**BEFORE THE ARIZONA CORPORATION COMMISSION**

**COMMISSIONERS**
SUSAN BITTER SMITH - CHAIRMAN
BOB STUMP
BOB BURNS
DOUG LITTLE
TOM FORESE

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| 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 THE PROPERTIES OF TUCSON ELECTRIC POWER COMPANY DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA AND FOR RELATED APPROVALS. | ) ) ) ) ) ) ) ) ) ) | DOCKET NO. E-01933A-15-____ <br><br> **APPLICATION** |

Tucson Electric Power Company ("TEP" or "Company"), through undersigned counsel, and pursuant to A.R.S. §§ 40-250 and 40-251 and A.A.C. R14-2-103, hereby submits its Application for new rates to be effective no later than January 1, 2017. As proposed, the new rates are intended to result in an increase in non-fuel retail revenues of approximately $109.5 million, or approximately 12% over adjusted test year retail revenues. TEP's requested retail revenues represent an increase of approximately 7% over annualized revenue based on rates currently in effect, which includes a higher fuel cost component.

TEP is also seeking approval of: (i) critical modifications to its rate design and net metering tariff; (ii) modifications to its Purchased Power and Fuel Adjustment Clause mechanism ("PPFAC"), its Environmental Compliance Adjustor ("ECA") and Lost Fixed Cost Recovery mechanism ("LFCR"); (iii) updated depreciation rates; (iv) modifications to its Tariffs and Rules and Regulations; and (v) other related matters.

The significant updates to TEP's rate design and the proposed revenue requirement will result in the current average monthly bill for a typical TEP residential customer based on 1,150 kWh consumption in the summer and 785 kWh consumption in the winter to increase from $105.57 to $117.48 (an $11.91 increase).

The Company's request is fully supported by the testimony, exhibits, and schedules submitted concurrently with this Application.

## I. OVERVIEW.

TEP's current rates were established in Decision No. 73912 (June 27, 2013), based on a test year ending December 31, 2011, with rates effective on July 1, 2013. As outlined below and as set forth in the supporting testimony, the Company is filing this rate case for several reasons. Over the three and a half years since the last test year, TEP has invested approximately $1.3 billion to maintain and improve service to its customers, to diversify its generation resource portfolio and to meet new environmental requirements. Changing customer usage patterns, declining use per customer and lower overall sales also have resulted in under-recovery of fixed cost revenues. Further, the current rate design and net metering policies, coupled with increased deployment of distributed generation and energy efficiency, have exacerbated inequities among customers in paying for the fixed costs of the grid.

Accordingly, TEP is filing this rate case to: (i) update and improve its rate design and tariffs to provide for more equitable allocation of its fixed costs to its customers; (ii) enable TEP to continue to provide safe and reliable service; (iii) provide the Company with an opportunity to recover its full cost of service, including an appropriate return on invested capital; (iv) maintain or improve its credit rating; and (v) obtain necessary approvals for the relief sought in its Application, all of which will benefit TEP and its customers.

### A. Need for Increased Revenue.

Since its previous test year, TEP has invested approximately $1.3 billion to diversify its resource portfolio; maintain its existing generation fleet; upgrade, expand and reinforce its transmission and distribution plant systems; enhance customer service and leverage the use of technology throughout the Company. All of these investments contribute to the Company's ability to maintain and improve safe, reliable and economic electric service. For example, in December 2014, TEP acquired a 75% interest in Gila River Power Plant Unit 3 ("Gila River"), a 550 MW combined cycle gas-fired generation facility for approximately $164 million. Since the last test year, TEP has also invested approximately $100 million in solar generating facilities. These investments reflect the significant steps the Company is taking to reduce its reliance on coal-fired generation and to build a cleaner, more diverse energy portfolio.

In addition to these capital expenditures, TEP has incurred increases in operating costs over the past three and a half years that were required to provide safe and reliable service to customers.

