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Arizona Corporation Commission
DOCKETED
JUL 28 1999
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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-01933 A-98-0471
IN THE MATTER OF THE FILING OF TUCSON ELECTRIC POWER COMPANY OF UNBUNDLED TARIFFS PURSUANT TO R14-2-1606, *et.seq.*	DOCKET NO. E-01933A-97-0772

COMMENTS
OF THE ARIZONA UTILITY INVESTORS ASSOCIATION

Pursuant to the revised Procedural Order dated June 23, 1999, the Arizona Utility Investors Association (AUIA) hereby files its Comments in the above-captioned matters. AUIA will not introduce direct testimony or offer a witness in this proceeding.

1. Introduction

On June 9, 1999, Tucson Electric Power Company (TEP) filed an application for approval by this Commission of a Settlement Agreement (Agreement) which was reached through negotiations with individuals representing much of TEP's commercial and residential customer base.

Among other things, the Agreement purports to resolve stranded cost recovery and other related issues, provides rate reductions for TEP ratepayers and establishes unbundled distribution tariffs for standard offer and direct access customers.

AUIA was not a party to the negotiations nor a signatory to the Agreement. There are elements of risk in the Agreement that AUIA would choose to modify if it could, but we recognize that the parties have negotiated a package of provisions that are interdependent and we do not propose to upset the equilibrium.

Overall, the Agreement strikes a fair balance between the interests of TEP's customers and the shareholders of UniSource Energy Corp. By disposing of the thorny problem of stranded cost recovery, the Agreement prevents months or years of litigation, and it allows retail electric competition to proceed quickly in TEP's service territory.

Approval of the Agreement will also remove from TEP the cloud of regulatory and financial uncertainty that hangs over all investor-owned utilities in Arizona.

In summary, AUIA believes the Agreement is in the public interest and urges the Commission to approve it.

2. Comparing the Previous Settlement

As the Commission knows, this is the second settlement agreement that has been put forward by TEP. In AUIA's view, the current Agreement is far superior to the settlement that was reached in the fall of 1998 between TEP and the Commission Staff.

It is superior in a political sense because the parties to this Agreement include the company and its customers. In AUIA's view, the new Agreement also provides more benefits, greater certainty and less risk for both shareholders and customers.

The previous settlement was based solely on a divestiture strategy in which TEP would have divested all of its generation capability but also would have acquired significant high voltage transmission assets from Arizona Public Service Company (APS).

At that time, AUIA expressed concerns that TEP's complicated financial structure made divestiture a risky business for shareholders and customers alike.

Among other problems, TEP would have been required to buy out leveraged leases on some of its generating facilities at an unknown cost. In addition, there was the undefined impact of two-county financing and the potential need to replace that financing or face retroactive tax consequences. TEP indicated that its stranded cost exposure could vary as much as $600 million, depending largely on those contingencies.

AUIA believed then that it would have been a perilous undertaking for all parties to leave financial contingencies of such magnitude unresolved until a final bill could be delivered to a future Commission. For TEP, divestiture would not be a clean, tidy way of determining stranded costs.

AUIA revisits this circumstance because there are parties to the stranded cost dockets who continue to advocate divestiture as the only viable solution to stranded cost determination.

3. TEP's Stranded Cost Position

Charles Bayless, TEP's previous chief executive officer (CEO), was a company witness at the Commission's generic hearing on stranded cost recovery in February 1998. He was asked on cross examination what would happen if TEP had to forego a significant chunk of its stranded costs.

His answer was direct. The company would be bankrupt, he said.

Similarly, James Pignatelli, TEP's current CEO, has indicated in testimony that TEP's frail financial condition will not permit extensive write-offs of stranded costs. In his words, "...the <u>opportunity</u> for 100 percent stranded cost recovery is essential to the Company's financial viability." (Direct Testimony, Pg. 2, Line 13, emphasis supplied)

Although TEP's financial condition has improved since February 1998, it cannot afford to write down its assets and damage "its already fragile balance sheet." (Pignatelli, Pg. 8, Line 15)

TEP needs a reasonable chance to collect all of its stranded costs, including its regulatory assets. When TEP succumbed to the divestiture strategy in the previous settlement, it was the only option that allowed an opportunity for full recovery under then-current Commission rulings.

