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Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION)
OF THE ARIZONA ELECTRIC DIVISION)
OF CITIZENS COMMUNICATIONS)
COMPANY TO CHANGE THE CURRENT)
PURCHASED POWER AND FUEL)
ADJUSTMENT CLAUSE RATE, TO)
ESTABLISH A NEW PURCHASED)
POWER AND FUEL ADJUSTMENT)
CLAUSE BANK, AND TO REQUEST)
APPROVED GUIDELINES FOR THE)
RECOVERY OF COSTS INCURRED IN)
CONNECTION WITH THE ENERGY)
RISK MANAGEMENT INITIATIVES.)

DOCKET NO. E-01032C-00-0751

IN THE MATTER OF THE APPLICATION)
OF CITIZENS COMMUNICATIONS)
COMPANY, ARIZONA GAS DIVISION,)
FOR A HEARING TO DETERMINE THE)
FAIR VALUE OF ITS PROPERTIES FOR)
RATEMAKING PURPOSES, TO FIX A)
JUST AND REASONABLE RATE OF)
RETURN THEREON, AND TO APPROVE)
RATE SCHEDULES DESIGNED TO)
PROVED SUCH RATE OF RETURN.)

DOCKET NO. G-01032A-02-0598

1 IN THE MATTER OF THE JOINT)
2 APPLICATION OF CITIZENS)
3 COMMUNICATIONS COMPANY AND)
4 UNISOURCE ENERGY CORPORATION)
5 FOR THE APPROVAL OF THE SALE OF)
6 CERTAIN ELECTRIC UTILITY AND)
7 GAS UTILITY ASSETS IN ARIZONA,)
8 THE TRANSFER OF CERTAIN)
9 CERTIFICATES OF CONVENIENCE)
10 AND NECESSITY FROM CITIZENS)
11 COMMUNICATIONS COMPANY TO)
12 UNISOURCE ENERGY CORPORATION,)
13 THE APPROVAL OF THE FINANCING)
14 FOR THE TRANSACTIONS AND OTHER)
15 RELATED MATTERS.)

DOCKET NO. E-01933A-02-0914
DOCKET NO. E-01032C-02-0914
DOCKET NO. G-01032A-02-0914

10 **JOINT APPLICANTS' POST-HEARING BRIEF**

11
12 Joint Applicants, Citizens Communications Company ("Citizens") and
13 UniSource Energy Corporation ("UniSource"), on behalf of itself, its designated affiliates,
14 and Tucson Electric Power Company ("TEP"), submit this Post-Hearing Brief in support
15 of their Joint Application and the Settlement Agreement ("Settlement Agreement")
16 between UniSource, TEP, Citizens, and the Staff of the Utilities Division of the Arizona
17 Corporation Commission ("Staff").

18 UniSource's purchase of Citizens' Arizona electric and gas assets provides
19 unquestioned benefits to Arizona. The Settlement Agreement presents the Arizona
20 Corporation Commission ("Commission") with a valuable opportunity to resolve
21 important and complicated regulatory issues in the public interest. Local control, reduced
22 rate base resulting in reduced revenue requirements, forfeiture of the more than \$135
23 million PPFAC balance, elimination of lengthy and costly regulatory proceedings,
24 consolidation and coordination of existing operations, and valuable commitments to a
25 three-year rate moratorium and to retail competition all hinge on approval of the
26 Settlement Agreement. This case is unique: ordinarily a purchaser of utility assets is

1 seeking to collect a return from ratepayers on the premium paid for the assets. In this case,
2 UniSource is passing through the benefits of a discounted purchase price. Both the Staff
3 and RUCO, two parties charged with evaluating the public interest, concur that this sale is
4 in the public interest.

5 Understandably, customers do not like rate increases, but the rate increases
6 in the Settlement Agreement are fair and reasonable, justified by overwhelming (and often
7 uncontested) evidence and are significantly less than the rate increases proposed by
8 Citizens.

9 Failure to approve the Settlement Agreement will result in renewed, costly
10 litigation over the PPFAC balance and the gas rate case and will force Citizens to remain
11 in the electric and gas business, contrary to its business plan and focus. The record is
12 absolutely clear: the Arizona public, and Citizens' customers and employees in particular,
13 will be better off as a result of this Settlement Agreement.

14 Joint Applicants submit that the Settlement Agreement, as supported by the
15 record in this proceeding, achieves a fair and reasonable balance of the diverse issues
16 raised by the Joint Application, provides substantial benefits for electric and gas customers
17 in Citizens' certificated areas, is in the public interest, and should be approved.

18 **I. PROCEDURAL HISTORY**

19 In the Joint Application, UniSource and Citizens requested the consolidation
20 of the approval of the sale and transfer of Citizens' gas and electric assets with Citizens'
21 pending gas rate case (Docket No. G-01032A-02-0598) ("Gas Rate Case") and Citizens'
22 pending purchased power and fuel adjustment clause case (Docket No. E-01032C-00-
23 0751) ("PPFAC Case"). The consolidation of these proceedings and the resolution of the
24 PPFAC Case and the Gas Rate Case prior to the closing of this transaction provides
25 meaningful benefits to customers and is critical to the consummation of this transaction.
26

1 See Pignatelli Cross-Examination, Tr. at 75:22-76:3; 76:9-25.¹ Recognizing the
2 interdependence of these proceedings, the Administrative Law Judge's February 7, 2003
3 Procedural Order consolidated these cases and provided a framework for the parties to
4 attempt to reach a settlement.

5 All parties to this proceeding first met to discuss the Joint Application and
6 the settlement process on January 13, 2003. See Exhibit S-1, at 1:19-20. Additional
7 meetings, during which each of the parties discussed their concerns with the Joint
8 Applicants, occurred on January 22, 2003 and January 31, 2003. See *id.* at 1:21-22. At
9 the January 31 meeting, Staff indicated to the intervenors that it intended to meet
10 separately with the Joint Applicants in an attempt to negotiate a settlement. See *id.* at 2:2-
11 4. Staff and the Joint Applicants encouraged the intervenors to meet separately with the
12 Joint Applicants. None of the intervenors objected to this procedure. See Glaser Cross-
13 Examination, Tr. at 142:24-143:3; Jaress Direct, Tr. at 287:19-20; Statement of Mr. J.
14 White, Tr. at 336:4-16. The Joint Applicants then met with Mohave County, Santa Cruz
15 County, RUCO, Mr. Magruder, and the City of Nogales to continue the dialogue on issues
16 important to the respective intervenor. See Glaser Direct, Tr. at 125:20-126:6. Indeed,
17 many of these discussions were a continuation of meetings held with the intervenors prior
18 to filing the Joint Application. See Glaser Cross-Examination, Tr. at 125:6-10.

19 On March 31, 2003, all of the parties again convened to discuss the
20 settlement reached by the Joint Applicants and Staff. See Exhibit S-1, at 2:4-6. Following
21 that meeting, the Joint Applicants filed the signed Settlement Agreement to allow
22 comment by all parties through pre-filed testimony or statements of position. Ultimately,
23 as evidenced by the limited nature of the issues raised by the intervenors in pre-filed
24 testimony and comments and at the hearing, the Settlement Agreement resolved many of

25 _____
26 ¹ Citations to "Tr." in this Brief refer to the transcripts of the hearing. Transcript citations
and specific citations to exhibits are included in the accompanying Appendix to this Brief.

1 the issues and concerns raised by the intervenors. *See* Exhibits RUCO-1, AUIA-1, Diaz
2 Cortez Cross-Examination, Tr. at 541:16-543:14. Although it was not possible to satisfy
3 all of the intervenors on each of their respective issues, Joint Applicants submit that the
4 Settlement Agreement, when taken as a whole, properly balances the diverse interests of
5 the parties, is in the public interest, and should be approved.

6 **II. THE SETTLEMENT AGREEMENT AND ITS BENEFITS**

7 The Joint Application and the Settlement Agreement address numerous
8 issues, including the sale and transfer of Citizens' assets, the financing of the transaction
9 by UniSource, and the resolution of the Gas Rate Case and the PPFAC Case. As Staff has
10 testified, these issues are inextricably linked and the resolution of these issues, as detailed
11 in the Settlement Agreement, "reasonably balances diverse interests, is fair to ratepayers
12 and consistent with the public interest." Exhibit S-1, Executive Summary at 3; Jaress
13 Direct, Tr. at 286:10-13.

14 This transaction and the commitments set forth in the Settlement Agreement
15 provide numerous benefits, including:

- 16 • Significant gas and electric facilities, operations and customers in
17 both northern and southern Arizona will become the responsibility of UniSource, an
18 Arizona-based company that is well known, accessible and held in high regard by the
19 community.
- 20 • The benefits from the reduced purchase price of the gas and electric
21 assets will flow through to Citizens' gas and electric customers and will result in lower
22 rates than these customers would likely experience if this transaction is not consummated.
- 23 • The Settlement Agreement resolves the long-standing PPFAC Case
24 and provides enormous benefits to electric customers through the forfeiture of any
25 recovery from those customers of the PPFAC balance existing at the time of closing of the
26 transaction, which is estimated to be more than \$135 million.

- 1 • UniSource will retain substantially all the Arizona-based employees
2 of Citizens, which will minimize any negative economic impact of this transaction.
- 3 • UniSource has committed to a three-year moratorium on the filing of
4 a general gas or electric rate case.
- 5 • UniSource has committed to establishing a procedure to open
6 Citizens' electric service territories to competition by December 31, 2004.
- 7 • UniSource has committed to submitting a study and plan for the
8 consolidation or coordination of the Santa Cruz electric operations with TEP.
- 9 • UniSource has committed to continued pipeline and operational
10 safety standards of the highest quality.
- 11 • Finally, UniSource has committed to ensure joint efforts by TEP and
12 the new electric company to comply with the Environmental Portfolio Standard.

13 **A. Transfer of Citizens' Gas and Electric Assets to UniSource**

14 At the core of these consolidated proceedings is the sale and transfer of
15 Citizens' Arizona gas and electric assets, including its Certificates of Convenience and
16 Necessity, to UniSource. Through this proceeding, UniSource has demonstrated that this
17 transfer is in the public interest and that UniSource is a fit and proper entity to purchase
18 and to operate these assets. *See* Exhibit JA-1, at 2:21-3:12; Jaress Direct, Tr. at 286:14-17;
19 Diaz Cortez Direct, Tr. at 537:6-9; Meek Direct, Tr. at 512:15-19. UniSource is an
20 Arizona-based company that is well known, accessible, and held in high regard by the
21 community. *See* Exhibit JA-1, at 2:24-3:2. Similarly, UniSource is experienced in
22 providing quality utility service to Arizona customers and will continue to provide that
23 service to Citizens' customers. *See id.* Recognizing the significant benefits that this
24 transaction will provide, there is no question that UniSource is a fit and proper entity to
25 purchase and to operate Citizens' Arizona gas and electric assets. As Ms. Diaz Cortez
26 confirmed: "[RUCO] found that the sale and transfer was in the public interest [and] that

1 UniSource was a reputable, reliable, and known entity to run the former Citizens electric
2 and gas properties.” Diaz Cortez Direct, Tr. at 537:6-9.

3 For these reasons and other reasons supported in the record, the transfer of
4 Citizens’ gas and electric assets to UniSource should be approved.

5 **B. Gas Rate Case and Other Gas-Related Issues**

6 **1. Resolution of the Gas Rate Case**

7 Citizens’ amended Gas Rate Case filing made in August 2002 proposed a
8 total rate base of approximately \$150 million and an increase in the annual revenue
9 requirement for its Arizona operations of more than \$21 million or approximately 28.9
10 percent. *See* Exhibit JA-6, at Appendix B, Sch. 1; Mason Direct, Tr. at 462:7-13. As
11 confirmed by Staff, these amounts are not inflated, and the requested increase is largely
12 attributable to additions to gross plant in service, the majority of which arose as a result of
13 the Commission-ordered Build-Out Program. *See* Exhibit S-1, at 12:14-22; Dittmer
14 Direct, Tr. at 290:1-8.

15 Despite the reasonableness of Citizens’ request, the Settlement Agreement
16 greatly reduces the increase requested in Citizens’ Gas Rate Case filing. These reductions
17 result primarily from the negotiated purchase price of the gas assets, as well as an
18 agreement to permanently write down the gas plant in service by \$10 million based on
19 Staff’s review of the prudence of the Build-Out Program. *See* Exhibit JA-6; Dittmer
20 Direct, Tr. at 290:9-291:12. As a result, the parties to the Settlement Agreement have
21 agreed to reduce the total rate base for the gas assets from \$150 million, as proposed and
22 supported by Citizens, to approximately \$117 million. *See* Exhibit JA-6, at Appendix B,
23 Sch. 1. In addition, the revenue requirement increase proposed in the Settlement
24 Agreement is \$15,191,276—a reduction of approximately \$6 million from the annual
25 increase proposed and supported by Citizens. *See id.* The Settlement Agreement further
26 proposes a fair value rate base of \$142,132,013 and a rate of return of 7.49 percent on that

1 fair value rate base. *See* Exhibit JA-6, at 13. To implement the increased revenue
2 requirement, the Settlement Agreement includes a rate design supported by Staff, with
3 input from RUCO, which will spread the increase evenly across all retail rate classes. *See*
4 Exhibit JA-6, at Appendix B, Sch. 3; Dittmer Direct, Tr. at 292:23-25.

5 The rate base and revenue requirement amounts proposed in the Settlement
6 Agreement incorporate a cost of debt of 7.75 percent, a cost of equity of 11 percent, and a
7 weighted average cost of capital of 9.05 percent. *See* Exhibit JA-6, at Appendix B, Sch. 1.
8 The cost of debt proposed by the Joint Applicants is reasonable when viewed in relation to
9 the debt costs for similarly-rated utilities and in light of the relatively small size of the
10 bond issuances for these companies. *See* Exhibit JA-7, at 16:17-17:21. Similarly,
11 although the actual cost of equity for the new companies may be higher in light of
12 prevailing circumstances in the energy industry, UniSource agreed to the 11 percent cost
13 of equity proposed by Citizens in its original filing. *See* Exhibit JA-7, at 18:1-7. Finally,
14 although the weighted average cost of capital of 9.05 percent proposed in the Settlement
15 Agreement is slightly higher than that proposed by Citizens, Staff analysis confirms that,
16 on a pre-tax basis, the cost of capital proposed in the Settlement Agreement results in a
17 lower revenue requirement than that proposed by Citizens. *See* Exhibit S-1, at 25. These
18 assumptions, when viewed together with the reduced rate base, provide a substantial
19 benefit to customers and allow UniSource to earn a reasonable return.

20 **2. Benefits to Gas Customers**

21 The benefits of the purchase of the gas assets by UniSource are well
22 documented in this proceeding. Because UniSource is purchasing the gas assets from
23 Citizens at a price well below their net book value, Citizens' gas customers will benefit
24 greatly from the corresponding long-term reduction in rate base. *See* Dittmer Direct, Tr. at
25 290:14-18. As Mr. Dittmer explained, the purchase of these types of assets below book
26 value is highly unusual, as is the pass through of such savings to customers. *See* Dittmer

1 Direct, Tr. at 290:19-291:2. In addition to the decreased purchase price, the parties to the
2 Settlement Agreement negotiated an additional \$10 million reduction in the recorded cost
3 of the gas plant attributable to the Build-Out Program. *See* Exhibit JA-6, at 18. These
4 concessions by UniSource provide for a net utility plant in service value that is more than
5 \$40 million below the amount requested and supported by Citizens in its Gas Rate Case
6 filing. *See* Exhibit JA-6, at Appendix B, Sch.1. In other words, gas customers will
7 ultimately pay through rates only \$35 million of the approximately \$75 million spent by
8 Citizens on the Build-Out Program. *See* Glaser Cross-Examination, Tr. at 188:11-15.

