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**BEFORE THE ARIZONA CORPORATI
COMMISSION**

COMMISSIONERS

BOB STUMP- CHAIRMAN
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

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ARIZONA CORPORATION COMMISSION
SECRET CONTROL

IN THE MATTER OF THE APPLICATION OF)
TUCSON ELECTRIC POWER COMPANY FOR)
THE ESTABLISHMENT OF JUST AND)
REASONABLE RATES AND CHARGES)
DESIGNED TO REALIZE A REASONABLE)
RATE OF RETURN ON THE FAIR VALUE OF)
ITS OPERATIONS THROUGHOUT THE STATE)
OF ARIZONA.)

DOCKET NO. E-01933A-12-0291

**TUCSON ELECTRIC POWER COMPANY'S
INITIAL POST-HEARING BRIEF**

Arizona Corporation Commission

DOCKETED

MAR 22 2013

DOCKETED BY *JM*

March 22, 2013

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1 Tucson Electric Power Company (“TEP” or “Company”), through undersigned counsel,
2 hereby submits its Initial Post-Hearing Brief in support of the Settlement Agreement dated
3 February 4, 2013 (as updated March 1, 2013) (the “Settlement Agreement”).¹

4 **I. INTRODUCTION.**

5 The record in this case establishes that the Settlement Agreement is in the public interest
6 and should be approved in its entirety and without modification by the Arizona Corporation
7 Commission (“Commission”). The Settlement Agreement provides real and significant benefits to
8 TEP’s customers, employees and shareholders. For example, the Settlement Agreement provides
9 benefits that include, but are not limited to the following:

- 10 • A limited first year bill impact (less than \$3.00 per month for a residential customer
11 using an annual average of 767 kilowatt-hour (“kWh”) per month) despite the fact
12 that TEP’s current rates will have been in effect for almost 5 years at the time the
13 new rates go into effect;
- 14 • A deferral of the 2013 Purchase Power and Fuel Adjustment Clause (“PPFAC”)
15 reset in order to synchronize the change in the PPFAC rate with the change in rates
16 approved in this docket;
- 17 • A lower percentage rate impact on small commercial customers than the other
18 customer classes;
- 19 • Increased bill assistance for low income customers;
- 20 • An Energy Efficiency Resource Plan (“EERP”) proposal that provides rate
21 treatment for investments in energy efficiency in a manner similar to rate treatment
22 for investments in other generation resources and that reduces the Demand Side
23 Management Surcharge (“DSMS”) and the rate impact to the customer;
- 24 • Resumption of energy efficiency programs during the pendency of this rate case;
- 25 • An Environmental Compliance Adjustment (“ECA”) mechanism (with a cap) that
26 allows recovery of government-mandated environmental compliance costs in a
27 manner that “smoothes” the rate impact of such compliance;
- A narrowly-tailored Lost Fixed Cost Recovery (“LFCR”) mechanism that supports
energy efficiency (“EE”), demand side management (“DSM”) and distributed
generation (“DG”) at any level or pace set by this Commission;

¹ Admitted as Ex. TEP-1; see Tr. at 101.

- 1 • A fixed cost LFCR rate option for residential customers preferring to pay a
2 specified charge for lost fixed costs rather than the usage-based LFCR charge;
- 3 • Rate simplification and consolidation; and
- 4 • Clarifications to the Company's Rules and Regulations.

5
6 These benefits were negotiated by the signatories to the Settlement ("Signatories") in good faith as
7 an integrated and comprehensive package. TEP's participation in the Settlement Agreement is
8 predicated on the economics of the terms and conditions as agreed to by the Signatories. No
9 Signatory to the Settlement Agreement has proposed any modification to those terms and
10 conditions and the evidence in the record of this case does not support any such change.
11 Accordingly, the evidence supports approval of the Settlement Agreement as executed.

12 **II. THE SETTLEMENT PROCESS WAS OPEN, TRANSPARENT AND FAIR TO**
13 **ALL PARTIES.**

14 The testimony and exhibits in the record of this proceeding clearly establish that the pre-
15 filing meetings, multiple technical conferences and the settlement negotiations were open and
16 transparent. In particular, the open and transparent nature of the settlement negotiations served as
17 a check and balance that ensured that all interested parties had an opportunity to participate and to
18 be heard on the terms and conditions of the Settlement Agreement. This process also ensured that
19 the final Settlement Agreement is balanced, fair, just and reasonable, and in the public interest.

20 The testimony at the hearing confirmed that the negotiation process was fair, open and
21 transparent.² For example, prior to the July 2, 2012 filing of the rate case, TEP has several pre-
22 filing meetings with the Commission's Utilities Division ("Staff") and the Residential Utility
23 Consumer Office ("RUCO"). The Company also invited interested parties and stakeholders to a
24 meeting in Tucson where TEP summarized its proposed rate case application and addressed
25 questions about the application and the process. In the fall of 2012, TEP conducted four (4)
26 technical conferences on the various aspects of its rate case application and had numerous

27

² See, e.g., Ex. S-15 (Olea Settlement) at 4-6; Ex. RUCO-1 (Quinn Settlement) at 2-4.

1 discussions with various stakeholders.³ In addition to the Company and Staff, there were 18
2 intervenors (15 of which ultimately became Signatories to the Settlement Agreement)
3 representing a broad range of interests in various aspects of the rate case application. TEP
4 initiated, and Staff hosted, several settlement meetings where those interested parties that could
5 not attend in person, were able to participate telephonically and were given access to all of the
6 documents discussed at the meetings via TEP's electronic data room.⁴

7 The open and transparent nature of the negotiation process provided a forum where parties
8 were able to raise, discuss and resolve a broad range of issues. At the evidentiary hearing, the
9 parties described the complexity of the issues involved in this case, and the potentially highly
10 contested nature of some of those issues. Yet, as described by several witnesses at the hearing,
11 those issues were ultimately resolved through this process.

12 The Settlement Agreement is the end result of a process that fostered significant work by
13 Signatories with disparate constituencies and interests. The Settlement Agreement's terms and
14 conditions reflect a balanced resolution of the parties' issues and should be approved as
15 presented to the Commission.

16 **III. THE SETTLEMENT AGREEMENT IS IN THE PUBLIC INTEREST AND**
17 **SHOULD BE APPROVED.**

18 The evidence in the record overwhelmingly demonstrates that the Settlement Agreement as
19 submitted is in the public interest. It resolves numerous complex issues and provides significant
20 benefits to TEP's customers, employees and shareholders, as well as to the Commission and the
21 Signatories. The Settlement Agreement should be approved as expeditiously as possible so that
22 the benefits provided therein can inure to the parties without delay.

23 All parties recognize that TEP needs a rate increase following an almost five-year freeze in
24 base rates in order to continue to provide safe and reliable service.⁵ The evidence in the record
25 clearly established that TEP must make substantial investments in its system over the next five

26 _____
27 ³ Ex. TEP-2 (Hutchens Settlement Direct) at 6.

