnecessary and burdensome.

The condition allows TEP and UniSource to determine which costs are incurred for the utility and its customers and which costs are incurred for the holding company and the investors. If Staff were to disagree during a rate case, those accounting entries would need to be unwound. Also, during merger proceedings, these costs are reviewed by Staff. Continuing to waive this condition would avoid duplication. Staff recommends that the condition continue to be waived.

**Condition 27:** This condition addressed the Commission's concerns about potentially unfair marketing practices by new entities formed during divestiture and diversification by TEP or UniSource which might have used TEP's name or logo on their advertisements. It required the filing of licensing agreements, operating and service agreements, business plans, description of promotional campaigns, joint marketing work products, registered logos and trademarks and a description of all products and services offered by TEP and each sister company. The 1999 Settlement Agreement waived the filing of this information.

TEP requests that this condition continue to be waived because it is burdensome. Staff believes the majority of the documents and information required by this condition would be filed under R14-2-805 discussed below. To avoid duplication, Staff recommends the condition continue to be waived.

## **HOLDING COMPANY RULES**

The 1999 Settlement Agreement also resulted in some partial waivers from the Holding Company Rules. The Holding Company Rules are attached to this report as Exhibit 2.

**R14-2-803**

This Rule requires a utility to file a Notice of Intent when it intends to organize or reorganize a public utility holding company and sets forth the information to be included in the Notice of Intent. The 1999 Settlement Agreement waived the Rule to the extent that TEP would only be required to file the Notice when it was changing its position in the holding company. TEP is not requesting the extension of the waiver, so the Rule will once again apply to any reorganization of the holding company, not just reorganizations involving TEP. Staff agrees to this change.

**R14-2-804.A**

This Rule addresses transactions between a utility and its affiliates and confirms Commission access to TEP's affiliates' books and records. The 1999 Settlement Agreement limited that access to investigations performed during a rate case. TEP is not requesting the continuation of the limitation and agrees that none of this Rule will be waived. Staff agrees that this limitation should be discontinued.

**R14-2-805.A.**

TEP is requesting a continued partial waiver of 805.A and five of its subsections (A.2, A.6., A.9, A.10 and A.11). This Rule requires extensive annual filing requirements from both the utility and the holding company. The 1999 Settlement Agreement waived the requirement that the holding company (UniSource) make the annual filing but still required annual filings by "only TEP (the UDC), unless the diversification plans or efforts of affiliates are likely to adversely affect the UDC's financial integrity." UniSource, then, currently does not have to file its diversification plans with the Commission.

Staff believes that this waiver should not be extended. UniSource is a holding company primarily for Arizona utilities. Significant diversification efforts by UniSource could place the utilities at risk. The Holding Company Rules were created to protect the utilities and their rate payers from the imprudent actions of their holding company parents. The waiver was received during a time when competition in the electric utility industry was expected and utilities or their holding companies may have needed the flexibility to form or disband without Commission approval. Those factors no longer apply. Also, Staff has recommended continuation of the 1999 Settlement Agreement waiver of Condition 27 to Decision No. 60480. If the Commission were to continue to waive both Condition 27 and this portion of R14-2-805, one of the purposes of the Holding Company Rules would be defeated. That purpose is the reporting of transactions and the provision of contracts between the utility and its affiliates to verify that the affiliates are not treating the utility unfairly. Thus, Staff recommends that the waiver of R14-2-805A no longer continue and the filing requirements apply.

### **R14-2-805.A.2**

R14-2-805.A.2 requires utilities to provide a “brief description of the business activities conducted by the utility's affiliates with whom transactions occurred during the prior year, including any new activities not previously reported.” The waiver set in place in the 1999 Settlement Agreement allows TEP to provide only a “broad description of the nature of the business of each affiliate.”

Staff recently reviewed TEP's 2008 annual Holding Company filing. TEP's description of the business activities is very broad, to the extent that the reader cannot develop an understanding of the activities of the affiliates. For example, one affiliate is described as engaging in “the business of maintaining miscellaneous assets and property.” If the filings are to be at all useful as a way to determine the risks of affiliate activities to the utility, then Staff believes the waiver of R14-2-805.A.2 should not be extended.