9 Under the terms of the Settlement Agreement, Citizens' gas customers will
10 enjoy the significant benefits of the Build-Out Program and other capital improvements at
11 a significant discount from the actual cost of those improvements. As a result, the
12 requested annual revenue increase proposed by Citizens is reduced by approximately \$6
13 million, and Citizens' proposed monthly service charge for residential customers of \$10.00
14 is reduced to \$7.00. *See* Exhibit JA-6, at Appendix B, Sch. 1, 3. Although the increase in
15 gas base rates is not insignificant, it is important to note that customers of the Santa Cruz
16 division have not experienced a rate increase since 1987, and customers of the northern
17 division have not experienced a rate increase since 1996. *See* Exhibit S-1, at 8:11-13;
18 Dittmer Direct, Tr. at 289:21-25. Furthermore, following the increase approved in the
19 Settlement Agreement, gas customers will experience stability in base rates, as UniSource
20 has agreed in the Settlement Agreement to a three-year moratorium on the filing of a
21 future rate case. *See* Exhibit JA-6, at 19. A further benefit of the transaction is the
22 consolidation of the northern and southern gas divisions, which should allow for certain
23 administrative efficiencies and would extend to gas customers in Santa Cruz County low-
24 income programs currently available only to customers in the northern division. *See*
25 Glaser Direct, Tr. at 127:16-19; Glaser Cross-Examination, Tr. at 257:18-22.

26

1 **C. PPFAC Case and Other Electric-Related Issues**

2 In addition to the many benefits of this transaction for gas customers, this
3 transaction provides significant benefits for electric customers through the resolution of
4 the PPFAC Case and other commitments made by UniSource. Citizens first filed its
5 PPFAC Case in September of 2000. In that filing, Citizens requested full recovery of the
6 under-recovered balance for purchase power costs incurred under the 1995 contract (“Old
7 Contract”) between Citizens and APS. *See* Exhibit S-1, at 33:1-9. In an amended filing,
8 Citizens also requested a PPFAC surcharge to recover the costs under the 2001 contract
9 (“New Contract”) between Citizens and Pinnacle West Capital Corporation (“PWCC”).
10 *See id.* The PPFAC Case involved detailed analysis by all parties involved and many
11 complex issues relating to the treatment of those under-recovered amounts.

12 **1. Resolution of the PPFAC Case**

13 As part of the Settlement Agreement, UniSource has agreed that it will not
14 pursue recovery from retail customers of the PPFAC balance existing at the date of closing
15 of the purchase. *See* Exhibit JA-6, at 15. Currently, the parties estimate that this amount
16 will be approximately \$136.8 million. *See* Glaser Direct, Tr. at 128:18-21. As a result,
17 electric customers, who have not experienced an increase in power costs since 1997, will
18 have paid much less during this period than the cost of power that they have consumed.
19 *See* L. Smith Direct, Tr. at 298:9-15. Indeed, as explained by Staff, given the increase in
20 power costs, it is “surprising that [customers] did not experience increases several years
21 ago or maybe several increases.” L. Smith Direct, Tr. at 309:16-20.

22 Although much discussion in this proceeding has focused on the prudence of
23 the Old Contract, the Settlement Agreement makes those issues moot, as UniSource has
24 agreed not to pursue those amounts from retail customers. However, this should not
25 diminish the importance of UniSource’s agreement not to pursue recovery of those
26 amounts from retail customers. Indeed, if this transaction does not close, Citizens has

1 vowed to continue to pursue full recovery of the PPFAC balance. *See* McCarthy Cross-
2 Examination, Tr. at 467:13. Under Citizens’ proposal for recovery in the PPFAC Case,
3 rates would increase by more than 40 percent. *See* RUCO-1, at 3:4-5; Jaress Cross-
4 Examination Tr. at 328:4-5; 343:13; 344:6-7. As Staff explained, under a “best case”
5 scenario for customers, rates under the PPFAC would increase by approximately 27
6 percent. *See* L. Smith Cross-Examination, Tr. at 345:5-7; 345:11-12. Because UniSource
7 has agreed to forego recovery of the PPFAC balance existing at the time of closing, the
8 rate increase under the Settlement Agreement will be approximately 22 percent. *See*
9 Exhibit JA-6, at 15; L. Smith Direct, Tr. at 309:1-5.

10 To account for the increase in power costs, the Settlement Agreement sets a
11 new PPFAC adjustor of \$0.01825 per kWh, with the base rate remaining at \$0.05194 per
12 kWh. *See* Exhibit JA-6, at Appendix C. Although the increase under the Settlement
13 Agreement is not insubstantial, the increase is “quite justified” as it represents an increase
14 in the cost of power experienced by Citizens under the New Contract. *See* L. Smith
15 Direct, Tr. at 309:4-5. Based upon a detailed analysis, Staff has concluded that the cost of
16 power under the New Contract is reasonable. *See* L. Smith Direct, Tr. at 304:24-25.
17 RUCO’s analysis also confirmed that, on a going-forward basis, the cost of power under
18 the New Contract is reasonable and that the increases to the PPFAC adjustor rate are cost-
19 based. *See* Diaz Cortez Cross-Examination, Tr. at 549:14-20; 576:11; Diaz Cortez Re-
20 Direct, Tr. at 577:12.

21 The detailed testimony presented and analysis conducted by Mr. DeConcini
22 support the same conclusion. *See* Exhibit JA-9; DeConcini Cross-Examination, Tr. 165:7;
23 196:9-13. In his analysis, Mr. DeConcini explained that the New Contract is a full-
24 requirements supply agreement, which requires PWCC to meet the instantaneous demand
25 of Citizens’ customers for a price of \$58.79 per MWh. *See* Exhibit JA-9, at 2:18-19;
26 DeConcini Direct, Tr. at 138:15-25. Mr. DeConcini’s analysis provides three bases for

1 comparison. First, when compared to other comparable power contracts signed in 2001,
2 which had prices ranging from \$60 per MWh to \$165 per MWh, the New Contract price of
3 \$58.79 per MWh is reasonable. *See* Exhibit JA-9, at 4:18-5:19; DeConcini Direct, Tr. at
4 139:22-140:10. Second, when compared to a cost of power of \$55 to \$65 per MWh,
5 which Citizens would have paid in 2001 had it built a combined cycle unit to provide
6 power or had a third party build such a unit, the New Contract is reasonable. *See* Exhibit
7 JA-9, at 5:22-6:8; DeConcini Direct, Tr. at 140:11-22. Finally, when compared to the
8 same range of \$55 to \$65 per MWh if Citizens were to build the same type of combined
9 cycle unit in today's market, the New Contract is reasonable. *See* Exhibit JA-9, at 8:23-
10 9:16; DeConcini Direct, Tr. at 140:23-141:3. As Mr. DeConcini explained, because two
11 years of the existing PPFAC balance that will be forfeited relate to the New Contract—a
12 contract that has proven to be reasonable—electric customers receive an enormous benefit
13 from the forfeiture of any recovery for this period. *See* DeConcini Cross-Examination, Tr.
14 at 184:11-15; L. Smith Direct, Tr. at 304:24-25.

15 **2. Other Benefits of the Transaction**

16 In addition to the benefits relating to the forfeiture of more than \$135 million
17 of the PPFAC balance, electric customers will benefit from stable power costs for the
18 remaining life of the New Contract. *See* Exhibit S-1, at 32:1-2. Furthermore, if
19 UniSource successfully renegotiates the contract with PWCC, customers will receive sixty
20 percent of the savings under the renegotiated contract. *See* Exhibit JA-6, at 15-16. The
21 Settlement Agreement also provides for a permanent reduction in the electric rate base
22 reflecting the negative acquisition adjustment resulting from the discounted purchase
23 price, which will provide benefits to electric customers in future rate cases. *See* L. Smith
24 Direct, Tr. at 297:12-16. RUCO's estimate of the impact of this write down is a reduction
25 of approximately \$17 million to the annual electric revenue requirement. *See* RUCO-1, at
26 4:19-20. Similarly, as with gas rates, UniSource has agreed to a three-year moratorium on

1 the filing of an electric rate case. *See* Exhibit JA-6, at 19. Finally, UniSource has agreed
2 to complete a feasibility study for the consolidation or coordination of the Santa Cruz
3 electric operations of the new company with the operations of TEP and to establish a
4 process to open the new company's electric service territory to competition by December
5 31, 2004. *See* Exhibit JA-6, at 8-9. These benefits would not arise without the purchase
6 of the assets by UniSource and, therefore, provide overwhelming evidence that the
7 approval of the Settlement Agreement is in the public interest.

8 **3. Other Issues Raised by Intervenors**

9 Although supporting the majority of the Settlement Agreement, RUCO has
10 raised two issues relating to electric operations. First, RUCO requests an increase in funds
11 used for demand side management ("DSM") from \$175,000 to \$600,000 (and possibly \$1
12 million if the New Contract is renegotiated). Although UniSource agrees that the efficient
13 use of electricity is a worthwhile and important goal, there are differences in opinion as to
14 the best means to achieve this goal. *See* Exhibit JA-5, at 3:10-13. Currently, Citizens' per
15 customer funding for DSM is comparable to the level of funding for DSM activities by
16 other electric utilities in Arizona. *See* Exhibit JA-5, at 6. RUCO's proposal would
17 greatly inflate DSM spending and would result in upward pressure on rates—the very
18 issue that RUCO seeks to avoid. *See* Glaser Direct, Tr. at 130:18-25; Glaser Cross-
19 Examination, Tr. at 167:17-21. As Ms. Diaz Cortez testified, this upward pressure on
20 rates would occur "whether [the DSM programs] worked or they didn't." Diaz Cortez
21 Cross-Examination, Tr. at 573:9-10.

22 As discussed by Mr. Glaser, the Commission has shifted its focus from
23 funding DSM programs to market-based solutions and to the development of renewable
24 energy resources. *See* Exhibit JA-5, at 3:20-22. In light of this shift and the
25 Commission's direction to explore DSM issues in the Track B workshops, it is premature
26 to address these issues in this proceeding. *See* Glaser Cross-Examination, Tr. at 130:16-

1 25. UniSource has committed to work with RUCO and other interested parties to re-
2 allocate the DSM funds to more effectively use those funds to benefit customers. *See*
3 Exhibit JA-5, at 6:20-22. However, until the Commission provides more direction on the
4 issue of DSM, UniSource submits that the current level of DSM funding is appropriate.

5 RUCO and other intervenors also challenge the sharing of any savings of a
6 renegotiated power contract with PWCC. UniSource submits that the sharing is
7 appropriate to continue to achieve the balancing of interests set forth in the Settlement
8 Agreement. This issue cannot be viewed on a stand-alone basis. As Staff explained, the
9 parties negotiated many diverse issues, including the sharing of savings, and any
10 modification to this provision will upset the balance struck by the parties to the Settlement
11 Agreement. *See Jaress Direct, Tr. at 330:20-23.* Given the substantial benefits achieved
12 for customers, this issue must be viewed “as part and parcel of the entire settlement
13 package” and should not be revised. Exhibit JA-5, at 3:4-6.

14 Other intervenors also raised the issue of the transmission line between
15 Tucson and Nogales approved in Decision No. 64356. The Joint Applicants have
16 maintained throughout this proceeding and continue to maintain that the transmission line
17 is not an issue in this proceeding and will be addressed in another docket at the appropriate
18 time. *See Pignatelli Cross-Examination, Tr. at 114:16-23.* Similarly, the issue of
19 franchises to provide electric service has been raised in this proceeding. The Settlement
20 Agreement appropriately requires UniSource to file copies of appropriate franchises,
21 licenses and other similar authorizations to the Commission within 365 days of approval
22 of the transfer. *See Exhibit JA-6, at 8.* Such a provision is standard in Commission orders
23 and allows the Joint Applicants the necessary time to procure and to process the
24 assignment of these authorizations. *See Jaress Cross-Examination, Tr. at 354:16-27.* If
25 UniSource is unable to meet this condition within 365 days, it is wholly appropriate for
26 UniSource to return to the Commission so that the Commission may address the issue at

1 that time. *See* Jaress Cross-Examination, Tr. at 356:14-17. The Commission should reject
2 the City of Nogales' self-serving suggestion that a penalty should be automatically
3 imposed. *See* City of Nogales Opposition to Proposed Settlement Agreement (April 21,
4 2003), at 1-2.

5 **D. Financing the Transaction**

6 The Settlement Agreement provides UniSource with the necessary flexibility
7 to consummate this transaction in a timely and cost-effective manner, while ensuring the
8 continued success and viability of the new electric and gas companies and TEP. *See*
9 Exhibit JA-7, at 2:20-21; Larson Direct, Tr. at 132:11-15. UniSource intends to create an
10 intermediate holding company ("HoldCo") and two operating companies—one to operate
11 the electric assets ("ElecCo") and one to operate the gas assets ("GasCo"). *See* Exhibit
12 JA-6, at 7-10. UniSource intends to target the two operating companies for a 60/40 debt-
13 to-equity ratio. *See* Larson Direct, Tr. at 149:5-18. To provide incentive for the
14 companies to achieve this ratio, the Settlement Agreement provides that GasCo and
15 ElecCo shall not issue dividends to HoldCo or to UniSource that total more than seventy-
16 five percent of their respective earnings until equity capitalization equals forty percent of
17 total capital. *See* Exhibit JA-6, at 12-13. In good faith, TEP agreed to the same
18 restriction, which modifies a lesser equity capitalization threshold of 37.5 percent from a
19 prior Commission order.² *See id.* at 13.

20 Under the terms of the Settlement Agreement, the new companies are
21 authorized: (1) to issue or to guarantee up to \$175 million of debt securities in order to
22 fund a portion of the acquisition or to refinance any bridge financing used to fund the
23 acquisition; (2) to issue or to guarantee additional debt securities, when appropriate, under
24

25 ² At the hearing, the issue of a graduated dividend structure was discussed. UniSource
26 objects to such a structure and believes that such a structure is not appropriate in this
proceeding. *See* JA-8, at 7:3-11.

1 the terms of a new revolving credit agreement that would provide ongoing liquidity
2 support; (3) to enter into indentures or security agreements which grant liens on some or
3 all of the properties held by the new companies to secure the debt obligations of the new
4 companies; (4) to issue common stock to UniSource or to HoldCo; and (5) to acquire
5 bridge financing to fund all or a portion of the acquisition on an interim basis in an amount
6 not to exceed \$250 million. *See* Exhibit JA-6, at 10-12; Appendix A.

7 The bridge financing would allow UniSource to close this transaction if the
8 long-term capital market is not favorable at the time of closing. *See* Larson Direct, Tr. at
9 133:13-22. The amounts approved for interim bridge financing and the amounts approved
10 for long-term bond financing are not additive. Rather, the funds from the long-term bond
11 financing will be used to pay off any interim bridge financing. *See* Exhibit JA-6, at
12 Appendix A; Jaress Cross-Examination, Tr. at 317:25. Furthermore, although the
13 Settlement Agreement allows the new companies to enter into a revolving credit
14 agreement in an amount not to exceed \$50 million, the use of the revolving credit
15 agreement will be for short-term liquidity needs of the utility. *See* Jaress Cross-
16 Examination, Tr. at 318:16; Thornton Cross-Examination, Tr. at 442:21-23. As explained
17 by Staff and by UniSource, the revolving credit facility will address seasonal cash flow
18 issues, such as those relating to increased gas prices, and will not be used to fund the
19 initial purchase price. *See* Larson Cross-Examination, Tr. at 263:8-12; Jaress Cross-
20 Examination, Tr. at 318:12. The use of a revolving credit agreement is standard in the
21 utility industry and allows utilities to address short-term cash flow needs. *See* Jaress
22 Cross-Examination, Tr. at 318:8.