The new Agreement offers that same opportunity but without the black hole of financial uncertainty that goes with divestiture.

4. Specific Provisions

a) Stranded Cost Recovery

AUIA accepts at face value that $450 million is an adequate stranded cost recovery target so long as the company isn't forced to unwind its lease agreements and defease its other financing mechanisms (i.e., two-county bonds). In that context, the combination of a "fixed" and "floating" competitive transition charge (CTC) is rather novel.

The fixed CTC, set at .93 cents per kWh as a system average, is designed to collect $450 million by Dec. 31, 2008 or sooner. The floating CTC, employing a two-part "shopping credit," is designed to reflect changes in the market price of generation and may produce positive or negative stranded cost numbers on a quarterly basis.

The shopping credit, which includes an "adder" that varies by customer class from 2.5 to 5.2 mills per kWh, will enable competition among electric service providers (ESPs).

While it may be true that the combination of CTCs will prevent accounting penalties (write-offs), it is also true that these provisions put the shareholders at some risk for collecting all of their stranded costs. AUIA would prefer an assured recovery mechanism, but in the context of the Agreement, the risk seems acceptable.

b) Rate Provisions

TEP's standard offer and unbundled rates will be frozen until Dec. 31, 2008 except for two rate reductions of 1 percent each which will take effect July 1, 1999 and July 1, 2000. These reductions follow a decrease of 1.1 percent that was implemented in 1998.

Given TEP's financial condition and the uncertain effects of retail competition, rate reductions totaling 3.1 percent over 3 years are nearly pushing the envelope.

c) Asset Transfers

The Agreement provides that TEP will transfer its generation and other competitive assets at market value to a subsidiary of TEP by Dec. 31, 2002. Unless accounting or legal requirements are at issue, AUIA believes it is immaterial whether the assets are transferred at book or market value. However, there is no indication what method will be used to determine market value or how administrative costs will be recovered. Absent a final determination in the electric competition rules, we wish the Agreement would protect shareholders from absorbing these costs.

d) Waivers

AUIA doesn't purport to have enough to evaluate all of the requests TEP has made for waivers to various Commission rules and orders. However, we are particularly cognizant of the conditions that were placed on UniSource, as a holding company, and TEP in the Commission's Decision No. 60480.

Many of the conditions cited by TEP will no longer be appropriate in a competitive environment and will be simply unworkable when applied to a disaggregated utility. In particular, AUIA would cite: Condition No. 17 -- Capitalization; No. 19 -- Public Equity Issuances; No. 20 -- Dividends; No. 21 -- Capital Structure; and No. 26 -- M&A Activity.

These and other conditions of Decision No. 60480 are not only inappropriate to the new company structure but will disadvantage TEP because its competitors do not have to meet the same requirements.

5. Conclusion

Although UniSource shareholders face some risk in recovering all of TEP's stranded costs, the Agreement offers a reasonable opportunity. As a product of negotiations, the Agreement fairly balances the interests of the company's customers and its shareholders. It will provide a quick launch to electric competition and reduce the likelihood of paralyzing litigation.

AUIA urges the Commission to approve the Settlement Agreement.

RESPECTFULLY SUBMITTED,
this 28th day of July, 1999, by

WALTER W, MEEK, PRESIDENT

Original and ten (10) copies of the referenced Comments were filed this 28th day of July, 1999, with:

Docket Control
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Copies of the referenced Comments were hand-delivered this 28th day of July, 1999, to:

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Jerry Rudibaugh, Hearing Division
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Copies of this Notice were mailed this 28th day of July, 1999, to:

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