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BEFORE THE ARIZONA CORPORATION COMMISSION

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CARL J. KUNASEK
Chairman
JIM IRVIN
Commissioner
WILLIAM A. MUNDELL
Commissioner

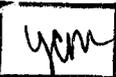
Arizona Corporation Commission

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AZ CORP COMMISSION
DOCUMENT CONTROL

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IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-01933A-98-0471
TUCSON ELECTRIC POWER COMPANY FOR)
APPROVAL OF ITS STRANDED COST)
RECOVERY AND FOR RELATED APPROVALS,)
AUTHORIZATIONS AND WAIVERS.)

IN THE MATTER OF THE FILING OF TUCSON) DOCKET NO. E-01933A-97-0772
ELECTRIC POWER COMPANY OF)
UNBUNDLED TARIFFS PURSUANT TO A.A.C.)
R14-2-1602 *et seq.*)

IN THE MATTER OF THE COMPETITION IN) DOCKET NO. RE-00000C-94-0165
THE PROVISION OF ELECTRIC SERVICES)
THROUGHOUT THE STATE OF ARIZONA.) NOTICE OF FILING AMENDED
SETTLEMENT AGREEMENT AND
LATE FILED EXHIBIT

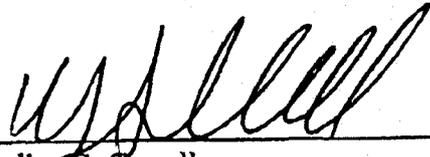
Pursuant to the request of the Chief Hearing Officer that was made at the hearing in the above-captioned matters, TEP hereby files an Amended Settlement Agreement that is marked to show TEP's agreed upon changes. These changes were agreed to at the hearing and have been approved by AECC, ACAA and RUCO. The changes are contained in Sections 2 and 12 of the Settlement Agreement. In addition, Rider No. 1 to Exhibit B has been modified to reflect the increase in the Adder.

Also at the hearing, the Chief Hearing Officer indicated that in light of Commonwealth's introduction of Dr. Rosen's January 1998 testimony into evidence over the objections of TEP, AECC and RUCO, the parties could file late filed exhibits relating to the cross-examination of Dr. Rosen. Additionally, in light of a Commonwealth objection, the Chief Hearing Officer requested that TEP file foundational evidence to support its cross-examination of Mr. Bloom related to Dr. Rosen. In both instances, TEP was under the mistaken belief that such documents were to be filed by Friday, August 20th, along with the Amended Settlement Agreement. Upon review of the

1 transcript, the late filed exhibits were to be filed by Monday, August 16th. TEP requests leave to
2 late file the attached February 17, 1998 cross-examination of Dr. Rosen by TEP which addresses
3 both issues. As the testimony of Dr. Rosen was the subject of much debate at both the TEP and APS
4 proceedings, the filing at this time will not prejudice Commonwealth as Commonwealth has already
5 acknowledged that the document is a matter of public record from this docket.

6 RESPECTFULLY SUBMITTED this 19th day of August, 1999.

7 TUCSON ELECTRIC POWER COMPANY

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10 By: 
11 Bradley S. Carroll
12 Senior Counsel, Regulatory Affairs
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15 Tucson, Arizona 85702

16 **Original and fourteen copies of the foregoing**
17 **filed this 19th day of August, 1999, with:**

18 Docket Control
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20 1200 West Washington Street
21 Phoenix, Arizona 85007

22 **Copy of the foregoing hand-delivered**
23 **this 19th day of August, 1999, to:**

24 Jerry L. Rudibaugh, Chief Hearing Officer
25 Hearing Division
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6 **this 19th day of August, 1999, to:**

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22 By: Kelly Johnson
23 Secretary for Bradley S. Carroll
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AMENDED SETTLEMENT AGREEMENT

This Settlement Agreement is entered into this 9th day of June, 1999 by Tucson Electric Power Company ("TEP" or the "Company"), the Arizona Residential Utility Consumer Office ("RUCO"), members of the Arizonans For Electric Choice And Competition ("AECC")¹ and Arizona Community Action Association ("ACAA") (collectively the "Parties").

BACKGROUND

A. TEP is a public service corporation that, along with its predecessors, has provided electric service in Arizona since 1892. TEP currently provides retail electric service to the City of Tucson and in the surrounding Pima County area, and to Fort Huachuca in Cochise County pursuant to Certificates of Convenience and Necessity ("CC&Ns"); these areas shall collectively be referred to as the "TEP CC&N Service Territory" that it has received from the Arizona Corporation Commission ("Commission").

B. On December 26, 1996, the Commission issued an Order approving A.A.C. R14-2-1601, *et seq.* (the "Electric Competition Rules") for the purpose of introducing competitive access to retail electric generation and certain other services that are deemed to be competitive (hereinafter referred to as "Competitive Retail Access"). Since then, the Electric Competition Rules have been the subject of multiple litigation and the

¹ AECC consists of the following organizations: Arizonans for Electric Choice and Competition is a coalition of energy consumers in support of competition and includes Cable Systems International, BHP Copper, Motorola, Chemical Lime, Intel, Honeywell, Allied Signal, Cyprus Climax Metals, Asarco, Phelps Dodge, Homebuilders of Central Arizona, Arizona Mining Industry Gets Our Support, Arizona Food Marketing Alliance, Arizona Association of Industries, Arizona Multihousing Association, Arizona Rock Products Association, Arizona Restaurant Association, Arizona Retailers Association, Boeing, Arizona School Board Association, National Federation of Independent Business, Arizona Hospital Association, Lockheed Martin, Abbot Labs, and Raytheon.

implementation thereof has been stayed while additional amendments and revisions thereto are being considered.

