

ORIGINAL

OPEN MEETING



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MEMORANDUM

Arizona Corporation Commission

DOCKETED

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AZ CORP COMMISSION
DOCKET CONTROL**

TO: THE COMMISSION

JUL 26 2016

2016 JUL 26 A 10:17

FROM: Utilities Division

DOCKETED BY 

DATE: July 26, 2016

RE: IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR AN ORDER PERMITTING EXPENSES RELATED TO PURSUING TAX REFUNDS TO BE RECOVERED THROUGH ITS PURCHASE POWER AND FUEL ADJUSTMENT CLASUE MECHANISM (DOCKET NO. E-01933A-15-0344).

BACKGROUND

On October 1, 2015, Tucson Electric Power Company ("TEP" or "Company") filed an application requesting an order permitting it to recover legal fees associated with pursuing tax refunds from Arizona and Nevada through its Purchase Power and Fuel Adjustment Clause ("PPFAC"). TEP has proposed that its PPFAC's Plan of Administration ("POA") be revised to allow TEP to recover the outside professional fees and expenses associated with seeking tax refunds through the PPFAC. TEP states the following:

"Any fuel-related tax refunds. . . are credited to TEP customers through its PPFAC However, TEP does not have the ability to similarly pass through expenses associated with the pursuit of PPFAC Tax Refunds, even though those refunds directly benefit its customers. The inability to recover those expenses acts as an unfortunate disincentive to pursuing tax refunds that could directly benefit customers. Therefore, TEP requests the Commission issue an order modifying its PPFAC to allow recovery of reasonable outside professional expenses incurred in seeking PPFAC Tax Refunds."

Potential Tax Refunds. TEP believes that the Company may be eligible to obtain a total of approximately \$24.9 million in tax refunds. The total consists of the following amounts:

- Up to approximately \$17 million for taxes assessed by New Mexico for coal purchases between 2012 and 2014;
- Up to \$2.9 million in refunds for taxes assessed by New Mexico between 2013 and 2014 for natural-gas purchases; and
- \$5 million in refunds for taxes from Arizona for lime purchases.

Legal Representation. TEP believes that it has a reasonable potential for success in obtaining the tax refunds, but does not believe it has the in-house legal expertise to pursue the New Mexico claims. TEP also states that it needs to retain outside counsel for limited purposes in its pursuit of the Arizona tax refund. In the interim, however, TEP is trying to use internal personnel to pursue tax refunds to the extent possible. TEP has already filed a claim against New Mexico for natural gas purchases made in 2011, to preserve potential benefits from being impacted by the statute of limitations, and is “moving forward with additional claims related to subsequent natural gas purchases and coal purchases.” TEP has also procured professional legal assistance in New Mexico on a contingency fee basis. TEP has indicated that litigation could be prolonged and has not indicated what the total cost might be.

Issues and Recommendations. Staff does not believe it is appropriate to recover legal costs through TEP’s fuel adjustor. Fuel adjustors are created to track and compensate for variations in the cost of fuel and power between rate cases. Recovering legal costs through the PPFAC would obscure the purpose of the fuel adjustor, would reduce transparency about the costs being recovered through the fuel adjustor, and might result in the recovery of costs not adequately reviewed for reasonableness and prudence.

In addition to Staff’s more general concerns, Staff has concerns specific to the current Docket. These include the following:

- i. TEP has stated that, given the wide range of possibilities and time, it cannot reasonably estimate the per-customer impacts of the legal fees it wishes to recover through the PPFAC. Staff believes it is not appropriate to revise the POA so non-fuel costs can be recovered through the fuel adjustor mechanism, particularly when there is no reasonable estimate regarding the potential impact on individual ratepayers.

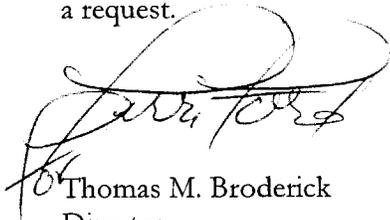


- iii. TEP states that it has strong arguments in favor of tax refunds, but has also indicated it cannot reasonably estimate the probability of success in obtaining the tax refunds. Staff does not believe it is appropriate to revise the POA to allow the recovery of legal fees without a reasonable estimate on the probability of success in obtaining the tax refunds.
- iv. TEP has stated that the legal fees would be charged in the months incurred and could be reviewed for prudence as part of TEP’s annual PPFAC filing.

- v. TEP has requested that the following phrase be added to the Plan of Administration ("POA") for its PPFAC: "Outside Professional fees and expenses incurred in seeking tax refunds that are creditable through the PPFAC." Staff believes this language is too broad and open-ended and could result in the recovery of expenses not intended to pass through a power and fuel adjustor.

