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CARL J. KUNASEK  
Chairman

JIM IRVIN  
Commissioner

WILLIAM A. MUNDELI  
Commissioner

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IN THE MATTER OF THE APPLICATION )  
OF TUCSON ELECTRIC POWER )  
COMPANY FOR APPROVAL OF ITS PLAN )  
FOR STRANDED COST RECOVERY AND )  
FOR RELATED APPROVALS, )  
AUTHORIZATIONS AND WAIVERS. )

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. R14-2-1602 *et seq.* )

DOCKET NO. E-01933-~~97~~-0772

IN THE MATTER OF THE COMPETITION )  
IN THE PROVISION OF ELECTRIC )  
SERVICES THROUGHOUT THE STATE )  
OF ARIZONA )

DOCKET NO. RE-00000C-94-0165

NOTICE OF FILING

Staff of the Arizona Corporation Commission hereby files testimony of Ray T. Williamson  
and Lee Smith in the above-captioned dockets.

RESPECTFULLY SUBMITTED this 28 day of July, 1999.

*Christopher C. Kempley*

Paul A. Bullis  
Christopher C. Kempley  
Janice Alward  
Attorneys, Legal Division  
Arizona Corporation Commission

1 Original and ten copies of  
2 the foregoing document filed  
3 this 28 day of July, 1999 with:

4 Docket Control  
5 Arizona Corporation Commission  
6 1200 West Washington  
7 Phoenix, Arizona 85007

8 Copy of the foregoing mailed  
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By: 

**DIRECT  
TESTIMONY OF**

**RAY T. WILLIAMSON  
LEE SMITH**

**DOCKET NOS. E-01933A-98-0471  
E-01933A-97-0772  
RE-00000C-94-0165**

**JULY 28 1999**



BEFORE THE ARIZONA CORPORATION COMMISSION

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 STRANDED COST )  
RECOVERY AND FOR RELATED APPROVALS, )  
AUTHORIZATIONS AND WAIVERS )

DOCKET NO. E-01933A-98-0471

IN THE MATTER OF THE FILING OF TUCSON )  
ELECTRIC POWER COMPANY OF UN- )  
BUNDLED TARIFFS PURSUANT TO A.A.C. )  
R14-2-1602 *et seq.* )

DOCKET NO. E-01933A-97-0772

IN THE MATTER OF THE COMPETITION IN )  
THE PROVISION OF ELECTRIC SERVICES )  
THROUGHOUT THE STATE OF AIRZONA )

DOCKET NO. RE-00000C-94-0165

DIRECT

TESTIMONY

OF

RAY T. WILLIAMSON

ACTING DIRECTOR

UTILITIES DIVISION

JULY 28, 1999

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1     **I.     INTRODUCTION**

2     Q.     Please state your name, title and business address for the record.

3     A.     My name is Ray T. Williamson. I am Acting Director of the Utilities Division of the  
4           Arizona Corporation Commission (Commission or ACC). My business address is 1200  
5           West Washington, Phoenix, Arizona 85007.

6  
7     Q.     Prior to becoming Acting Director, where were you employed?

8     A.     I have been employed at the Commission since 1992 in various positions, including  
9           Economist, Senior Rate Analyst and Chief of Economics and Research.

10

11    Q.     Please describe the balance of your background and experience?

12    A.     My statement of Professional Qualifications is appended to this testimony as Schedule  
13           RTW-1.

14

15    Q.     What is the purpose of your testimony?

16    A.     The purpose of my testimony is to discuss the policy implications of the Tucson Electric  
17           Power Company Settlement Agreement.

18

19    **II.    APPROVAL OF THE SETTLEMENT**

20    Q.     Does Staff recommend approval of the Settlement?

21    A.     Yes. Staff recommends approval of the Settlement with certain changes that will clarify  
22           the provisions in the Settlement, help customers better understand their Market  
23           Generation Credit, and address requests for waiver from specific rules and Commission  
24           decisions.

25

26    Q.     Why is Staff recommending approval of the Settlement?

27    A.     Staff believes the proposed Settlement provides certainty and a known path to  
28           competition. Staff reviewed the Settlement within the public interest framework of

1 balancing the Settlement's implications for competition in Arizona with the guaranteed  
2 rate reductions reflected in the Settlement. This balancing of interests included an  
3 evaluation of the immediate benefits of the Settlements' known rate reduction schedules  
4 with the Settlement's impact on establishing a truly competitive market that would  
5 provide greater future reductions due to competitive pricing pressures.

6  
7 Q. Why would Staff support addressing the issues through a settlement rather than through  
8 evidentiary hearings on the individual issues?

9 A. Staff wants to foster the development of robust and meaningful competition at the earliest  
10 possible date. As a practical matter, if these issues are not addressed in a settlement, it is  
11 almost certain that competition would be slower to develop.

12  
13 Without the resolution of the major issues included in a settlement, it is doubtful whether  
14 many competitors would offer service or whether many customers would risk signing a  
15 contract for competitive service. Issues such as stranded costs, competition transition  
16 charges, market generation credits, final unbundled tariffs and other issues are all matters  
17 necessary for competitors and customers to determine whether they will be able to forge a  
18 better deal than is available from Affected Utilities.

19  
20 **III. STAFF'S CLARIFICATIONS AND MODIFICATIONS**

21 Q. What clarifications and modifications is Staff proposing to the Settlement?

22 A. As mentioned in Staff Consultant Lee Smith's testimony, modifications and clarifications  
23 need to be made to the Market Generation Credit, the mechanism by which MGC is  
24 calculated, and the MGC adder.

25  
26 In addition, my testimony will address Staff's analysis of provisions for waivers of the  
27 Affiliated Interest Rules, Integrated Resource Planning Rules, and certain conditions in  
28 various Commission decisions.

1     **IV.   IMPACT ON TEP'S CUSTOMERS**

2     Q.    Is this Settlement a good deal for the customers of TEP?

3     A.    Yes.  The purpose of moving toward retail electric competition is to allow customer  
4           choice and lower rates in a changing market structure.  The Settlement Agreement allows  
5           all customers, whether eligible for competition or not, to get lower rates starting in 1999.