⁴ Ex. TEP-2 (Hutchens Settlement Direct) at 6.

⁵ See, e.g., Ex. S-15 (Olea Settlement) at 19;

1 years, and the rates set in this case must be sufficient to allow TEP to attract the capital needed to
2 make those critical investments. The rates and adjustors proposed in the Settlement Agreement
3 will provide TEP with the cash flow necessary to maintain facilities and meet demand, while
4 minimizing the base *and* overall rate impacts to our customers.

5 The Settlement Agreement also represents a compromise reached among a very diverse
6 range of interests. Having such diverse interests sign on to the Settlement Agreement confirms
7 that the Settlement Agreement, when taken as a whole, is in the public interest and should be
8 adopted without change. Any material modification to the Settlement Agreement would disrupt
9 that balance and may alter or eliminate a provision that was critical to one of the diverse
10 Signatories.

11 **IV. THE SPECIFIC SETTLEMENT PROVISIONS PROVIDE BENEFITS AND**
12 **RESOLVE DISPUTED ISSUES.**

13 For convenience, set forth below are the major sections of the Settlement Agreement in the
14 order they appear in the Settlement Agreement. Each of these sections represent compromises that
15 were reached in the settlement process and taken as a whole, provide benefits that are in the public
16 interest.

17 **A. Rate Increase (Section II).**

18 As set forth in Paragraph 2.1 of the Settlement Agreement, TEP will receive a non-fuel
19 base rate increase of \$76,194,000 over adjusted test-year retail revenues. This compares to
20 \$127,760,000 requested by TEP in its application in this docket.⁶ The settlement amount also falls
21 within Staff's initial range for a base rate increase of \$75,405,000 and \$84,036,000 and is very
22 similar to AECC's initial proposed base rate increase.⁷ Paragraph 2.3 sets forth the fair value rate
23 base and the revenue requirement underlying the proposed rate increase.

24 Attachment "A" to the Settlement Agreement sets forth the adjustments to TEP's initial
25 revenue requirement that resulted in the Settlement Agreement revenue requirement. This is the
26

27 ⁶ Ex. TEP-2 (Hutchens Settlement Direct) at 9.

⁷ Ex. TEP-2 (Hutchens Settlement Direct) at 9-10; Hearing Transcript ("Tr.") (Higgins) at 247.

1 result of extensive negotiations principally with Commission Staff, RUCO and AECC, which are
2 the parties in the docket that addressed revenue requirement in their Direct Testimony.⁸ Several of
3 the adjustments reflect what one or more of these parties had proposed in that testimony.⁹ Overall,
4 TEP substantially compromised on its revenue requirement request in this case.

5 From TEP's perspective, this increase in revenue requirement, along with the other
6 provisions, will allow TEP to: (i) maintain safe and reliable service throughout its service area;
7 (ii) comply with new environmental regulations; (iii) build necessary infrastructure; and (iv) have
8 a reasonable opportunity to earn its Commission-authorized rate of return.¹⁰ The rate relief
9 provided by the Settlement Agreement, along with other provisions, will also strengthen TEP's
10 underlying financial position and credit metrics, that could ultimately result in higher credit
11 ratings, all of which will help TEP attract capital at reasonable terms, thereby reducing costs and
12 helping to minimize future rate increases to our customers.¹¹

13 Other Signatories agree that the revenue increase is important to maintain TEP as a
14 financially healthy utility.¹²

15 Paragraph 2.2 increases the amount recovered through base fuel rates by \$31,599,730
16 annually, but also explains that the PPFAC rate will be reset on the effective date of the new base
17 fuel rates, which will have the effect of reducing present annual recovery of fuel costs by
18 \$52,750,597. The interplay of the reduction of the PPFAC rate and the new rates is discussed in
19 more detail in the sections below addressing Bill Impact and the PPFAC.

20 **B. Bill Impact (Section III).**

21 The Signatories were sensitive to the overall bill impact on TEP's customers. As a result
22 of the proposed timing of the PPFAC rate reset (including the one-time sulfur credit and San Juan
23 Thermal Event cost deferral), and the DSMS reduction under the proposed EERP, the monthly bill
24 for a residential customer under the R-1 Tariff using the annual average of 767 kWh per month

25 ⁸ Ex. TEP-4 (Dukes Settlement) at 3.

26 ⁹ Ex. TEP-4 (Dukes Settlement) at 3.

27 ¹⁰ Ex. TEP-2 (Hutchens Settlement Direct) at 4.

¹¹ Ex. TEP-2 (Hutchens Settlement Direct) at 11.

¹² See, e.g., Ex. S-15 (Olea Settlement) at 19; Ex. AIC-2 (Yaquinto Settlement) at 2.

1 will increase less than \$3.00.¹³ The timing of the PPFAC reset will offset some of the base rate
2 increase and help mitigate the overall bill impact. Given that TEP has not had a rate increase in
3 almost five years and a meaningful increase was necessary, this offset was described as an
4 “elegant” means to reduce the initial impact on customer and to achieve rate certainty.¹⁴

5 Moreover, the Signatories agreed to a revenue allocation that somewhat mitigated the rate
6 impact on residential and small business customers.¹⁵ The customer class cost of service study
7 (“CCOSS”) revealed that, under current rates, the small general service class contributes a greater
8 return than other classes.¹⁶ Therefore, the Settlement Agreement allocates this class less of a
9 percentage base rate increase (on average) than other customer classes. As a result, the base rate
10 revenue increase allocated to small general service is approximately 1% less than the aggregate,
11 and is the lowest of any customer class.¹⁷ The residential customer class was allocated a base
12 revenue increase that equaled the aggregate percentage increase in order to keep bill impacts
13 reasonable on that class, particularly the low-income customers.¹⁸ As a result of the treatment of
14 those two customer classes, the percent increase allocated to the remaining customer classes (large
15 general service, water pumping, lighting and large light and power) is slightly higher (less than
16 1%) than the aggregate.¹⁹

17 TEP submits that the approach adopted by the Settlement Agreement – and agreed to by
18 the Signatories -- is equitable, while at the same time gradually moving towards matching
19 customer classes to their actual costs.

20
21 ¹³ Ex. TEP-2 (Hutchens Settlement Direct) at 9; Ex. TEP-8.

22 ¹⁴ Tr. (Higgins) at 247.

23 ¹⁵ Attachment “B” to the Settlement Agreement sets forth the base rate non-fuel increase of \$76.194 million
24 and the base rate fuel increase of \$31.600 million allocated to each major customer class (including
25 residential, small general service, large general service, large light and power, lighting and water pumping).
In aggregate, the base rate revenue change averages 13.3% compared to test year base rates. However, this
percentage change in base rates does not take into account the \$52.751 million reduction in fuel rates
resulting from the reset of the PPFAC scheduled to occur on the effective date of new base rates. Ex. TEP-
4 (Dukes Settlement) at 4. When that change is accounted for, the aggregate increase in fuel and non-fuel
revenues is just 2.6%. Ex. TEP-4 (Dukes Settlement) at 4.