C. TEP has worked with the Commission Staff and other interested parties towards finalization of the Electric Competition Rules and the implementation of Competitive Retail Access in Arizona.

D. The Parties acknowledge that in order to restructure the Arizona retail electric industry to provide for Competitive Retail Access and customer choice, this Settlement Agreement provides TEP's shareholders a reasonable opportunity to recover their prudently incurred investments and costs, including stranded costs.

E. The Parties also acknowledge that each Affected Utility (as defined in the Electric Competition Rules) has unique financial and other circumstances such that the Commission should review the provisions of this Settlement Agreement relating to TEP's recovery of stranded costs independently from the proposals of any other Affected Utility.

F. The Parties believe that this Settlement Agreement provides for the timely implementation of Competitive Retail Access in TEP's CC&N Service Territory and for TEP's shareholders to have a reasonable opportunity to recover their prudently incurred investments and costs. The Parties further believe that competition in the electric industry will benefit all customers in providing greater efficiencies and lower electric power costs. Accordingly, this Settlement Agreement is to be interpreted so as to bring about these consumer benefits as soon as possible.

G. The Parties further believe that the terms and conditions of this Settlement Agreement are just, reasonable and in the public interest in that they, among other things,

provide for Competitive Retail Access in TEP's Service Territory, establish rate reductions for all TEP customers, set a mechanism for stranded cost recovery and resolve contentious litigation.

H. The Parties desire that the Commission issue an Order: (a) finding that the terms and conditions of this Settlement Agreement are just and reasonable; (b) concluding that this Settlement Agreement is in the public interest; (c) approving this Settlement Agreement; and (d) implementing the terms and conditions set forth herein (the "Commission's Approval Order").

NOW, THEREFORE, in consideration of the mutual covenants and promises contained herein and for other good and valuable consideration, the Parties hereto agrees as follows:

1. COMPETITIVE RETAIL ACCESS.

1.1 Competitive Retail Access in TEP's CC&N Service Territory shall commence sixty (60) days after the issuance of the Commission's Approval Order ("Commencement Date"), and subject to: (a) the provisions of effective Electric Competition Rules; and (b) the terms and conditions herein.²

1.2 Upon the Commencement Date, TEP shall make available for Competitive Retail Access the amount of system peak load set forth in the currently proposed Electric Competition Rules, plus an additional fifty-four (54) megawatts of load which shall be made available to eligible non-residential customers. Unless subject to judicial or

² The Parties recognize that Y2K issues will be of critical importance during the fourth quarter of 1999. Therefore, the Parties respectfully request approval of this Settlement Agreement on or before August 1, 1999 so that Competitive Retail Access may commence in TEP's service territory on or before October 1, 1999.

regulatory restraint, all TEP customers will be eligible to receive Competitive Retail Access on January 1, 2001.

1.3 The Parties shall urge the Commission to approve the Electric Competition Rules, at least on an emergency basis, so that meaningful Competitive Retail Access can begin in TEP's service territory subject to the provisions of Section 1.1 herein.

1.4 Electric Service Agreements ("ESAs"), in effect as of the Commencement Date, shall remain in effect, unless TEP and the respective parties thereto agree to a modification or a termination thereof. In the event that an ESA, in effect as of the Commencement Date, terminates by its terms prior to January 1, 2001, then the ESA customer shall have the option of choosing: (a) Competitive Retail Access; or (b) an extension of the ESA up to January 1, 2001 at the then-current contract price (with any applicable seasonal adjustment and continuing escalation that would have applied had the ESA not terminated).

2. STRANDED COST RECOVERY.

2.1 TEP shall have a reasonable opportunity to recover its stranded costs, including its regulatory assets. TEP shall be authorized to recover its stranded costs in the following manner:

(a) The Commission shall authorize TEP to implement a competition transition charge ("CTC") in two components: (i) a "Fixed" CTC; and (ii) a "Floating" CTC.

(b) The Fixed CTC shall be set so as to equal a charge of 0.93 cents/kWh (average) ("Fixed CTC amount"), which shall include recovery of TEP's regulatory assets. The Fixed CTC component shall terminate when it has yielded a stranded cost

recovery of four hundred fifty million dollars (\$450 million), or on December 31, 2008, whichever occurs first. When the Fixed CTC terminates, unbundled service rates will be reduced by the same amount. The amortization schedule for the \$450 million of Fixed CTC is attached hereto as Exhibit A. The parties acknowledge that the actual collection of the Fixed CTC will vary with actual kWh sales.

(c) The Floating CTC shall be calculated using a Market Generation Credit ("MGC") methodology (as defined in subsection 2.1(d) below) and will terminate on December 31, 2008. The Floating CTC shall be determined on a quarterly basis. TEP shall set the Floating CTC amount forty-five (45) days prior to each calendar quarter. The Parties acknowledge that the Floating CTC amount may vary from month-to-month, as the MGC varies. The Floating CTC amount shall equal the difference between the customer's bundled rate and the sum of: (i) the MGC; (ii) the "Adder" (as defined in subsection 2.1(e) below); and (iii) the unbundled charges for: a) distribution; b) transmission; c) metering; d) billing; e) ancillary services; f) fixed must-run generation; g) system benefits; and h) the Fixed CTC. In a given quarter, the Floating CTC can have a negative value, in which case the negative value will be credited to the customers' monthly bill. The sum of the MGC and the Adder shall be reflected on customers' bills as a single line item.