23 In addition to the financing described above, the Settlement Agreement
24 authorizes TEP to loan up to \$50 million to UniSource to provide UniSource with the
25 necessary flexibility to close this transaction. *See* Thornton Direct, Tr. at 313:17-19. TEP
26 has sufficient cash flows to provide the loan to UniSource, and the loan will not have an

1 adverse impact on TEP. *See* Larson Cross-Examination, Tr. at 146:25-147:5; 170:8-11.
2 Despite this, TEP has agreed to certain restrictions on the loan to benefit its customers and
3 to ensure that its customers are held harmless from the loan. For example, the loan will be
4 secured with one hundred percent of the common equity of HoldCo or the new companies,
5 the term of the loan is limited to four years, and the Settlement Agreement requires
6 UniSource to pay interest on the loan at a rate of 383 basis points above the rate on an
7 equivalent U.S. Treasury security. *See* Exhibit JA-6, at 10-11. The agreement also
8 requires TEP to use 262 basis points of the interest income as a credit to customers to
9 reduce rates in the future. *See id* at 11. The remaining interest income will be used to
10 build TEP's equity capitalization. *See id*. As an added protection, the Settlement
11 Agreement provides that TEP customers will be held harmless from any increase in the
12 cost of capital as a result of the loan. *See id*.

13 The financing plan set forth in the Settlement Agreement provides
14 UniSource with the necessary flexibility to close this transaction and to adequately
15 capitalize the new companies. Although the Joint Applicants appreciate the concerns
16 regarding the financing raised during this proceeding, they submit, as did Staff, that the
17 financing plan proposed is necessary to close this transaction in a timely and cost-effective
18 manner and that the substantial benefits provided by this transaction make the approval of
19 this financing plan in the public interest. *See* Thornton Direct, Tr. at 314:4-8.

20 **III. RELIEF REQUESTED/CONCLUSION**

21 For the reasons set forth above, Joint Applicants request the approval of the
22 Settlement Agreement and all necessary approvals for the transactions contemplated in the
23 Settlement, including:

- 24 • necessary approvals pursuant to A.R.S. § 40-285 for Citizens to
25 transfer its Arizona gas assets and electric assets, including its Certificates of Convenience

26

1 and Necessity, to UniSource and for ElecCo and GasCo to encumber the gas assets and
2 electric assets for financing purposes;

3 • necessary approvals pursuant to A.R.S. §§ 40-301 *et seq.* for the
4 financing of the transaction, including bridge financing, bond financing, and revolving
5 credit financing by ElecCo and GasCo and the issuance of stock by those companies,
6 including, but not limited to, appropriate findings pursuant to A.R.S. §§ 40-301.C and
7 -302.A.

8 • necessary approvals pursuant to A.A.C. R14-2-801 *et seq.* for the loan
9 from TEP to UniSource;

10 • necessary approvals under A.A.C. R14-2-801 *et seq.* for the
11 capitalization of ElecCo and GasCo;

12 • waiver of that portion of Decision No. 60480, as amended by
13 Decision No. 62103, that requires UniSource to invest thirty percent of the proceeds of a
14 public stock issuance in TEP so that UniSource may fund this acquisition;

15 • approval of the increased revenue requirement for GasCo, the new
16 rate design for GasCo, and a tariff modification relating to the service line and main
17 extension policy, all as set forth in the Settlement Agreement;

18 • a fair value rate base finding of \$142,132,013 and a rate of return on
19 the fair value rate base of 7.49 percent in the Gas Rate Case;

20 • approval of a new PPFAC adjustor of \$0.01825 per kWh;

21 • approval to recover certain asset acquisition costs as an offset to the
22 negative acquisition premium; and

23 • all other approvals necessary to approve the Settlement Agreement
24 and to consummate the transactions contemplated in the Joint Application.

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26

Respectfully submitted this 15th day of May, 2003.

LEWIS AND ROCA LLP

By Michael T. Hallam
Thomas H. Campbell
Michael T. Hallam
40 N. Central Avenue
Phoenix, Arizona 85004
Attorneys for Joint Applicants

ORIGINAL AND seventeen (17) copies
of the foregoing hand-delivered
this 15th day of May, 2003, to:

Arizona Corporation Commission
Utilities Division – Docket Control
1200 W. Washington Street
Phoenix, Arizona 85007

COPY of the foregoing hand-delivered
this 15th day of May, 2003, to:

Marc Spitzer
Chairman
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Jim Irvin
Commissioner
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

William A. Mundell
Commissioner
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

LEWIS
AND
ROCA
L.L.P.

LAWYERS

1 Mike Gleason
Commissioner
2 Arizona Corporation Commission
1200 W. Washington Street
3 Phoenix, Arizona 85007

4 Jeff Hatch-Miller
Commissioner
5 Arizona Corporation Commission
1200 W. Washington Street
6 Phoenix, Arizona 85007

7 Jason Gellman
Lisa A. Vandenberg
8 Legal Division
Arizona Corporation Commission
9 1200 W. Washington Street
Phoenix, Arizona 85007

10 Dwight D. Nodes
11 Assistant Chief Administrative Law Judge
Arizona Corporation Commission
12 1200 W. Washington Street
Phoenix, Arizona 85007

13 Ernest Johnson, Director
14 Utilities Division
Arizona Corporation Commission
15 1200 W. Washington Street
Phoenix, Arizona 85007

16 Christopher Kempley, Chief Counsel
17 Legal Division
18 Arizona Corporation Commission
1200 W. Washington Street
19 Phoenix, Arizona 85007

20 COPY of the foregoing sent by mail
21 this 15th day of May, 2003,
to:

22 Andrew W. Bettwy
23 Assistant General Counsel
Southwest Gas Corporation
24 5241 Spring Mountain Road
25 Las Vegas, Nevada 89150
26

LEWIS
AND
ROCA
LLP

LAWYERS

- 1 Scott Wakefield
Daniel W. Pozefsky
- 2 RUCO
Suite 1200
- 3 2828 N. Central Avenue
Phoenix, Arizona 85004
- 4
- 5 Walter Meek, Esq.
Arizona Utility Investors Association
2100 N. Central Ave., Suite 210
- 6 Phoenix, Arizona 85004
- 7
- 8 Christine Nelson
John White
Deputy County Attorney
P.O. Box 7000
- 9 Kingman, Arizona 86402-7000
- 10
- 11 Susan Mikes Doherty
John D. Draghi
Huber Lawrence & Abell
605 3rd Avenue
- 12 New York, New York 10158
- 13
- 14 Marshall Magruder
Lucy Magruder
P.O. Box 1267
Tubac, Arizona 85646
- 15
- 16 Robert J. Metli
Cheifetz & Iannitelli, P.C.
3238 N. 16th Street
- 17 Phoenix, Arizona 85016
- 18
- 19 Jose L. Machado
City Attorney, City of Nogales
777 N. Grand Avenue
Nogales, Arizona 85621
- 20
- 21 Holly J. Hawn
Martha S. Chase
Santa Cruz County Attorney
2150 N. Congress Drive
Suite 201
- 22 Nogales, Arizona 85621
- 23
- 24 Vincent Nitido
Tucson Electric Power
One S. Church Ave., Suite 1820
- 25 Tucson, Arizona 85701
- 26

LEWIS
AND
ROCA
LLP
LAWYERS

1 Deborah Scott, Associate General Counsel
Citizens Communications Company
2 2901 N. Central Avenue
Suite 1660
3 Phoenix, Arizona 85012-2736

4 L. Russell Mitten
Citizens Communications Company
5 Three High Ridge Park
Stamford, CT 06905

6 Gary Smith
7 Citizens Communications Company
2901 W. Shamrell Boulevard
8 Suite 110
Flagstaff, Arizona 86001

9 Raymond Mason, Director, Corporate Regulatory Affairs
10 Citizens Communications Company
Three High Ridge Park
11 Stamford, CT 06905

12 Tom Ferry
P.O. Box 3099
13 Kingman, Arizona 86402-3099

14 Nicholas J. Enoch
Lubin & Enoch, P.C.
15 349 N. Fourth Avenue
Phoenix, AZ 85003

16

17

18

Betty J. Griffin

19

20

21

22

23

24

25

26

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IN THE MATTER OF THE APPLICATION)
OF THE ARIZONA ELECTRIC DIVISION)
OF CITIZENS COMMUNICATIONS)
COMPANY TO CHANGE THE CURRENT)
PURCHASED POWER AND FUEL)
ADJUSTMENT CLAUSE RATE, TO)
ESTABLISH A NEW PURCHASED)
POWER AND FUEL ADJUSTMENT)
CLAUSE BANK, AND TO REQUEST)
APPROVED GUIDELINES FOR THE)
RECOVERY OF COSTS INCURRED IN)
CONNECTION WITH THE ENERGY)
RISK MANAGEMENT INITIATIVES.)

DOCKET NO. E-01032C-00-0751

IN THE MATTER OF THE APPLICATION)
OF CITIZENS COMMUNICATIONS)
COMPANY, ARIZONA GAS DIVISION,)
FOR A HEARING TO DETERMINE THE)
FAIR VALUE OF ITS PROPERTIES FOR)
RATEMAKING PURPOSES, TO FIX A)
JUST AND REASONABLE RATE OF)
RETURN THEREON, AND TO APPROVE)
RATE SCHEDULES DESIGNED TO)
PROVED SUCH RATE OF RETURN.)

DOCKET NO. G-01032A-02-0598

IN THE MATTER OF THE JOINT
APPLICATION OF CITIZENS
COMMUNICATIONS COMPANY AND
UNISOURCE ENERGY CORPORATION
FOR THE APPROVAL OF THE SALE OF
CERTAIN ELECTRIC UTILITY AND
GAS UTILITY ASSETS IN ARIZONA,
THE TRANSFER OF CERTAIN
CERTIFICATES OF CONVENIENCE
AND NECESSITY FROM CITIZENS
COMMUNICATIONS COMPANY TO
UNISOURCE ENERGY CORPORATION,
THE APPROVAL OF THE FINANCING
FOR THE TRANSACTIONS AND OTHER
RELATED MATTERS.

DOCKET NO. E-01933A-02-0914
DOCKET NO. E-01032C-02-0914
DOCKET NO. G-01032A-02-0914

JOINT APPLICANTS' POST-HEARING BRIEF

APPENDIX

May 15, 2003

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At: Phoenix, Arizona

Date: May 1, 2003

Filed: **MAY - 7 2003**

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME I
(Pages 1 - 275, inclusive)

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2627 North Third Street
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By: **DAWNA J. BOSWELL, RPR**
Certified Court Reporter
Certificate No. 50326

Prepared for:

CITIZENS AND UNISOURCE

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(When in red)

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1 Additionally, a lot of people like to utilize
2 power market index prices to estimate the relevance or
3 the reasonableness of power prices, and first, as I've
4 already stated, you have to look at time and compare
5 the relative, an index that meets the time when you
6 need the power. In addition to that, however, those
7 price indexes tend to relate to power that's purchased
8 in blocks. In reality, people demand their power in
9 much smaller increments than those blocks represent.
10 They want their power to be there when the air
11 conditioning goes on or when the lights go on, and
12 there are costs above those index prices that are
13 incurred by utilities in fully serving the demand of
14 their customer base.

15 With those three key points, I will move on
16 to talking briefly about the Pinnacle West agreement
17 with Citizens. The Pinnacle West agreement with
18 Citizens was signed in May or June of 2001. It runs
19 through May of 2008. It is a full requirement supply
20 agreement. What that means is all of those elements
21 that I discussed in my opening are included in that
22 agreement, and Pinnacle West is thus required to meet
23 the instantaneous demand of Citizens' customers
24 whenever they happen to turn on those lights or air
25 conditioners. Conversely, when they turn those things

1 off, Pinnacle West needs to take the power back. In
2 exchange for this obligation, Pinnacle West receives
3 \$58.79 per megawatt hour.

4 And there's a couple other important factors
5 I want to mention. Because that price is fixed and
6 power markets have been fairly volatile, there's a
7 benefit to Citizens' customers in that the power price
8 risk is all to the benefit of Pinnacle West.
9 Additionally, all the operational risk of delivering
10 the power is also in Pinnacle West's hands. And a
11 last beneficial point is that as Steve has mentioned
12 and I believe Jim Pignatelli also mentioned earlier,
13 per our settlement, we're required to open the
14 Citizens customer base to competition by the end of
15 2004. The structure of the existing Pinnacle West
16 agreement allows for that to occur with no penalty to
17 Citizens or its customers, and we think that's
18 important as well.

19 Now, you ask how did I look at this agreement
20 and determine whether the pricing was reasonable. I
21 looked at it in three different ways that I'll discuss
22 briefly now. First, the first two I looked at were in
23 the time frame in 2001 when the agreement was signed,
24 and I think it's most relevant to look at the time
25 frame in which the contract was signed and where the

1 markets were at that time. The first measure was to
2 look at other contracts that were signed in the
3 marketplace for either similar terms to the Pinnacle
4 West agreement or in some cases longer terms. And you
5 may recall some of the California situation was at a
6 head at that point in time and the State of California
7 was signing many long-term agreements. So there are
8 quite a few comparables out there. The prices in
9 those comparables range from \$60 per megawatt hour to
10 \$165 per megawatt hour.

11 An additional look and analysis that we've
12 done to determine the reasonableness in the 2001 time
13 frame is we made the assumption that Citizens either
14 built a combined cycle unit to serve their load or had
15 someone build one for them and purchased the power
16 from them. Then we determined what forward gas prices
17 and power market prices were at that time, and we
18 dispatched that generating unit to meet the load and
19 also dispatched the market against that generating
20 unit when the market was at a better cost point. The
21 results that came out of that study were the price for
22 power in the range of 55 to \$65 per megawatt hour.

23 I've done one additional analysis in today's
24 time frame. We did the same analysis that was done
25 with the combined cycle case and took today's forward

1 gas prices and today's power market prices, and
2 interestingly came up with the same price range of 55
3 to \$65 per megawatt hour for that service.

4 To summarize, in all the ways that I've
5 looked at the Pinnacle West agreement, the pricing
6 seems to be reasonable, and therefore, I think it's
7 valid to pass those costs on to the retail customers
8 of Citizens.

9 MR. CAMPBELL: Thank you, Mr. DeConcini.

10 The UniSource panel is available for
11 cross-examination.

12 ACALJ NODES: All right. Mr. Gellman, any
13 questions for the panel?

14 MR. GELLMAN: Yes, Your Honor.

15

16 CROSS-EXAMINATION

17

18 Q. (BY MR. GELLMAN) Good afternoon, gentlemen.

19 Mr. Glaser, I'd like to start with you and
20 talk a little bit more about the process. Is it fair
21 to say that you were one of the principals involved,
22 not just in the January meetings involving all the
23 intervenors but throughout the negotiation process
24 with Staff as part of this Joint Application?

25 A. (BY MR. GLASER) Yes, it is. I was the

1 estimate to be the fuel adjustment clause balance,
2 approximately 48 million of that has been accrued
3 since the signing of the new agreement.

4 Q. So let me summarize your testimony. Is it
5 your testimony that the Pinnacle West contract was
6 prudent when it was negotiated in June of 2001?

7 A. (BY MR. DeCONCINI) Yes, it is.

8 Q. And is it your testimony that the contract
9 price today is reasonable today and into the
10 foreseeable future?

11 A. (BY MR. DeCONCINI) Yes, it is.

12 Q. We've had some odd circumstances in this
13 proceeding since it first began, and so I'm going to
14 ask a couple questions that maybe seem a little odd.
15 They're for the whole panel. Does anybody up there
16 play Saturday night poker with Bill Post or Jack
17 Davis?