**B. Need for Updated Rate Design.**

TEP's test year retail sales are nearly 3% below the December 31, 2011 test year used in the Company's last rate case. Residential usage per customer fell nearly 7.5% between 2011 and the test year. The declining usage per customer and overall sales levels are due to several factors, including: (i) the effects of increased conservation, energy efficiency ("EE") and distributed generation ("DG"), and (ii) the slow pace of economic growth in the Tucson metropolitan area.

The effect of lower energy sales means that the Company must recover its increased fixed costs over fewer kilowatt-hours ("kWh") sales. Because the majority of the Company's fixed costs are currently recovered volumetrically on a per-kWh basis, lower electricity sales contributes to a significant under-recovery of costs over time, particularly as the Company's cost of service increases. The ability to recover fixed costs through volumetric rates is compounded by an inclining block rate structure – where more of the fixed costs are collected at higher usage levels. Although this historic rate design may have been appropriate in times of increasing customer usage and sales growth, as customer usage has declined, this approach has contributed to under-recovery of TEP's authorized revenue requirement. The current rate design also does not fit our customers' evolving use of the electric system; rather it is creating greater inequities in recovering fixed costs from TEP's customers, increasing the level of cross-subsidies between customers, and discouraging the use and deployment of new technologies.

Moreover, TEP has many residential and small general service customers with relatively low volumetric usage over the course of a year. However, there are times when these customers, such as seasonal residents and customers with rooftop PV systems, place significant energy demands on TEP's system that the Company must be prepared to meet. As a result, customers with low annual usage, but average peak demand, are not paying an equitable share of the fixed costs to operate and maintain the TEP grid to which they are connected. Because of the volumetric rate design and the current net metering rules, a significant amount of fixed cost recovery must ultimately be shifted to other customers.

In addition to the fixed cost recoveries being shifted disproportionately to the customers who use higher volumes of electricity on a more regular basis, the Company is also suffering lost revenues because its LFCR is not designed to capture all of the lost fixed cost revenues associated with meeting the Commission's Renewable Energy Standard and Energy Efficiency Rules.

Therefore, the Company is proposing changes to its rate design to help ensure that all customers pay a more equitable share of the fixed, ongoing costs of providing safe and reliable service. TEP also is proposing to modify its net metering tariff to reduce the subsidies provided to net metered customers, which will also reduce future cost shifting. These proposed tariffs and rates will provide the Company with a better opportunity to recover its fixed costs and earn a reasonable return on its investment, as well as provide a more equitable allocation of costs among customers.

## II. KEY ELEMENTS OF THE RATE CASE.

### A. Revenue Requirement.

The Company is requesting a $109.5 million increase to test year adjusted non-fuel revenues. TEP's requested retail revenues represent an increase of approximately 7% over annualized revenue based on rates currently in effect, which includes a higher fuel cost component. As proposed, the average monthly bill for a typical TEP residential customer would increase from $105.57 to $117.48.

TEP's revenue requirement is based on a Fair Value Rate Base ("FVRB") of $2.91 billion, calculated using a traditional 50/50 weighting of Original Cost Rate Base ("OCRB") of $2.10 billion and a Replacement Cost New Less Depreciation ("RCND") rate base of $3.72 billion. The FVRB has increased by $645 million since TEP's last test year.

TEP proposes to use its actual capital structure, adjusted for recent long-term debt retirements, to determine the weighted average cost of capital ("WACC"). That capital structure consists of 50.03% common equity and 49.97% long-term debt.

TEP's cost of long-term debt is 4.32% and required cost of common equity is 10.35%. The Company's WACC, based on these cost rates and the test year capital structure, is 7.34%.

TEP is further proposing a fair value rate of return ("FVROR") of 5.69%. This FVROR is based on the methodology adopted by the Commission in several recent rate cases. The FVROR also reflects a lower return on the fair value increment of rate base than what TEP believes it could justify.

**B. Rate Design.**

TEP is proposing to continue its efforts to update and modernize its rate design. Through its proposals, the Company is seeking to better align rate design with cost causation and to reduce inter- and intra-class inequities. The proposed rate structure is intended to meet our customers' evolving use of the electric system, reduce the level of cross-subsidies among customers, encourage the use and deployment of new technologies, and improve the Company's ability to recover its fixed costs. The rate design will provide for a more equitable allocation of the cost of the TEP infrastructure that is the backbone of providing safe and reliable service to all of its customers.