6  
7           For low-income customers, TEP will maintain its existing low-income programs through  
8           2004.  The Settlement also indicates that the parties to the Settlement will make certain  
9           recommendations to the Commission for the low-income rate discount program.

10  
11    Q.    Is this a better deal than could be obtained without the Settlement?

12    A.    It is uncertain whether a better deal could be obtained without the Settlement.  One of the  
13           benefits of the Settlement is that it brings immediate and quantifiable benefits to  
14           ratepayers, rather than requiring ratepayers to wait an indefinite length of time for  
15           benefits that may or may not be greater than those contained in the Settlement.  In  
16           addition, the Settlement provides certainty, resolves issues, and establishes a path for  
17           competition in TEP's service territory.  The Settlement allows us to put many contentious  
18           issues behind us and focus on bringing competition to TEP's customers.

19  
20    **V.   COMMISSION APPROVALS AND REQUESTED WAIVERS**

21    Q.    Are there any approvals inherent in the body of the Proposed Settlement to which the  
22           Staff has concerns?

23    A.    Yes.  Article 12 of the Proposed Settlement states at Section 12.1:

24           "The Parties agree that waivers for TEP of the Affiliated Interest Rules,  
25           Integrated Resource Planning Rules, certain conditions in Decision No.  
26           60480, and certain Commission decisions are in the public's interest."  
27           ...  
28           ...  
          ...

1 Q. Has Staff reviewed the Rules and Decisions referenced in Section 12.1 of Article 12 of  
2 the Proposed Agreement?

3 A. Yes. Staff reviewed the Rules and the Decisions referenced in Article 12, Section 12.1 of  
4 the Proposed Agreement.

5  
6 Q. What is the Staff's recommendation to the Commission regarding the granting of the  
7 requested waivers in Article 12, Section 12.1 of the Proposed Agreement?

8 A. Although TEP may no longer be vertically integrated, it will remain a regulated  
9 monopoly distribution company. Although the Competition Rules provide for certain  
10 affiliate transactions and compliance filings, TEP remains a special case requiring  
11 additional oversight because of its current financial position. TEP's capital structure  
12 reflects only 15 percent common equity and 85 percent debt and its non-utility affiliates  
13 are suffering net losses. Therefore, Staff believes that until TEP's financial health is  
14 improved to a level where its equity position is reasonably strong (37.5 percent equity),  
15 that a complete waiver of the Affiliated Interest Rules and the waiver of the conditions  
16 included in the Holding Company Decision would not be in the public interest.

17  
18 However, Staff agrees that a partial waiver of the Affiliated Interest Rules, a partial  
19 waiver from the conditions in Decision No. 60480, and waivers from selected  
20 Commission decisions would be consistent with the onset of competition and the  
21 divestiture of (including transfer to an affiliate) generation assets while maintaining a  
22 moderate level of oversight.

23  
24 All of the waivers requested in the Proposed Settlement, except for Condition Nos. 23,  
25 25, and 28 of Decision No. 60480 ("the Holding Company Order"), were requested and  
26 addressed in the November 1998 Settlement between TEP and the Staff, that was  
27 subsequently withdrawn. During the course of the negotiations which culminated in the  
28 November 1998 Settlement, the Staff performed a thorough analysis of the impact of the

1 requested waivers on the public interest. The evaluation resulted in a recommendation to  
2 grant or limit some of the requested waivers. The waivers are summarized in Exhibit  
3 RTW-2.

4  
5 Q. What is Staff's recommendation regarding the requested waivers from Condition Nos. 23,  
6 25 and 28 of Decision No. 60480, the Holding Company Order?

7 A. Condition Nos. 23 and 25 establish procedures designed to assist in the verification of  
8 inter-affiliate transactions to avoid cross-subsidization which could occur with the new  
9 holding company structure. Since the Commission will be approving Codes of Conduct  
10 for TEP, it is Staff's opinion that the waiver of these two conditions be deferred and  
11 reevaluated in the context of that proceeding.

12  
13 Condition No. 28 was a condition that the Company agreed to during the hearing on the  
14 formation of UniSource. The condition limits investments in any single investment by  
15 UniSource (and the sister companies) to \$60 million. Commission approval is required  
16 for any single investment greater than \$60 million. It is the Staff's opinion that the  
17 Holding Company Order (Decision No. 60480) was intended to be in effect throughout  
18 the life of UniSource and its successors. Staff does not think the intent of the order was  
19 to restrict requests for modifications to the conditions, but justification for removal of this  
20 condition is not warranted at this time. As TEP's generation portion of the business is  
21 restructured, the Commission should retain review of investments greater than \$60  
22 million until the Company has demonstrated that TEP has a capital structure more in line  
23 with a typical electric utility, or distribution company, as the case may be.

24  
25 **VI. CONCLUSION**

26 Q. In light of the above, what is Staff's final recommendation?

27 A. The Commission should approve the Settlement as clarified and modified by Staff.

28 ...

1 Q. How would you propose that the Settlement Agreement be modified to address the  
2 problems you have outlined above?

3 A. Staff proposes that the modifications as proposed by Staff Consultant Lee Smith be  
4 adopted and that Staff's recommendations on TEP's requested waivers also be adopted.  
5

6 Q. Does this conclude your direct testimony?

7 A. Yes, it does.  
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**RAY T. WILLIAMSON**

**STATEMENT OF PROFESSIONAL QUALIFICATIONS**

**EDUCATION:**

M.B.A. (Finance)	Arizona State University, Tempe, AZ, 1982
M.P.S. (Public Administration)	Western Kentucky University, Bowling Green, KY, 1976
B.S. (Engineering)	U.S. Military Academy, West Point, NY, 1970

**PROFESSIONAL DESIGNATIONS:**

Certified Energy Manager (CEM), Association of Energy Engineers, 1984

**CURRENT PROFESSIONAL ACTIVITIES:**

- Chairman, Solar Electricity Division, American Solar Energy Society
- Member, Association of Energy Engineers
- Member, International Association for Energy Economics
- Member, American Solar Energy Society