26 ¹⁶ Ex. TEP-4 (Dukes Settlement) at 4.

27 ¹⁷ Ex. TEP-4 (Dukes Settlement) at 4.

¹⁸ Ex. TEP-4 (Dukes Settlement) at 4.

¹⁹ Ex. TEP-4 (Dukes Settlement) at 5.

1 **C. Cost of Capital (Section IV).**

2 As set forth in Section IV of the Settlement Agreement, TEP's return on common equity
3 ("ROE") will be 10.0% and its embedded cost of debt will be 5.18% for long-term debt and 1.42%
4 for short-term debt. Using TEP's actual test-year capital structure, the Settlement Agreement
5 adopts a fair value rate of return of 5.05% which includes a 0.68% rate of return on the fair value
6 increment of rate base²⁰.

7 The agreed upon ROE matches the 10% originally proposed by RUCO in this case and is
8 significantly lower than the 10.75% initially requested by TEP. The fair value rate of return is
9 significantly lower than the 5.64% approved in TEP's last rate case, primarily because TEP has
10 been diligent to lower its cost of debt in recent years and because TEP's ROE drops from 10.25%
11 to 10.0%. The rate of return on the fair value increment is significantly lower than the 1.0% rate
12 of return approved for Arizona Public Service Company ("APS") in Decision No. 73183 (May 24,
13 2012) and for UNS Gas, Inc. ("UNS Gas") in Decision No. 73142 (May 1, 2012).

14 **D. Depreciation/Amortization (Section V).**

15 Section V of the Settlement Agreement confirms that the depreciation and amortization
16 rates proposed by TEP in Exhibit REW-1 to Dr. Ron White's pre-filed Direct Testimony should
17 be adopted.²¹ Those rates were not in dispute in this case.

18 **E. PPFAC (Section VI).**

19 This Section addresses several PPFAC issues. First, Paragraph 6.1 sets the base fuel rate at
20 \$0.032335 per kWh to reflect \$300,252,951 in annual fuel and purchased power costs. In a typical
21 rate case, the PPFAC rate would then be reset to zero. However, in this case, the Settlement
22 Agreement provides that a one-time \$3 million credit related to previous sulfur credits and a \$9.7
23 million deferral of costs related to the San Juan Thermal Event (discussed below) will be reflected
24 in the reset PPFAC rate, resulting in a rate of negative \$0.001388 per kWh (i.e. a credit to the bill).

25
26 ²⁰ The fair value increment results from the constitutionally required fair value analysis that the
27 Commission must perform in determining just and reasonable rates. See *Chaparral City Water Company v.*
Arizona Corporation Comm'n, No. 1 CA-CC 05-0002, Memorandum Decision dated February 13, 2007.

²¹ Dr. White's Direct Testimony is included as part of Ex. TEP-7.

1 Therefore, under the Settlement Agreement, the overall fuel rate will be \$0.030947 per kWh upon
2 the effective date of new rates. TEP's current overall fuel rate is \$ 0.036592 per kWh(\$0.028896
3 per kWh base fuel rate + \$0.007696 per kWh PPFAC rate). Thus, on the effective date of the new
4 rates, the overall fuel rate decreases, which is being used to offset the non-fuel base rate increase
5 agreed to in the Settlement Agreement.

6 Second, TEP's existing PPFAC mechanism will continue to collect or refund to
7 customers the actual costs of fuel and purchased power that are above or below the amount
8 included in base rates. The Settlement Agreement modifies the PPFAC to allow the inclusion of
9 certain costs and credits, including lime costs; broker fees; sulfur credits and 100% of revenues
10 from the sale of SO2 emission allowances.

11 Third, the Settlement Agreement states that the Signatories believe it is in the public
12 interest to defer the next reset of TEP's PPFAC rate until the effective date of rates in this
13 docket. That deferral will help mitigate the bill impact of new rates by reducing the True-Up
14 Component portion of the new 2013-14 PPFAC rate (which would otherwise have a significant
15 under-collected bank balance as of April 1, 2013), avoid "yo-yoing" of rates, and reduce
16 customer confusion.

17 **F. EERP (Section VII).**

18 Section VII of the Settlement Agreement sets forth the general parameters for the EERP.
19 A detailed Plan of Administration for the EERP is included in the Settlement Agreement as
20 Attachment "D". The EERP is based on proposals made by both Staff and TEP in their direct
21 testimony.²² Effectively, the EERP is a new way to recover the costs of Commission-approved
22 EE/DSM programs and related budgets.²³ The EERP allows TEP to invest in cost-effective
23 EE/DSM programs and recover those costs, including a return on its investment, but not a
24 performance incentive, from customers through the Commission-approved DSMS over a five
25 year period. Currently, TEP recovers EE/DSM program costs, including a performance
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27 ²² Ex. S-15 (Olea Settlement) at 9.

²³ See Ex. S-15 (Olea Settlement) at 20.

1 incentive, from customers through the DSMS over a one year period and expenses the costs of
2 implementing these programs in that same year.

3 Under the EERP, as TEP invests in cost-effective EE/DSM programs, it will record its
4 investment as regulatory asset and amortize the investments over five years. As set forth in the
5 Plan of Administration, TEP will recover its annual EE amortization expense and a return on the
6 EE investment (based on the Company's approved Weighed Average Cost of Capital
7 ("WACC")) from customers through the DSMS. The Company will only be allowed to recover
8 the costs of its EE/DSM investments if TEP demonstrates that certain performance metrics have
9 been met. The EERP does not bind the Commission to a specific EE policy or standard.

10 Consistent with current practice, annual implementation plans and budgets will be filed
11 with the Commission for review and approval. TEP will be allowed to invest in EE/DSM
12 programs and measures as approved by the Commission, both in terms of programs and budgets.
13 The EERP process is explained in more detail in Exhibit DGH-1 to the Direct Testimony of
14 David Hutchens in Support of the Settlement Agreement and in the detailed EERP Plan of
15 Administration.

16 Under the EERP, the Commission would continue to review and approve annual EE
17 implementation plans and budgets. However, if the Company's investments do not provide results
18 above the minimum expected energy savings and below a targeted price per kWh, then TEP will
19 not be allowed to recover its costs related to EE/DSM programs. To the extent TEP does meet
20 those performance metrics (which are set forth in the EERP Plan of Administration), TEP will
21 collect the authorized costs over a five-year period (instead of the current one-year period). By
22 collecting the annual costs of the EERP over a five year period (instead of the current one year
23 period), the EERP would lower and "smooth" the rate impacts to TEP's customers and better
24 synchronize the benefits of EE/DSM programs with their associated costs. It also aligns the costs
25 and benefits of the programs, which helps reduce any "intergenerational" cost shifting.²⁴

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²⁴ Tr. (Higgins) at 251-52.