18 A. (BY MR. GLASER) No.

19 Q. Is anybody married to Bill Post's sister?
20 No?

21 A. (BY MR. GLASER) No.

22 Q. Is anybody in a real estate partnership with
23 either of those guys?

24 A. (BY MR. GLASER) No.

25 A. (BY MR. DeCONCINI) No.

1 that's currently being requested as far as that rate,
2 this additional \$50 million?

3 A. (BY MR. DeCONCINI) No, that additional
4 \$51 million we are actually also not requesting
5 recovery of in this process. It's part of that
6 \$136 million that we're saying, "Okay, all these
7 dollars go away. In exchange, we would like to
8 receive the full cost of the current Pinnacle West
9 agreement in rates." So all the PPFAC including the
10 last 24 months under the new agreement are going away
11 under the settlement. And as I've stated, I believe
12 the contract with Pinnacle West to be reasonable, so
13 if that's reasonable, you're getting a bargain by not
14 having to ever pay for those costs that have been
15 incurred in the last two years.

16 Q. I think I understand, but to make sure that I
17 understand, the new, the proposed settlement agreement
18 continues that, even though that 50 million is gone,
19 the new Settlement Agreement will contain for the
20 years to come the equivalent of the \$50 million that
21 you're including in this forfeiture, PPFAC forfeiture
22 under this agreement?

23 A. (BY MR. DeCONCINI) It will include those
24 dollars on an annualized basis in the rates, but those
25 dollars won't flow to the PPFAC. There won't be a

1 you looked at putting in your own resource to serve
2 the load and came up with a price in the \$60 range,
3 both of which made in my view the contract look
4 reasonable in that time frame.

5 So I think the conclusion you're trying to
6 draw is that somehow this contract is totally invalid
7 because there is alleged or actually there's found to
8 have been some market manipulation during that time
9 frame. The conclusion I have drawn is that in fact,
10 this contract is reasonable in light of everything
11 that was going on during that time frame, including
12 the market manipulation that is alleged in this, or as
13 determined in this FERC Opinion.

14 Q. One of the factors you cite on page 12 of
15 your conclusion is the fact, and correct me if I'm not
16 characterizing this properly. I am on line 23 on
17 page 12, that one of the factors that entered into
18 your conclusion was the fact of PWCC and Citizens had
19 equal access to market prices, conditions, and
20 information. If the information they have is somehow
21 tainted by this market manipulation, do you still feel
22 that customers or ratepayers should be responsible for
23 bearing the burden of that erroneous information?

24 A. (BY MR. DeCONCINI) Yes, because if you read
25 the Staff Report and the conclusion that was supported

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7 At: Phoenix, Arizona

8 Date: May 5, 2003

9 Filed: **MAY - 8 2003**

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13 REPORTER'S TRANSCRIPT OF PROCEEDINGS

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VOLUME III
(Pages 504 through 596)

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Court Reporting
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24

25

MR. THOMAS H. CAMPBELL
Attorney at Law

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1 of the settlement agreement to be that it included a
2 write-off of the \$135 million PPFAC liability. The
3 settlement also included a writedown of both the gas and
4 electric rate base. For all time, we might add, not just
5 specifically for the cases in front of us.

6 We also found that the sale and transfer was
7 in the public interest, that UniSource was a reputable,
8 reliable, and known entity to run the former Citizens
9 electric and gas properties.

10 However, we found that, unfortunately, the
11 settlement agreement, despite its merits, would result in
12 relatively high rate increases of approximately 21 percent
13 for the gas and 22 percent for the electric, so in my
14 testimony, we proposed two modifications to the settlement
15 agreement which are aimed at mitigating the 22 and 21
16 percent rate increases, respectively.

17 The first is we're proposing that UniSource
18 invest in DSM programs which would give Citizens'
19 customers the tools, if you will, to enable them to
20 mitigate a portion, if not all, of the unfortunate result
21 of these rate increases.

22 Currently, Citizens has \$175,000 embedded in
23 its base rates for DSM programs. We're proposing that be
24 increased to 25 million to bring it up to a total of
25 \$1 million per year spent on DSM. Appendix 2 of my

1 the Santa Cruz and northern Arizona.

2 MR. WAKEFIELD: Thank you.

3 With that I'll move RUCO Exhibit 1, and
4 Ms. Diaz Cortez is available for cross-examination.

5 ACALJ NODES: Any objection to the admission
6 of the exhibit?

7 (No response.)

8 ACALJ NODES: RUCO Exhibit 1 is admitted.

9 Mr. Campbell, do you have questions for
10 Ms. Diaz Cortez?

11 MR. CAMPBELL: Just a few. Thank you, Your
12 Honor.

13

14 CROSS-EXAMINATION

15 BY MR. CAMPBELL:

16 Q. Good morning, Ms. Diaz Cortez. I think it's
17 fair to say that RUCO believes there's much to like in
18 this settlement agreement; would you agree with that?

19 A. Yes.

20 Q. In fact, you mentioned that one of the
21 examples was the forfeiture of the large PPFAC balance; is
22 that correct?

23 A. Yes.

24 Q. I think another example you mentioned in your
25 summary was reduced rate base; is that correct?

1 A. Yes.

2 Q. Is it also correct that you actually, in your
3 testimony, calculated that you thought there would be an
4 annual electric revenue requirement reduction of
5 approximately \$17 million as a result of the electric rate
6 writedown; is that correct?

7 A. Yes.

8 Q. And I think you also mentioned as a benefit,
9 there will be a rate moratorium on the electric side; is
10 that correct?

11 A. Yes.

12 Q. On the gas side, similarly, I think you did an
13 analysis and I think you determined that there would be an
14 annual reduction in gas revenue requirement as a result of
15 this writedown of approximately 5.5 million; is that
16 correct?

17 A. Yes.

18 Q. And would you agree that there are some
19 additional benefits, following additional benefits to this
20 program, to this settlement agreement? For instance, I
21 think I just heard you say this, there's a benefit from
22 operational consolidation?

23 A. Yes.

24 Q. Do you believe it's also a benefit that both
25 the new company and TEP have agreed to restriction on the

1 issuance of dividends till they get 40 percent equity?

2 A. Yes.

3 Q. And would you agree it's a benefit that in the
4 settlement agreement there is a required maintenance in
5 quality of service and safety standards?

6 A. Yes.

7 Q. And would you agree another benefit of the
8 settlement agreement is that the ratepayers are held
9 harmless from any excess transition costs resulting from
10 any delays in the transfer?

11 A. Yes.

12 Q. Would you agree that there are potentials for
13 economies of scale from this transaction?

14 A. Yes.

15 Q. Now, with respect to DSM, were you here when
16 Mr. Glaser testified last week?

17 A. Yes.

18 Q. Do you remember that Mr. Glaser offered to
19 reconfigure the use of the current DSM amounts if it had
20 to work with other parties such as RUCO to reconfigure the
21 current DSM amounts, if they could be used more
22 effectively?

23 A. I believe he testified to something similar to
24 that.

25 MR. CAMPBELL: Thank you. I have no further.

1 Mr. Holub.

2 MR. HOLUB: Thank you.

3

4

CROSS-EXAMINATION

5 BY MR. HOLUB:

6 Q. As I understand your testimony, you have two
7 recommendations, the DSM and the reduction in percentage
8 aimed at mitigating the impact on the rate increase on the
9 ratepayers; is that correct?

10 A. Yes.

11 Q. Why do you feel there should be a mitigation
12 on the impact to the ratepayers?

13 A. Because 22 percent is a large increase.
14 Unfortunately, from our analysis, it's cost based and a
15 lot of debate, had we had the PPFAC filing and a lot of
16 these other things would go to the dysfunctional markets
17 during 2000, 2001, and why these price spikes occurred.
18 But the fact remains that they did, and so we were looking
19 at a situation where the costs were incurred, and the
20 costs have to be recovered.

21 The company has gone a long way to share in
22 the responsibility or mitigation of what would be in
23 writing off the 135 million. But still, 22 is better than
24 45, but 22 is a lot to ask of people to pay. And I
25 understand that there's proportionately more low income

1 Q. Ms. Diaz Cortez, I obviously understand that
2 everybody would operate in good faith and try to develop
3 programs that would work, but my question is really kind
4 of a ratemaking, theoretical ratemaking question.

5 If additional moneys were to be spent on DSM,
6 and if those DSM programs, despite good efforts by
7 everyone, don't work, isn't the result upward pressure on
8 rates in the next rate case?

9 A. That would be true whether they worked or they
10 didn't.

11 Q. Thank you.

12 One final question. Are you aware of the fact
13 that as a part of the Commission agenda, that Staff will
14 be studying in a more generic sense DSM programs during
15 the course of the next year?

16 A. Could you read the first part of that
17 question?

18 Q. Are you aware that the Commission, primarily
19 Staff, will be studying DSM programs for a generic
20 proceeding during the course of the next year?

21 A. Pursuant to?

22 Q. I think it's just pursuant to an agenda set
23 forth by the Commission. Are you aware of that?

24 A. No.

25 MR. CAMPBELL: Thank you. No further

1 Pinn West, that being the one in 2001? Did you analyze
2 the reasonableness of that agreement?

3 A. I believe that was done about a year and a
4 half ago, when the PPFAC was proceeding on its own, or the
5 PPFAC docket was proceeding on its own.

6 Q. Okay. And was it RUCO's conclusion that you
7 agreed with Staff, at least as part of this settlement
8 agreement, that the contract or at least the price set
9 forth therein was a reasonable purchased power agreement
10 on a going-forward basis?

11 A. Yes.

12 Q. So RUCO did some form of analysis, came to the
13 conclusion that as Staff found, it was a reasonable
14 contract going into the future?

15 A. Yes. I think basically we used pretty much
16 the same criteria that we did when we looked at it back at
17 our testimony in 2002. The difference in the result is
18 primarily because of the difference in the economic power
19 environment today, versus a year or so ago, when we looked
20 at it before.

21 ACALJ NODES: Thank you.

22 Mr. Wakefield, redirect?

23 MR. WAKEFIELD: Yes. I'm going to start with
24 that last point.

25

1 REDIRECT EXAMINATION

2 BY MR. WAKEFIELD:

3 Q. Ms. Diaz Cortez, do you recall that RUCO's
4 position in the PPFAC docket before the joint application
5 was filed did include a concern that the wholesale price
6 of the new Pinnacle West contract was too expensive at the
7 time that that analysis was being performed?

8 A. Yes.

9 Q. But today, does RUCO believe that the Pinnacle
10 West contract is too expensive when you analyzed the
11 contract from today's perspective?

12 A. No.

13 Q. Ms. Diaz Cortez, would you agree with me that
14 demand-side management programs can have different kinds
15 of benefits for customers?

16 A. Yes.

17 Q. Specifically, they can have economic benefits
18 and they can have environmental benefits; is that correct?

19 A. Yes.

20 Q. What was RUCO's motivation in proposing DSM
21 programs as a part of this process? Was it the economic
22 benefits that RUCO was seeking or the environmental
23 benefits?

24 A. The economic. That's the reason we wanted
25 this part to be in the settlement. I think the

Dittmer

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At: Phoenix, Arizona

Date: May 2, 2003

Filed: **MAY - 7 2003**

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 276 through 503)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite Three
2627 North Third Street
Phoenix, Arizona 85004-1126

Prepared for: MR. THOMAS H. CAMPBELL
Attorney at Law

By: CECELIA BROOKMAN, RPR
Certified Court Reporter
Certificate No. 50154

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1 analysis of the buildout program?

2 A. (BY MR. DITTMER) Yes.

3 Q. And the Staff report, or that portion of the
4 Staff report, Pages 6 through 30, represents your
5 testimony in these proceedings?

6 A. (BY MR. DITTMER) It does.

7 Q. And could you summarize your portion of the
8 Staff report?

9 A. (BY MR. DITTMER) Certainly. The major
10 elements of the settlement agreement affecting Citizens'
11 Arizona gas properties, regulated retail rates and books
12 of account include the following major items: First, in
13 August of 2002, Citizens filed a gas base rate application
14 with the ACC, wherein it sought approximately a
15 \$21 million annual increase, or an overall average
16 increase of 28.9 percent. Pursuant to the settlement
17 agreement, base gas rates and rates will increase
18 approximately 15.2 million, which equates to an average
19 overall increase of 20.9 percent.

20 The 20.9 percent increase included in the
21 settlement agreement is not insignificant. However, the
22 Santa Cruz gas division has not had a base rate increase
23 for approximately 15 years, and the northern Arizona gas
24 division has not experienced a base rate increase for
25 approximately eight years.

1 Further, in Staff's view, the vast majority of
2 the increase in this case is attributable to the hard sunk
3 costs that Citizens has incurred by way of a massive
4 construction program in the form of a buildout.

5 Other than the controversy surrounding the
6 massive buildout program, the Staff views the Citizens gas
7 filing as a relatively clean rate filing that does not
8 include a lot of exaggerated cost of service claims.

9 UniSource has negotiated a purchase price that
10 was approximately 30.7 million below the net original
11 depreciated cost of Citizens' Arizona gas properties,
12 included in the December 31, 2001 test year ending rate
13 base, resulting in a negative acquisition adjustment.

14 The settlement rates pass on all the savings
15 from the negotiated sales price to Arizona retail gas
16 ratepayers in the instant case, as well as in all future
17 rate cases, until such time that negative acquisition
18 adjustment is fully amortized.

19 I would like to emphasize that the purchase of
20 energy properties below book value or significantly below
21 book value, as is the situation in the instant case, is
22 very unusual.

23 Further, the company's agreement to pass on
24 the purchase price savings to ratepayers in what is an
25 original cost ratemaking jurisdiction for the most part is

1 also very unusual, and results in significant savings to
2 ratepayers in this and future rate cases.

3 The settlement rates also incorporated
4 \$10 million writedown to gas plant in service attributable
5 to the buildout program. This noted \$10 million writedown
6 to gas plant is separate and distinct from and above and
7 beyond the negative acquisition adjustment just described.

8 Like the negative acquisition adjustment, the
9 \$10 million writedown to gas plant in service attributable
10 to the buildout program represents a permanent writedown
11 of the plant that results in savings to future Arizona gas
12 base rate proceedings as well as in the instant case.

13 If the Citizens gas rate case had proceeded or
14 has to proceed because the transaction before this
15 Commission is rejected, the buildout program issue will
16 prove, in my opinion, to be a highly complex, at least
17 somewhat subjective as to the quantification of an
18 imprudence allowance, and really a pretty colorful issue.

19 Regarding the complexity and subjectivity
20 surrounding the issues in the case, the Staff's case, if
21 we were to proceed in litigation, would likely include an
22 attempted quantification of the costs of the buildout pipe
23 between what should have been placed in service, if
24 Citizens had vigilantly restudied various elements of the
25 entire program, versus what Citizens actually placed in

1 service.

2 This will be a complex and somewhat subjective
3 calculation, inasmuch as many pipes constructed serve a
4 dual purpose of reinforcing the system to existing
5 customers for which Citizens did have an obligation to
6 provide service, as well as to service previously unserved
7 territories.

8 It is likely to be colorful in that you will
9 get to hear Gary Smith and perhaps others from that
10 organization state that they felt that Citizens had made a
11 commitment to proceed with the buildout program, and that
12 indeed, they felt they believed that the Commission was
13 pressuring them, if not an outright mandate to complete
14 the project as was originally presented to the Commission
15 in the 1993, '94 time frame.

16 An added benefit of the agreement is base
17 rates will not change, gas base rates will not change for
18 a three-year period, barring either emergency condition or
19 material change in cost of service attributable to a
20 select set of events that are beyond the control of
21 UniSource.