**PAST PROFESSIONAL ACTIVITIES:**

- Member, Board of Directors, Solar Rating & Certification Corporation (SRCC), 1988-91; Treasurer, 1989; Secretary, 1990
- Member, Rating Methodology Committee of SRCC, 1981-84
- Member, Arizona Photovoltaic Applications Task Force, 1985-86
- Participant, Arizona Energy Policy & Plan Development, 1989-90
- State Representative, Western Regional Biomass Energy Program, 1988-91
- Member, Arizona Electric Vehicle Task Force, 1991-92
- Member, Executive Committee, Interstate Solar Coordination Council, 1991-92
- Member, Externalities Task Force of the Arizona Corporation Commission, 1992
- Member, Environmental Technology Industry Cluster, Governor's Strategic Partnership for Economic Development (GSPED), 1992
- Member, Executive Committee, Interstate Renewable Energy Council, 1994-95
- Member, National Photovoltaics for Utilities Steering Committee, 1994-95
- Ex Officio Member, Planning Committee, Southwest Regional Transmission Association (SWRTA)

**TEAM LEADERSHIP AND COMMITTEE COORDINATION EXPERIENCE:**

- Coordinator, Arizona Electric System Reliability and Safety Working Group, 1996-98
- Coordinator, Arizona Photovoltaics for Utilities Cooperative, 1993-present
- Co-founder & Coordinator, Arizona Electric Vehicle Enterprise Network, 1990-92
- Founder & Chairman, Air Quality/Alternative Fuels Task Force of Phoenix Futures Forum, 1990-1992
- Coordinator, Externalities Prioritization Working Group, 1993-4
- Coordinator, Arizona Renewables Working Group, 1994-95
- Leader, Energy Efficiency & Environment Task Force, Retail Electric Competition Working Group, 1994-95

**PROFESSIONAL EXPERIENCE:**

**ARIZONA CORPORATION COMMISSION, PHOENIX, AZ (OCT '92 - PRESENT)**

**ACTING DIRECTOR, UTILITIES DIVISION, MAR '98-PRESENT:**

- Manages the 95-person Utilities Division
- Directly supervises five Section Chiefs, two Supervisors, and an Assistant Director

**CHIEF, ECONOMICS AND RESEARCH, JUNE '97 -MAR '98:**

- Managed the Economics and Research Section of the Utilities Division
- Supervised a staff of seven professionals
- Read, reviewed, edited, and approved tariffs, special contracts and other Commission Open Meeting items
- Prepared testimony for lawsuits regarding Retail Electric Competition
- Coordinated the Electric System Reliability and Safety Working Group
- Coordinated the Solar Portfolio Standard Subcommittee
- Staffed the Unbundled Services and Standard Offer Working Group
- Staffed the Independent System Operator and Spot Market Development Working Group
- Coordinated the overall Retail Electric Competition effort for the Division
- Wrote, edited, and published the Solar Portfolio Standard Subcommittee's final report
- Co-wrote, edited, and published the Unbundled Services and Standard Offer Working Group's final report
- From 12/15/97-2/6/98 performed duties of Acting Director for four weeks while Director was out of the country

**SENIOR RATE ANALYST, MAY '94 - JUNE '97:**

- Specialized in electric utility regulation activities and projects, including integrated resource planning, externalities, renewable energy resources, retail electric competition, and electric tariff review and evaluation
- Evaluated and developed recommendations on utility renewable energy plans and projects
- Served as the group leader of the Arizona Photovoltaics for Utilities Cooperative
- Coordinated the activities of the collaborative Renewables Working Group
- Wrote draft Commission rules for externalities and integrated resource planning
- Served as the Task Force Leader of the Energy Efficiency and Environment Task Force in the Retail Electric Competition Working Group
- Helped draft proposed Commission Retail Electric Competition Rules
- Participated as a member of the Planning Committee of the Southwest Regional Transmission Association
- Acted as the Coordinator of Arizona's Electric System Reliability and Safety Working Group

**ECONOMIST, OCT '92 - MAY 94:**

- Conducted economic and policy analyses of electric and telecommunications utility issues
- Analyzed applications of utilities regarding rate levels, rate design, and service offerings
- Prepared recommendations and testimony on renewable energy, energy conservation, demand-side management, integrated resource planning, special rates and contracts, and tariff filings
- Served as the Coordinator of the Arizona Photovoltaics for Utilities Cooperative
- Served as the Coordinator of the Externalities Prioritization Working Group
- Wrote, edited, and published the Externalities Prioritization Working Group's final report

**ARIZONA DEPARTMENT OF COMMERCE, PHOENIX, AZ (JULY '85 - OCT '92)**

**ENERGY BUSINESS TECHNICAL SPECIALIST** in the **ARIZONA ENERGY OFFICE**, MARCH '90 - OCT '92:

- Prepared testimony and testified as an expert witness in the first cycle of the Corporation Commission's Integrated Resource Planning. The testimony resulted in the formation of two Commission Task Forces to consider externalities and sliding-scale hook-up fees.
- Participated in the two-year Arizona Energy Policy and Plan development program
- Founded the collaborative Arizona Photovoltaics for Utilities Cooperative and coordinated its activities

**MANAGER** of the **ARIZONA SOLAR ENERGY OFFICE**, JULY '87 - MARCH '90:

- Managed the entire solar energy program for the State of Arizona
- Managed the accomplishments of a staff of eight employees and numerous contractors and subcontractors

**ENERGY ECONOMIC ANALYST** of the **ARIZONA ENERGY OFFICE**, JULY '85 - JUNE '87:

- Prepared various economic analyses, including the impact of the 1986 oil price decline
- Performed utility rate analyses and presented utility bill seminars to school officials and local governments
- Served on the Arizona Photovoltaic Applications Task Force established to evaluate the potential for the use of photovoltaics in Arizona and to make recommendations to the Arizona Corporation Commission

**ARIZONA SOLAR ENERGY COMMISSION, PHOENIX, AZ (DEC '80 - JUNE '85)**

**ASSOCIATE DIRECTOR, FEDERAL PROGRAMS MANAGER, & SOLAR ENGINEERING SPECIALIST:**

- Developed strategies and marketing plans to enhance the commercialization of solar energy products
- Was responsible for revising, drafting, staffing, and coordinating work on Commission rules and the public hearings on rules