The Company's rate design proposals include: (i) increased basic service charges for both residential and small commercial customers to assist in more equitable fixed cost recovery; (ii) a reduced number of volumetric rate tiers for residential customers; (iii) an optional three-part rate structure for residential and small commercial customers that includes a monthly service charge, a demand charge and a volumetric energy charge; and (iv) a mandatory three-part rate structure for partial requirements customers, including new users of solar arrays and other distributed generation equipment. In addition to these rate design proposals, TEP also is proposing modified large commercial rates and new interruptible rates.

### C. New Tariffs.

In order to incent business development and retention in its service area, TEP is proposing an Economic Development Rate. This rate will provide discounted electricity rates to new or existing businesses that meet certain qualifications, such as job creation or minimum load requirements. Given the slow economic recovery in the Tucson area, this proposal provides another avenue to attract or expand business.

TEP also is proposing a Prepaid Service tariff that will provide another option for customers to manage their energy costs.

Further, in compliance with Decision No. 73912, the Company is proposing a high voltage service tariff that would be available to customers taking service at 138kV or higher.

Finally, in compliance with Decision No. 74689 (August 12, 2014), TEP is submitting a pilot program for a "buy through" tariff that, if approved, would be available to Large Power Service customers.

### D. Net Metering Tariff.

The Company is proposing to modify its net metering rider.[1] The new net metering rider will modify how new net metered customers receive credit for excess energy that is generated by their DG system and delivered to TEP. The new rider would apply to net metered customers that submit applications for interconnection to TEP's grid facilities after June 1, 2015.[2]

Under the new rider:

- New net metered customers would pay the approved and applicable retail rate for all energy delivered by TEP. The applicable retail rates will be based on the proposed three-part rate design proposed by the Company; and
- New net metered customers would be compensated for any excess energy their DG system produces and delivers to TEP with bill credits calculated using the Renewable

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[1] The modifications are the same as set forth in its application in Docket No. E-1933A-15-0100 (that application was withdrawn on June 16, 2015 and the withdrawal was approved in Decision No. 75224 (August 26, 2015)).

[2] TEP customers have been and will continue to be notified of proposed modifications to the net metering tariff through a disclaimer in its interconnection materials.

Credit Rate (which is a rate that reflects the current cost of utility-scale solar energy tied to the distribution system). Besides mitigating the cost shift, this approach also is intended to result in TEP and its customers not overpaying for renewable energy. New net metered customers also will be allowed to carry over unused bill credits to future months if they exceed the amount of their current TEP bill.

**E. Adjustors.**

TEP is proposing modifications to its PPFAC, its ECA and its LFCR. With respect to the PPFAC, TEP is requesting a number of modifications that will smooth out the PPFAC rate changes and more closely align the PPFAC with individual customers' base fuel rate. The changes include modifying the PPFAC rate to adjust monthly based on a historic 12-month rolling average (as compared to changing the PPFAC rate once a year). In addition, the Company is proposing that the PPFAC rate be calculated as a percentage of a customer's base fuel rate, rather than as a single per kilowatt hour (kWh) energy rate that is applied to all customers. This approach will more fairly align the changes in fuel costs with each rate class' base fuel costs.

With respect to its ECA, TEP proposes to modify the ECA by: (i) increasing the cap on annual recovery through the ECA to help smooth the rate impacts of compliance with new environmental regulations and (ii) converting the cap to a percentage based cap, which will allow for more equitable recovery from all classes.

With respect to the LFCR, TEP proposes to modify the LFCR to include recovery of fixed generation costs and 100% of non-generation demand charges (instead of the current 50%), as well as increasing the annual recovery cap from 1% to 2% of total revenues. The proposed changes will better address the impacts of the continuing expansion of distributed generation and mandated energy efficiency programs and mitigate the erosion of revenues experienced under TEP's currents rates.