22 Staff views the three-year rate moratorium as
23 an added benefit to ratepayers. The base rate increase is
24 being proposed to be spread evenly among all retail rate
25 classes further. For residential customers, the customer

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At: Phoenix, Arizona

Date: May 1, 2003

Filed: **MAY - 7 2003**

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME I

(Pages 1 - 275, inclusive)

ARIZONA REPORTING SERVICE, INC.

Court Reporting

Suite Three

2627 North Third Street

Phoenix, Arizona 85004-1103

By: DAWNA J. BOSWELL, RPR
Certified Court Reporter
Certificate No. 50326

Prepared for:

CITIZENS AND UNISOURCE

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1 Agreement, I do want to talk a little bit about the
2 settlement process up front since there has been some
3 discussion about the process, and I want to give the
4 record, the ALJ and Commissioner Gleason from
5 UniSource's standpoint how we thought the process
6 went. And I should first note that even before we
7 filed the Settlement Agreement and before we filed
8 actually the Joint Application, we met with several of
9 the parties to explain what was going on and what we
10 intended to file.

11 But after we filed the Joint Application, we,
12 UniSource, and Staff held several settlement
13 conferences with all the intervenors, and we did that
14 to provide a forum for identified issues that each of
15 the parties felt they wanted to discuss regarding the
16 Joint Application. I believe we did have three
17 all-encompassing meetings where all the parties were
18 not shy about bringing up the issues that they had.
19 So I thought we had a good discussion up front.

20 Given the number of issues we've talked about
21 today and the number of parties, we, UniSource,
22 offered break-out sessions with all the intervenors in
23 the proceeding. And subsequently, we did obviously
24 meet with Staff. We met with RUCO, we offered to meet
25 with RUCO. As well, we met with Mr. Magruder on two

1 occasions, and we met with representatives from the
2 counties of Santa Cruz and Mohave separately as well
3 while this process was going on to further address
4 their issues. We also met with the City of Nogales
5 one time as well to talk about franchise issues with
6 representatives from the City of Nogales. And to the
7 extent that we could, we tried to address the issues
8 as we were working forward with Staff, but given the
9 multiple aspects of the Settlement Agreement, we tried
10 to work everything in to one agreement as best we
11 could. But obviously, we were focused on the meetings
12 with Staff, and I think we've entered into a fair and
13 reasonable compromise.

14 Turning to the gas rate case, in our initial
15 filing, in the Joint Application, UniSource supported
16 Citizens' gas rate filing. We did make certain
17 adjustments to reflect some known and measurable
18 changes including introduction of the rate base
19 through our negative acquisition investment. So our
20 original request reduced the revenue requirement
21 increase that Citizens had filed of almost 29 percent
22 to 23 percent in the initial proposal.

23 After the discussions with Staff, we further
24 agreed to reduce the increase in revenue requirement
25 to roughly 21 percent, and that's by and large

1 agreeing through an adjustment to rate base for the
2 build-out program of almost, a little over
3 \$10 million. For ratemaking purposes, as a result,
4 the Settlement Agreement agrees to a fair value rate
5 base of approximately \$142 million and a reasonable
6 rate of return, a fair value rate base of 7.49
7 percent. The parties then agreed to a revenue
8 requirement of approximately \$15.2 million. That's
9 the rate side of the gas case.

10 We also supported the consolidation of the
11 northern and Santa Cruz divisions into a single
12 entity. We did that, we agreed to that, and actually,
13 Citizens had previously filed for that to include
14 standard tariffs to be applied across the two
15 divisions.

16 As part of the consolidation, though, two low
17 income programs that were only available in the north,
18 Cares and Warm Spirit, will now be expanded to the
19 southern division. The Cares program provides for
20 financial assistance for certain customers on their
21 bills through a cooperative effort with the Arizona
22 Department of Economic Security, DES. DES qualifies
23 customers for the program, and really what it is is a
24 reduction on their bill of a set amount. The Warm
25 Spirit program permits all existing customers to

1 voluntarily contribute to a fund which is established
2 for helping low income customers with bill payment.

3 Further, in the Settlement Agreement,
4 UniSource agreed to maintain the same level of
5 commitment to gas pipeline safety as currently
6 provided by Citizens. That was something that the
7 Staff was very concerned about. They spoke highly of
8 the gas operations and the gas safety program, and
9 UniSource commits to using the current personnel and
10 to maintaining current safety practices in the gas
11 side.

12 On the electric side, what the Settlement
13 Agreement does as we talked earlier today is that
14 Citizens' original request to recover past balances of
15 the PPFAC will be foregone by UniSource from retail
16 customers. We've talked a little bit about what the
17 balance is and what it's estimated to be. I will
18 update it here today. With February actuals and
19 estimates through July, we estimate it to be
20 136.8 million by the close in the summer, by
21 July 28th. As Mr. DeConcini will discuss, we are in
22 discussions with Pinnacle West to see if we can reduce
23 the cost further. Those discussions are the subject,
24 however, of a confidentiality agreement. To the
25 extent we are successful as we have discussed, the

1 That's an overview of the Settlement
2 Agreement. In my rebuttal testimony, I address
3 response to RUCO's testimony. And as an overview, I
4 should say that we appreciate RUCO's testimony. We
5 also appreciate as I heard Mr. Wakefield state today
6 that RUCO generally supports the Settlement Agreement,
7 and I think that they see the merit in the Settlement
8 Agreement as well. I understand what their proposals
9 go toward, and conceptually I consider them to have,
10 the DSM proposal, consider it to have merit. It's not
11 something, though, that I think should be done today,
12 and let me talk about that.

13 The DSM proposals that RUCO proposes would
14 bring the expenditure levels of DSM to an extremely
15 high level at a point in time when I think that the
16 Commission is going to be providing all the parties a
17 little bit more guidance on how DSM should be
18 integrated into our portfolios in the future. To
19 increase it now before the Commission has determined
20 how to go forward is premature, and I think we also
21 need to understand that whatever we increase, if we
22 increase DSM funding now, it would have an upward
23 pressure on rates later, and I think that's something
24 that should be discussed in a rate case where we can
25 look at all the other expenses of these properties. I

1 principal negotiator on behalf of UniSource.

2 Q. And it's fair to say you were present during
3 all the three meetings in January that took place with
4 all the intervenors?

5 A. (BY MR. GLASER) Yes, I was.

6 Q. And did you understand or did you witness
7 Staff's intention to negotiate independently with the
8 Joint Applicants, UniSource, Citizens, communicated at
9 that third status meeting?

10 A. (BY MR. GLASER) Yes, I remember that, and at
11 that point in time, it was very clear that we were
12 going to have a break-out session between UniSource,
13 Citizens, and the Staff. And at the same time, we
14 offered as well to have break-out sessions with the
15 remainder of the intervenors. And as I've said in my
16 summary, UniSource and Citizens did carry forward and
17 offered to meet individually and in fact did meet
18 individually with the rest of the intervenors.

19 Q. And during that third meeting or at any time
20 during the course of negotiations that you
21 participated in, did any of the other intervenors
22 address any concerns to you or any objections as to
23 how the negotiations, the process was going forward?

24 A. (BY MR. GLASER) No, nobody objected to the
25 process. And as I said, it was openly communicated

1 and everybody was aware of what was going on, but to
2 answer your question, no, nobody objected to the
3 process.

4 Q. And is it fair to say that during the
5 meetings in January that there were an abundance of
6 issues that were brought up from all the intervenors,
7 including Staff, in the consolidated cases?

8 A. (BY MR. GLASER) Certainly. As I said in my
9 summary, nobody was shy in that room or over the
10 phone. There were numerous issues brought to the
11 table which we all, which we tried to address as we've
12 gone forward, but to my recollection, those meetings,
13 nobody either that was in the room or was there
14 telephonically was cut off in any way or restricted.
15 Staff made it abundantly clear to go around the table
16 and ask everybody what they wanted, if they wanted to
17 discuss any of the other issues, and in my opinion,
18 everybody was given ample opportunity to raise what
19 their opinions were on the Joint Application.

20 Q. And based on your conversations and meetings
21 with the intervenors during the break-out sessions
22 during the time in February and March when these
23 break-out sessions were going on, does it at least
24 appear that the Settlement Agreement tries to capture
25 some of the issues that were brought up by some of the

1 favorably renegotiated, DSM funding would increase
2 another \$400,00 per year, is that correct?

3 A. (BY MR. GLASER) Up to -- yes.

4 Q. Would you agree with me that RUCO's proposal
5 includes a provision that ElecCo would be permitted to
6 defer the incremental DSM costs for future recovery?

7 A. (BY MR. GLASER) I agree that is in RUCO's
8 proposal.

9 Q. And would you agree that under RUCO's
10 proposal, ElecCo would be allowed to accrue interest
11 on those deferrals?

12 A. (BY MR. GLASER) Yes.

13 Q. So would you agree with me that with the
14 deferral and accrual of such interest that ElecCo
15 could get full recovery for any additional recovered
16 DSM investment?

17 A. (BY MR. GLASER) Could, and that is really
18 the issue that I had, Mr. Wakefield, is that it does
19 create the potential upward pressure on rates at a
20 future point in time. But yes, it does allow us the
21 opportunity to come in and ask for recovery.

22 MR. WAKEFIELD: Those are all my questions.

23 ACALJ NODES: Thank you.

24 Mr. Bettwy.

25 MR. BETTWY: Thank you, Mr. Scott.

1 A. (BY MR. GLASER) That's correct, but please
2 remember, Ms. Hawn, that as part of the Settlement
3 Agreement, we agreed to a \$10 million reduction in
4 rate base related to the gas build-out program, and I
5 think that the Staff had talked about this as well
6 that the negative acquisition adjustment that, because
7 we bought the assets at below book of 30 million can
8 be, you can't maybe tie it directly to the gas
9 build-out program but that there's a total of a
10 \$40 million reduction to rate base related to the gas
11 assets. If you assume that I think in rough terms the
12 entire build-out was \$75 million or so, you're
13 discussing, you're putting in the rates and customers
14 are enjoying service of \$75 million worth of assets
15 for 30-odd million dollars.

16 Q. Am I correct, am I remembering correctly that
17 in the asset purchase agreement, there was a
18 \$10 million, I guess you might call it a signing bonus
19 or closing bonus that was going to be paid to
20 UniSource if this deal closes by a certain date?

21 A. (BY MR. GLASER) If the deal closes by
22 July 28th, the purchase price will be reduced from
23 230 million to 220 million.

24 Q. Is that 10 million related to the 10 million
25 that you were just talking about?

1 will have another, you will have a chance to give your
2 input into that procedure.

3 MR. MAGRUDER: Thank you. That's really all
4 my questions, sir.

5 ACALJ NODES: Okay. Thank you, Mr. Magruder.

6

7

EXAMINATION

8

9 Q. (BY ACALJ NODES) I've got just a few
10 questions. I think this is probably directed to
11 Mr. Glaser. Regarding the consolidation of the two
12 gas units that is proposed by the Settlement
13 Agreement, what criteria did you use for evaluating
14 whether that consolidation of the systems was
15 reasonable and in the public interest?

16 A. (BY MR. GLASER) We reviewed Citizens'
17 testimony, and I do believe that the Commission
18 actually requested that that analysis be done. The
19 systems are managed by the same group of folks up in
20 Flagstaff, and it provides common management, common
21 tariffs for customers, per my understanding, and
22 provides for some economies here at the Commission.
23 So what we did is we adopted what Citizens filed in
24 their Application as requesting that consolidation.
25 So we really since tested what was in their testimony.

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At: Phoenix, Arizona

Date: May 2, 2003

Filed: **MAY - 7 2003**

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 276 through 503)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite Three
2627 North Third Street
Phoenix, Arizona 85004-1126

Prepared for: **By: CECELIA BROOKMAN, RPR**
Certified Court Reporter
Certificate No. 50154

MR. THOMAS H. CAMPBELL
Attorney at Law

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1 summary.

2 Q. And basically, you are the, quote-unquote,
3 policy witness and the witness to describe the overall
4 benefit of the settlement agreement?

5 A. (BY MS. JARESS) Yes.

6 Q. And could you give your summary of your
7 portion of the Staff report for Your Honor?

8 A. (BY MS. JARESS) Yes. To briefly reiterate
9 what you heard from Mr. Gellman yesterday, and to
10 summarize the Staff report, Staff believes that the
11 settlement agreement taken as a whole reasonably balances
12 the diverse interests of the customers and the joint
13 applicants.

14 It facilitates the transfer of the Citizens
15 Arizona gas and electric Certificates of Convenience and
16 Necessity customers and assets to a fit and proper
17 Arizonan utility.

18 The reduction in the gas rate case revenue
19 requirement, restrictions placed on the post financing,
20 agreements of pipeline safety safeguards, and the rapid
21 movement towards opening the new electric company's
22 service territory to competition are some examples of
23 benefits that will accrue to the customers above and
24 beyond what was offered in the joint application.

25 Staff urges the Commission to adopt the

1 settlement agreement because it results in benefits to the
2 customers that in all likelihood are greater than the
3 benefits achievable through traditional processing of the
4 gas rate case, the sale and transfer case, and the
5 electric adjuster case individually.

6 Staff believes that the settlement agreement
7 is in the public interest, and urges the Commission to
8 adopt it.

9 Q. Ms. Jaress, just a couple of follow-up
10 questions.

11 Were you one of the principals from Staff who
12 participated in the negotiation process with the joint
13 applicants, and at a status meeting with the intervenors?

14 A. (BY MS. JARESS) Yes, I was.

15 Q. Did any party seem to have any problem with
16 the negotiation process of the procedure as Staff proposed
17 it, either back in January or during the negotiation
18 process?

19 A. (BY MS. JARESS) I was never made aware that
20 there was a problem.

21 MR. GELLMAN: Thank you, Ms. Jaress.

22 BY MR. GELLMAN:

23 Q. Mr. Dittmer, could you give your name and
24 business address for the record.

25 A. (BY MR. DITTMER) James R. Dittmer, 740

1 ACALJ NODES: Any objections?

2 (No response.)

3 ACALJ NODES: S-1 is admitted into the record.

4 MR. GELLMAN: With that, that completes my
5 direct examination. I offer the panel for
6 cross-examination.

7 ACALJ NODES: Thank you, Mr. Gellman.

8 Mr. Campbell, do you have questions for the
9 panel.

10

11

CROSS-EXAMINATION

12 BY MR. CAMPBELL:

13 Q. Ms. Jaress, the settlement agreement includes
14 a provision for bridge financing; isn't that correct?

15 A. (BY MS. JARESS) Yes, that's correct.

16 Q. And the settlement agreement also includes a
17 provision for permanent financing; is that correct?

18 A. (BY MS. JARESS) Yes.

19 Q. And those two loans are not additive; is that
20 correct?

21 A. (BY MS. JARESS) That's correct.

22 Q. In fact, the settlement agreement, under the
23 settlement agreement the proceeds from the permanent loan
24 would be used to pay off the bridge loan; is that correct?

25 A. (BY MS. JARESS) Yes.

1 Q. Let's talk for a minute about the revolving
2 credit line, \$50 million. The settlement agreement calls
3 for a revolving credit line; correct?

4 A. (BY MS. JARESS) Yes.

5 Q. And is it typical that public service
6 corporations in Arizona would have a revolving credit
7 line?

8 A. (BY MS. JARESS) Yes.

9 Q. And is it also accurate to say that energy
10 companies such as the companies in this proceeding, that
11 their cash flow varies seasonally?

12 A. (BY MS. JARESS) Yes.

13 Q. And is it also true that one of the primary
14 reasons for a credit line for an energy company is to
15 address the seasonal cash flow?

16 A. (BY MS. JARESS) Yes.

17 Q. Let's talk about the TEP loan for just a
18 minute. The settlement agreement contemplates that TEP
19 may loan up to \$50 million to UniSource to provide
20 flexibility in the financing of this transaction; is that
21 correct?