**RAMADA ENERGY SYSTEMS, INC., TEMPE, AZ (JUNE '79 - JULY '80)**

**MANAGER, MARKETING SERVICES:**

- Managed all services and support of the Marketing Department and of the company distribution network
- Established office administration programs, developed standard operating procedures for the Marketing Department, and initiated a comprehensive national inquiry response program
- Developed and implemented advertising, publicity and public awareness plans

**SOLARON CORPORATION, DENVER, CO (JULY '76 - JUNE '79)**

**FEDERAL PROGRAMS ADMINISTRATOR**, AUG '78 - JUNE '79:

- Managed all activities of the federal solar grant programs
- Wrote grant applications, assisted applicants with design and grant preparation, follow-up reporting, and assistance on winning grants

**ASSISTANT TO THE MANAGER, DISTRIBUTOR SALES, SEP '77 - JUL '78:**

- Responsible for the day-to-day activities of the distributor network for Solaron products
- Developed marketing plans for the distributor network
- Assisted distributors in project design, computer simulation, and equipment selection

**MARKETING ADMINISTRATOR, JUL '76 - AUG '77:**

- Coordinated office administration
- Provided training and grant application preparation assistance to customers in federal grant programs. Sales through these grant programs accounted for 26 percent of all 1977 Solaron sales
- Served as a sales engineer, designing and selling individual systems in areas without distributors and sales to walk-in customers

**U.S. ARMY EXPERIENCE:** Commissioned Officer from June 1970-January 1976

**ADDITIONAL TRAINING:**

1984-1993 Arizona State University, College of Business: 36 semester hours of economics courses. This included course work in public utility economics & finance.

1976-1996 Attendance at 110+ seminars, conferences and workshops covering subjects such as: electric industry restructuring, energy conservation, demand-side management, thermal storage, energy economics, financing of energy projects, cogeneration, solar energy, integrated resource planning, solar energy in utilities, environmental concerns, electric vehicles, biomass, and energy-conserving building design.

**PUBLICATIONS**

Williamson, Ray T. "The Versatile Transparent Polymer Collector." Paper presented at the 1980 Annual Meeting of the International Solar Energy Society, Phoenix, Arizona.

Williamson, Ray T. **Standards for Solar Devices.** Arizona Solar Energy Commission, May 1981.

Williamson, Ray T., Editor. **Information Sources for the Solar Industry.** Arizona Solar Energy Commission, May 1981.

Williamson, Ray T., Editor. **Licensing Solar Contractors in Arizona.** Arizona Solar Energy Commission, May 1981.

Williamson, Ray T., Editor. **Arizona's Solar Laws & Rules.** Arizona Solar Energy Commission, May 1981.

Williamson, Ray T., Editor. **Arizona's Solar Energy Tax Credits.** Arizona Solar Energy Commission, May 1981. "Standards for Solar Collectors." Arizona Solar Energy Commission, March 1982.

Williamson, Ray T. "Tax Credits for Photovoltaic Devices." Arizona Solar Energy Commission, March 1983.

Williamson, Ray T. **Standards for Solar Energy Devices in Arizona.** Arizona Solar Energy Commission, May 1983. "Standards for System Testing." AZ Solar Energy Commission, June 1983.

Williamson, Ray T., Richard Griswold and Frank Mancini. "Solar Energy Response Vehicle (SERV) Meets Emergency Needs." Paper presented at the 1991 Solar World Congress. **Proceedings of the Biennial Congress of the International Solar Energy Society**, Denver, Colorado, 19-23 August 1991.

- Williamson, Ray T., Doran Dalton and Robert Robin. "The Hopi Foundation's Solar Electric Enterprise: A Model for Renewable Industry Development in Developing Nations." Paper presented at the 1991 Solar Word Congress. **Proceedings of the Biennial Congress of the International Solar Energy Society**, Denver, Colorado, 19-23 August 1991.
- Williamson, Ray T., Peter Eckert, Tom Lepley, and Frank Mancini. "Testing and Evaluation of a Mobile Photovoltaic/Genset Hybrid System." Paper presented at the 22nd IEEE Photovoltaic Specialist Conference. **Proceedings of the 22nd Institute of Electrical and Electronics Engineers, Inc. Photovoltaic Specialists Conference**, Las Vegas, Nevada, 7-11 October 1991.
- Williamson, Ray T., Editor/Co-author, and Robert Hammond, Frank Mancini, and James Arwood. "The Solar Electric Option (Instead of Power Line Extension)." A 16-page brochure published by the Arizona Corporation Commission and the Arizona Department of Commerce. Phoenix, Arizona, August 1993.
- Williamson, Ray T., Co-author, and Staff of Economics & Research Section, Arizona Corporation Commission. "Staff Report on Resource Planning." Arizona Corporation Commission, September 1993.
- Williamson, Ray T. "Staff Report on Arizona Public Service Company's Carol Spring Mountain Project," (Docket No. U-1345-94-335), Arizona Corporation Commission, October 1994.
- Williamson, Ray T., and Robert Gray. "Staff Report on Arizona Public Service Company's Photovoltaic Applications and Systems Development Program," (Docket No. U-1345-95-323), Arizona Corporation Commission, August 1995.
- Williamson, Ray T., Co-author, and Staff of Economics & Research Section, Arizona Corporation Commission. "The Electric Industry In Arizona: Staff Report on Resource Planning." Arizona Corporation Commission, October 1996.
- Williamson, Ray T., David Berry, and Kim Clark of Economics & Research Section, Arizona Corporation Commission. "Staff Discussion of the Proposed Rule on Electric Industry Restructuring," (Docket No. U-0000-94-165), Arizona Corporation Commission, October 1996.
- Williamson, Ray T., "Incorporating Solar in a Restructured Electric Utility Industry," **Proceedings of the 1997 Annual Conference of the American Solar Energy Society**, Washington, D.C., 25-30 April 1997.
- Williamson, Ray T. and David Berry, "Solar Power and Retail Electric Competition in Arizona," **Solar Today**, Vol. 11, No. 2, March/April 1997.
- Williamson, Ray T. "Designing an Effective Solar Portfolio Standard," **Proceedings of the SOLAR '98 Conference**, American Solar Energy Society, Albuquerque, N.M., 13-18 June 1998.
- Williamson, Ray T. and Howard Wenger, "Solar Portfolio Standard Analysis," **Proceedings of the SOLAR '98 Conference**, American Solar Energy Society, Albuquerque, N.M., 13-18 June 1998.

