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December 17, 2010

Arizona Corporation Commission

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AZ CORP COMMISSION
DOCKET CONTROL

Commissioner Sandra D. Kennedy
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

RE: Docket No. ACC 00000A-10-0466

Dear Commissioner Kennedy:

Tucson Electric Power Company ("TEP"), UNS Electric, Inc. ("UNS Electric"), and UNS Gas, Inc. ("UNS Gas"), collectively referred to as the "Companies," hereby jointly file their response to your letter dated November 18, 2010 regarding potential modifications to the utility ratemaking process in Arizona.

The Companies believe that, in light of current circumstances, there are modifications to the ratemaking process that, if implemented appropriately, can benefit public service corporations, customers and regulators. Public service corporations have the ongoing obligation to provide safe and reliable utility service. In order to do so, they must be financially viable and able to attract capital at reasonable terms. Customers rely upon utility service and expect public service corporations to prudently manage their business and costs. Rate regulators, such as the Arizona Corporation Commission (the "Commission"), have the responsibility to set just and reasonable rates in a manner that provides public service corporations with a meaningful opportunity to recover their costs and earn the authorized return on investment.

When public service corporations are unable to recover costs and earn the authorized return on investment, for whatever reason, the companies and their customers suffer the negative consequences. Those consequences include increased costs, a degraded financial condition and a diminution in services. These impacts frequently contribute to an increase (and sometimes a "pancaking") of rate case applications.

There are various factors that tend to erode a public service corporation's ability to recover costs and earn the authorized return on investment. One factor that has been identified in your letter and addressed in many jurisdictions is regulatory lag. There are many causes of regulatory lag, including but not limited to, budgetary and manpower deficits, multiple ongoing ratemaking proceedings, and the use of historical test years.

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The perception that the current time clock rules need to be reviewed and modified, in order to appropriately balance the interests of the Commission, consumers and utility companies, is accurate. The Companies had identified this issue and proposed some initial solutions in a letter from Mr. Raymond S. Heyman to Mr. Steven Olea, Director of the Commission's Utilities Division, dated April 26, 2010. In that letter, which is attached for your review, the Companies suggested some ways to immediately reduce regulatory lag without making any modifications to the existing time clock rules. While the Companies believe that proposal is a good first step, the Companies support the Commission's further efforts to review the ratemaking process and to take steps to provide a more holistic solution to regulatory lag.

Your letter poses four potential solutions to the regulatory lag problem. The first proposal would be to maintain the status quo. However, a general dissatisfaction with the status quo in processing rate cases, combined with concerns about budget constraints exacerbating that issue, is the focal point your letter. The Companies agree and believe that the status quo is no longer in the public interest.

Currently, the Commission's rules of practice and procedure provide for a process whereby public service corporations can request interim rates be put in place in the event permanent rates are not in effect thirteen months after a rate case application has been filed with the Commission. A.A.C. R14-2-103(H)(11)(h); see also A.R.S. Sec. 40-256. In practice, this rule provides little, if any, relief and is counterproductive. The time and resources required to request, adjudicate and implement interim rate relief should be dedicated to processing the permanent rate application. Thus, this rule would be more effective if interim rates became effective automatically after the passage of the thirteen month period.

The second proposal would implement interim rates at the expiration of 365 days from the notice of sufficiency. The precise amount of interim rates is not settled in the proposal and interim rates could be subject to refund. The Companies believe that of the four proposals, this one provides the best foundation for a solution. However, the details of this proposal should be refined in harmony with your stated goal of reaching a remedy that appropriately balances customer and utility interests. The third and fourth proposals are variations of the second proposal that change the timing, amount and terms of refundability of interim rates.

The Companies believe that the Commission should hold open meetings where a full range of remedies for regulatory lag can be discussed by affected stakeholders. This will allow parties to provide the Commission with additional information to consider in reaching solutions. Information regarding remedies to regulatory lag applied in other jurisdictions can provide important insight into the potential solutions for Arizona. For example, many jurisdictions utilize interim rates to counteract regulatory lag. The experience of those jurisdictions can help the Commission determine if it will utilize interim rates and how to do so in the public interest.

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Additionally, some jurisdictions that use a historic test year mitigate regulatory lag by allowing Companies to include construction work in progress ("CWIP") and post test year plant in rate base. Another important tool used to deal with effects of regulatory lag in many jurisdictions is the filing of a projected (or "future") test year. Again, affected stakeholders should have the opportunity to present the Commission with information regarding how future test years have been used to provide adequate and timely rate relief in other jurisdictions.

Interim rates are one of many tools that the Commission may use to improve the adequacy and timeliness of rate relief. Other mechanisms, such as the allowance of construction work in progress, post test year plant and future test years, individually and collectively, also can achieve those improvements. Regarding the proposals in your letter and the other solutions referenced in this letter, it is important to note that those solutions are not mutually exclusive and in its review of this issue the Commission should consider the benefits of using a combination of these measures to improve the rate making process.

The Companies request that the Commission schedule open meetings for affected parties to present a broad range of proposals for modifying the ratemaking process to alleviate regulatory lag. The Companies look forward to providing the Commission additional information, including remedies implemented in other jurisdictions, to assist in the improvement of the ratemaking process.

If you have any questions, or request additional information, please do not hesitate to contact me.