1 These two significant differences - putting recovery at risk subject to meeting
2 performance metrics and collecting the costs over five years - provide better customer benefits
3 when compared to the current expensing methodology. Under the EERP, customers will only
4 pay for EE/DSM programs if TEP can show that its investments in those programs have
5 provided quantifiable benefits in accordance with the performance metrics approved by the
6 Commission.²⁵

7 No party to this docket, including SWEEP, opposed the EERP. The EERP presents a
8 reasonable approach to EE cost recovery that spreads the impact to customers over time, rather
9 than having a necessary sharp increase in the DSM surcharge under the existing paradigm to fund
10 the same programs with the same budget.

11 **G. LFCR (Section VIII).**

12 The LFCR is a mechanism narrowly tailored to collect distribution and transmission
13 service costs that would have been recovered through usage lost to EE/DSM programs and DG
14 systems.²⁶ It is not intended to recover lost fixed costs attributable to other factors, such as
15 generation, weather or general economic conditions.²⁷ As such, it is not a full decoupling
16 mechanism. The LFCR will have a 1% year-over-year cap based on total applicable TEP retail
17 revenues and is similar to the LFCR approved by the Commission for other Arizona utilities.²⁸
18 The LFCR will be applied to all customers' bills through a per kWh rate, excluding large light
19 and power, water pumping and lighting customers. For the customer classes exempted from the
20 LFCR, rates have been designed to collect their fair share of the fixed costs through their
21 monthly minimum and/or demand charge.²⁹ There is a detailed Plan of Administration for the
22

23 ²⁵ As discussed in the hearing, the Commission can modify those performance metrics when it approves a
24 specific annual implementation plan. Thus, the approved metrics can change annually. That said, once the
25 Commission has approved the annual implementation plan, then the EE/DSM investments for that year will
be measured against the performance metrics approved by the Commission for that year. See Tr.
(Schlegel) at 485-87.

26 ²⁶ Ex. TEP-2 (Hutchens Settlement Direct) at 13.

27 ²⁷ Ex. TEP-2 (Hutchens Settlement Direct) at 13.

28 ²⁸ The LFCR mechanism is similar to the LFCR mechanisms recently approved by the Commission for
29 APS (Decision No. 73183 (May 24, 2012)) and UNS Gas (Decision No, 73142 (May 1, 2012)).

²⁹ Ex. TEP-2 (Hutchens Settlement Direct) at 13.

1 LFCR included as part of the Settlement Agreement. Under the Plan of Administration, the
2 LFCR charge will not appear on customers' bills until July 1, 2014.

3 Moreover, residential customers who do not want to be charged the standard LFCR
4 variable rate charge based on kWh usage will have the option of choosing a fixed, monthly
5 LFCR charge.³⁰ TEP will implement an extensive customer education and outreach program
6 commencing in 2014 to help customers understand the new LFCR and available options.³¹

7 An LFCR is needed because TEP's current rate structure is designed to recover the
8 Company's authorized revenue requirement primarily through usage-based kWh sales.³² The
9 volumetric rate charged for those sales is calculated based on the system-wide usage, based
10 largely on the sales volumes experienced during the rate case test year.³³ A majority of the costs
11 included in TEP's revenue requirement, however, do not vary with kWh sales, but are fixed in
12 nature.³⁴ Given the current rate structure, when kWh sales decline as a result of EE/DSM
13 programs and DG systems, TEP is unable to recover the fixed distribution and transmission costs
14 that are embedded in its volumetric-based rates. As a result, without a mechanism in place to
15 capture and recover these lost revenues, TEP's rates are inadequate as they do not provide the
16 Company with a reasonable opportunity to recover certain costs or achieve its Commission-
17 authorized rate of return.

18 Finally, the narrower scope of the LFCR and the ability to craft a reasonable residential
19 fixed charge option (the "opt-out" rate) allowed the Signatories to reach the consensus on the
20 LFCR included as part of the Settlement Agreement.

21 **H. ECA (Section IX).**

22 The ECA is a mechanism that will allow TEP to recover a portion of the significant costs
23 required to meet environmental compliance standards imposed by federal or other governmental
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26 ³⁰ Ex. TEP-2 (Hutchens Settlement Direct) at 14.

27 ³¹ Ex. TEP-2 (Hutchens Settlement Direct) at 14.

³² Ex. TEP-2 (Hutchens Settlement Direct) at 14.

³³ Ex. TEP-2 (Hutchens Settlement Direct) at 14.

³⁴ Ex. TEP-2 (Hutchens Settlement Direct) at 14.

1 agencies between rate cases.³⁵ It is very similar to the mechanism that the Commission approved
2 for APS in Decision No. 73183.

3 TEP, and the utility industry in general, is facing an ever-increasing number of rules
4 creating more stringent environmental standards that require the Company to invest an
5 unprecedented amount of capital in its generation resource portfolio over the next five years.³⁶
6 Costs recovered through the ECA will include environmental improvement projects required to
7 comply with current and future federal, state, tribal, and local environmental standards. In
8 general, these environmental standards seek to reduce the emission of certain substances
9 including: SO₂, nitrogen oxide, carbon dioxide, ozone, particulate matter, volatile organic
10 compounds, mercury and other toxics, coal ash and other combustion residuals.³⁷

11 The ECA will provide additional cash flow to help TEP recover the costs of capital
12 additions on a more timely basis and to support credit quality. This can lower financing costs for
13 TEP, which will ultimately benefit our customers. More importantly, the ECA will moderate the
14 impact on our customers by avoiding the large rate increases that would result from deferring
15 these costs to a future rate filing. In addition, the annual amount collected from customers through
16 the ECA capped at 0.25% of TEP's retail revenues, or approximately \$2.3 million.

17 The initial ECA will not appear on customers' bills prior to the first billing cycle in May of
18 2014. Once it does, the rate impact is expected to be nominal.³⁸

19 **I. Springerville Unit 1 (Section X).**

20 TEP currently owns 14% of Springerville Unit 1 and leases the remaining capacity. Under
21 the lease, TEP has an option to purchase the remaining capacity of Springerville Unit 1 in 2015.
22 Section X sets forth the information that TEP will formally provide to the Commission regarding
23 the status of Springerville Unit 1.³⁹

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25 _____
26 ³⁵ Ex. TEP-2 (Hutchens Settlement Direct) at 12.

27 ³⁶ Ex. TEP-2 (Hutchens Settlement Direct) at 12.

³⁷ Ex. TEP-2 (Hutchens Settlement Direct) at 12-13.

³⁸ See Ex. TEP-10 (late-filed)

³⁹ Ex. TEP-2 (Hutchens Settlement Direct) at 21.