### **R14-2-805.A.6**

R14-2-805.A.6 addresses the allocation processes by which costs are assigned between the holding company and the affiliates and requires a thorough discussion of the allocations of plant, revenues and expenses from the holding company to the affiliates. The waiver granted makes this Rule applicable to only TEP. Staff believes that the allocations from the holding company to the affiliates, including TEP, can be the source of unfair cost sharing. One of the purposes of the Rules was to protect the utilities from paying more than its share of common costs. Thus, Staff recommends the waiver of this Rule not be continued.

### **R14-2-805.A.9, 10 AND 11**

R14-2-805.A.9, 10 and 11 require the annual filing of contracts for goods or services between the utility and its affiliates. The waiver limits the production of those documents to rate cases. Staff agrees. These documents are useful during rate cases where they would be reviewed for reasonableness and prudence. Furthermore, the filing of the same contract year after year would not be useful. Staff recommends that the waiver to these sections be continued.

## **RECOMMENDATIONS**

In conclusion, Staff recommends the Commission extend the waivers of the following requirements:

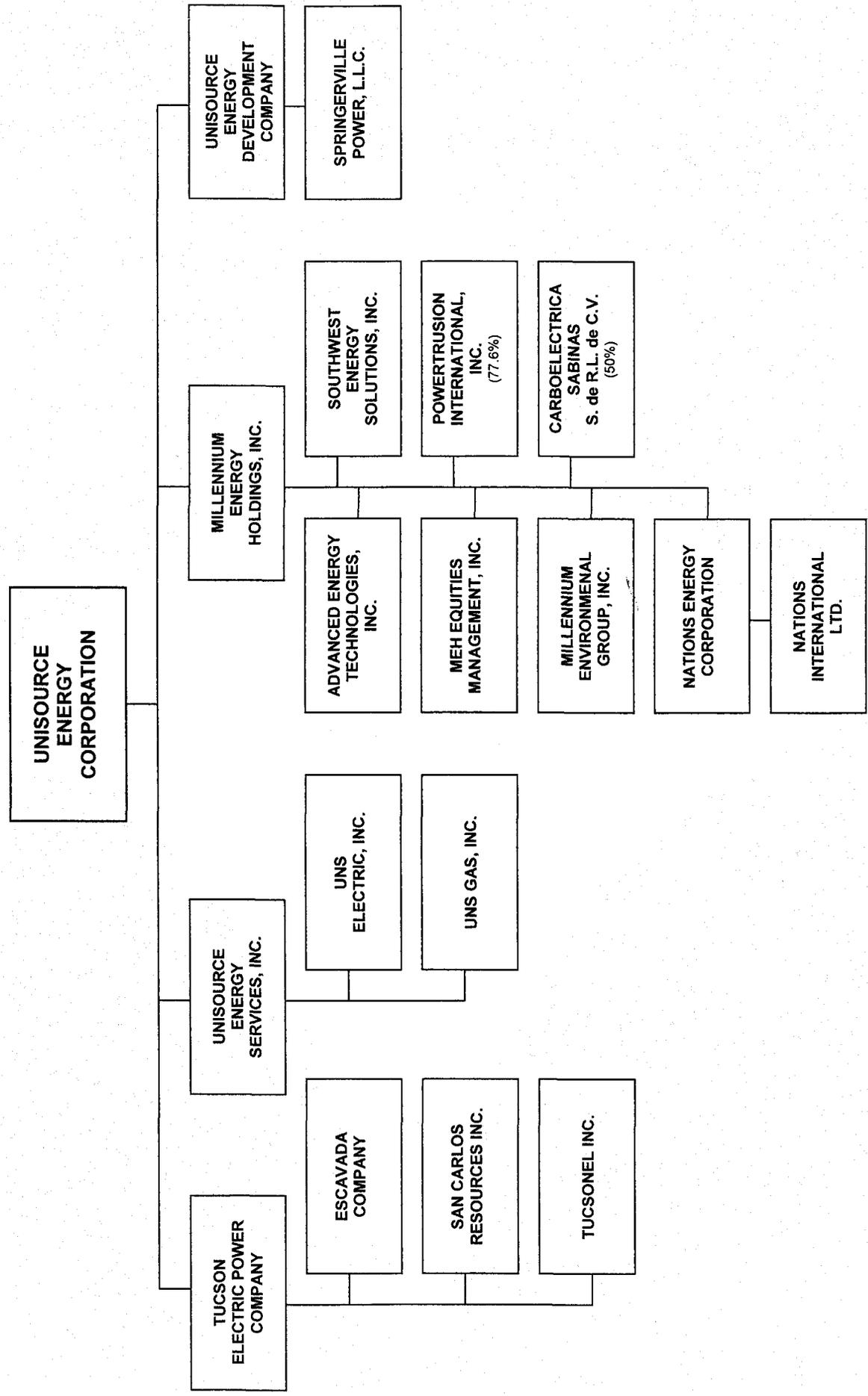
1. Filings regarding transactions with TEP Board of Directors (Decision No. 57586);
2. Filing of information regarding the liquidation of Tucson Resources, Inc. and Sierrita Resources, Inc. (Decision No. 58316);
3. Filing of cost containment reports (Decision No. 59594);
4. Method of determination of costs allocated between TEP and its affiliates (Condition 2 of Decision No. 60480);