In contrast to the potential negative consequences of broadening recovery, the main benefit for recovering legal costs through the adjustor is to remove a "disincentive" for pursuing refunds of taxes, an activity which should be pursued by TEP in the normal course of its business. In Staff's view, the potential negative consequences of allowing recovery of legal fees through the fuel adjustor greatly outweigh the potential benefits. Accordingly, Staff recommends against the Commission approving changes to the PPFAC's POA that would allow TEP to recover legal fees expended in pursuing tax refunds from Arizona and New Mexico.

TEP has an obligation to pursue the \$24.9 million in tax refunds described herein, so that these funds can be returned to its ratepayers. TEP has the option of requesting Commission approval to defer its outside legal fees and expenses and have them treated as a regulatory asset. TEP has indicated that it currently opposes treating the legal costs incurred in pursuing the tax refunds as a regulatory asset. Staff recommends that if TEP opts to refile for regulatory asset treatment of these legal costs, its request should include a reasonable estimate, along with a preliminary plan for recovery, indicating the manner (such as through a surcharge or netting against tax refunds) in which the regulatory asset should be recovered. Staff would very likely support such a request.



Thomas M. Broderick
Director
Utilities Division

TMB:JMK:red\RRM

ORIGINATOR: Julie McNeely-Kirwan

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BEFORE THE ARIZONA CORPORATION COMMISSION

- DOUG LITTLE
Chairman
- BOB STUMP
Commissioner
- BOB BURNS
Commissioner
- TOM FORESE
Commissioner
- ANDY TOBIN
Commissioner

IN THE MATTER OF THE APPLICATION
 OF TUCSON ELECTRIC POWER
 COMPANY FOR AN ORDER
 PERMITTING TAX REFUNDS TO BE
 RECOVERED THROUGH ITS PURCHASE
 POWER AND FUEL ADJUSTMENT
 CLAUSE MECHANISM.

DOCKET NO. E-01933A-15-0344
 DECISION NO. _____
ORDER

Open Meeting
 August 9 and 10, 2016
 Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Tucson Electric Power Company (“TEP” or “Company”) is engaged in providing electric power within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission (“Commission”).

2. TEP serves approximately 415,000 electric customers. Of these, approximately 374,000 are Residential customers and 37,500 are Commercial customers. TEP also serves a smaller number of Industrial, Public Street and Highway Lighting, and Irrigation customers.

Background

3. On October 1, 2015, Tucson Electric Power Company (“TEP” or “Company”) filed an application requesting an order permitting it to recover legal fees associated with pursuing tax refunds from Arizona and Nevada through its Purchase Power and Fuel Adjustment Clause (“PPFAC”). TEP has proposed that its PPFAC’s Plan of Administration (“POA”) be revised to allow

1 TEP to recover the outside professional fees and expenses associated with seeking tax refunds
2 through the PPFAC. TEP states the following:

3 “Any fuel-related tax refunds . . . are credited to TEP customers through its
4 PPFAC However, TEP does not have the ability to similarly pass
5 through expenses associated with the pursuit of PPFAC Tax Refunds, even
6 though those refunds directly benefit its customers. The inability to recover
7 those expenses acts as an unfortunate disincentive to pursuing tax refunds
8 that could directly benefit customers. Therefore, TEP requests the
9 Commission issue an order modifying its PPFAC to allow recovery of
10 reasonable outside professional expenses incurred in seeking PPFAC Tax
11 Refunds.”

12 4. Potential Tax Refunds. TEP believes that the Company may be eligible to obtain a total
13 of approximately \$24.9 million in tax refunds. The total consists of the following amounts:

- 14 • Up to approximately \$17 million for taxes assessed by New Mexico for coal
15 purchases between 2012 and 2014;
- 16 • Up to \$2.9 million in refunds for taxes assessed by New Mexico between 2013
17 and 2014 for natural-gas purchases; and
- 18 • \$5 million in refunds for taxes from Arizona for lime purchases.

19 5. Legal Representation. TEP believes that it has a reasonable potential for success in
20 obtaining the tax refunds, but does not believe it has the in-house legal expertise to pursue the New
21 Mexico claims. TEP also states that it needs to retain outside counsel for limited purposes in its
22 pursuit of the Arizona tax refund. In the interim, however, TEP is trying to use internal personnel to
23 pursue tax refunds to the extent possible. TEP has already filed a claim against New Mexico for
24 natural gas purchases made in 2011, to preserve potential benefits from being impacted by the statute
25 of limitations, and is “moving forward with additional claims related to subsequent natural gas
26 purchases and coal purchases.” TEP has also procured professional legal assistance in New Mexico
27 on a contingency fee basis. TEP has indicated that litigation could be prolonged and has not indicated
28 what the total cost might be.

6. Issues and Recommendations. Staff does not believe it is appropriate to recover legal costs
through TEP’s fuel adjustor. Fuel adjustors are created to track and compensate for variations in the
cost of fuel and power between rate cases. Recovering legal costs through the PPFAC would obscure

1 the purpose of the fuel adjustor, would reduce transparency about the costs being recovered through
2 the fuel adjustor, and might result in the recovery of costs not adequately reviewed for reasonableness
3 and prudence.