22 A. (BY MS. JARESS) Yes.

23 Q. And that loan will be secured by all of the
24 stock of the new companies or their holding company; is
25 that correct?

1 1.825 cents. The 1.825 cents is about 20 percent,
2 22 percent increase. If you had that and you added the
3 recovery of the amounts under the old contract, my
4 calculations were it would be about a total of 40 some
5 percent increase.

6 MR. MEEK: I'm on the same page. My only
7 point is that I'm trying to help Mr. White understand what
8 the differences are, where we were a couple of years ago,
9 and where we are today. I think that's all.

10 ACALJ NODES: Thank you, Mr. Meek.

11 Mr. Wakefield.

12

13 CROSS-EXAMINATION

14 BY MR. WAKEFIELD:

15 Q. Good morning, Ms. Jaress. I think you may be
16 the one to answer all my questions; if not, toss the
17 question off to whoever is the appropriate person.

18 Ms. Jaress, the settlement agreement that's
19 the subject of this hearing resulted from negotiations
20 that took place between Staff and the joint applicants; is
21 that correct?

22 A. (BY MS. JARESS) That's correct.

23 Q. And in those settlement negotiations, did
24 Staff raise the issue of any additional demand-side
25 management programs that might be a mechanism to allow

1 A. (BY MS. JARESS) Yes.

2 Q. Ms. Jaress, absent this settlement agreement,
3 if Citizens were to renegotiate the Pinnacle West
4 contract, any savings of that renegotiation would flow
5 through 100 percent to customers; correct?

6 A. (BY MS. JARESS) That is correct, but I think
7 you need to keep in mind two things. First, the joint
8 application offered to split 50/50 those savings, and
9 through negotiations, the customers result with a larger
10 percentage of those savings. Now, when it comes to
11 renegotiating a power contract, the company would, I
12 believe, would be likely to be even more motivated to
13 bargain harder, get a better contract if they retain part
14 of the savings.

15 Q. So the reason that Staff concluded their
16 settlement negotiations while still allowing the company
17 to retain 40 percent of those savings was because you felt
18 it was necessary as an incentive for the company to
19 renegotiate the Pinn West contract?

20 A. (BY MS. JARESS) The reason -- it's difficult
21 to look at these issues alone. That is a reason for
22 having it in there. The reason it's in there has to do
23 with the entire settlement agreement and a give and take.

24 Q. Fair enough.

25 Ms. Jaress, has Staff done any analysis as to

1 provided in the procedural order. But we were not denied
2 any opportunity to be involved.

3 ACALJ NODES: Thanks. Can you hand the
4 microphone back to Mr. White, let's see if we can continue
5 with cross-examination.

6 MR. WHITE: Now I can see that I shouldn't try
7 to clarify that. Thank you very much, Your Honor.

8 BY MR. WHITE:

9 Q. Ms. Jaress, in response to a question from
10 Mr. Meek, when he asked you to go back and give your
11 estimate of the rates as they would have been, you came up
12 with a 40 to 45 percent increase figure; is that correct?

13 A. (BY MS. JARESS) Yes.

14 Q. Is that taken into account, Ms. Smith's
15 recommendation that \$70 million of the old contract amount
16 be put over until it had been determined by somebody to be
17 a valid amount to pass through?

18 A. (BY MS. JARESS) No, that was the entire
19 underrecovery.

20 Q. And it also included the new contract amount,
21 too?

22 A. (BY MS. JARESS) Yes.

23 Q. So if you take out the new contract amount for
24 a moment, and Ms. Smith's recommendation that 70 million
25 be looked at by some third party to determine its

1 validity --

2 ACALJ NODES: Wait a minute. I'm not sure
3 that that was her recommendation. She may want to jump in
4 here and clarify it. That isn't what I understood her
5 recommendation to be. If it is, please clarify.

6 MS. JARESS: No, all that 40, 42 percent was
7 the worst-case scenario.

8 BY MR. WHITE:

9 Q. Okay, that's what I wanted to clarify.

10 A. (BY MS. JARESS) If the Commission approved
11 the recovery of the old contract and the new contract
12 together.

13 Q. But if it didn't, that's the worst-case
14 scenario, and the best-case scenario would have been what?
15 Either of you.

16 A. (BY MS. SMITH) I mentioned earlier that I
17 believe that -- I computed these exact numbers, but I
18 think that the recoveries would have been about
19 40 million. And on Page 41, the numbers that are called
20 best are the percentage increase that would have resulted
21 from what I thought was the best case, which was that FERC
22 agreed to deny APS and therefore return to Citizens the
23 entire \$70 million. And our disallowance of \$7 million
24 was by the Commission, and that the Commission disallowed
25 the underrecovery under the new contract, that would have

1 provision relating to franchises in the settlement
2 agreement, that we have a right to explore their thinking
3 about their language in that agreement.

4 ACALJ NODES: We'll take judicial notice of
5 the settlement agreement and the Commission's decision
6 approving that settlement agreement.

7 The witness can answer to the extent that she
8 is able to answer personal knowledge of that agreement.

9 MR. HOLUB: I understand.

10 BY MR. HOLUB:

11 Q. Ms. Jaress, did you, in your negotiations with
12 UniSource to put the settlement agreement together,
13 consider this prior decision of the Commission and that
14 issue when you came up with your language for the
15 franchise section?

16 A. (BY MS. JARESS) When we came up with our
17 language for the franchise section, we adopted language
18 that we almost without exception, that I can remember,
19 always used. The franchise issue is generally between the
20 municipality or the county and the company.

21 We have what we recommend as the requirement
22 that the franchise be filed in 365 days.

23 Q. Is it not a mandate of this state that any
24 utility doing business in a city have a franchise?

25 MR. GELLMAN: Your Honor, beyond the scope of

1 BY MR. HOLUB:

2 Q. Is it the Commission's normal pattern to check
3 on franchises when CC&Ns are being transferred?

4 A. (BY MS. JARESS) What do you mean check?

5 Q. You have a checklist when you go through
6 transfers of CC&Ns, don't you, issues?

7 A. (BY MS. JARESS) I assume we do, yes. If it's
8 not written down it's certainly what we do when there are
9 certain things that we look at.

10 Q. What's the Commission's position if a company
11 doesn't have a franchise, say in the 365 days, or your
12 Staff's position? Does that mean we have to file another
13 case here?

14 A. (BY MS. JARESS) Well, that would normally
15 mean that something would get filed. Either Staff would
16 do an order to show cause, the company would file for an
17 extension, something would happen, yes.

18 Q. Do you remember in the teleconference that I
19 specifically advised you of, in this fact situation, of an
20 order and a default of the order, in fact that my city had
21 a huge problem with this?

22 MR. GELLMAN: Your Honor, again, continuing
23 objection. The franchise issue involving whatever docket
24 Mr. Holub cited is beyond the scope of this proceeding.

25 MR. HOLUB: Your Honor, it's not. They have

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At: Phoenix, Arizona

Date: May 1, 2003

Filed: **MAY - 7 2003**

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME I
(Pages 1 - 275, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite Three
2627 North Third Street
Phoenix, Arizona 85004-1103

By: DAWNA J. BOSWELL, RPR
Certified Court Reporter
Certificate No. 50326

Prepared for:

CITIZENS AND UNISOURCE

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ARIZONA REPORTING SERVICE, INC.
Realtime Specialists

(602) 274-9944
Phoenix, AZ

1 I am testifying on matters relating to the
2 acquisition and financing plan specified in the
3 Settlement Agreement between the Joint Applicants and
4 the Arizona Corporate Commission Staff as well as
5 certain financial safeguards in the settlement related
6 to Tucson Electric Power and the new utility companies
7 to be formed as a result of the acquisition. Finally,
8 I am testifying in support of the rate of return
9 specified in the settlement for the use in the Arizona
10 gas rate filing.

11 Let me first talk about the financing plan.
12 The acquisition financing plan described in the
13 settlement provides UniSource with the flexibility
14 needed to complete the acquisition in a timely and
15 cost-effective manner. This plan contemplates an
16 increase of debt securities by using assets of the
17 company to be established under UniSource or by
18 intermediate holding company that would own and
19 finance these new companies. The new companies would
20 also be authorized to issue common stock to UniSource
21 or the holding company to reflect the equity capital
22 invested by UniSource in the new companies.

23 The combination of debt issuance proceeds
24 which we requested up to \$175 million and the equity
25 investment by UniSource which we estimate between 75

1 and \$125 million should be sufficient to fund the
2 purchase price and the initial working capital needs
3 of the new companies.

4 Assuming an all-in purchase price of
5 \$230 million, we estimate today the debt of
6 approximately \$140 million and UniSource equity
7 investment of \$90 million. The specifics of this plan
8 which are outlined in the Financing Plan which is
9 outlined in Appendix 8 of the agreement also provide
10 an option for the holding company or the new companies
11 to obtain interim bridge financing for the
12 acquisition.

13 I need to note that the short-term bridge
14 financing is not additive to the \$230 million funding
15 I described earlier. Bridge financing is an
16 alternative, a substitute for all or a portion of the
17 long-term financing that may not be available under
18 reasonable terms at the time we close the transaction.
19 The bridge financing is a backstop that gives us
20 flexibility and more confidence that we can complete
21 the transaction on a timely basis under the timeline
22 we've discussed.

23 In light of the significant long-term
24 benefits to be realized by customers as a result of
25 the acquisition, approval of the financing plan

1 perspective of maintaining the right balance of equity
2 and debt when financing this acquisition?

3 A. (BY MR. LARSON) Yes, that's correct.

4 Q. And from a financial perspective, the TEP
5 loan would be considered equity for that perspective?

6 A. (BY MR. LARSON) Yes, the design that Tucson
7 Electric Power would lend the money to UniSource, and
8 UniSource would use those funds along with other funds
9 that it has or would have and contribute it into the
10 new operating companies related to Citizens' assets.

11 Q. And it's important from UniSource's
12 perspective to have this loan included as part of the
13 equation such that the right combination of debt
14 equity financing is preserved?

15 A. (BY MR. LARSON) That is a component of it.
16 Also another component is to make sure we have
17 sufficient tools to complete the acquisition in late
18 July.

19 Q. And even though TEP is part of this
20 Application, and hopefully if the settlement is
21 approved by the Commission, is part of the equation,
22 will there be any I guess decreased chance of or
23 impact on TEP being able to perform its operations and
24 maintenance if this TEP loan is actually done?

25 A. (BY MR. LARSON) We don't believe it would

1 impact Tucson Electric Power, and that is a key issue
2 that we looked at. And I think that the rating
3 agencies have come away with a similar conclusion that
4 it will not be adverse to Tucson Electric Power
5 Company.

6 Q. So there won't be any problem with "fixing
7 things" even if the TEP loan does go to UniSource?

8 A. (BY MR. LARSON) I'm not sure what you mean
9 by fixing things.

10 Q. If something were to break, TEP would be able
11 to go fix it and there wouldn't be a problem because
12 of this loan?

13 A. (BY MR. LARSON) It should not be a problem.

14 Q. And could you talk a little bit about the
15 importance of the new companies acquiring I think what
16 you called investment grade status?

17 A. (BY MR. LARSON) Yes. We structured this
18 that we anticipate getting investment grade ratings
19 from the credit rating agencies, and it will be
20 critical in terms of reducing the cost of capital, in
21 particular on the debt side. An investment grade we
22 anticipate would probably be a triple B flat or a
23 triple B minus investment grade rating which is at the
24 bottom end of an investment grade rating, but the
25 critical point is it's better than a non-investment

1 A. (BY MR. LARSON) Yes, it will.

2 Q. And that's because there's a minimized
3 combination of what's known as financial risk and in
4 combination with a less expensive cost of capital?

5 A. (BY MR. LARSON) Yes, that's right. There's
6 a trade-off between the cost of debt and the cost of
7 equity. Equity is typically going to cost more than
8 debt cost would be. And so in the perfect world, I
9 guess, in theory at least, the lowest cost you could
10 have is if you did all debt financing, but you
11 couldn't get all debt financing because the lenders
12 would not be willing to take that risk that there's no
13 equity cushion to protect them in the event there are
14 surprises at that operating company. So typically,
15 what you see in the electric utility and gas
16 industries is an equity ratio somewhere between 35 to
17 maybe 45 percent, and that's why we're essentially
18 targeted in between that at 40 percent.

19 Q. And so by having the flexibility to finance
20 this transaction or the acquisition of Citizens'
21 electric and gas assets, you will have a better chance
22 of getting investment grade status for both the ElecCo
23 and the GasCo?

24 A. (BY MR. LARSON) Yes, I believe we will.

25 Q. And that will result in lower cost of capital

1 lease obligations, in excess of
2 \$300 million. We are continuing, we still have that
3 same intent. We're targeting from 30 to 50 million on
4 an annual basis to deleverage the firm, and we believe
5 we have more than sufficient cash flows, cash balances
6 to fund a \$50 million, up to a \$50 million loan to the
7 UniSource parent.

8 And so one, there shouldn't be any real cash
9 concerns for Tucson Electric Power Company, and I
10 referenced earlier that the rating agencies have
11 essentially come to the same conclusion. They haven't
12 made a final decision, I have to caution you on that,
13 but the rating agencies I think view the proposed
14 settlement with the ACC Staff we have reached
15 regarding the Citizens assets including the loan
16 component as not an adverse impact to Tucson Electric
17 Power Company. We do not envision the rates of TEP
18 changing.

19 So beyond just a cash flow impact for Tucson
20 Electric Power Company which I think is small given
21 the cash flows of that company, if you look at the,
22 some of the benefits for Tucson Electric Power
23 Company, TEP currently on a short-term basis is
24 probably earning one and a half percent, 2.25 percent.
25 This loan we will be lending to UniSource will be

1 company for Citizens, again, we are assuming, if we
2 end up with a \$230 million acquisition price, all-in
3 price, I would estimate the amount of debt, longer
4 term debt would be 140 to \$150 million, and as part of
5 my testimony, we estimate the cost of that debt would
6 be all-in 7.75 percent. In addition to that, that's
7 kind of the funding for the acquisition.

8 We've also requested as part of this
9 Application ability to have a bank line, a revolver
10 available to just deal with seasonal fluctuations in
11 cash flow of the businesses, but that would not
12 immediately be funded.

13 COM. GLEASON: And that's 190, right?

14 MR. LARSON: Let's say \$150 million permanent
15 or longer term debt, and separately just to deal with
16 the working capital needs, we would have a bank
17 facility that we could draw down on for seasonal
18 periods, maybe just for one month, and then once the
19 cash flows of the business improve, simply pay down
20 the revolver. So it's more of a short-term financing,
21 the revolver component.

22 COM. GLEASON: But I'm looking at part of the
23 Staff Report here on page 44. The debt issuances are
24 limited to 175,000, 175 million. That's also I think
25 someplace in your deposition here.

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At: Phoenix, Arizona

Date: May 2, 2003

Filed: MAY - 7 2003

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 276 through 503)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite Three
2627 North Third Street
Phoenix, Arizona 85004-1126

Prepared for: MR. THOMAS H. CAMPBELL
Attorney at Law

By: CECELIA BROOKMAN, RPR
Certified Court Reporter
Certificate No. 50154

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1 Finally, in accordance with the Commission's
2 standard filing requirements, I sponsor schedules showing
3 the cost of long-term debt and preferred stock. I present
4 projections and forecasts of financial statements for
5 2002, and of construction expenditures for years 2002
6 through 2004.

7 Based on the testimony summarized above, the
8 AGD is requesting an overall revenue increase of
9 approximately \$21 million. That revenue increase is
10 premised on a rate base of approximately \$150 million,
11 total operating expenses of approximately \$30 million and
12 an overall rate of return of 8.85 percent and an 11
13 percent cost of equity.