5. Filing of quarterly financial statements of TEP affiliates (Condition 12 of Decision No. 60480);
6. Filing of an annual report regarding transfers of employees between TEP and its affiliates (Condition 13 of Decision No. 60480);
7. Capital structure requirements of the sister companies (Condition 17, Decision No. 60480);
8. Accounting requirements for time spent by TEP employees on mergers, acquisitions and business development (Condition 26, Decision No. 60480);
9. Filing of licensing agreements, service agreements, promotional campaigns, trademarks, etc. (Condition 27, Decision No. 60480); and
10. Annual filings of contracts for goods or services between the utility and its affiliates. The waiver limits the production of the contracts to rate cases.

Staff also recommends against extending the following waivers:

1. Filing of notice only when TEP changes its position in the holding company (R14-2-803);
2. Limitation of examination of TEP books and records to only rate cases (R-1-2-804.A.);
3. Limitation of annual filing regarding diversification plans to TEP and not UniSource (R14-2-805.A.);
4. Limitation to depth of information regarding business activities of TEP's affiliates (R114-2-805.A.2); and
5. Reporting of allocation process by which costs are assigned between the holding company and the affiliates (R14-2-805.A.6).

# UNISOURCE ENERGY CORPORATION & SUBSIDIARIES



## ARTICLE 8. PUBLIC UTILITY HOLDING COMPANIES AND AFFILIATED INTERESTS

### R14-2-801. Definitions

In this Article, unless the context otherwise requires:

1. "Affiliate," with respect to the public utility, shall mean any other entity directly or indirectly controlling or controlled by, or under direct or indirect common control with, the public utility. For purposes of this definition, the term "control" (including the correlative meanings of the terms "controlled by" and "under common control with"), as used with respect to any entity, shall mean the power to direct the management policies of such entity, whether through ownership of voting securities, or by contract, or otherwise.
2. "Commission." The Arizona Corporation Commission.
3. "Entity." A corporation, partnership, limited partnership, joint venture, trust, estate, or natural person.
4. "Holding Company" or "Public Utility Holding Company." Any affiliate that controls a public utility.
5. "Reorganize" or "Reorganization." The acquisition or divestiture of a financial interest in an affiliate or a utility, or reconfiguration of an existing affiliate or utility's position in the corporate structure or the merger or consolidation of an affiliate or a utility.
6. "Subsidiary." Any affiliate controlled by a utility.
7. "System of Accounts." The accounting system or systems prescribed for utilities by the Commission.
8. "Utility" or "Public Utility." Any Class A investor-owned public service corporation subject to the jurisdiction of the Arizona Corporation Commission.