(d) The monthly MGC amount shall be calculated in advance and stated as both an on-peak value and an off-peak value. The monthly on-peak MGC component shall be equal to the Market Price multiplied by one plus the appropriate line loss (including unaccounted for energy ("UFE")) amount. The Market Price shall be equal to the Palo Verde NYMEX futures price, except when adjusted for the variable cost of

TEP's must-run generation. The Market Price shall be determined 45 days prior to each calendar quarter using the average of the most recent three (3) business days of Palo Verde NYMEX settlement prices. The off-peak MGC component shall be determined in the same manner as the on-peak component, except that the Palo Verde futures price will be adjusted by the ratio of off-peak to on-peak hourly prices from the California Power Exchange of the same month from the preceding year. The market price shall reflect the cost of serving a one hundred percent (100%) load factor customer. If the nature of the Palo Verde NYMEX changes such that it no longer accurately reflects the intent of the Settlement, the Company, Staff or any other interested party may request that an alternative index be utilized to the extent such index is consistent with the Settlement.

(e) The Parties acknowledge that the purpose of the Adder is to estimate the cost of supplying power to a specific customer or customer group and stratum relative to the value of the NYMEX futures prices used in the calculation of the market price for a one hundred percent (100%) load factor. The Adder will be adjusted for each customer class and stratum, shall average 4.23-5 mills and shall be subject to the same line loss adjustment outlined in subsection (d) herein. However, the initial Adder for any customer shall not be less than 3.02-5 mills.

(f) The Parties acknowledge that the Adder is intended to estimate the difference between the flat load costs associated with the PV index and actual customer load characteristics plus an additional amount for costs that will not be readily quantifiable until the Arizona market more fully develops. After June 1, 2004, any interested party ~~Party to this Settlement Agreement~~ may submit a request to the Commission to alter/amend the initial Adder based upon actual market conditions. Any

such requests will be considered as part of the rate modifications contemplated pursuant to Section 5.2.

(g) The Commission shall authorize TEP to securitize any portion of the CTC, provided that TEP shall file with the Commission a financing application that provides that TEP will share the benefits of such securitization with its customers.

(h) The CTC for an ESA customer shall be calculated using the customer's ESA price as of May 1, 1999 (subject to any automatic escalation provisions contained in the ESA) as the customer's bundled rate.

(i) Self-generation and other reductions in purchases "off-the-grid" shall not be subject to the CTC (consistent with the Electric Competition Rules).

(j) During a month in which must-run generation is provided to meet retail load, the Market Price component used in calculating the on-peak MGC shall be a weighted average of the Palo Verde NYMEX futures price and the must-run variable cost charges that are levied on scheduling coordinators serving retail customers in the TEP load zone during that month, consistent with AISA protocols.

3. SEPARATION OF COMPETITIVE AND NON-COMPETITIVE SERVICES.

3.1 On or before December 31, 2002, TEP shall transfer its generation and other assets deemed to be competitive (as defined in the Electric Competition Rules) to a subsidiary of TEP, at market value. Commission approval of this Settlement Agreement shall constitute any necessary approval or waiver under Title 40, Arizona Revised Statutes and the Commission's Affiliated Interest Rules (A.A.C. R14-2-801, *et seq.*) for the formations of the subsidiary and the transfer of the assets. At such time that TEP

effectuates the transfer of its generation assets, it shall be required to procure generation for its standard offer customers in accordance with the Electric Competition Rules.

4. UNBUNDLED RATES.

4.1 TEP's rates shall be fully unbundled into separate charges for: (a) distribution; (b) transmission; (c) metering; (d) billing; (e) ancillary services; (f) fixed must-run generation; (g) system benefits; and (h) standard offer generation, the sum of which shall not exceed a customer's current bundled rates. For TEP's standard offer customers, the CTC shall be included in the cost of standard offer generation service, and shall be separately identified on the customers' bills.

4.2 TEP's cost for variable must-run generation shall be billed directly to scheduling coordinators in accordance with AISA protocols, and shall be included in the standard offer generation charge.

4.3 TEP shall take reasonable steps to minimize the "collapsing" of tariffs that are on file with the Commission as of the Commencement Date.

4.4 TEP shall charge rates for transmission and ancillary services based upon its FERC Open Access Transmission Tariff.

4.5 TEP's tariffs shall be unbundled for all customers, including those who are not initially eligible for Competitive Retail Access.

4.6 TEP shall defer for future recovery its cost to implement Competitive Retail Access. The Commission shall authorize TEP to recover its reasonable and prudently incurred Competitive Retail Access implementation costs as a plant cost and/or deferred debit subject to review in the TEP June 1, 2004 filing (as discussed in section 5.2 below.)

5. RATE REDUCTIONS.

5.1 TEP shall reduce the rates charged to all non-ESA customers by two percent (2%) as follows: one percent (1%) on July 1, 1999 and one percent (1%) on July 1, 2000. Except for the non-ESA two percent (2%) rate reductions, TEP's rates shall be frozen until December 31, 2008, except for: (a) those adjustments that will result as a consequence of this Settlement Agreement; (b) changes in TEP's transmission tariffs due to AISA or Desert STAR; and (c) changes authorized hereinbelow.