1 **J. Procurement (Section XI).**

2 As part of its analysis of TEP's application in this Docket, Staff engaged a consultant to
3 conduct an audit of TEP's PPFAC and a review of TEP's power and fuel procurement practices.
4 Staff's consultant recommended several modifications to TEP's energy procurement program.
5 Attachment H to the Settlement Agreement sets forth the recommendations that have been agreed
6 to by the Signatories.⁴⁰

7 **K. Low Income Programs (Section XII).**

8 The Signatories, particularly Staff, Cynthia Zwick and TEP, spent many hours trying to
9 devise low-income rates that would simplify the myriad of current low-income rates without
10 unduly adversely impacting low-income customers. However, in order to keep bill impacts for
11 low income customers at a level similar to all other residential customers, the Signatories were
12 unable to consolidate the existing 17 Lifeline rates. As a result, the Settlement Agreement
13 proposes rates that mitigate the bill impacts while putting in place a process to slowly modernize
14 those rates. Key elements in the Settlement Agreement include:

- 15 • All new low-income customers will have available to them one of the four
16 standard Residential Service schedules. The total fixed rate discount will
17 increase from \$8.00 per month to \$9.00 per month for these open Lifeline
18 rates;
- 19 • In the hope that at least some of the complex Lifeline rates that have been
20 created over the years will be reduced, the portability of all frozen Lifeline
21 rates will be eliminated;
- 22 • In order to mitigate the impact on the Lifeline customers, the rates
23 maintain the shoulder peak periods for the Lifeline Time of Use ("TOU")
24 rate schedules to minimize the changes to these customers;
- 25 • Low-income customers will now be subject to the PPFAC rate and the
26 Demand Side Management surcharge ("DSMS"); and

27

⁴⁰ Ex. TEP-2 (Hutchens Settlement Direct) at 22.

1 • TEP will provide \$150,000 to fund low-income bill assistance programs.⁴¹
2 These provisions allowed the low-income representative in this case to fully support the
3 Settlement Agreement.⁴²

4 As a result, most low-income customers will see a monthly bill impact in the two-to-three-
5 dollar range. Attachment “I” to the Settlement Agreement details the bill impacts for low-income
6 customers, including the anticipated changes to the PPFAC if those take place when the new base
7 rates go into effect.

8 **L. Nogales Transmission Line (Section XIII).**

9 Section XIII of the Settlement Agreement explains how TEP will seek recovery of the cost
10 of developing the 345kV line between Tucson and Nogales. TEP had requested recovery of those
11 costs in this rate case. However, TEP has now agreed to seek recovery from the Federal Energy
12 Regulatory Commission (“FERC”) before requesting any recovery from the Commission. This
13 provision is not intended to guarantee that TEP will be able to recover through retail rates any
14 costs that are not recovered through a FERC proceeding.⁴³

15 **M. San Juan Thermal Event (Section XIV).**

16 As a result of a fire at the San Juan coal mine, TEP incurred additional fuel costs in its
17 efforts to replace the coal it normally received from the mine. Although fuel costs are typically
18 passed through the PPFAC, the increased costs resulting from the fire may be covered in whole or
19 in part by insurance. Therefore, TEP has agreed to credit the PPFAC and defer recovering any
20 uninsured additional fuel costs until issues regarding the insurance coverage are settled.⁴⁴

21 **N. Rate Design (Section XV).**

22 The Signatories were able to negotiate a rate design in the Settlement Agreement that
23 begins the process of simplifying and modernizing the Company’s rate offerings.⁴⁵ The
24 Settlement Agreement implements many of Staff’s, TEP’s and other intervenors’ rate design

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26 ⁴¹ Ex. TEP-4 (Dukes Settlement) at 9-10; Ex. S-14 (Solganick Settlement) at 8; Ex. TEP-1, Para. 12.3.

27 ⁴² Ex. Zwick-2 (Zwick Settlement) at 2-3.

⁴³ Ex. TEP-2 (Hutchens Settlement Direct) at 22.

⁴⁴ Ex. TEP-2 (Hutchens Settlement Direct) at 23.

⁴⁵ See Ex. S-14 (Solganick Settlement) at 5-7; Ex. TEP-4 (Dukes Settlement) at 6.

1 concepts and provides substantial movement in modernizing the Company's rate design.⁴⁶ The
2 highlights of the agreed-upon rate design include consolidating and simplifying the Company's
3 rate offerings so that the schedules are more closely aligned with its CCOSS while incorporating
4 many other important rate design factors. The one exception is that the Settlement Agreement
5 retains the numerous frozen low-income rate tariffs for the reasons described above.⁴⁷

6 The Signatories also agreed to simplify the Company's TOU offerings in a way that will
7 make them less confusing and more appealing to our customers. The changes include: (i) making
8 the peak times consistent across all classes in recognition that the actual peak times on TEP's
9 system do not vary by class; (ii) eliminating the shoulder period for all non-frozen TOU rate
10 classes; and (iii) reducing the length of the peak period to provide for greater opportunity for
11 customer participation.⁴⁸

12 The Settlement Agreement further adjusts the rate schedules for large customers with a
13 demand charge – by adjusting the demand charges to better reflect the cost to serve, modifying the
14 “ratchet” to be consistent across these classes, and adjusting the per-kWh or “energy” charge for
15 these customers, which in some instances included a decrease.⁴⁹

16 Attachment “J” to the Settlement Agreement provides a detailed account of the rate design
17 changes. The first few pages of that Attachment summarize the settled rate design principles and
18 provide a comparison to the current design. As this portion of Attachment “J” shows, the
19 Signatories agreed to simplify, consolidate and modernize the rate design. The remaining portions
20 of Attachment “J” details the billing determinants, shows the proposed revenues to be obtained by
21 each rate schedule going forward, and details the proposed rates including: (1) the monthly
22 customer charges; (2) the energy charges; (3) base power charges; (4) demand charges (where
23 applicable). Attachment “J” also includes the new tariff language for the surviving rate schedules.

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26 ⁴⁶ See Ex. S-14 (Solganick Settlement) at 10-11.

27 ⁴⁷ Tr. (Solganick) at 512.

⁴⁸ See Ex. S-14 (Solganick Settlement) at 7; Ex. TEP-4 (Dukes Settlement) at 6.

⁴⁹ Ex. TEP-4 (Dukes Settlement) at 6-7.

1 All of these rate design changes lead to a more balanced and equitable rate impact on all
2 customers while reducing the administrative burden and costs for the Company (and ultimately to
3 the customers.) In short, the agreed-upon rate design is reasonable and should be adopted.

4 Finally, the Signatories realize that the substantial consolidation and simplification of rates
5 may have unintended consequences. Therefore, the Settlement Agreement leaves the docket open
6 until July 1, 2014 for the express purpose of possibly adjusting specific tariffs to correct for
7 unanticipated customer impacts, which are not consistent with the public interest. Any such
8 changes, however, must be revenue neutral so that the Company's non-fuel revenue requirement is
9 not adversely impacted.