## STAFF'S RESPONSES TO TEP'S REQUESTS FOR WAIVERS

TEP has requested selected waivers of Commission rules and decisions. The Staff is recommending the following responses to these various requests for waivers to the Commission:

- **R14-2-701, et seq. – Integrated Resource Planning Rules. (Article 12, Section 12.1 (a))**

TEP should comply with the Resource Planning Rules until divestiture of its generation. After such time as divestiture occurs, Staff believes that the IRP Rules do 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. Staff does not believe that it is in the public interest for the Commission to agree to forego its authority pursuant to R14-2-702.B at this time.

- **R14-2-801, et seq. – Affiliated Interest Rules. (Article 12, Section 12.1 (b))**

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

R14-2-804 (A) Agreement by affiliates to allow Commission access to its books and records may be limited to investigations which are performed during the course of a rate case.

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

R14-2-805 (A)(2) should be limited to a broad description of the nature of the business of each affiliate.

R14-2-805 (A)(6) should be limited to disclosure of allocations applicable to the UDC. However, 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) should be limited to production of such documents in rate cases and no annual filing is necessary.

- **Decision No. 60480, Holding Company Order. (Article 12, Section 12.1 (c))**

Condition Nos. 2, 13, and 17 are waived under this Agreement.

Condition No. 12. The Staff recommends that the Commission waive the filing requirements for sister companies. However, TEP should continue to file quarterly. TEP's holding company should file annually. SEC filings should be filed with the Commission as required under Condition 12.

Condition 19 should be modified to reduce the percentage of UniSource equity issuances that must be shared with TEP from 60 percent to 30 percent.

Conditions 19, 20 and 21 should remain in force, as modified, until the equity portion of TEP's capital structure reaches or exceeds 37.5 percent. The Staff is not opposed, however, to reconsideration of a request for waiver of these conditions in conjunction with TEP's next rate case.

Condition No. 26 should remain in effect but should be limited to TEP employees.

Condition No. 27. The Staff recommends that the Commission waive the requirement for annual filings. However, 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.

- **Decision No. 59594 – Cost Containment Report**

Although not requested in conjunction with the Proposed Settlement, Staff recommends that the Commission waive the requirement to file the Cost Containment Report.

- **Decision No. 59594 – Mid-Year DSM and Renewables Report (Article 12, Section 12.1 (d))**

TEP should comply with this filing requirement until such time as divestiture occurs. Thereafter, Staff recommends that the requirement to file mid-year DSM and Renewables Reports be waived.

- **Decision No. 57586 – Director Transaction Report (Article 12, Section 12.1 (e))**

Staff recommends that the requirement to file the Director Transaction Report be waived by the Commission.

- **Decision No. 58316 – Investment Subsidiary Liquidation Report and Purchase Agreement Summary (Article 12, Section 12.1 (f))**

Staff recommends that the requirement to file an Investment Subsidiary Liquidation Report and Purchase Agreement Summary be waived by the Commission.

- **Decision No. 58497 – Avoided Cost Report (Article 12, Section 12.1 (g))**

Staff recommends that the requirement to file an Avoided Cost Report be waived by the Commission after TEP's divestiture of generating assets.

- **Decision No. 57090 – Time of Use Letters (Article 12, Section 12.1 (h))**

Staff recommends that the Commission waive the filing of the Time of Use Letters Report after divestiture of the generating assets.

- **Decision No. 56659 – Time of Use Report (Article 12, Section 12.1 (i))**

Staff recommends that the Commission waive the filing of the Time of Use Report after divestiture of the generating assets.

- **Decision No. 56526 – Fuel & Performance Filing (Article 12, Section 12.1 (j))**

Staff recommends that the requirement to make a Fuel and Performance filing be waived by the Commission after divestiture of the generating assets.

- **Decision No. 57924 – Interruptible Report (Article 12, Section 12.1 (k))**

Staff recommends that the requirement to file an Interruptible Report be waived by the Commission after divestiture of the generating assets.

- **Statistical Data on Generating Units (Article 12, Section 12.1 (l))**

Staff recommends that the requirement to file Statistical Data on Generating Units Reports be waived by the Commission after divestiture of the generating assets.

- **Generating Unit Outage Report (Article 12, Section 12.1 (m))**

Staff recommends that the requirement to file Generating Unit Outage Reports be waived by the Commission after divestiture of the generating assets.

**BEFORE THE ARIZONA CORPORATION COMMISSION**

**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 AND FOR RELATED )  
APPROVALS, AUTHORIZATION AND )  
WAIVERS )

DOCKET NO. E-01933A-98-0471

IN THE MATTER OF THE APPLICATION OF )  
TUCSON ELECTRIC POWER COMPANY OF )  
UNBUNDLED TARRIFS PURSUANT TO A.A.C. )  
R-14-2-1601 ET SEQ. )

DOCKET NO. E-01933A-97-0772

IN THE MATTER OF COMPTETITION IN THE )  
PROVISION OF ELECTRIC SERVICES )  
THROUGHOUT THE STATE OF ARIZONA )

DOCKET NO. RE-00000C-94-0165

DIRECT

TESTIMONY

OF

LEE SMITH

LA CAPRA ASSOCIATES  
BOSTON, MASSACHUSETTS

JULY 28, 1999

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1 **INTRODUCTION**

2 Q. What is your name and business address?

3 A. My name is Lee Smith, and I work for La Capra Associates, 333 Washington Street,  
4 Boston, Massachusetts.

5  
6 Q. On whose behalf are you testifying in this proceeding?