14 Mr. Apuzzo, Citizens' director of tax and
15 actuarial compliance, sponsored testimony relating to
16 calculated deferred income taxes, and the differences
17 between the books kept for regulatory purposes, and the
18 books kept for tax purposes.

19 The ADIT served to reduce the Arizona gas
20 division's rate base in Citizens' filing. As of the date
21 of the acquisition of Citizens' Arizona gas assets, the
22 deferred taxes for those properties are eliminated.

23 Mr. Apuzzo also testified to various tax
24 expenses included in the filing, and amounts related to
25 tax refunds associated with pre-tax year items that have

McCarthy

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At: Phoenix, Arizona
Date: May 2, 2003
Filed: **MAY - 7 2003**

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1 MR. GELLMAN: Thank you. No further
2 questions.

3 ACALJ NODES: Thank you.

4 Mr. Meek.

5

6

CROSS-EXAMINATION

7 BY MR. MEEK:

8 Q. Good afternoon, gentlemen. Mr. McCarthy, I
9 have three or four pretty short questions for you. If
10 this transaction fails, will Citizens pursue recovery of
11 the PPFAC underrecovery at its current amount, plus any
12 accumulated amounts?

13 A. (BY MR. McCARTHY) Yes, we will.

14 Q. Will you do that aggressively?

15 A. (BY MR. McCARTHY) Yes, we will.

16 Q. If this transaction should fail, would
17 Citizens commence to litigate its gas rate case based on
18 the original revenue deficiency that was filed in that
19 case?

20 A. (BY MR. McCARTHY) Yes, we will.

21 Q. And that amount will be, as I recall, what,
22 \$28 million or so, \$21 million?

23 A. (BY MR. McCARTHY) 21. Yes, we will.

24 Q. If this transaction were to fail, would
25 Citizens voluntarily reduce its gas rate base by

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7 At: Phoenix, Arizona

8 Date: May 5, 2003

9 Filed: **MAY - 8 2003**

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Attorney at Law

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1 shareholders and Citizens Communications Company have to
2 give away more than 250 million in assets in order to make
3 this transaction happen. Having said that, my testimony
4 points out that Citizens' sacrifice produces a very good
5 deal for the ratepayers of Citizens' gas and electric
6 divisions.

7 With more than \$150 million in direct consumer
8 benefits, those benefits accrue from the forfeiture of a
9 PPFAC balance through next July, reduction of gas revenue
10 requirement in the rate case, and permanent elimination of
11 \$10 million in the gas system rate base. In addition, the
12 settlement agreement contains adequate buffering and risk
13 mitigation to protect Tucson Electric Power Company's
14 ratepayers from any unforeseen consequences.

15 This transaction is clearly in the public
16 interest. In addition to the financial benefits to the
17 consumers, there is no question that Unisource Energy
18 Corporation is a fit and proper entity to acquire
19 Citizens' gas and electric assets.

20 Another factor is that Citizens clearly wants
21 to exit the gas and electric businesses, and this
22 agreement allows them to do so.

23 Now, I'd like to add an observation on some of
24 the assertions that have been made by the intervenors from
25 Mohave and Santa Cruz Counties. I don't expect anyone to

Pignatelli

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7 At: Phoenix, Arizona

8 Date: May 1, 2003

9 Filed: **MAY - 7 2003**

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(Pages 1 - 275, inclusive)

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CITIZENS AND UNISOURCE

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1 transaction, and the citizens in those counties can
2 enjoy continuous dealing with Citizens Utility.

3 That's all my prepared remarks.

4 MR. CAMPBELL: Mr. Pignatelli is available
5 for cross-examination.

6 ACALJ NODES: Thank you.

7 Mr. Gellman, do you have any questions for
8 the witness?

9 MR. GELLMAN: Your Honor, just a couple
10 questions.

11

12

CROSS-EXAMINATION

13

14 Q. (BY MR. GELLMAN) Good morning,
15 Mr. Pignatelli.

16 A. Good morning, sir.

17 Q. From your perspective and from UniSource's
18 perspective, how important was it to have all of the
19 three cases that were before this proceeding today to
20 be resolved, three cases being the PPFAC case, the
21 general gas rate filing, and the Joint Application?

22 A. We have to resolve it all at this time.
23 UniSource will not accept ongoing liability or
24 uncertainty in either rates or recovery of past
25 charges or reasonableness of past contracts. We want

1 to put all of that behind the state and move forward.
2 We will not close the transaction unless all of this
3 is resolved at this time.

4 Q. And just to follow up on that, was it
5 important to have a process of negotiation by which a
6 Settlement Agreement could be approved by this
7 Commission such that the anticipated date of closing,
8 July 28th of this year, could be reached?

9 A. I think it was important not only for the
10 timing to bring to closure all of these, but factually
11 just the pure volume and the technicalities and the
12 extensive testimony that would be required to
13 individually hear these, we felt that settlement was
14 the proper way to do it, especially considering that
15 we were going to waive complete recovery of past PPFAC
16 that should take that out of issue. We just felt that
17 the litigation which would be out there would be
18 continuous, ongoing, and end up in making a
19 transaction which could never be consummated. We
20 needed rapidity in understanding of the facts, and
21 Staff and the settlement I think did a great job in
22 representing the consumer in this, but we needed to
23 tie it all together so that we could go out and
24 finance this in a timely manner and not leave all
25 these issues hanging over everyone interminably.

1 up?

2 A. We have three transactions, correct. We
3 don't have a financial obligation with Springerville.

4 Q. Okay.

5 A. So we have two transactions. The
6 transmission line is down the road. I don't see the
7 transmission line being built before 2004, 2005,
8 simply because of permitting. So I'm focusing on this
9 transaction right now, the Citizens transaction.

10 Q. Okay. You know the Commission Order for the
11 transmission line says it should be installed by the
12 end of this year, and there's a \$30,000 a month fine.
13 Are you familiar with those penalty clauses in that
14 Order? Are you familiar with that portion of the
15 Order?

16 A. You can discuss that with Mr. Glaser, but we
17 have already indicated to the Commission that that
18 cannot be met because of conditions outside of our
19 power, and we will be, as soon as we can make a firm
20 determination of when we expect final permitting to be
21 completed and the length of time necessary to build a
22 line that we will come to the Commission and ask for a
23 change in that Order.

24 Q. In some of the discovery, I found out that
25 the present transmission line and the new transmission

Smith, L.

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7 At: Phoenix, Arizona

8 Date: May 2, 2003

9 Filed: **MAY - 7 2003**

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(Pages 276 through 503)

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MR. THOMAS H. CAMPBELL
Attorney at Law

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1 service.

2 This will be a complex and somewhat subjective
3 calculation, inasmuch as many pipes constructed serve a
4 dual purpose of reinforcing the system to existing
5 customers for which Citizens did have an obligation to
6 provide service, as well as to service previously unserved
7 territories.

8 It is likely to be colorful in that you will
9 get to hear Gary Smith and perhaps others from that
10 organization state that they felt that Citizens had made a
11 commitment to proceed with the buildout program, and that
12 indeed, they felt they believed that the Commission was
13 pressuring them, if not an outright mandate to complete
14 the project as was originally presented to the Commission
15 in the 1993, '94 time frame.

16 An added benefit of the agreement is base
17 rates will not change, gas base rates will not change for
18 a three-year period, barring either emergency condition or
19 material change in cost of service attributable to a
20 select set of events that are beyond the control of
21 UniSource.

22 Staff views the three-year rate moratorium as
23 an added benefit to ratepayers. The base rate increase is
24 being proposed to be spread evenly among all retail rate
25 classes further. For residential customers, the customer

1 The dollars that I mentioned, the 135 million do not
2 include any carrying costs from the past on a
3 going-forward basis. This could have been another
4 \$18 million in carrying costs.

5 And I would like to mention that even if we
6 had had a very favorable Commission decision in the
7 adjuster case, and subsequently a favorable decision on
8 the part of the FERC, the Federal Energy Regulatory
9 Commission, there still would have been some recovery of
10 these dollars. My estimate is, at a very minimum,
11 \$40 million, and quite possibly much higher than that.

12 The second thing that's beneficial, the second
13 group of things have to do with base rates. The rate base
14 has been reduced by approximately one-half, which is a
15 significant concession, and it will mean that rates will
16 be lower into the long-term for electric customers.

17 The next point is that the company has agreed
18 that they will not file a rate increase for three years.
19 And I don't see Mr. Pignatelli here, but I hate to tell
20 him there is not going to be an increase in electric rates
21 for four years, because if the company files in three
22 years, there's a 12-month period before that becomes an
23 increase.

24 Then also associated with rates, power costs
25 will be fixed for the next five years. There will be an

1 increase at this time, but there will be no further
2 increase for five years.

3 Now, that brings us to the painful part of
4 this proceeding, is that the PPFAC will increase by,
5 you've heard again many times, 1.825 cents per kilowatt
6 hour, although I would note that the PPFAC has not really
7 increased since 1995, so customers have had stable power
8 costs for a long time.

9 And I also note, and I think this is crucial
10 to this proceeding, is that currently customers are paying
11 less than the cost of the power they are using. They're
12 paying less than the cost they're using; they're paying
13 less than the cost of almost any alternative source of
14 power that would be available.

15 We have to keep in mind in this case that
16 Citizens does not own any generation, that means they have
17 to buy from someone else, and this PPFAC, as a result,
18 comes from a FERC approved contract, which I will discuss
19 later.

20 There is some potential for rate relief going
21 forward, and that includes the renegotiation which you've
22 heard discussed, which could lead to some decrease in the
23 PPFAC. In addition, the coordination of the Santa Cruz
24 division with TEP may in the long-term lead to some
25 reduction in rates, but it also should increase

1 prices, not shaped prices -- let's talk in megawatt hours.
2 Then instead of talking about 4.8 cents a kilowatt hour,
3 we'll say \$48 a megawatt hour. Same thing. He started
4 with a base price of \$48 a megawatt hour. To that you're
5 going to have to follow load. Our estimates in New
6 England PGM easily costs you \$6 a megawatt hour. So in
7 addition you're going to have to pay for transmission and
8 ancillary services, that's going to cost about \$5 a
9 megawatt hour. That brings us up to \$59 dollars a
10 megawatt hour. This is without the risk premium that I
11 mentioned. It is my belief that the risk premium is going
12 to run about 10 percent.

13 Now, I had originally done some analysis based
14 on recent spot prices. You may not be aware, but one of
15 the things that's happened as the electric industry has
16 gotten more competitive, it's gotten harder to find data.
17 A lot of data becomes valuable so it's not publicly
18 available. So based on spot prices from Palo Verde, which
19 are available, over the last year, I think I would have
20 started with a base that might have been \$42.

21 Now, when we went through that same exercise
22 and we add to the \$42 flat power costs, load following
23 transmission ancillary services and a risk premium, we
24 come up to \$58. So my analysis suggests that this
25 contract is quite reasonable. It definitely would pass

1 A. (BY MS. SMITH) Well, I have testified from
2 the standpoint of consumer advocates many times, and I
3 know a 22 percent increase is a concern; it is a real
4 concern to customers. But I don't think it's outrageous,
5 and I think that it's quite justified.

6 And I think that the perspective that we need
7 to put it in, it's very hard for customers to put it in,
8 is that they have essentially had no increase in power
9 costs from 1995 through 2003. And once they get this
10 increase, there will be no further increase in power costs
11 for the next five years. In addition to that, these
12 customers had been paying the same base rates from 1997 to
13 2003, and they will continue paying those same base rates
14 through 2007.

15 So it's a big jump, but it would not have been
16 surprising, in fact it's surprising that they did not
17 experience increases several years ago or maybe several
18 increases, so that the total position that they're in I
19 think is not surprising when viewed in the historical
20 perspective.

21 MR. GELLMAN: Thank you, Ms. Smith.

22 BY MR. GELLMAN:

23 Q. Mr. Thornton, could you please give your name
24 and business address for the record.

25 A. (BY MR. THORNTON) Good morning. My full name

1 led to my comments leading to best.

2 Q. Just so we put that in context of the
3 22 percent increase that's under the settlement, what
4 would that increase have been?

5 A. (BY MS. SMITH) It would have been about
6 5 percent higher. You'll see it's different for each
7 class, something like 27 to 28 percent.

8 Q. So the comparison of this new contract,
9 looking at even the best-case scenario that you could
10 expect under the old contract, would have been a
11 27 percent increase as opposed to the 22 percent increase
12 we see now?

13 A. (BY MS. SMITH) Yes, that's correct.

14 MR. WHITE: That's the question I've been
15 searching for. Thank you so much, Ms. Smith. And I have
16 no further questions.

17 ACALJ NODES: Thank you.

18 Mr. Holub.

19 MR. HOLUB: Thank you.

20

21

CROSS-EXAMINATION

22 BY MR. HOLUB:

23 Q. Ms. Jaress, could you first explain the
24 benefit of the competition, opening up this area to retail
25 competition?

Thornton

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7 At: Phoenix, Arizona

8 Date: May 1, 2003

9 Filed: **MAY - 7 2003**

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REPORTER'S TRANSCRIPT OF PROCEEDINGS

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(Pages 1 - 275, inclusive)

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CITIZENS AND UNISOURCE

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1 attached. First is the term, which is limited to four
2 years.

3 Second, the interest rate UniSource pays is
4 the same noninvestment grade rate used in the recent APS
5 financing case, that is to say 383 basis points above the
6 equivalent U.S. treasury.

7 The third is the dividend payment
8 restrictions, which were approved for TEP and imposed on
9 the new companies.

10 Fourth, 264 basis points of the interest rate
11 paid to TEP will be deferred and used to reduce TEP's
12 customers' rates in the future. I estimate the balance of
13 this deferred credit account to be about \$6 million.

14 Finally, I'd like to address Commissioner
15 Gleason's letter of April 24th. He raised some excellent
16 concerns, which Staff shares.

17 The loan from TEP to UniSource provides
18 UniSource the needed financial flexibility to complete
19 this transaction, and Staff's concern with it led to hard
20 negotiations to limit its risks to TEP.

21 First I interpret his concerns to generally
22 show a sensitivity to utility/affiliate relationships.
23 And it's a pleasure to serve in a jurisdiction in which
24 these relationships are heartily scrutinized.

25 In particular, I viewed the letter, showed the

1 concern over the proposed loan from TEP to UniSource.
2 Staff's position is that a loan from a regulated utility
3 to an affiliate should be approved only under
4 extraordinary and unique circumstances. The extent of the
5 rate concessions, the operational transfer of Citizens'
6 electric and gas operations to a local utility, and other
7 benefits enumerated in the Staff report offer such
8 extraordinary circumstances.

9 Staff has tried diligently to establish new
10 conditions or improve existing conditions to protect TEP's
11 ratepayers from harm. Commissioner Gleason's first
12 question regards policy implications of a regulated
13 utility's loaning money to its parent. The policy
14 implications are broad, and it should be taken seriously.

15 In this case, however, the proceeds of the
16 loan are going to eventually fund an investment in
17 regulated utility operations. Staff feels that the policy
18 of locations would be more serious if the proceeds were to
19 be used for nonregulated and nonutility purposes.

20 Commissioner Gleason's second question regards
21 the transaction's benefits to TEP's ratepayers. If TEP
22 does make the \$50 million loan to UniSource, then TEP
23 customers should potentially reap a \$6 million gain to
24 offset future rates. The gain is through a deferral of
25 part of the interest payment that UniSource pays to TEP

1 one of the metrics uses assets as part of the calculation.