4 7. In addition to Staff's more general concerns, Staff has concerns specific to the current
5 Docket. These include the following:

6 i. TEP has stated that, given the wide range of possibilities and time, it cannot
7 reasonably estimate the per-customer impacts of the legal fees it wishes to
8 recover through the PPFAC. Staff believes it is not appropriate to revise the
9 POA so non-fuel costs can be recovered through the fuel adjustor mechanism,
10 particularly when there is no reasonable estimate regarding the potential impact
11 on individual ratepayers.

12 ii. TEP states that it has strong arguments in favor of tax refunds, but has also
13 indicated it cannot reasonably estimate the probability of success in obtaining
14 the tax refunds. Staff does not believe it is appropriate to revise the POA to
15 allow the recovery of legal fees without a reasonable estimate on the
16 probability of success in obtaining the tax refunds.

17 iii. TEP has stated that the legal fees would be charged in the months incurred
18 and could be reviewed for prudence as part of TEP's annual PPFAC filing.

19 iv. TEP has requested that the following phrase be added to the POA for its
20 PPFAC: "Outside Professional fees and expenses incurred in seeking tax
21 refunds that are creditable through the PPFAC." Staff believes this language is
22 too broad and open-ended and could result in the recovery of expenses not
23 intended to pass through a power and fuel adjustor.

24 8. In contrast to potential negative consequences of broadening recovery, the main
25 benefit for recovering legal costs through the adjustor is to remove a "disincentive" for pursuing
26 refunds of taxes, an activity which should be pursued by TEP in the normal course of its business. In
27 Staff's view, the potential negative consequences of allowing recovery of legal fees through the fuel
28 adjustor greatly outweigh the potential benefits. Accordingly, Staff has recommended against the

1 Commission approving changes to the PPFAC's POA that would allow TEP to recover legal fees
2 expended in pursuing tax refunds from Arizona and New Mexico.

3 9. TEP has an obligation to pursue the \$24.9 million in tax refunds described herein, so
4 that these funds can be returned to its ratepayers. TEP has the option of requesting Commission
5 approval to defer its outside legal fees and expenses and have them treated as a regulatory asset. TEP
6 has indicated that it currently opposes treating the legal costs incurred in pursuing the tax refunds as a
7 regulatory asset. Staff recommends that if TEP opts to refile for regulatory asset treatment of these
8 legal costs, its request should include a reasonable estimate, along with a preliminary plan for recovery,
9 indicating the manner (such as through a surcharge or netting against tax refunds) in which the
10 regulatory asset should be recovered. Staff would very likely support such a request.

11 CONCLUSIONS OF LAW

12 1. Tucson Electric Power Company is an Arizona public service corporation within the
13 meaning of Article XV, Section 2, of the Arizona Constitution.

14 2. The Commission has jurisdiction over Tucson Electric Power Company and over the
15 subject matter of the application.

16 3. The Commission, having reviewed the application and Staff's Memorandum dated July
17 26, 2016, concludes that it is in the public interest to not approve changes to Plan of Administration
18 for Tucson Electric Power Company's Purchased Power Fuel Adjustment Clause, as discussed herein.

19 ORDER

20 IT IS THEREFORE ORDERED that Tucson Electric Power Company not revise the Plan
21 of Administration for its Purchase Power and Fuel Clause in order to allow the recovery of legal or
22 other professional fees and expenses incurred in seeking tax refunds.

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1 IT IS FURTHER ORDERED that should Tucson Electric Power Company opt to refile for
 2 regulatory asset treatment of these legal costs, its request should include a reasonable estimate, along
 3 with a preliminary plan for recovery, indicating the manner (such as through a surcharge or netting
 4 against tax refunds) in which the regulatory asset should be recovered.

5 IT IS FURTHER ORDERED that this Order shall take effect immediately.

6
 7
 8 **BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

9
 10 _____
 11 CHAIRMAN LITTLE

COMMISSIONER STUMP

12
 13 _____
 14 COMMISSIONER FORESE

COMMISSIONER TOBIN

COMMISSIONER BURNS

15 IN WITNESS WHEREOF, I, JODI JERICH, Executive
 16 Director of the Arizona Corporation Commission, have
 17 hereunto, set my hand and caused the official seal of this
 Commission to be affixed at the Capitol, in the City of
 Phoenix, this _____ day of _____, 2016.

18
 19 _____
 20 JODI JERICH
 EXECUTIVE DIRECTOR

21
 22 DISSENT: _____

23
 24 DISSENT: _____

25 TMB:JMK:red/RRM

1 SERVICE LIST FOR: TUCSON ELECTRIC POWER COMPANY
2 DOCKET NO. E-01933A-15-0344

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