10 **O. Rules and Regulations (Section XVI).**

11 The changes to the Rules and Regulations are largely as the Company proposed in its July
12 2, 2012 filing. Most of the changes were "clean-up" in nature as they eliminated inconsistencies
13 and ambiguities that occurred over time. The more substantive changes were discussed in the
14 Direct Testimony of Lindy Sheehey filed with the Application in this docket.⁵⁰ In particular,
15 many of the changes were intended to clarify areas for the Rules and Regulations that led to
16 customer inquiries or complaints. Additional changes were incorporated as a result of the
17 settlement negotiations, particularly with Southern Arizona Home Builders Association and Staff.
18 Moreover, pursuant to Paragraph 16.1 of the Settlement Agreement, the Company further
19 discussed its proposed revisions to the Rules and Regulations with Staff during January and
20 February 2013. Exhibit DJD-4 to the Settlement Testimony of Dallas Dukes is a redline version
21 of the changes to the Rules and Regulations that reflects the revisions that TEP and Staff have
22 agreed should be adopted by the Commission. Ex. TEP-6 is a clean version of the revised Rules
23 and Regulations.

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⁵⁰ The Direct Testimony of Lindy Sheehey is part of Ex. TEP-7.

1 **P. GreenWatts Tariff and Statement of Charges (Section XVII).**

2 First, given the Commission’s REST rules, the GreenWatts tariff is no longer necessary
3 since TEP has other similar programs in place. Therefore, the Settlement Agreement provides that
4 the GreenWatts tariff will be cancelled.

5 Second, similar to the Rules and Regulations, the Statement of Charges reflects a
6 negotiated resolution between Staff and TEP for the items set forth in the Statement of Charges.
7 The Statement of Charges also reflects other rate design issues resolved in other sections of the
8 Settlement Agreement.

9 **Q. Quality of Service (Section XVIII).**

10 As part of its rate case analysis, Staff engaged an engineering consultant to review TEP’s
11 plant and operations. As a result of the consultant’s review, Staff identified several issues to
12 ensure continuing quality of service. Section XVIII sets forth what actions TEP will undertake as
13 a result of Staff’s review.⁵¹

14 **R. Compliance Matters (Section XIX).**

15 Some previous Commission orders included compliance requirements without any
16 “sunset” date. Several of those orders are quite old and the compliance requirements are moot,
17 have been supplanted by subsequent orders, or are no longer necessary. The two reporting
18 requirements that are being eliminated date from 1989 and 1990. The reporting requirement that
19 is being modified dates from 1989. Section XIX of the Settlement Agreement (and Attachment
20 “L” thereto) set forth the specific information for each change.⁵² These proposed changes to the
21 reporting requirements are the result of consultation between Staff and TEP.

22 **S. Additional Settlement Provisions (Section XX).**

23 This section includes provisions to address a variety of issues that arose during the course
24 of the settlement discussions, but which are not necessarily being resolved as part of this docket.
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27 ⁵¹ Ex. TEP-2 (Hutchens Settlement Direct) at 23.

⁵² Ex. TEP-2 (Hutchens Settlement Direct) at 23.

1 Paragraph 20.1 is intended to require TEP to propose a similar treatment of the retail space
2 in TEP's headquarters building in the next TEP general rate case. This provision is not intended,
3 however, to bind the Commission to that treatment in the next rate case.

4 Paragraph 20.2 requires TEP to request the opening of a generic docket to address the
5 appropriate treatment of Net Operating Losses in rate cases. This issue may arise more frequently
6 as a result of increased bonus depreciation opportunities and guidance from the Commission
7 would assist the parties in future rate cases.

8 Paragraph 20.3 addresses RUCO's concern about TEP's depreciation reserves.

9 Paragraph 20.4 provides a process for addressing RUCO's concerns about distribution
10 plant. Staff did review TEP's plant and found that it was used and useful. However, this process
11 will provide an on-going dialog with RUCO and Staff about future capital expenditure,
12 particularly on distribution plant. Over the next three years, TEP will meet with Staff and RUCO
13 in the fourth quarter of each year to review its capital expenditure plans.

14 Paragraph 20.5 requires TEP to file a proposed tariff for interruptible rates by August 30,
15 2013 and for Staff to file a Staff Report and Proposed Order for Commission consideration by
16 December 31, 2013.

17 Paragraph 20.6 addresses a request from AECC to consider a rate for very large customers.
18 TEP has agreed to propose such a new rate in its next rate case.

19 **T. Commission Evaluation of Proposed Settlement (Section XXI).**

20 The provisions in Section XXI are similar to general provisions included in other rate case
21 settlement agreements. In particular, these provisions provide the Signatories understanding of the
22 process for consideration of the Settlement Agreement by the Commission.

23 **U. Miscellaneous Provisions (Section XXII).**

24 Section XXII contains miscellaneous provisions regarding the settlement process and the
25 impact on the Signatories of executing the Settlement Agreement.

1 **V. ISSUES NOT ADDRESSED IN THE SETTLEMENT AGREEMENT.**

2 During the course of the settlement process, Staff and TEP discussed additional tariffs that
3 TEP should submit for consideration. Although not included in the Settlement Agreement, TEP
4 has stated on the record that it will file by August 31, 2013 two additional tariffs: (i) a revised
5 Partial Requirements Service (“PRS”) tariffs and (ii) a new “super-peak” TOU tariff.⁵³

6 **VI. TEP REQUIRES RESOLUTION OF ITS ENERGY EFFICIENCY ISSUES.**

7 Over the past two years, TEP has attempted to have an Energy Efficiency Implementation
8 Plan approved by the Commission. During the course of those efforts, numerous issues have been
9 raised and, to date, the Commission has not approved an Energy Efficiency Implementation Plan
10 for TEP since 2010. However, adoption of the Settlement Agreement, including the EERP,
11 resolves this issue.

12 As demonstrated at the public comment sessions held on July 11, 2012 (Docket No. E-
13 01933A-11-0055) and on March 4, 2013 (Docket No. E-01933A-12-0291), as well as by the
14 numerous letters filed in this docket, energy efficiency is widely supported in TEP’s service
15 territory. Although it fully supports the EERP, TEP also recognizes that energy efficiency is a
16 policy issue for the Commission. In the event that the EERP provisions of the Settlement
17 Agreement are not approved, it is imperative that the Commission address and resolve *in this rate*
18 *case* both: (i) the desire of our customers to have TEP reinstate and expand its EE/DSM programs
19 and (ii) the impacts that EE/DSM programs have on TEP.

20 The proposed EERP does not set or bind the Commission to any certain policy or standard
21 regarding EE. In TEP’s opinion, and others, the EERP is merely another method to fund and
22 collect the costs of EE/DSM programs. It does not dictate what EE/DSM programs and budgets
23 that the Commission may approve. However, if the Commission determines that it does not want
24 to adopt the EERP, the Company still needs resolution as to how TEP will be remunerated for the
25 costs and effects of its EE/DSM programs and otherwise comply with the EE Standard.

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⁵³ Tr. (Dukes) at 314.