Sincerely,



Philip Dion

cc: Docket Control (Original and 13 copies)
Chairman Kristin K. Mayes
Commissioner Gary Pierce
Commissioner Paul Newman
Commissioner Bob Stump
Ernest Johnson
Lyn A. Farmer
Janice Alward
Steve Olea
Rebecca Wilder

Attachment

ATTACHMENT



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Raymond S. Heyman
Senior Vice President and
General Counsel

Office: (520) 884-3635
Fax: (520) 884-3612

April 26, 2010

APR 29 2010

Mr. Steven Olea
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

RE: RATE CASE APPLICATION ADJUDICATIONS

Dear Steve:

Pursuant to our recent conversations, I propose for your consideration a process for adjudicating rate cases within the timelines set forth in Arizona Administrative Code ("AAC") R14-2-103. The process is straightforward and would not require any amendment to any existing rule or regulation.

Background

AAC R14-2-103 provides, among other things, the following schedule for adjudication of rate case applications:

Upon filing a rate case application, the utility will also submit specified supporting schedules and direct testimony. (A.3.g)¹

Within thirty (30) days after receipt of the rate case application, Arizona Corporation Commission ("Commission") Utilities Division Staff ("Staff") shall file notice that the application is either sufficient or deficient. If no notice is filed, the application is deemed sufficient on the 31st day. (B.7)

Within thirty (30) days of the sufficiency of the application, a procedural schedule is submitted by the Administrative Law Judge. (B.11.a)

¹All references are to subsections of AAC R-14-2-103.

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Staff Testimony is filed within one hundred eighty (180) days of sufficiency. (B.11.b)

A recommended opinion and order is filed at least twenty (20) days prior to the last regularly scheduled open meeting before the final order deadline date. (B.11.c)

For Class A utilities, a final order that disposes of all issues is voted on and effective three hundred sixty (360) days from sufficiency or the application ("the final order deadline date"). (B.11.d)

If a hearing is held, the final order deadline date shall be extended three (3) days for every day of hearing held. (B.11.f)

If a final order is not issued by the final order deadline date, the utility may request a hearing to consider putting new rates in effect on an interim basis and subject to refund. The order shall be issued within sixty (60) days of the request (plus the number of days spent in hearing the request). (B.11.h)

AAC R14-2-103 also provides flexibility with regards to (i) Staff assistance to the utility in filing a rate application (B.10); (ii) additional information that can be filed with an application (A.2); and (iii) utility pre-filing notice which would allow the Commission to open a docket and assign a hearing date, etc. prior to the actual application filing date. (A.3.g)

Proposal

Not later than ninety (90) days prior to the filing of a rate case application, the utility will meet with Staff representatives to discuss the proposed rate case application and to present a general overview of the issues to be addressed in the filing.

Not later than thirty (30) days prior to the filing of a rate case application, the utility will file with Docket Control a Notice of Intent to File Rate Case Application ("Notice of Intent"). This filing will provide an overview of the utility's anticipated requests and issues to be addressed. The Notice of Intent will also request that a docket be opened in the matter. A copy of the Notice of Intent will be provided to all intervenors who participated in the utility's most recent rate case as well as Staff and the Residential Utility Consumer's Office ("RUCO").

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Upon filing a rate case application, the utility will also file with the Commission (i) supporting schedules and testimony; (ii) supporting work papers; and (iii) responses to the Uniform Rate Case Data Requests. A copy of the proposed Uniform Rate Case Data Requests is attached hereto.

Not later than thirty (30) days after the utility files its rate case application, Staff shall submit its notice of sufficiency or deficiency.

Within seven (7) days after sufficiency of the rate case application, the Commission Hearing Division shall issue a procedural order setting forth a schedule that identifies all dates, including the date upon which new rates will go in to effect (on or before the 360th day after the date of sufficiency).

Next Steps

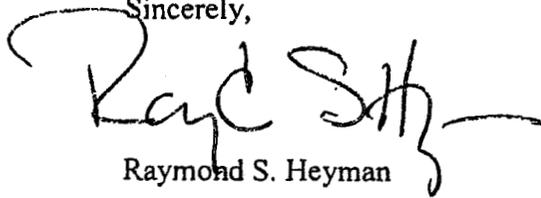
Steve, as indicated, I have attached proposed versions of both the Notice of Intent to File Rate Case Application and the Uniform Rate Case Data Requests. Please review them and provide me with any modifications that you feel are appropriate.

We also discussed the concept of having the utility pay a rate case filing fee in an amount prescribed by the Commission. The filing fee would be dedicated for use by Staff in order to hire consultants to work on the utility's rate case, and would be included in the utility's rate base in the case for recovery. If that is still something you would like to include in this process, we should discuss potential fee amounts and ways to ensure that the funds are protected for use by Staff for hiring consultants to work on the rate case.

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I look forward to continuing our discussions on this important matter. Please feel free to contact me with any questions or comments. I will contact your office to schedule another meeting to address this proposal.

Sincerely,

A handwritten signature in black ink, appearing to read "Ray S. Heyman". The signature is fluid and cursive, with a long horizontal stroke extending to the right from the end of the name.

Raymond S. Heyman

RSH:mi
Attachments
cc: Ernest Johnson
Phil Dion