5.2 TEP shall file a report with the Director of the Utilities Division by June 1, 2004 identifying any required modifications to the Fixed or Floating CTC, TEP's distribution tariffs and other unbundled components ("TEP June 1, 2004 filing"), that would have the effect of reducing standard offer and/or overall unbundled rates while providing for TEP's recovery of costs associated with provider of last resort service in standard offer rates. This report shall include a recommendation as to whether the Fixed CTC can be eliminated/reduced prior to December 31, 2008. Any changes in TEP's rates made pursuant to this section 5.2 shall be implemented no later than January 1, 2005.

5.3 TEP's rate reductions provided for herein shall constitute full compliance with provisions of the Electric Competition Rules requiring that Affected Utilities implement rate reductions.

6. TARIFF FILINGS.

6.1 The Parties agree that the Unbundled Distribution Tariffs, attached hereto as Exhibit B, are just and reasonable. The Commission's Approval Order shall include such a finding and approve TEP's Unbundled Distribution Tariffs.

7. CODE OF CONDUCT.

7.1 All transactions between TEP (the regulated Utility Distribution Company) and its affiliates engaged in Competitive Retail Access shall be governed by a Code of Conduct. Within thirty (30) days of the filing of this Settlement Agreement, TEP shall file with the Commission an Interim Code of Conduct. TEP will voluntarily comply with this Interim Code of Conduct until the Commission approves a final Code of Conduct for TEP in accordance with the Electric Competition Rules. TEP shall confer with the Parties prior to filing its Interim Code of Conduct.

8. CERTIFICATE OF CONVENIENCE AND NECESSITY.

8.1 TEP agrees to the amendment and modification of its CC&N in order to permit Competitive Retail Access consistent with the terms of this Settlement Agreement. The Commission's Approval Order shall contain the necessary findings and conclusions and constitute the necessary Commission Order amending and modifying TEP's CC&Ns to permit competitive Retail Access consistent with the terms of this Settlement Agreement.

9. INDEPENDENT SCHEDULING ADMINISTRATOR/INDEPENDENT SYSTEM OPERATOR.

9.1 TEP shall fully support the development of the Arizona Independent Scheduling Administrator ("AISA") and Desert STAR. TEP shall modify its FERC Open Access Transmission Tariff ("OATT") to be fully compatible with the AISA/ISO Bylaws and Protocols Manual. The Parties reserve their rights with respect to any AISA protocols, including the right to challenge or seek modifications to, or waivers from, such protocols. TEP shall file changes to its existing OATT consistent with this Section

within ten (10) days of Commission approval of this Settlement Agreement pursuant to Section 13.3.

10. RESOLUTION OF LITIGATION.

10.1 Upon issuance by the Commission of the Commission's Approval Order that is no longer subject to judicial review, TEP shall move to dismiss with prejudice all pending litigation brought by TEP against the Commission and assist the Commission in any remaining litigation regarding implementation of the Electric Competition Rules.

11. LOW-INCOME PROGRAMS.

11.1 To ensure that low-income customers and programs are not negatively impacted by the introduction and transition to Competitive Retail Access, TEP's System Benefits Charge as set forth in the tariffs filed herewith, shall include charges to maintain its existing low-income programs (which include weatherization, Life Fund, bill assistance and rate discounts) in an amount of at least current levels through December 31, 2004 when all such programs will be reviewed as part of TEP's June 1, 2004 filing. Additionally, the Parties agree to recommend to the Commission that TEP's low income rate discount program (with the exception of the medical discount which shall remain the same) be amended as follows: (a) to replace the current percentage discounts with a flat eight dollar (\$8.00) per month discount; (b) the applicant for the program must receive the bill in their name, be a residential customer and meet one-hundred fifty percent (150%) of the federal poverty income guidelines; and (c) the program would operate as follows: (i) the program would have an application which is self-declared/self-addressed and available in English and in Spanish; (ii) once TEP receives the application, it would be reviewed; (iii) once the customer has been

determined to be eligible, the discount would become effective immediately; (iv) participants who move within TEP's service territory would have their eligibility transferred with them; and (v) the customers would be notified annually by TEP when it is time to reapply.

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) ~~(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.

- R14-2-804.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 UDC's 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) ~~(e)~~ Decision No. 60480, Holding Company Order:

- ~~Condition Nos. 2, 12, 13, 17, 19, 20, 21, 23, 25, 26, 27 and 28.~~ 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 from 60 percent to 30 percent.

- Condition Nos. 19, 20 and 21 will remain in force, as modified, until the equity portion of TEP's capital structure reaches or exceeds 37.5 percent. TEP may request reconsideration of these waiver requests in conjunction with its next rate case.
- 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 No. 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 filing 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 & Performance Filing - ~~(upon transfer of generation assets)~~ - 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 ~~(upon transfer of generation assets)~~ - 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 ~~(upon transfer of generation assets)~~ - TEP will comply with this filing requirement until such time as divestiture occurs. Thereafter, the requirement is waived.

(m) ~~(m)~~ - Generating Unit Outage Report Filing ~~(upon transfer of generation assets)~~ - 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.

13. CONTINGENCIES TO THIS SETTLEMENT AGREEMENT.

13.1 Neither the Parties nor the Commission shall take any action that would diminish the recovery of TEP's stranded costs or regulatory assets provided for herein.

In entering into this Settlement Agreement, TEP has relied upon the Commission's irrevocable promise to permit recovery of TEP's stranded costs and regulatory assets as provided herein. Such irrevocable promise by the Commission shall be evidenced by the issuance of the Commission's Approval Order, shall survive the expiration of the Settlement Agreement and shall be specifically enforceable against this and any future Commission.