#### Historical Note

Adopted effective July 30, 1992 (Supp. 92-3).

### R14-2-802. Applicability

- A. These rules are applicable to all Class A investor-owned utilities under the jurisdiction of the Commission and are applicable to all transactions entered into after the effective date of these rules.
- B. Information furnished to the Commission in compliance with these rules will not be open to public inspection, or made public, except on order of the Commission, or by the Commission, or a Commissioner in the course of a hearing or proceeding.

#### Historical Note

Adopted effective July 30, 1992 (Supp. 92-3).

### R14-2-803. Organization of Public Utility Holding Companies

- A. Any utility or affiliate intending to organize a public utility holding company or reorganize an existing public utility holding company will notify the Commission's Utilities Division in writing at least 120 days prior thereto. The notice of intent will include the following information:
  1. The names and business addresses of the proposed officers and directors of the holding company;
  2. The business purposes for establishing or reorganizing the holding company;
  3. The proposed method of financing the holding company and the resultant capital structure;
  4. The resultant effect on the capital structure of the public utility;
  5. An organization chart of the holding company that identifies all affiliates and their relationships within the holding company;
  6. The proposed method for allocating federal and state income taxes to the subsidiaries of the holding company;
  7. The anticipated changes in the utility's cost of service and the cost of capital attributable to the reorganization;
  8. A description of diversification plans of affiliates of the holding company; and
  9. Copies of all relevant documents and filings with the United States Securities and Exchange Commission and other federal or state agencies.
  10. The contemplated annual and cumulative investment in each affiliate for the next five years, in dollars and as a percentage of projected net utility plant, and an explanation of the reasons supporting the level of investment and the reasons this level will not increase the risks of investment in the public utility.
  11. An explanation of the manner in which the utility can assure that adequate capital will be available for the construction of necessary new utility plant and for improvements in existing utility plant at no greater cost than if the utility or its affiliate did not organize or reorganize a public utility holding company.
- B. The Commission staff will, within 30 days after receipt of the notice of intent, notify the Applicant of any questions which it has concerning the notice or supporting information. The Commission will, within 60 days from the receipt of the notice of intent, determine whether to hold a hearing on the matter or approve the organization or reorganization without a hearing.
- C. At the conclusion of any hearing on the organization or reorganization of a utility holding company, the Commission may reject the proposal if it determines that it would impair the financial status of the public utility, otherwise

prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service.

**Historical Note**

Adopted effective July 30, 1992 (Supp. 92-3).

**R14-2-804. Commission Review of Transactions Between Public Utilities and Affiliates**

- A. A utility will not transact business with an affiliate unless the affiliate agrees to provide the Commission access to the books and records of the affiliate to the degree required to fully audit, examine or otherwise investigate transactions between the public utility and the affiliate. In connection therewith, the Commission may require production of books, records, accounts, memoranda and other documents related to these transactions.
- B. A utility will not consummate the following transactions without prior approval by the Commission:
  - 1. Obtain a financial interest in any affiliate not regulated by the Commission, or guarantee, or assume the liabilities of such affiliate;
  - 2. Lend to any affiliate not regulated by the Commission, with the exception of short-term loans for a period less than 12 months in an amount less than \$100,000; or
  - 3. Use utility funds to form a subsidiary or divest itself of any established subsidiary.
- C. The Commission will review the transactions set forth in subsection (B) above to determine if the transactions would impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service.
- D. Every transaction in violation of subsection (A) or (B) above is void, and the transaction shall not be made on the books of any public service corporation.
- E. The system of accounts used by the public utility will include the necessary accounting records needed to record and compile transactions with each affiliate.

**Historical Note**

Adopted effective July 30, 1992 (Supp. 92-3).