7 A. I am testifying on behalf of the Arizona Corporation Commission (Commission) Staff.  
8

9 Q. What is the purpose of your testimony?

10 A. I am testifying as to the concepts in the 18 Page Settlement Agreement between Tucson  
11 Electric Power Company ("TEP" or "Company") and the Residential Utility Consumer  
12 Office ("RUCO"), Arizona Community Action Association ("ACAA"), and Arizonans  
13 for Electric Choice in Competition ("AECC") excluding Enron ("Proposed Settlement").  
14

15 Q. Have you submitted testimony previously in this proceeding?

16 A. Yes. I submitted testimony on the proposed November 4, 1998 Settlement between TEP  
17 and the Commission Staff which was subsequently withdrawn ("November Settlement").  
18

19 Q. What major changes should be made in the regulation and organization of the electric  
20 industry to foster the development of a competitive electric services market?

21 A. In order to have competition in electric services, the following must occur:

- 22 • Assurance that all potential suppliers have fair access to customers;  
23 • Assurance that all potential suppliers have fair access to the wires;  
24 • The ability to identify and address market power in generation;  
25 • The opportunity for customers to purchase electric services from a supplier of their  
26 choice;  
27 • Customers must be informed of what they pay the utility for each service, so they can  
28 compare different providers;

- 1 • Subsidization of unregulated services by regulated services must be avoided,  
2 otherwise the utility will have an unfair advantage over competitive suppliers; and
- 3 • Disputes over stranded cost must be resolved.

4 Q. What criteria should be evaluated before approval of the TEP settlement?

5 A. It is Staff's opinion that any settlement agreement presented to the Commission should be  
6 evaluated using the above-mentioned criteria. The Commission should apply criteria that  
7 measure whether the agreement contributes to the goals of allowing competition and  
8 providing benefits to Arizona consumers. On this basis, an approved settlement should  
9 facilitate the development of a competitive market in Arizona. Facilitating the  
10 development of a competitive market requires the characteristics described above. An  
11 approved settlement should also provide all customers with some immediate benefits that  
12 they would not receive under a continuation of existing regulatory practices.

13  
14 Q. Does the Proposed Settlement ensure that all potential suppliers have fair access to  
15 customers?

16 A. The Proposed Settlement is consistent with the Electric Competition Rules ("Rules") as  
17 they relate to providing fair access to customers by the Affected Utilities as reflected in  
18 Article 1, Sections 1.1 and 1.2. The Commission will have the authority to ensure equal  
19 access by all potential suppliers to the customers through its approval of the Code of  
20 Conduct contemplated by the Rules and referred to in the Proposed Settlement at Article  
21 7, Code of Conduct. Based upon the foregoing, it is Staff's opinion that the Proposed  
22 Settlement adequately ensures that all potential suppliers will have fair access to  
23 customers.

24 ...

25 ...

26 ...

27 ...

28 ...

1 Q. Does the Proposed Settlement ensure that all potential suppliers have fair access to the  
2 wires?

3 A. The support by TEP of the Arizona Independent Scheduling Administrator (AISA) and of  
4 the formation of the Desert Star Independent System Operator (ISO) is an important step  
5 in providing fair access to the wires. However, as long as a single entity owns and  
6 controls transmission and owns generation there will be an incentive for and the  
7 possibility of limiting access of other suppliers to the wires.

8  
9 Q. Does the Proposed Settlement enable the Commission to identify and address generation  
10 market power?

11 A. The Proposed Settlement does not address the issue of generation market power. I have  
12 some concerns about must-run generation being provided from an affiliate. Although a  
13 price cap on this generation provides some protection against exorbitant rates, this  
14 arrangement may make it more difficult to eliminate the conditions that give rise to must-  
15 run generation. In its recent FERC Notice of Proposed Inquiry regarding Regional  
16 Transmission Organizations ("RTO"), FERC expresses concerns that the existing utility-  
17 by-utility control of transmission is not efficient and may allow a transmission owner to  
18 favor its own generation, in spite of the rules about Open Access Transmission Tariffs  
19 established in FERC Order 888.

20  
21 Q. What impact may the FERC proceeding have on the TEP Proposed Settlement and the  
22 proposed transfer of generating assets to an affiliate?

23 A. I would recommend that the Commission's approval of the generation transfer as laid out  
24 in the Proposed Settlement be conditioned upon appropriate progress toward an RTO.  
25 This has the potential of greatly alleviating, if not eliminating, concerns about both  
26 vertical and horizontal market power.

27 ...

28 ...

1 Q. Does the Proposed Settlement provide customers the opportunity to purchase electric  
2 services from a supplier of their choice?

3 A. Article 1 of the Proposed Settlement, Competitive Retail Access, addresses providing  
4 customers the opportunity to purchase electric services from a supplier of choice. The  
5 Proposed Settlement provides for retail access to be introduced according to the existing  
6 Retail Competition Rules. Based upon the foregoing, the Proposed Settlement will  
7 provide customers the opportunity to purchase electric services from a supplier of their  
8 choice in accordance with the approved phase-in schedule in the pending Rules.

9  
10 Q. Does the Proposed Settlement inform customers what they pay the utility for each  
11 service, so they can compare different providers?

12 A. Yes. The TEP Settlement, unlike the proposed Arizona Public Service ("APS")  
13 settlement filed May 17, 1999 in Docket Nos. E-01345A-98-0473, E-01345A-97-0773,  
14 and RE-00000C-94-0165 ("APS Settlement"), unbundles the Company's rates on a  
15 comparable and consistent basis so that customers will be provided separate rates for  
16 eight different services. However, I recommend some small changes to the competitive  
17 generation portion of the rate in Section 2.

18  
19 Q. Does the Proposed Settlement contain adequate safeguards to avoid the subsidization of  
20 unregulated services by regulated services, which would give the utility an unfair  
21 advantage over competitive suppliers?

22 A. Consistent with the Electric Competition Rules, the Proposed Settlement contemplates  
23 the filing of a Company-specific code of conduct. The Code of Conduct is subject to the  
24 Commission's approval of the terms that should establish procedures to eliminate the  
25 potential for subsidization of unregulated services by regulated services. Based upon the  
26 foregoing, it is Staff's opinion that the Proposed Settlement contains appropriate language  
27 to allow the Commission to approve a Code of Conduct, consistent with the Rules, to  
28 provide adequate safeguards to avoid the subsidization of unregulated services by

1 regulated services, to avoid giving the utility an unfair advantage over competitive  
2 suppliers.