13.2 The Parties acknowledge that TEP's ability to offer Competitive Retail Access is contingent upon conditions and circumstances, a number of which are not within the direct control of the Parties. Accordingly, the Parties agree that it may become necessary to modify the terms of retail access to account for such factors, and they further agree to address such matters in good faith and to cooperate in an effort to propose joint resolutions for any such matters.

13.3 This Settlement Agreement shall not become effective until the issuance of a final Commission Order approving this Settlement Agreement, without modification, on or before August 1, 1999. In the event that the Commission fails to approve this Settlement Agreement without modification according to its terms on or before August 1, 1999, any Party to this Settlement Agreement may withdraw from this Settlement Agreement and shall thereafter not be bound by its provisions; provided, however, that if TEP withdraws from this Settlement Agreement, the Settlement Agreement shall be null and void and of no further force and effect. Parties so withdrawing shall be free to pursue their respective positions without prejudice. Approval of this Settlement Agreement by the Commission shall make the Commission a Party to this Settlement Agreement and fully bound by its provisions.

13.4 TEP shall not be prevented from seeking a change in unbundled or Standard Offer rates prior to December 31, 2008, in the event of (a) conditions or circumstances which constitute an emergency, such as the inability to finance on reasonable terms; or (b) material changes in TEP's cost of service for Commission regulated services resulting from federal, tribal, state or local laws, regulatory requirements, judicial decisions, actions or orders. Except for the changes otherwise specifically contemplated by this Agreement, unbundled and Standard Offer rates shall remain unchanged until at least December 31, 2008.

13.5 Each provision of this Settlement Agreement is in consideration and support of all the other provisions, and expressly conditioned upon acceptance by the Commission without change. In the event that the Commission fails to adopt this Settlement Agreement according to its terms, this Settlement Agreement shall be deemed withdrawn and the parties shall be free to pursue their respective positions in these proceedings without prejudice.

13.6 This Settlement Agreement shall not preclude TEP from requesting, or the Commission from approving, changes to specific rate schedules or terms and conditions of service, or the approval of new rates or terms and conditions of service, that do not significantly affect the overall earnings of the Company or materially modify the tariffs or increase the rates approved in this Settlement Agreement. Nothing contained in this Settlement Agreement shall preclude TEP from filing changes to its tariffs or terms and conditions of service which are not inconsistent with its obligation under this Settlement Agreement.

14. MISCELLANEOUS PROVISIONS.

14.1 This Settlement Agreement represents an attempt to compromise and settle disputed claims in a manner consistent with the public interest. Nothing contained in this Settlement Agreement is an admission by any of the Parties that any of the positions taken, or that might be taken by each in a formal proceeding, is unreasonable. In addition, acceptance of this Settlement Agreement by the Parties is without prejudice to any position taken by any party in these proceedings.

14.2 The Parties agree that they shall make all reasonable and good faith efforts necessary to (a) obtain final approval of this Settlement Agreement by the Commission; and (b) ensure full implementation and enforcement of all the terms and conditions set forth in this Settlement Agreement. Neither the Parties nor the Commission shall take or propose any action which would be inconsistent with the provisions of this Settlement Agreement. All parties shall actively defend this Settlement Agreement in the event of any challenge to its validity or implementation.

14.3 To the extent that any provision of this Settlement Agreement is inconsistent with any existing or future Commission order, rule or regulation or is inconsistent with the Electric Competition Rules as now existing or as may be amended in the future, the provisions of this Settlement Agreement shall control and the approval of this Settlement Agreement by the Commission shall be deemed to constitute a Commission-approved variation or exemption to any conflicting provision of the Electric Competition Rules.

14.4 The provisions of this Settlement Agreement shall be implemented and enforceable notwithstanding the pendency of a legal challenge to the Commission's approval of this Settlement Agreement, unless such implementation and enforcement is stayed or enjoined by a court having jurisdiction over this matter. If any portion of the

Commission's Approval Order or any provision of this Settlement Agreement is declared by a court to be invalid or unlawful in any respect, then (a) TEP shall have no further obligations or liabilities under this Settlement Agreement, including, but not limited to, any obligation to implement any future rate reductions under Section 5.1 not then in effect; and (b) the modifications to TEP's CC&Ns referred to in Section 8.1 shall be automatically revoked, in which event TEP shall use its best efforts to continue to provide noncompetitive services (as defined in the proposed Electric Competition Rules) at then current rates with respect to customer contracts in effect for competitive generation (for the remainder of their term) to the extent not prohibited by law and subject to applicable regulatory requirements.

14.5 The terms and provisions of this Settlement Agreement apply solely to and are binding only in the context of the purposes and results of this Settlement Agreement and none of the positions taken herein by any party may be referred to, cited or relied upon by any other Party in any fashion as precedent or otherwise in any other proceeding before this Commission or any other regulatory agency or before any court of law for any purpose except in furtherance of the purposes and results of this Settlement Agreement.

14.6 The filing of this Settlement Agreement with the Commission shall constitute TEP's compliance with the requirements of Decision No. 61677 that it file with the Commission a plan for stranded cost recovery and unbundled tariffs on or before June 14, 1999.