**R14-2-805. Annual Filing Requirements of Diversification Activities and Plans**

- A. On or before April 15th of each calendar year, all public utilities meeting the requirements of R14-2-802 and public utility holding companies will provide the Commission with a description of diversification plans for the current calendar year that have been approved by the Boards of Directors. As part of these filings, each public utility meeting the requirements of R14-2-802 will provide the Commission the following information:
  - 1. The name, home office location and description of the public utility's affiliates with whom transactions occur, their relationship to each other and the public utility, and the general nature of their business;
  - 2. A brief description of the business activities conducted by the utility's affiliates with whom transactions occurred during the prior year, including any new activities not previously reported;
  - 3. A description of plans for the utility's subsidiaries to modify or change business activities, enter into new business ventures or to acquire, merge or otherwise establish a new business entity;
  - 4. Copies of the most recent financial statements for each of the utility's subsidiaries;
  - 5. An assessment of the effect of current and planned affiliated activities on the public utility's capital structure and the public utility's ability to attract capital at fair and reasonable rates;
  - 6. The bases upon which the public utility holding company allocates plant, revenue and expenses to affiliates and the amounts involved; an explanation of the derivation of the factors; the reasons supporting that methodology and the reasons supporting the allocation;
  - 7. An explanation of the manner in which the utility's capital structure, cost of capital and ability to raise capital at reasonable rates have been affected by the organization or reorganization of the public utility holding company;
  - 8. The dollar amount transferred between the utility and each affiliate during the annual period, and the purpose of each transfer;
  - 9. Contracts or agreements to receive, or provide management, engineering, accounting, legal, financial or other similar services between a public utility and an affiliate;
  - 10. Contracts or agreements to purchase or sell goods or real property between a public utility and an affiliate; and
  - 11. Contracts or agreements to lease goods or real property between a public utility and an affiliate.
- B. After reviewing the diversification plans, the Commission may, within 90 days after plans have been provided, request additional information, or order a hearing, or both, should it conclude after its review that the business activities would impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service.

**Historical Note**

Adopted effective July 30, 1992 (Supp. 92-3).

**R14-2-806. Waiver from the Provisions of this Article**

- A. The Commission may waive compliance with any of the provisions of this Article upon a finding that such waiver is in the public interest.

- B. Any affected entity may petition the Commission for a waiver by filing a verified application for waiver setting forth with specificity the circumstances whereby the public interest justifies noncompliance with all or part of the provisions of this Article.
- C. If the Commission fails to approve, disapprove, or suspend for further consideration an application for waiver within 30 days following filing of a verified application for waiver, the waiver shall become effective on the 31st day following filing of the application.

**Historical Note**

Adopted effective July 30, 1992 (Supp. 92-3).

LANGUAGE FROM THE 1999 SETTLEMENT AGREEMENT  
APPROVED BY DECISION NO. 62103  
NOVEMBER 30, 1999

12. WAIVERS.

12.1 The parties agree that certain waivers for TEP of the Affiliated Interest Rules, Integrated Resource Planning Rules, certain conditions in Decision No. 60480, and certain Commission decisions are in the public's interest. The Commission's Approval Order shall include and grant to TEP waivers from the following as set forth below:

- (a) A.A.C. R14-2-701, et seq. – Integrated Resource Planning Rules – TEP shall comply with the Integrated Resource Planning (“IRP”) Rules until divestiture of its generation. After such time as divestiture occurs, the IRP Rules shall not apply to TEP pursuant to R14-2-702.A. Pursuant to R14-2-702.B. the Commission may apply the IRP Rules to TEP upon two years notice.
- (b) A.A.C. R14-2-801 et seq. – Affiliated Interest Rules (to the extent necessary to comply with this Settlement Agreement and the electric Competition Rules).

Additional Specific Waivers:

R14-2-803 is limited to organizations or reorganizations of UniSource when the organization or reorganization changes the position of TEP (the UDC) in the holding company organizational structure.

R-14-2-804.A. the agreement by affiliates to allow Commission access to their books and records is limited to investigations which are performed during the course of a rate case.

R14-2-805.A. is limited to require annual filings by only TEP (the UDC), unless the diversification plans or efforts of affiliates are likely to adversely affect the UDCs financial integrity.