**F. Springerville Generating Station.**

Since TEP's last rate case, there have been significant changes with respect to its interest in the Springerville Generating Station ("SGS") and TEP's rates should reflect these changes. In

December 2014 and January 2015, TEP purchased leased interests in SGS Unit 1 totaling 35.4% for an aggregate purchase price of $65 million; these purchases brought TEP's total ownership interest in the unit to 49.5%. Prior to January 1, 2015, TEP leased 100% of SGS Unit 1 and owned an equity interest in one of the leases covering a 14% share of the unit. The Company's rate application removes the lease costs from TEP's revenue requirement and includes adjustments to rate base and operating expenses to reflect the Company's 49.5% ownership interest in SGS Unit 1. In April 2015, TEP also purchased the SGS coal handling facilities at the end of the lease for those facilities. The purchase price paid was $120 million. Accordingly, the Company's rate application removes the lease costs from TEP's revenue requirement and includes adjustments to rate base and operating expenses to reflect the Company's ownership interest in the coal handling facilities. TEP is also seeking other approvals related to changes at the SGS, including an extended recovery period for leasehold improvements made to SGS common facilities, as well as recovery of operating costs through TEP's PPFAC for energy dispatched from the 50.5% co-owner share of SGS Unit 1, to the extent that capacity is available to meet retail customer needs.

**G. Depreciation Rates.**

TEP is proposing new depreciation rates based on an updated depreciation study. The updated depreciation rates would modify the depreciation rates approved by the Commission in Decision No. 73912.

**H. Rules and Regulations.**

The Company is proposing modifications to its Rules and Regulations and to its Tariffs. These modifications are intended to modernize TEP's Rules and Regulations and to clarify areas in the Rules and Regulations that have caused undue confusion.

## III. APPLICATION.

In support of this Application, TEP respectfully states as follows:

A. The Company is a corporation duly organized, existing and in good standing under the laws of the State of Arizona. Its principal place of business is 88 East Broadway Boulevard, Tucson, Arizona 85701

B. The Company is a public service corporation principally engaged in the generation, transmission and distribution of electricity for sale in Arizona pursuant to Certificates of Convenience and Necessity issued by the Commission.

C. All communications and correspondence concerning this Application, as well as communications and pleadings with respect thereto filed by other parties, should be served upon the following:

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D. The Commission has jurisdiction to conduct public hearings to determine the fair value of the property of a public service corporation, to fix a just and reasonable rate of return thereon, and thereafter, to approve rate schedules designed to develop such return. Further, the Commission has jurisdiction to establish the practices and procedures to govern the conduct of such hearing, including, but not limited to, such matters as notice, intervention, filing, service, exhibits, discovery, and other prehearing and hearing matters.

E. Accompanying this Application are the standard filing requirements and rate design schedules described in A.A.C. R14-2-103. The Company also provides pre-filed direct testimonies and related exhibits from the following witnesses for TEP supporting the requests made within the Application and schedules:

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| David Hutchens: | Overview of TEP's rate application and primary proposals, including the need for the modified rate design. |
| Susan Gray: | Overview of TEP's operations. |
| Michael Sheehan: | Overview of TEP's generation portfolio and planning; acquisition of Gila River; certain modifications to PPFAC. |
| Carmine Tilghman: | Scope and impact of the deployment of distributed generation in the TEP service area; utility scale solar facilities. |
| Kentton Grant: | Overview of TEP's financial condition; capital structure; cost of debt; WACC; cost of credit support for fuel and purchased power procurement; cost of the SGS common facilities lease, end-of-lease purchases of SGS Unit 1 and the SGS coal handling facilities; and the status of the co-owner share of SGS Unit 1. |
| Ann Bulkley: | Cost of equity; fair value rate base; and fair value rate of return. |
| Dr. Ron White: | Depreciation methodology and rates. |
| Frank Marino: | Regulatory treatment of certain coal assets; income tax and property tax; revenue requirement, including rate base, income and expense adjustments. |
| Dallas Dukes: | Revenue requirement, including income and expense adjustments; rate base and income statement pro forma adjustments; post-test |