14.7 The Parties agree and recommend that the Commission schedule public meetings and hearings for consideration of this Settlement Agreement. The filing of this Settlement Agreement with the Commission shall be deemed to be the filing of a formal

request for the expeditious issuance of a procedural schedule that establishes such formal hearings and public meetings as may be necessary for the Commission to approve the Settlement Agreement and that afford interested parties adequate opportunity to comment and be heard on the terms of this Settlement Agreement consistent with applicable legal requirements.

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15. Proposed Order.

15.1 Within thirty (30) days of the filing of this Settlement Agreement, TEP shall file with the Commission a Proposed Form of Order approving this Settlement Agreement. TEP shall confer with the Parties prior to filing the Proposed Form of Order.

DATED as of this _____ day of June, 1999.

TUCSON ELECTRIC POWER COMPANY

By: _____

Title: _____

TUCSON ELECTRIC POWER COMPANY

Tucson, Arizona

Filed by: Steven J. Glaser

Title: Vice President, Rates & Regulatory Support

District: Entire Electric Service Area

Tariff No. RIDER NO. 1-ADDENDUM

Sheet No. 1 of 1

Revision No. _____

Effective: _____

ADDER ASSOCIATED WITH MGC -- RIDER NO. 1
(ADDENDUM-REVISED)

(all prices in mills per kWh)

Residential & General Service (to 200 kW); (Rates 1 & 10)

Summer kWh up to 115% of winter kWh	3.84
Summer kWh greater than 115% but less than or equal to 145% of winter kWh	4.44
Summer kWh greater than 145% but less than or equal to 175% of winter kWh	5.04
Summer kWh greater than 175% but less than or equal to 205% of winter kWh	5.64
Summer kWh greater than 205% of winter kWh	6.24

Large General Service (over 200 kW); (Rate 13)

Summer kWh up to 106% of of winter kWh	3.00
Summer kWh greater than 106% but less than or equal to 136% of winter kWh	3.48
Summer kWh greater than 136%	3.96

Large Light & Power Rate 14 and Contract Customers

Liquid Air	3.00
Fort Huachuca	3.00
Arizona Portland Cement	3.00
IBM	3.00
Asarco Mission 1	3.00
Asarco Mission 2	3.00
Asarco Silverbell	3.00
Cyprus	3.00
University of AZ (Main)	3.00
University of AZ (Medical)	3.00
University of AZ (Heating & Refrig.)	3.00
Burr Brown	3.00
DM AFB	3.00
Raytheon	3.00

1 Thank you.

2 HEARING OFFICER RUDIBAUGH: Tucson
3 Electric.

4

5 CROSS-EXAMINATION

6

7 Q. (BY MR. CARROLL) Dr. Rosen, Brad Carroll
8 for Tucson Electric Power. Good afternoon.

9 A few preliminary questions. Prior to
10 making your recommendations as set forth in your
11 testimony as filed, did you review any of the prior
12 rate case orders as they related to Tucson Electric
13 Power since rate proceedings from 1989 forward?

14 A. No, I did not.

15 Q. Did you have a chance to review any of
16 TEP's lease arrangements with respect to
17 Springerville Unit 1 or Irvington generating
18 stations?

19 A. No, I didn't.

20 Q. Or one last thing, any of the indenture as
21 it relates to TEP's two-county financing?

22 A. No.

23 Q. On Page 64 of your testimony, you briefly
24 discuss what I'll call FASB 71 implications; is
25 that correct?

1 A. Yes.

2 Q. And starting on Line 10, you state that:
3 FASB 71 allows regulators to create assets,
4 regulatory assets, by deferring to future periods
5 by making recoverable in rates certain costs which
6 would otherwise be charged to expenses under
7 generally accepted accounting principles.

8 Is that a correct reading of your
9 testimony?

10 A. Yes.

11 Q. Continuing on Line 13, you state that:
12 Since FASB 71 will be discontinued due to electric
13 industry restructuring and utilities would
14 essentially have to charge to retained earnings all
15 generation related regulatory assets not in rates,
16 this could have a significant impact on stranded
17 costs.

18 Is that correct?

19 A. Yes.

20 Q. Dr. Rosen, based upon this testimony, it
21 would appear that only regulatory assets are
22 FASB 71 issue. Isn't it true that FASB 71 also
23 allows other generation assets to be carried out on
24 a utility's regulatory books, and if those assets
25 are impaired so that their recovery for regulatory

1 rates cannot be somewhat assured, those assets must
2 be written down to their fair market value?

3 A. Yes, that's my understanding.

4 Q. Dr. Rosen, in your direct testimony, you
5 did a stranded cost analysis for TEP for
6 illustrative purposes; is that correct?

7 A. Yes.

8 Q. What I'm going to do is I'm just going to
9 focus on TEP, obviously. On Page 25 of your direct
10 testimony, you indicated that you used TEP's FERC
11 Form 1 for your stranded cost numbers; is that
12 correct?

13 A. Yes, that was the basic source of data for
14 the unbundling exercise that appears in the
15 exhibit.

16 Q. And again, I'm aware that you did this only
17 for illustrative purposes, but are you aware that
18 certain regulatory assets would not be reflected on
19 FERC Form 1 as they are off the balance sheet for
20 GAAP but on TEP's regulatory books?

21 A. Well, let's just say I was concerned that
22 that might be the case. I did not have a chance to
23 investigate that as totally as, of course, I would
24 if this were a final determination of TEP's
25 stranded costs. And any regulatory assets that I

1 may have missed would first, of course, have to be
2 added to generation and could be folded into the
3 stranded cost result.