3  
4 Q. Please explain how the Settlement addresses the issue of stranded costs.

5 A. The Proposed Settlement at Article 2 - Stranded Cost Recovery provides for stranded cost  
6 to be collected through two mechanisms, so that the amount of collection will be partially  
7 dependent on actual market prices. The "Fixed" Competitive Transition Charge ("CTC")  
8 will be the mechanism to recover a net present value of \$450 million, based on a carrying  
9 charge of 11.03 percent applied to unamortized balances, terminating on December 31,  
10 2008, whether or not this full amount has been collected. In addition, there is a Floating  
11 CTC, the size of which will be determined by the difference between the full bundled rate  
12 and the sum of the other rate components, including all delivery rates, the market  
13 generation credit, and the Fixed CTC. The Company estimates that the net present value  
14 so collected will be about \$650 million. I believe that the Company's estimate of load  
15 growth is slightly low, but its estimate of the market generation credit is somewhat low  
16 also. The two have an offsetting effect. With the change to the MGC adder that I am  
17 recommending, I estimate that stranded cost collection will be about \$660 million.  
18 According to its calculations of TEP's stranded costs, Staff has confirmed that the amount  
19 of stranded cost recovery is at the low end of the range of the potential stranded costs that  
20 TEP will actually experience. Consequently, Staff recommends approval of this stranded  
21 cost amount, which includes regulatory assets, as well as the stranded cost recovery  
22 mechanisms.

23 ...  
24 ...  
25 ...  
26 ...  
27 ...  
28 ...

1 **SPECIFIC RECOMMENDATIONS**

2 Q. Of your recommended criteria to be used by the Commission in evaluating a settlement  
3 associated with competition in electric services, you have identified problems with the  
4 market generation credit and stranded costs. Would you please explain why some  
5 modifications are necessary to fully meet the first of these criteria?

6 A. The market generation credit is used synonymously with the term shopping credit, which  
7 indicates how much the customer's bill will decrease if the customer chooses an  
8 alternative provider. TEP's proposed shopping credits include both a Market Generation  
9 Credit, based directly on the futures market, and an Adder. The adder is intended to  
10 reflect a number of retail costs which are not included in the Company's MGC. The  
11 Market Generation Credit will be calculated and posted in advance.

12  
13 Neither the Settlement nor the proposed tariff indicate exactly how much in advance TEP  
14 will calculate the MGC. In response to discovery, the Company indicates that the MGC  
15 will be calculated for the next quarter 45 days in advance of that quarter. This should be  
16 specified in the Settlement.

17  
18 It would be preferable for customers to know the price for the next year before making a  
19 decision between the Company and alternative providers. However, offset against this  
20 goal is the consideration that there is not a reconciling mechanism should the futures  
21 price change dramatically during the year, which could result in windfalls for customers  
22 or for the Company. Accordingly, I do not recommend a change to this provision at this  
23 time, although this is an issue that might be revisited.

24  
25 The proposed form of the tariff may be confusing to customers. The adder should be  
26 combined with what the Company labels the MGC, to reflect the full shopping credit for  
27 generation.

28 ...

1 Q. Is any thing else necessary to avoid subsidization of competitive services by monopoly  
2 services?

3 A. Yes. Rates for metering and billing services should be based on embedded costs. Utility  
4 rates for these services are based on the embedded costs of all services, including  
5 metering and billing. If the utility charges less than this amount, its remaining  
6 distribution rates will subsidize its competitive metering and billing service. I would  
7 expect that new providers will only enter the market if the alternative price is based on  
8 embedded costs. If one utility only provided credits based on decremental costs,  
9 metering and billing providers would find it difficult to compete in that territory. That, in  
10 turn, would hinder development of the competitive market.

11  
12 Q. Are TEP's proposed metering and billing rates appropriate?

13 A. The proposed metering and billing rates are lower than those in the proposed November  
14 Settlement. According to the response to Staff Request LS-7, these rates "reflect" cost  
15 levels and methodology from the last general rate case. However, they were "adjusted  
16 downward" to satisfy the constraint of the "bundled levels". Since it is my understanding  
17 that the Settlement specified total distribution charge is as high as, if not higher than, the  
18 total distribution charge in the current bundled rates, this adjustment does not seem  
19 appropriate. I recommend that tariffs resulting from the Settlement should include higher  
20 full embedded metering and billing rates. This does not require a change to the language  
21 in the Settlement.

22  
23 Q. Is the credit level in the Proposed Settlement such that alternative suppliers will be able  
24 to compete effectively with TEP? In other words, is the base adequate, and is the adder  
25 large enough?

26 A. The adder may not be adequate to be combined with a single base MGC price that was  
27 determined on the basis of a 100 percent load factor. The Settlement and the filed  
28 unbundled tariffs do not fully clarify how the MGC will be defined. According to

1 Mr. Pignatelli's testimony on Page 7, the monthly "MGC amount will be . . . stated as an  
2 on-peak value and an off-peak value." However, the tariffs describe the computation of a  
3 single MGC. If Mr. Pignatelli's words are intended to prevail, a customer's MGC would  
4 vary with the customer's peak/off-peak usage. The adder then would include only the  
5 cost of hourly price variation within periods. Since the futures price is for a fixed amount  
6 of energy in every hour, most customers will pay a higher average price because their  
7 load within the peak and off-peak periods is not flat. If the MGC is a single number per  
8 month, then the adder must also reflect the difference between peak and off-peak usage  
9 by customers, and I would estimate that the MGC needs to be at least .5 mills higher to  
10 incorporate this. If the MGC is applied separately to peak and off-peak load, as  
11 Mr. Pignatelli implies it will be, or alternatively with the change to the MGC adder that I  
12 recommend I estimate that stranded cost collection will still be about \$660 million.

13  
14 In addition to the above, the Settlement would be improved by a provision that allowed a  
15 redefinition of the Market Generation Credit under some circumstances. For instance,  
16 there has been recent concern that the NYMEX futures market may not survive in its  
17 current form. In that situation, an alternative measure of the market generation price  
18 would be needed. I recommend that a clause be included which would allow the  
19 Company, the Staff, or ESPs to request a revision in the measure of the MGC if it  
20 becomes impossible to compute with the current definition or otherwise proves  
21 unworkable.