1 Therefore, TEP has proposed an alternative option for comparison with the EERP.⁵⁴ The Existing
2 EE Rule Option is set forth in Ex. DGH-2, as revised by Ex. TEP-11 (which clarified the actual
3 DSMS rates for year one of the Existing EE Rule Option). TEP must have an EE implementation
4 plan, including the mechanism for cost recovery, approved *in this rate case* so that it can move
5 forward with cost-effective EE/DSM programs in an effort to meet the EE Standard set by this
6 Commission. As part of that approval, TEP also needs to have certain elements of the EE
7 implementation plan approved in this rate case in order to avoid the legal hurdles that faced the
8 Company in Docket No. E-01933A-11-0055. Although not the preferred and agreed-upon method
9 to fund EE/DSM programs (as delineated in the Settlement Agreement through EERP), approval
10 of the Existing EE Rule Option EE Plan would resolve those issues and allow EE to move forward
11 for TEP's customers.

12 **VII. SWEEP'S PARTIAL OPPOSITION IS NOT WELL FOUNDED.**

13 Although SWEEP believes the overall Settlement Agreement is in the public interest and
14 supports the EERP proposal,⁵⁵ it was the only party to the docket that filed any opposition to the
15 Settlement Agreement.⁵⁶ SWEEP opposed: (i) the use of the LFCR instead of a full decoupling
16 mechanism; and (ii) the proposed increases to the customer charges.

17 Although SWEEP argues that the LFCR mechanism "inadequately reduces utility
18 disincentives to energy efficiency" and urges that the Commission adopt a full decoupling
19 mechanism instead of the LFCR,⁵⁷ the LFCR, in fact, is narrowly tailored to remove such
20 disincentives. The Settlement Agreement includes an LFCR mechanism similar to the LFCR
21 mechanisms recently approved by the Commission for APS (Decision No. 73183 (May 24, 2012))
22 and UNS Gas, Inc. ("UNS Gas") (Decision No, 73142 (May 1, 2012)). Like the APS and UNS
23 Gas LFCRs, TEP's proposed LFCR also includes a fixed charge "opt-out" option, while not
24 limiting the Commission's authority to determine energy efficiency or distributed generation

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26 ⁵⁴ Ex. TEP-2 (Hutchens Settlement Direct) at 17-21 and Ex. DGH-2 thereto; Ex. TEP-11 (revised version
of Ex. DGH-2)(late-filed).

27 ⁵⁵ Tr. (Schlegel) at 436, 454.

⁵⁶ The Sierra Club joined in SWEEP's position but did not submit testimony on its own behalf.

⁵⁷ Ex. SWEEP-3 (Schlegel Settlement Direct) at page 4, line 29.

1 policy in the future. The LFCR included in the Settlement Agreement reflects the desire of the
2 Signatories (including Staff, RUCO and the other diverse customer interests) to have a more
3 limited and targeted mechanism than full revenue per customer decoupling and is consistent with
4 current Commission policy in this regard.

5 SWEEP also asserts that by increasing the standard monthly residential customer charge
6 to \$10.00 “customers will not be able to take action to reduce or mitigate this increased cost.”⁵⁸
7 This is simply not true. The components that make up a customer’s total bill are designed to
8 recover both the fixed and variable costs of TEP’s system. As Ex. TEP-8 shows, the monthly
9 customer charge is designed to recover only a small portion of the fixed costs of TEP’s system,
10 while the variable components are designed to recover both fixed and variable costs. Indeed, for
11 the average residential customer, the monthly charge will cover only \$10 of the estimated \$55 of
12 fixed costs.⁵⁹ By reducing consumption, through implementing EE or DSM measures,
13 conservation, or installing DG, customers still have a significant opportunity to lower their
14 overall bill and mitigate the impact of any increase in the monthly charge. The rate design
15 proposed in the Settlement Agreement, included the increased customer charges, is fair and
16 balanced to both the Company and its customers and is in the public interest.

17 SWEEP’s nominal opposition to the Settlement Agreement is not well founded and
18 should not be allowed to disrupt the balanced resolution of issues supported by diverse interests.
19 Indeed, Mr. Schlegel acknowledged that he “believe[d] that the settlement agreement as
20 proposed is in the public interest.”⁶⁰

21 **VIII. RESPONSE TO LEGAL ISSUES RAISED DURING HEARING.**

22 During the course of the hearing, the Administrative Law Judge (“ALJ”) requested that
23 several legal issues be addressed in the post-hearing briefs. All of these legal issues relate to the
24 adjustors included in the Settlement Agreement, particularly the new ECA and LFCR adjustors for
25 TEP. It is important to note that although the ECA and LFCR adjustors included in the Settlement

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27 ⁵⁸ Ex. SWEEP-3 (Schlegel Settlement Direct) at page 15, line 17.

⁵⁹ Ex. TEP-8.

⁶⁰ Tr. (Schlegel) at 454.

1 Agreement are new to TEP, they are not new for Arizona utilities. Indeed, as set forth above,
2 those adjustors are the same or very similar to adjustors previously approved by the Commission
3 for APS. Additionally, as discussed above, the Commission has also approved a similar LFCR for
4 UNS Gas.

5 Moreover, the Commission has routinely approved adjustor mechanisms for utilities in
6 Arizona for many years and adjustor mechanisms are widely approved by public utilities
7 commissions and used by utilities throughout the United States. None of these adjustors have
8 been challenged or overturned by the Arizona courts.

9 Finally, the adjustors included in the Settlement Agreement are important for TEP to
10 maintain, and hopefully improve, its capital structure and credit rating. This is particularly true in
11 times of little, if any, sales growth. All of the adjustors also have detailed plans of administration
12 and considerable provisions for Commission oversight. Moreover, the adjustors help to moderate
13 rate impacts to customers in between rate cases. As a result, TEP believes that the adjustors are
14 just, reasonable, and in the public interest and well within the Commission's Constitutional
15 ratemaking authority.

16 **A. The Adjustors Comport with the Fair Value Requirement and with Scates.**

17 The Settlement Agreement includes four adjustor mechanisms for the recovery of certain
18 costs: the PPFAC, the DSMS, the LFCR and the ECA. The mechanisms and formulas for
19 calculating each adjustor, including the detailed costs that are to be recovered, are set forth in
20 detailed plans of administration for each adjustor. The Commission has previously approved the
21 same or very similar adjustors for TEP or other utilities in Arizona.

22 Each of these adjustors satisfy the Fair Value requirement of Article 14, Section 15 of the
23 Arizona Constitution and the parameters identified in *Scates v. Arizona Corporation Comm'n*, 118
24 Ariz. 531, 578 P.2d 612 (App. 1978). First, all of the adjustors are being set in a general rate case
25 in which there is a fair value rate base determination. Second, none of the adjustors will result in
26 an increase in the TEP's overall rate of return authorized in this rate case, which is the key tenet of
27 *Scates*. See *Scates*, 578 P.2d at 615-16. Moreover, the adjustors all are being adopted as part of

1 TEP's rate structure and are carefully designed to insure that specific, readily identifiable costs
2 will be recovered through a set formula that is not intended to change TEP's overall authorized
3 rate of return.