4 Q. And subject, again, to obviously your check
5 and review of that, in terms of TEP's excess
6 capacity deferrals, post-retirement benefits, some
7 of its above market fuel contracts, are you aware
8 that those regulatory assets that I just mentioned
9 total approximately \$100 million?

10 A. Again, I got an inkling of that from your
11 witnesses' testimony, but I was not aware of the
12 exact sum, no.

13 Q. So not counting the discount factor that I
14 know that you ultimately would have applied, your
15 numbers were off by about \$100 million, at the very
16 least?

17 A. That could be the case. I wanted to look
18 in more detail and think about the appropriate
19 allocation to generation, but certainly that's
20 possible.

21 Q. Now, on Page 9 of your testimony, starting
22 on Line 19, you state: I have concluded that of
23 these three utilities, only TEP may have a
24 significant level of positive stranded costs. This
25 is because the ratepayers have already paid off any

1 uneconomic costs that previously existed on the APS
2 and SRP systems.

3 Let me ask you this: With respect to APS
4 in that statement that I just read you, are you
5 aware in its last rate proceeding the Commission
6 permitted APS to accelerate the amortization of
7 regulatory assets that would be potentially
8 strandable?

9 A. Yes. And, in fact, I think I mentioned
10 that earlier this morning.

11 Q. Are you aware as to whether TEP has, was or
12 has been afforded the same opportunity?

13 A. My understanding was they have not.

14 Q. However, you also state in your testimony
15 that you do not believe that accelerated
16 depreciation is an acceptable way to mitigate
17 stranded costs; is that correct?

18 A. That's right. I do not generally support
19 that approach to what I want to call mitigation of
20 stranded costs. Of course, in my testimony I want
21 to make it clear that's not what I call true
22 mitigation, it's just ratepayers pay the costs
23 later, so it doesn't mitigate anything.

24 Q. You call this an example of soft cost
25 shifting in your testimony?

1 A. That's correct.

2 Q. Do you believe the Commission should adopt
3 a plan that would give advantages to one utility
4 and not another?

5 A. No, I think the Commission should be fair.

6 Q. Now, isn't it also true that by utilizing
7 accelerated depreciation while keeping rates
8 constant, as a possible mitigation approach, that
9 ratepayers are funding recovery for assets that
10 they otherwise would be obligated to fund over a
11 shorter period of time, without putting upward
12 pressure on rates?

13 A. If I understand your question correctly --
14 actually, maybe you'll have to repeat it. It
15 seemed to me there were a couple of --

16 Q. Isn't it also true that by utilizing
17 accelerated depreciation while keeping rates
18 constant, as a possible mitigation approach, that
19 ratepayers are funding recovery for assets that
20 they would otherwise be obligated to fund under
21 regulation over a shorter period of time, without
22 putting upward pressure on a rates?

23 A. Yes, the shorter period of time that I
24 think is as ambiguously you wrote it, what it is,
25 if accelerated depreciation and accelerated

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1 recovery of the costs means you're collecting those
2 costs that they would otherwise be obligated to pay
3 in a shorter period of time. I think that's what
4 you meant, right. And yes, I mean, it's possible
5 that it could be done, quote, without putting
6 upward pressure on rates, i.e., by keeping rates
7 constant.

8 But, of course, what that means is that if
9 there were no accelerated depreciation, rates could
10 have gone down otherwise. And one reason I oppose
11 accelerated depreciation other than the fact that
12 in theory, you know, it's just cost shifting, it
13 also shifts costs over, I mean primarily shifts
14 costs over time, and therefore ratepayers could
15 have benefited from a rate decrease and didn't have
16 that opportunity, and it often leads to
17 overrecovery of stranded costs, or at least could
18 have that additional implication.

19 Q. Dr. Rosen, for TEP, who has positive
20 stranded costs, you propose not less than basically
21 a 50/50 sharing of stranded costs between
22 ratepayers and shareholders; is that correct?

23 A. Yes.

24 Q. Now, Doctor, let's assume that TEP has gone
25 through its specific stranded cost proceeding and

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1 at the end of the hearing, the Commission
2 determines TEP's stranded costs to be \$1 billion.
3 And I just picked that because it's a round
4 number.

5 Now, correct me if I'm wrong, but under
6 your proposal, TEP shareholders would only have the
7 opportunity to recover 50 percent of that amount,
8 or \$500 million; is that correct?

9 A. Yes, in present value terms.

10 Q. And to the extent that other generation
11 assets would be required under FASB 71 to be
12 written down to market, this could result in
13 additional write-offs beyond the 500 million or 50
14 percent level; is that correct?

15 A. I don't see where it would lead to
16 additional write-offs. It seems to me it would
17 lead to write-offs corresponding to the lack of
18 recovery of the 500 million.

19 Q. Well, if TEP was -- if the Commission came
20 out and said TEP will only have the opportunity to
21 recover \$500 million, it would be required to write
22 off \$500 million under FASB 71; would you agree
23 with that?

24 A. Right, that's what I was saying.

25 Q. To the extent that there were any

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1 additional generation assets, and keep in mind that
2 the original determination was a billion dollars,
3 so to the extent that there were additional
4 generation assets not covered in the original \$500
5 million, wherein FASB 71 required them to be
6 written down to market, isn't it true that the
7 potential would be that there would be in excess of
8 a 50 percent write-off?

9 A. That's what I'm not understanding. I'm not
10 clear where the additional write-off would be
11 required to come from, because it's only the 500
12 million that the Commission is not allowing to be
13 recovered.