22  
23 Q. Are there any other issues with regard to the use of the NYMEX futures price?

24 A. Yes. Prices on the futures market have exhibited considerable volatility. Using the  
25 monthly futures prices based on a single day only could result in the credit being  
26 influenced by "gaming" or unusual events. I would recommend that the MGC  
27 calculation be based upon the average of at least three days on settlement prices from the  
28 NYMEX market.

1 Q. Please describe other elements of market price that must be covered by the adder.

2 A. Customers, or their suppliers, will need to pay for "load balancing", customer service,  
3 and some profit. These elements must be added to the wholesale price to determine what  
4 retail prices will be. The higher adder that I have recommended should produce a  
5 shopping credit that makes competition workable.

6  
7 Q. Has the Company used a reasonable method for estimating stranded costs?

8 A. Yes. This Company methodology estimates the difference between market revenues and  
9 embedded costs over the lives of its generating units and contracts.

10  
11 Q. What was the range of the Company's stranded cost estimates?

12 A. The Company estimated that its stranded costs would be roughly between \$600 million  
13 and one billion dollars.

14  
15 Q. Do you have any other concerns with the Settlement?

16 A. I am concerned that provision 5.2 of Article 5-Rate Reductions, does not appear to allow  
17 appropriate future rate adjustments within the rate cap. As presently worded, it would  
18 appear to allow only rate reductions. It may be appropriate to increase future  
19 transmission and distribution rates, if cost justified, and if the floating CTC or the market  
20 generation credit decreases so that total rates do not increase. Without such a  
21 modification, essentially some distribution costs will probably be collected through the  
22 floating CTC. I would recommend that the third sentence in this provision be replaced by  
23 "Any increases in rate components will be accompanied by decreases in other rate  
24 components."

25 ...

26 ...

27 ...

28 ...

1 Q. The TEP Proposed Settlement proposes rate reductions that are lower than those in the  
2 proposed APS Settlement. Is this appropriate?

3 A. TEP's rates were found to be just and reasonable in Decision No. 59594, dated March 9,  
4 1996. Subsequently, TEP's rates were reduced by Settlement in Decision No. 61104,  
5 dated August 28, 1998. This proceeding is an attempt to restructure TEP's rates to  
6 appropriately reflect the introduction of competition into an unbundled rate structure.  
7 Because TEP has been growing at a lower rate than APS, I would not expect that it would  
8 have the same potential for rate savings as APS.

9  
10 **RECOMMENDED REMEDIES TO PROBLEMS IDENTIFIED**

11 Q. What is your final recommendation to the Commission regarding this agreement?

12 A. I am recommending that the Commission approve the Proposed Settlement with the  
13 minor modifications discussed above which will make the Settlement more consistent  
14 with the goal of establishing a competitive market.

15  
16 Q. Does this complete your direct testimony?

17 A. Yes, it does.  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

**LEE SMITH**

LA CAPRA ASSOCIATES  
Senior Economist

---

**Ms. Lee Smith** is a Senior Economist at La Capra Associates. Ms. Smith has over fifteen years experience in utility economics and regulation. Her work has encompassed all aspects of utility pricing, cost analysis, forecasting, and both demand-side and supply planning in electric, gas, and water utility cases. As a consultant, her clients have included gas and electric utilities, regulatory commissions and other public bodies. Ms. Smith has advised the Massachusetts Division of Energy Resources on position on changes in Integrated Resource Management, including proposal to open Transmission and Distribution access to meet resource needs. Previous to La Capra Associates, Ms. Smith was employed as the Director of Rates and Research at the Department of Public Utilities.

**ACCOMPLISHMENTS**

- Assisting the Arizona Corporation Commission in developing unbundled rates for all Arizona utilities; preparing positions, and negotiating with utilities.
- Advised and provided testimony on rate unbundling for the Maryland Office of the Public Counsel for all utilities in Maryland in restructuring proceedings.
- Advised Pennsylvania Office of the Public Advocate staff in restructuring proceedings; presented testimony on rate unbundling in eight cases.
- Assisted Massachusetts Division of Energy Resources in drafting restructuring legislation and negotiating additional restructuring settlements with utilities.
- Assisted Commission staff in both electricity restructuring cases and utility requests for Qualified Rate Orders allowing securitization of some stranded costs for the Pennsylvania Office of the Consumer Advocate.
- Assisted New Hampshire Public Utilities Commission staff in writing Draft Order on Restructuring; prepared discovery for utilities; prepared discovery questions for hearings on various issues, including corporate unbundling, market structure, transmission, stranded cost theory, measurement, and mitigation.
- Assisted DOER in all aspects of electric industry restructuring from rate unbundling to planning and developing revised market structure for the New England Power Pool.

- Represented the DOER at NEPOOL committees engaged in developing an Independent System Operator, a revised NEPOOL Agreement, and an Open Access Transmission Tariff for New England. Assisted the DOER in other matters including development of model for Boston Edison pilot program based on proxy for competitive market real-time pricing.
- Prepared alternative marginal cost study on Maine Public Service Company. Presented testimony advocating allocation of excess costs on the basis of generation allocators rather than EPMC.
- Prepared testimony on cost allocation and rate design for local gas distribution utility for Kansas Citizens' Utility Ratepayers Board. Assisted in settlement negotiations.
- Testified for Massachusetts Municipal Wholesale Electric Company on appropriate allocation of gas transition costs; assisted MMWEC in formulating response to generic docket on interruptible gas transportation; prepared comments.

## **EMPLOYMENT**

**Department of Public Utilities:  
*Director of Rates and Research,*  
1982 - 1984**

## **EDUCATION**

**Ph.D.**, all but dissertation, Tufts University, Economics  
**B.A.**, Honors, Brown University,  
International Relations and Economics  
**Study of Statistics**, Boston College

## **HONORS**

Bunting Institute Fellowship, 1970-71  
Tufts University Economics Department Fellowship, 1967-68  
Prize in International Relations, Brown University, 1965