R14-2-805.A.2. is limited to a broad description of the nature of the business of each affiliate.

R14-2-805.A.6 is limited to disclosure of allocations applicable to the UDC. The Commission's jurisdiction to require disclosure of the bases of other allocations should be reserved for rate cases.

R14-2-805.A.9, 10 and 11 is limited to production of such documents in rate cases and no annual filings are necessary.

(c) Decision No. 60480, Holding Company Order:

Condition Nos. 2, 13, 17, 23 and 25 are waived.

Condition No. 12 is waived for sister companies. However, TEP will continue to file quarterly. UniSource will file annually. SEC filings will continue to be filed with the Commission.

Condition No. 19 is modified to reduce the percentage of UniSource equity issuances that must be shared with TEP.

Condition No. 26 will remain in effect but is limited to TEP employees.

Condition No. 27 is waived for the annual filing requirement. This waiver does not preclude the Commission from requiring the filing of information that would have been filed annually for purposes the Commission deems necessary, including but not limited to rate setting.

- (d) Decision 59594 – Mid-Year DSM and Renewables Report—TEP will comply with this filing requirement until such time as divestiture occurs. Thereafter the requirement is waived.
- (e) Decision No. 57586 – Director Transaction Report - This requirement is waived.
- (f) Decision No. 58316 – Investment Subsidiary Liquidation Report and Purchase Agreement Summary – This requirement is waived.
- (g) Decision No. 58497 – Avoided Cost Report – TEP will comply with this filing requirement until such time as divestiture occurs. Thereafter, the requirement is waived.
- (h) Decision No. 57090 – Time of Use Letters – TEP will comply with this requirement until such time as divestiture occurs. Thereafter, the requirement is waived.
- (i) Decision No. 56659 – Time of Use Report – TEP will comply with this filing requirement until such time as divestiture occurs. Thereafter, the requirement is waived.
- (j) Decision No. 56526 – Fuel and Performance Filing – TEP will comply with this filing requirement until such time as divestiture occurs. Thereafter, the requirement is waived.
- (k) Decision No. 57924 – Interruptible Report Filing – TEP will comply with this filing requirement until such time as divestiture occurs. Thereafter, the requirement is waived.

- (l) Statistical Data on Generating Units Filing - TEP will comply with this filing requirement until such time as divestiture occurs. Thereafter, the requirement is waived.
- (m) Generating Unit Outage Report Filing - TEP will comply with this filing requirement until such time as divestiture occurs. Thereafter, the requirement is waived.
- (n) Cost Containment Report (Decision No. 59594) – This requirement is waived.

**ATTACHMENT A**

- 1) The Holding Company and sister companies will not conduct any material business activities that are not part of the "Electric Energy Business" or are not reasonably related to business activities derived from the changes in the electric industry as a result of competition without Commission approval. The term "Electric Energy Business" is defined in TEP's 1995 Proxy Statement.
- 2) The Holding Company, TEP and sister companies will strive to charge the lower of fully allocated cost or market price whenever goods, products or service are sold/provided by the Holding Company or sister companies to TEP and the higher of fully allocated cost or market whenever TEP sells/provides non-tariffed goods, products or services to the Holding company or sister companies. The Holding Company, TEP and sister companies recognize that determining a market price for all goods, products and services being transferred in and among the Holding Company, TEP and sister companies could be a complex or difficult task for some items. Nonetheless, the Holding Company, TEP and sister companies agree to attempt to determine a market price for any good, product or service being provided by TEP to the Holding Company or sister companies as well as for any good, product or service provided by Holding Company or sister companies to TEP whenever the annual, fully allocated cost for given good, product or service being transferred exceeds \$500,000 annually. Furthermore, TEP will retain such market research information (regardless of whether it is ever utilized) until such time as the Utilities Division Staff or its representative have reviewed such information.
- 3) The Holding Company will not pledge TEP common stock as collateral or security for the debt of the Holding Company or a sister company without Commission approval.
- 4) Any business that TEP finds to be necessary, reasonably incidental or economically appropriate to utility operations will remain within TEP and its subsidiaries.
- 5) TEP will account for, bill and otherwise treat transactions with the Holding Company and sister companies in the same manner as it customarily treats similar transactions with nonaffiliates. The Holding Company and sister companies will pay for services received from TEP by check or wire on the same terms offered to nonaffiliates. TEP will pay for services received from the Holding Company and sister companies in the same manner and on the same terms customarily applied to nonaffiliated vendors. Separate bank accounts will be maintained by the Holding Company and sister companies. The Holding Company and sister company funds will not be commingled in TEP bank accounts.
- 6) The Board of Directors of the Holding Company will establish procedures to review affiliated transactions between the Holding Company, TEP and sister companies.
- 7) The Holding Company, TEP and sister companies will adopt marketing standards and will not engage in coercive or misleading advertising.
- 8) The Holding Company will provide the Commission Staff, upon request and with appropriate notice, all information needed to verify compliance with the conditions authorized in this proceeding and any other information relevant to the Commission's ratemaking, financing, safety, quality of service and other regulatory authority over TEP.
- 9) The requirements of TEP, as determined to be necessary to meet its regulatory obligation to serve its customers shall be given first priority by the Holding Company Board of Directors.