14 Of course, ultimately, it didn't lead to a
15 \$500 million loss to the utility stockholders, of
16 course, the federal taxpayers share in the loss as
17 well.

18 Q. I'm sorry, did you just say that TEP's
19 stockholders would not have to absorb that
20 \$500 million write-off?

21 A. That's right, it would not cost them
22 500 million, because when you write off the loss
23 then you're paying a lot less federal tax, and
24 federal taxpayers are unwilling participants in the
25 sharing.

1 Q. So the write-off, in your opinion, because
2 of the tax implications, would be somewhere between
3 500 million, something north of 500 million,
4 because of the tax effect?

5 A. North, will you define north?

6 Q. In excess of 500 million.

7 A. No, saying the write-off -- my
8 understanding is the write-off would be roughly
9 500 million. I don't see where any additional
10 write-off would come from.

11 I was saying that, in addition, we need to
12 understand that when there is a write-off of any
13 kind of income, future income, that leads to less
14 than the 500 million in this case loss to the
15 shareholders because the federal taxpayers are, as
16 I say, implicitly sharing in the loss, i.e., the
17 company has less earnings and pays less taxes.

18 Q. So then you would not agree, then, that
19 there would be, if TEP had to go off FASB 71 to the
20 tune of a \$500 million write-off, that it would not
21 have to take a \$500 million hit to its equity
22 accounts?

23 A. No. It would be less. The loss to the
24 equity accounts would be less than 500 million.

25 Q. If TEP were to take -- let's just assume

1 that, let's assume a \$500 million hit to equity
2 being in round numbers again. If TEP was to take a
3 \$500 million hit to equity, under your proposal,
4 would TEP's equity be negative?

5 A. I'd have to check. I don't know.

6 Q. I think Mr. Bayless testified the other day
7 that he believed that TEP's equity was
8 approximately \$200 million. Assuming that's
9 correct, just for illustrative purposes, if TEP had
10 to take a \$500 million hit on a \$200 million
11 positive equity, it would have a negative
12 \$300 million equity account. Would you agree?

13 A. That's possible. I mean, I haven't
14 checked.

15 Q. Are you also aware that TEP is also, at
16 this time, approximately 90 percent debt?

17 A. Again, I haven't checked.

18 Q. If TEP was forced under this situation,
19 under this hypothetical, to write off the
20 500 million, would you agree, then, that this could
21 negatively impact the financial condition of the
22 company?

23 A. Certainly.

24 Q. Would you agree that its credit rating
25 could be negatively affected?

1 A. Certainly.

2 Q. Its ability to access the capital markets,
3 the company would have to pay more for debt?

4 A. Certainly, yes.

5 Q. More for equity?

6 A. Yes.

7 Q. It could potentially trigger loan or lease
8 covenants?

9 A. Certainly, that may be. Many
10 implications. Of course, I'm reminded the
11 \$500 million write-off is your --

12 Q. I understand that.

13 Could potentially put the company in a
14 Chapter 11 situation if the revenue stream was
15 impacted to the extent that TEP could not meet its
16 obligations?

17 A. That's possible.

18 Q. Is this consistent with your statement on
19 Page 78, Line 25, where you state that you believe
20 there will be no significant impact on debt
21 repayment even if there is significantly less than
22 100 percent stranded cost recovery?

23 A. It's consistent except for the fact that
24 you've come up with the numbers you want to use for
25 this example.

1 Q. I understand. I understand.

2 A. If the numbers are a lot smaller, then my
3 statement could be consistent with the fact that
4 there would be no problem in the recovery. It
5 depends on the size of the potential write-off.

6 Q. If, hypothetically, my numbers were
7 correct, then would your statement be accurate?

8 A. Clearly, my statement is a function of how
9 big the potential write-off is in terms of what the
10 financial impact of the company would be.

11 Q. Let me read this to you again. You state
12 you believe there will be no significant impact on
13 debt repayment, even if there is significantly less
14 than 100 percent stranded cost recovery.

15 If my hypothetical was correct, using the
16 billion dollars with the half a billion dollar
17 write-off and a hit to the equity account, is your
18 statement still accurate?

19 A. Again, that conclusion I reached was based
20 more on the range of my numbers than yours. But
21 no, it clearly -- I should have, to be more
22 precise, I should have said that that conclusion
23 would be a function of the size of any potential
24 write-off.

25 MR. CARROLL: I don't have anything

1 further. Thank you very much, sir.

2 HEARING OFFICER RUDIBAUGH: Mr. Meek.

3

4

CROSS-EXAMINATION

5

6 Q. (BY MR. MEEK) Dr. Rosen, Bill Meek from
7 Arizona Utility Investors Association.

8 Let me just pick right up where Brad was.

9 Well, I'm going to ask you a couple general
10 questions to start off about your testimony, and to
11 begin with, right off the bat here, your summary,
12 you say that an initial 50/50 split between
13 shareholders and ratepayers is a reasonable
14 approach. What tells you that that's reasonable?

15 A. Well, I think it just sort of, on its face,
16 represents a balancing where each party, if you
17 call them parties, to the issue roughly is treated
18 equally. In fact, as I just pointed out, if a
19 write-off occurs against utility income, in fact,
20 the shareholders take less than a 50 percent share.

21 Q. I thought you indicated to Mr. Wheeler, as
22 a matter of fact, that the shareholders' part of
23 this could never rise higher than 50 percent under
24 your formulation.

25 A. That's what I'm proposing, that the

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