4 The Commission has addressed the legality of an adjustor similar to the ECA in the context
5 of arsenic treatment cost recovery mechanisms. In Decision No. 66400 (October 14, 2003), the
6 Commission approved an arsenic cost recovery mechanism ("ACRM"). The ACRM was designed
7 to recover capital costs and associated O&M costs related to the construction and operation of
8 arsenic treatment plant. In reviewing the ACRM, the Commission noted that the courts have
9 stated that "the Commission has discretion to consider matters subsequent to the test year, as long
10 as the ratemaking method used by the Commission complies with the 'fair value' mandate of the
11 Arizona Constitution" and that "it was in 'the public interest to have stability in the rate structure
12 within the bounds of fairness and equity rather than a constant series of rate hearings.'" Decision
13 No. 66440 at 17-18 (*citing Arizona Corporation Comm'n v. Arizona Public Service*, 113 Ariz.
14 368, 555 P.2d 326 (1976)). The Commission concluded that the ACRM satisfied *Scates* and the
15 Arizona Constitution because it was an automatic adjustment mechanism that was being adopted
16 in a rate case that included a "fair value" finding and because the expenses eligible for recovery
17 were narrowly defined. Decision No. 66440 at 19-20.

18 As with the ACRM, the ECA has a detailed process that requires the submission of capital
19 and O&M costs before there is any recovery. The carrying costs recovered under the ECA are
20 identical to those recovered under the ACRM. Because those carrying costs are based on TEP's
21 Weighted Average Cost of Capital ("WACC") approved in this rate case, TEP will not see any
22 increase in its authorized rate of return. Indeed, applying the WACC to actual capital expenditures
23 results in a lower rate of return than the Fair Value Rate of Return that the Signatories have agreed
24 to in the Settlement Agreement because there is no fair value increment in that rate. As noted
25 above, the Commission has approved a similar ECA for APS in Decision No. 73183.

26 The Commission also has concluded that a decoupling mechanism, either full decoupling
27 or an LFCR, "satisfy constitutional requirements because the mechanisms flow from a general rate

1 case in which all costs have been determined to be just and reasonable, and [the] FVRB and
2 FVROR will not fluctuate for purposes of determining future adjustments.” Decision No. 72723
3 (January 6, 2012)(Southwest Gas Rate Case). The LFCR is designed to recover only a portion of
4 narrowly defined lost revenues. Those lost revenues are revenues TEP is entitled to under the
5 revenue requirement determined in the rate case. Even though there will be some lag in the
6 recovery of the lost revenues, TEP will not earn any return on the lost revenues during that lag.
7 Clearly, recovery under the LFCR will not increase TEP’s rate of return above that authorized in
8 the rate case. Moreover, the LFCR is consistent with the Commission’s Policy Statement on
9 Utility Disincentives to Energy Efficiency and Decoupled Rate Structures, dated December 29,
10 2010 (Docket E-00000J-08-0314). Finally, as set forth above, the Commission has approved
11 similar LFCR mechanisms for APS and UNS Gas.

12 The DSMS is designed to recover Commission-approved EE program costs that have met
13 the performance metrics set forth in the EERP. Again, even though under the EERP this recovery
14 takes place over five years, TEP’s carrying costs include only WACC, as determined in this rate
15 case. As noted in the hearing, this recovery effectively reflects the time value of money because
16 TEP will front the capital expenditures well before there is any recovery on those costs.⁶¹ The
17 Commission has approved a DSMS for almost every energy utility in Arizona.

18 Finally, the PPFAC is designed to pass through specifically defined fuel and purchased
19 power costs. This type of adjustor has been approved by the Commission in numerous previous
20 rate cases for Arizona energy utilities, including TEP’s last rate case.

21 **B. The Adjustors Cannot be Modified between Rate Cases except under ARS §**
22 **40-252.**

23 Under Arizona law, adjustors are necessarily set in a general rate case because they are
24 initially adopted as part of the utility’s rate structure. *See Scates*, 578 P.2d at 616; *Residential*
25 *Utility Consumer Office v. Arizona Corporation Comm’n*, 199 Ariz. 588, 592-93, 20 P.3d 1169,
26 1173-74 (App. 2001). The approved adjustor formula is effectively a rate that is being set. It

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⁶¹ Tr. (Higgins) at 289-90.

1 allocates what costs are to be recovered through base rates and what costs will be recovered
2 through the adjustor. As a result, the structure of the adjustor, including the formula, must be
3 modified in a rate case.⁶²

4 In order to potentially modify an adjustor, the rate case order setting the adjustor would
5 need to be reopened under A.R.S. § 40-252. That process would provide an opportunity to be
6 heard on the proposed modification. Depending on the scope of the proposed modification, the
7 adjustor may not be able to be modified due to a need to satisfy the constitutional Fair Value
8 requirement, a potential confiscatory impact or other legal impediment. Moreover, at a minimum,
9 any modification could only apply prospectively. See *Mountain States Tel. & Tel. Co. v. Arizona*
10 *Corporation Comm'n*, 124 Ariz. 433, 436, 604 P.2d 1144, 1147 (App. 1979).

11 Finally, this limitation on modifying the structure of an adjustor does not preclude the
12 Commission from changing policies that create the costs being recovered by the adjustor. To the
13 extent those costs are reduced or eliminated, the adjustor rate would then be reduced or
14 eliminated.⁶³

15 **IX. CONCLUSION AND RELIEF REQUESTED.**

16 For all the forgoing reasons, TEP submits that the Settlement Agreement provides for just
17 and reasonable rates and is in the public interest. TEP respectfully requests that the ALJ issue a
18 Recommended Opinion and Order that finds, concludes and orders that:

- 19 • The Settlement Agreement is in the public interest and should be approved in its
20 entirety;
- 21 • The rates, charges and adjustor mechanisms proposed in the Settlement Agreement
22 are just and reasonable and supported by the evidence in the record;

24 ⁶² This is true whether the adjustor is adopted in a litigated rate case or through a Commission-approved
25 settlement agreement.

26 ⁶³ For example, with respect to the DSMS, the Commission could approve a performance incentive in a rate
27 case but reserve the right to modify that performance incentive in between rate cases. The DSMS would
authorize recovery of a performance incentive, as approved by the Commission in connection with an EE
implementation plan, without locking in a specific performance incentive. This is what the Commission
did with respect to APS's DSMS in Decision No. 73183.

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- The new rates, charges and adjustor mechanisms shall become effective on or before July 1, 2013;
- The revised Rules and Regulations set forth in Exhibit TEP-5 are approved;
- TEP will meet with Staff and RUCO in the 4th quarter of each year to satisfy Paragraph 20.4 for the Settlement Agreement; and
- TEP will file on or before August 31, 2013 a revised Partial Requirements Service tariff, and a Super-Peak Time-of-Use tariff.

TEP further requests that the Commission approve the Settlement Agreement as expeditiously as possible so that new rates may go into effect by July 1, 2013.

RESPECTFULLY SUBMITTED this 22nd day of March, 2012.

TUCSON ELECTRIC POWER COMPANY

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