- 1 10) TEP will not guarantee the notes, debentures, debt obligations or other securities of any  
2 of the Holding Company or sister companies, or enter into any "make-well" agreements  
without prior Commission approval.
- 3 11) At the Commission's request, officers and employees of the Holding Company or sister  
4 companies will give testimony concerning affiliated transactions and diversification plans.
- 5 12) The Commission will be furnished with the Holding Company's quarterly and annual  
6 financial statements, which will consolidate the financial statements of the Holding  
Company, TEP and all sister companies, and any other SEC filings, and individual  
quarterly and annual financial statements for TEP and each sister company, individually.
- 7 13) The Commission will be furnished annually, a report identifying any non-clerical TEP  
8 personnel moved to the Holding Company or its subsidiaries on a full-time basis.
- 9 14) The Commission will be furnished annually, a report detailing TEP's proportionate share  
10 of the Holding Company's: i) assets; ii) operating revenues; and iii) operating and  
maintenance expenses.
- 11 15) Regardless of what tax allocation procedure or methodology is employed for assigning  
12 consolidated current and deferred income tax expense and accumulated deferred income  
13 taxes for financial statement purposes, TEP agrees to maintain stand alone federal and  
14 state current and deferred income tax expense calculations for all years subsequent to  
formation of the holding company calculated on a stand alone TEP basis which considers  
all available elections that produce the presumed lowest cost of service revenue  
requirements for TEP's regulated retail customers.
- 15 16) The Holding Company, TEP and sister companies will comply with all FERC  
16 requirements (including, but not limited to Order Nos. 888 and 889) relating to affiliate  
transactions between power brokers or marketers with respect to power sales.
- 17 17) The capitalization of the sister companies (debt and equity) may not exceed 30 percent  
18 of TEP's capitalization unless otherwise approved by the Commission.
- 19 18) The cost rate assigned to the notes issued TEP by UniSource in return for TEP's transfer  
20 of its unregulated investments to UniSource shall be at 9.78 percent, or a rate that will  
afford TEP the opportunity to earn at least its currently authorized 7.72 percent after-tax  
return.
- 21 19) For five years from commencement of operations of the holding company, the following  
22 proceeds will be used to reduce TEP's debt or added to TEP's equity accounts: a) 60  
percent of any public equity issuance (including dividend reinvestment or employee stock  
23 plans) undertaken by the holding company; b) two percent of the net after-tax profits  
attributable to the holding company's equity interest in sister companies; and c) in  
24 compensation for the use of the ratepayers' cash flow and because the ratepayers are at  
the base of whatever creditworthiness the company has, the two percent herein will be  
25 split 50 percent to reduce TEP's debt or added to TEP's equity accounts and 50 percent  
to directly lower rates.
- 26 20) Until such time as TEP's equity ratio equals 37.5 percent of total capital, TEP will not  
27 issue dividends to the parent (UniSource) which comprise more than 75 percent of TEP's  
earnings.
- 28 21) TEP will target attainment of a 37.5 percent equity ratio in its capital structure by  
December 31, 2000. If that capital structure goal is not attained, and the equity ratio is

1 less than 37.5 percent by that date, the Commission may set rates for TEP based on its  
2 actual capital structure at that date rather than the hypothetical 37.5 percent equity/62.5  
percent debt capitalization currently included in rates.