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| | year plant adjustments; Reconstructed Cost New Less Depreciation (RCND); depreciation expense; proposed rate design. |
| Craig Jones: | Cost of service study; proposed rate design; revisions to the base cost of fuel and purchase power; modifications to the cost recovery mechanisms; and revisions to tariffs. |
| Denise Smith: | Revisions to TEP's Rules and Regulations; customer satisfaction initiatives and customer assistance programs; compliance waivers. |

F. TEP respectfully requests that this Commission set a date for a hearing on this Application in Tucson, Arizona, such that new rates for the Company will become effective no later than January 1, 2017. At the hearing conducted pursuant to this rate request, TEP will establish, among other things, that:

(1) its current rates and charges do not permit the Company to earn a fair return on the fair value of its assets devoted to public service, and that as a result, its current rates and charges are not just and reasonable;

(2) the requested revenue increase is the minimum amount necessary to allow the Company an opportunity to earn a fair return on the fair value of its assets devoted to public service, for preservation of the Company's financial integrity and for the attraction of new capital on reasonable terms, and is in the public interest;

(3) the Company's revenue request is reasonable and necessary for the Company to continue to provide adequate and reliable electric service to its customers as required by law, and is in the public interest;

(4) including post-test year plant that will be in service by December 31, 2015 in rate base is in the public interest;

(5) modifying the Company's PPFAC to allow for recovery of additional costs and to more equitably allocate PPFAC rates is in the public interest;

(6) the proposed modifications to the LFCR will improve and more equitably allocate recovery of lost fixed cost revenues resulting from DG, net metering and EE programs is in the public interest;

(7) the proposed modifications to the ECA to allow it to continue to address the need to timely recover significant investment in pollution control and other facilities to respond to government mandates for environment standards, and is in the public interest;

(8) the proposed rate design will better align the fixed and variable costs of service with the rates paid by the customers causing those costs and is in the public interest

(9) the proposed Net Metering Tariff and related waiver of the Commission's Net Metering Rules provides for a more equitable allocation of fixed costs among customers, and is in the public interest;

(10) the proposed revisions to the Company's Tariff, Rules and Regulations and certain compliance requirements are in the public interest; and

(11) the proposed treatment of the SGS, H. Wilson Sundt Generating Station ("Sundt"), and San Juan Generating Station ("San Juan") is in the public interest.

G. In addition to setting a hearing date, TEP asks that the Commission issue a procedural order setting forth the prescribed public notice for the Application, establishing procedures for intervention, and providing for appropriate discovery. TEP further requests that the Company be authorized to serve all discovery requests, answers and objections electronically. Finally, TEP requests that a procedural schedule be established so that a final order in this case can be rendered and new rates can be effective by January 1, 2017.

WHEREFORE, TEP respectfully requests that the Commission issue an order:

(1) establishing a date for hearing evidence concerning the Application, prescribing the time and form of public notice to TEP customers, establishing procedures for intervention and discovery as described above;

(2) finding and concluding that the Company's rate application is just and reasonable and granting new rates that result in an increase in retail revenues of approximately $109.5 million to allow it to recover its expenses and a reasonable opportunity to earn its authorized rate of return on its investment;

(3) approving the tariffs (including any related waivers) and statement of charges included with the Company's Application with an effective date no later than January 1, 2017;

(4) approving the Company's proposed revisions to its Purchased Power and Fuel Adjustment Clause;

(5) approving the Company's proposed revisions to its Lost Fixed Cost Recovery Mechanism;

(6) approving the Company's proposed revisions to its Environmental Compliance Adjustor;

(7) approving the Company's proposed Net Metering Tariff and granting a related waiver of A.A.C R14-2-2301 et seq.;

(8) approving the Company's proposed depreciation rates as set forth in Dr. White's testimony;

(9) approving the Company's proposed rate and regulatory treatment of SGS, Sundt, and San Juan generation assets;

(10) approving the Company's revised Rules and Regulations and modified compliance requirements; and

(11) granting the Company such additional relief as the Commission deems just and proper.

RESPECTFULLY SUBMITTED this 5th day of November 2015.

TUCSON ELECTRIC POWER COMPANY

By ______________________

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Original and 13 copies of the foregoing filed this 5th day of November 2015, with:

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