- 3 22) The Holding Company, TEP and sister companies will maintain up-to-date organizational  
4 charts that illustrate the vertical chain of command and, when applicable, horizontal  
5 reporting/coordination requirements in and among the Holding Company, TEP and sister  
6 company management.
- 7 23) The Holding Company, TEP and sister companies will maintain up-to-date job position  
8 descriptions which clearly delineate duties and responsibilities. The job descriptions will  
9 state whether the position can be expected to work for more than one entity (i.e., the  
10 Holding Company, TEP or sister companies). If the position is at the Holding Company  
11 level, the position description will state whether the duties relate to corporate governance  
12 functions and whether the duties and responsibilities of the position benefit more than one  
13 subsidiary.
- 14 24) Each sister company will disclose at the time of any TEP base retail rate filing each  
15 service function (i.e., accounting, treasury, human resources, information technology, risk  
16 management, etc.) that it does not fully staff, or which it relies in whole or in part upon  
17 the Holding Company or TEP.
- 18 25) All employees below the Vice President level, who work for more than one department  
19 or responsibility area or who may be called on to work for more than one entity, keep  
20 detailed time sheets on a "positive" time sheet. The time sheets the Company would  
21 utilize provide weekly time reports with daily entries for time worked. Time would be  
22 broken out between the various entities for whom work was performed, and area of  
23 activity where relevant. Further, Vice Presidents, Senior Vice Presidents and the  
24 President of TEP provide "exception" time reports. For future rate cases, when the  
25 Utilities Division Staff finds the Company's proposed allocations to be unreasonable,  
26 there will be a rebuttable presumption that the resources of the employee/department  
27 should be allocated between regulated and unregulated activities in the same percentage  
28 as their respective percentage of capital investments.
- 29 26) All time TEP and Holding Company employees spend on mergers, acquisitions ("M&A")  
30 and new business development will be tracked for below-the-line recording and/or  
31 assignment to a newly acquired or newly developed business. However, if the new  
32 business development or M&A activity is primarily and substantially for the benefit of  
33 TEP, that it be permitted to record the item above-the-line, subject to disallowance in a  
34 future base rate proceeding.
- 35 27) The Holding Company, TEP and/or sister companies will provide the following  
36 documents to the Utilities Division Staff on an annual basis:
- 37 • All royalty agreements, licensing agreement or other agreements entered into  
38 between TEP/parent company and any affiliate for the purpose of compensating  
39 for the use of intangible assets, including trademarks, trade names, software  
40 systems, etc.
  - 41 • All operating and service agreements entered into between TEP, the Holding  
42 Company and any sister company.
  - 43 • All new, revised and updated strategic business plans for the Holding Company,  
44 TEP and each sister company.
  - 45 • Description of any and all joint marketing/promotional campaigns between TEP,  
46 the Holding Company and any sister company.
  - 47 • Examples of all joint marketing work products (i.e., newspaper ads, magazine ads,  
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- TV and radio ad transcripts, etc.).
- Narrative description of all joint or common services shared between TEP, the Holding Company and all sister companies.
- All logos, trademarks and trade names registered by the Holding Company, TEP and sister companies.
- Narrative description all products and services offered by TEP and each sister company.
- Listing of the Board of Director and executive officers for TEP, the Holding Company and each sister company.

28) UniSource (and the sister companies) will not invest an amount greater than \$60 million in any single investment without Commission approval. The Commission shall be the sole arbitrator of what constitutes a "single investment".