2 Q. Let's not pursue it any further.

3 A. (BY MR. THORNTON) I can't think of one
4 offhand, I'm sorry.

5 Q. Thank you.

6 The other thing, now that we've had some
7 discussions of whether these debts are additive, as I read
8 the settlement, the settlement reads that they're
9 additive. In other words, would Staff have any objection
10 if we change that to not to be an additive nature, but as
11 it's been testified here, to be a simple verbal exchange
12 so that they're not perceived as additive? Is that a
13 problem?

14 A. (BY MR. THORNTON) The one element that is
15 additive, I would add, before Ms. Jaress speaks, is the
16 revolving credit agreement is in addition to the long-term
17 financing. Because what you need is either bridge
18 financing or long-term financing to get the assets in
19 place, and some capital for any needed additions up front.
20 That's long-term.

21 The revolving credit agreement is on the side,
22 and that's simply to match your cash flows. So that part
23 is additive, the revolving credit agreement.

24 A. (BY MS. JARESS) Commissioner, if the language
25 that you're looking for only clarifies what we agree is

White

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7 At: Phoenix, Arizona

8 Date: May 2, 2003

9 Filed: **MAY - 7 2003**

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MR. THOMAS H. CAMPBELL
Attorney at Law

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1 the testimony, that I thought the testimony was that you
2 were consulted and given an opportunity, but you were also
3 individually, perhaps.

4 MR. WHITE: Actually, we were not only
5 consulted and given the opportunity, the original
6 settlement agreement that was proffered to us to review
7 had in parentheses "and other parties that agree to the
8 proposed settlement." In other words, it was proposed
9 that the intervenors be signatories to the settlement if,
10 during the course of those negotiations, they agreed to
11 it, and those parties, to the extent -- we didn't, anyhow,
12 so I never saw it the least bit askance that we weren't
13 signatory parties to it. We didn't agree to it.

14 The implication now on the record is that
15 somehow we weren't offered that signatory status, and
16 that's the only reason I was offering it.

17 ACALJ NODES: I didn't understand that to be
18 the case, but if that was what you understood, feel free
19 to clarify the record on that.

20 MR. HOLUB: Your Honor, I understood that same
21 thing. I've got the same document and I have the same
22 problem with this process.

23 ACALJ NODES: Can you talk into the
24 microphone, Mr. Holub.

25 MR. HOLUB: Yes, Your Honor. I have the same

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**DIRECT TESTIMONY OF JAMES S. PIGNATELLI
UNISOURCE ENERGY CORPORATION**

DECEMBER 18, 2002

Q. Please state your name and business address.

A. My name is James S. Pignatelli. My business address is One South Church Avenue, Tucson, Arizona 85701.

Q. What is your position with UniSource Energy Company ("UniSource")?

A. I am Chairman of the Board, President and Chief Executive Officer. I also hold the same positions with Tucson Electric Power Company ("TEP").

Q. Please provide us with a summary of your education and employment background.

A. I received an undergraduate degree in accounting with a minor in economics from Claremont Men's College. I received a Juris Doctor Degree from the University of San Diego School of Law and am a member of the California State Bar.

I have worked in the utility industry since my college days, with the exception of two years when I was in the military during the Vietnam War. I served in various positions at San Diego Gas & Electric Company and Southern California Edison Company in accounting, economics, business planning and strategic planning. Prior to joining UniSource, I served as the Chief Executive Officer of Mission Energy, which was the largest independent power producer in the world at the time.

1 Q. Please generally describe UniSource's businesses?

2 A. UniSource Energy Corporation is the parent company of TEP, Millennium Energy
3 Holdings, Inc. ("Millennium"), and UniSource Energy Development Company
4 ("UED"). TEP, an Arizona public service corporation, is the principal subsidiary of
5 UniSource and serves approximately 360,000 customers in southern Arizona.
6 Millennium is the parent company of certain unregulated energy businesses,
7 including:

- 8 1. Global Solar Energy, Inc., which develops and manufactures flexible thin-
9 film photovoltaic material that converts sunlight to electricity. Its target
10 markets include military, aerospace and commercial applications.
- 11 2. Infinite Power Solutions, Inc., which is developing micro-miniature, thin-
12 film, solid state rechargeable batteries for use in medical implants, computer
13 components and radio frequency identification tags.
- 14 3. Southwest Energy Solutions, Inc. (SES), which is a regional electric
15 contractor and provider of energy support and construction services to
16 electric customers.

17 UED will be developing two new 400 MW generation units at the existing
18 Springerville Generation Site.

19
20 Q. Mr. Pignatelli, what is the purpose of your testimony?

21 A. My testimony will describe the benefits of this transaction and why it is in the
22 public interest. I urge the Arizona Corporation Commission to approve the
23 transaction for the following reasons:

- 24 • Significant gas and electric facilities, operations and customers in
25 both northern and southern Arizona will now be the responsibility of UniSource, an
26 Arizona-based company that is well known, accessible and held in high regard by

1 the community. UniSource is experienced in providing quality utility service to
2 Arizona citizens.

3 • UniSource will retain substantially all of the Arizona-based
4 employees of Citizens, which will minimize any negative economic impact of this
5 transaction.

6 • TEP's service and financial condition will not be impaired by this
7 transaction.

8 • This transaction will facilitate the resolution of the long-standing
9 purchased power and fuel adjustment clause case ("PPFAC Case").

10 • Although a gas rate increase is necessary due to substantial new
11 investment in facilities, this transaction will result in a reduction in the almost 29%
12 increase proposed by Citizens.

13 My testimony will discuss the transactions described in the Asset
14 Purchase Agreement between Citizens and UniSource dated October 29, 2002,
15 relating to the purchase of Citizens' electric utility business in Arizona ("Electric
16 Agreement") and the Asset Purchase Agreement dated October 29, 2002, relating to
17 Citizens' gas utility business in Arizona ("Gas Agreement"). My testimony will
18 describe UniSource's reasons for entering the Electric Agreement and the Gas
19 Agreement and the benefits that UniSource will provide in operating these electric
20 and gas businesses. Next, I will briefly describe the financing of the transaction.
21 Finally, I will describe UniSource's position with respect to Citizens' pending gas
22 rate case, Docket No. G-01032A-02-0598, ("Gas Rate Case") and the PPFAC Case,
23 Docket No. E-01032C-00-0751.

24
25 Q. Have you reviewed the Joint Application filed by UniSource, TEP and Citizens?

26 A. Yes.

1
2 **REBUTTAL TESTIMONY OF STEVEN GLASER**
3 **UNISOURCE ENERGY CORPORATION**

4 **APRIL 28, 2003**

5 **I. INTRODUCTION**

6 Q. Please state your name and business address.

7 A. My name is Steven Glaser. My business address is 4350 E. Irvington Road, Tucson, AZ
8 85714.

9
10 Q. Did you file direct testimony on behalf of UniSource Energy Corporation ("UniSource")
11 in this Docket?

12 A. Yes. I filed direct testimony on December 18, 2002.

13 Q. What is the purpose of your rebuttal testimony?

14 My testimony addresses proposed modifications to the Settlement Agreement as
15 recommended in the testimony of the Residential Utility Consumer Office ("RUCO")
16 witness, Ms. Marylee Diaz Cortez.

17
18 Q. What recommendations did Ms. Diaz Cortez propose in her testimony?

19 A. Although RUCO was supportive of the Settlement Agreement, Ms. Diaz Cortez did
20 propose the following changes: (1) modify allocation of any savings that may be realized
21 in a Pinnacle West Capital Corporation ("PWCC") contract renegotiation from 60/40
22 percent to 90/10 percent for Customer/UniSource, respectively; and (2) increase
23 expenditures for Demand Side Management ("DSM") programs from the current level of
24 \$175,000 per year to \$600,000 and potentially to \$1,000,000 per year.
25
26

1 for because UniSource has agreed not to seek recovery of the negative acquisition
2 adjustments.

3 Rather than looking at a single component of the proposed settlement in a vacuum,
4 the overall significant beneficial outcome should be the key consideration. Therefore, I
5 urge the Commission to view the 60/40 percent PWCC contract savings allocation as part
6 and parcel of the entire settlement package.

7
8 Q. What are your concerns regarding RUCO's proposal that the funding of DSM be increased
9 significantly?

10 A. DSM programs help customers to use energy more efficiently, which should help them
11 reduce their power bills. This is a worthwhile goal; however, in recent years, there have
12 been some significant differences of opinion as to the best way to assist consumers with
13 this endeavor. As I will discuss, the Commission will be providing further direction on
14 these issues in the near term. Therefore, to significantly increase the amount of funds
15 Citizens is currently working with for DSM programs is premature.

16
17 Q. How has DSM policy evolved over time?

18 A. DSM gained momentum in the electric utility industry in the early 1990's. Early DSM
19 programs were focused on offering rebates to consumers who purchased energy efficient
20 electric equipment. For the past five to seven years, the utility industry in Arizona has
21 shifted the DSM focus from rebate programs to market-based solutions, such as TEP's
22 Guarantee Home Program and renewable energy resources. Moreover, in the
23 Commission's Environmental Portfolio Standard ("EPS") order, Decision No. 62506, the
24 Commission has supported the renewable energy approach and authorized Arizona utilities
25 to shift funding from DSM programs to renewable energy resources.

26

	<u>TEP</u>	<u>APS</u>	<u>Citizens - Current</u>	<u>Citizens-RUCO's Proposal</u>
Current DSM Level	\$1,300,000	\$394,393	\$175,000	\$1,000,000
Customers	359,372	903,089	77,818	77,818
Cost per Customer	\$3.62	\$0.44	\$2.25	\$12.85

I would also note that TEP's DSM spending-per-customer would continue to decrease as the dollars allocated to EPS increases. In 2004, TEP estimates the cost per customer for DSM spending will be \$2.27.

Q. Has the Commission addressed the issue of DSM in recent dockets?

A. Yes. DSM policy was discussed during the Track B workshops and hearing. Ultimately, the Commission found, "We will therefore direct Staff to facilitate a workshop process to explore the development of a DSM policy and an environmental risk management policy, with such exploration to include an examination of the possible costs and benefits of the respective policies, and to file a report, within 12 months from the date of this Decision, informing the Commission of the progress achieved in the workshops." (Decision No. 65743).

Q. What is UniSource's conclusion?

A. UniSource believes that Citizens' current level of DSM spending is appropriate. However, UniSource is willing to work with Staff, RUCO and other interested parties to review the design and allocation of DSM funding.

I also believe it is prudent and in the public interest for the Commission to conduct a comprehensive review examining the costs and benefits of DSM policy before requiring

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**DIRECT TESTIMONY OF KEVIN LARSON
UNISOURCE ENERGY CORPORATION**

DECEMBER 18, 2002

I. **INTRODUCTION**

Q. Please state your name and business address.

A. My name is Kevin P. Larson. My business address is One South Church Avenue, Tucson, Arizona 85701.

Q. What is your position with UniSource Energy Corporation ("UniSource" or "Company")?

A. I am Vice President, Chief Financial Officer and Treasurer of UniSource. I also hold the same positions with Tucson Electric Power Company ("TEP").

Q. Please summarize your professional experience and education.

A. I joined TEP in 1985 as a financial analyst, and in 1991, I became Assistant Treasurer. In 1994, I was elected Treasurer, and in 1997, I became a Vice President at TEP. I became Vice President, Chief Financial Officer and Treasurer of TEP and UniSource in October 2000. I report directly to Mr. James Pignatelli, the Company's President and Chief Executive Officer.

My educational background includes a Bachelor of Science degree in Economics

1 from the University of Minnesota, Minneapolis, and graduate work in finance at the
2 University of Arizona. I am also a Chartered Financial Analyst ("CFA").
3
4

5 Q. What is the purpose of your testimony in this proceeding?

6 A. The purpose of my testimony is twofold. First, I will provide additional
7 information in support of the financing plan described in Section V of the Joint
8 Application filed by UniSource and Citizens Communications Company
9 ("Citizens") for the sale and transfer of certain electric and gas assets to UniSource
10 ("Joint Application"). Second, I will provide a cost of capital estimate for use in
11 the amended general rate case for Citizens' Arizona Gas Division ("Gas Rate
12 Case").
13
14

15 **II. SUMMARY OF FINDINGS AND CONCLUSIONS**
16

17
18 Q. Please summarize your findings and conclusions with respect to the financing plan
19 described in the Joint Application.

20 A. The financing plan contained in the Joint Application provides UniSource with the
21 flexibility needed to fund the acquisition in a timely and cost efficient manner. Due
22 to the potential for unanticipated changes in the capital markets, and the timeframe
23 required for closing the purchase transaction, the flexibility requested in the Joint
24 Application is both reasonable and necessary. The ability to fund the debt portion
25
26

1 requested rate of return. First, I recommend using a capital structure that better
2 reflects the financing plan described in the Joint Application. Second, I recommend
3 using a cost of debt that reflects the anticipated cost of debt to the New Utility
4 Companies.
5

6
7 Q. What capital structure are you recommending for the Gas Rate Case?

8 A. UniSource anticipates capitalizing the New Utility Companies with a common
9 equity investment in the range of 30-50% of total capital. As such, I recommend
10 using the midpoint of this range for rate setting purposes. For purposes of
11 calculating the weighted average cost of capital, the capital structure would
12 therefore consist of 40% common equity and 60% long-term debt.
13
14

15
16 Q. What cost of debt are you recommending for the Gas Rate Case?

17 A. As stated above in Section III of my testimony, the Company's preferred alternative
18 is to issue corporate bonds either through an intermediate holding company or
19 directly by the New Utility Companies. These bonds may be issued in several
20 different series, each having its own maturity date and interest rate. Assuming the
21 bonds are issued with low investment grade credit ratings (Baa or BBB), and that
22 bond market conditions do not change materially between now and the issuance
23 date, a cost of debt in the range of 7% to 8% should be attainable by the New
24 Utility Companies. This estimate falls within the range of debt costs realized by
25
26

1 other BBB rated utilities during the second half of 2002. BBB rated utility bonds
2 with maturities of seven to ten years have been issued over this time period at an
3 annual cost (or yield to maturity) of between 5.6% and 8.1%. Comparably rated
4 bonds with longer maturities (15 to 30 years) have also been issued at an annual
5 cost of between 6.8% and 7.6%. Although the estimated cost of debt for the New
6 Utility Companies is at the high end of each range, this is reasonable to expect in
7 light of the relatively small size of the New Utility Company issuances, as well as
8 the limited track record for these new companies. Additionally, as discussed
9 previously in my testimony, there is no guarantee that the bonds will actually
10 achieve an investment grade credit rating. Speculative grade issuers have had a
11 very difficult time issuing new bonds in recent months, and when successful, these
12 issuers have had to pay a significantly higher price for the capital relative to
13 investment grade issuers. Based on what is known today, my best estimate for the
14 cost of debt to be issued by the New Utility Companies is 7.5%. After factoring in
15 the amortization of debt issuance costs, as well as the costs of arranging and
16 maintaining a revolving credit facility, I recommend using a cost of debt of 7.75%
17 for rate setting purposes.
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24 Q. You previously mentioned that the cost of equity capital to the New Utility
25 Companies will likely be higher than the 11% return on equity requested by
26 Citizens. What is the basis for your statement?

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A. Citizens requested return on equity is based on the low end of a range estimated by witness Robert G. Rosenberg. This range was based on the cost of equity capital for a comparable group of gas distribution companies. Most of the companies in this group have credit ratings higher than Baa/BBB. Additionally, the group has a median equity to capital ratio of 50%. Since the New Utility Companies are expected to have lower credit ratings and slightly higher debt leverage relative to Mr. Rosenberg's comparable group, the cost of equity capital for the New Utility Companies will likely be higher than the 11% requested by Citizens. However, for purposes of setting rates in this proceeding, UniSource is willing to accept the 11% return on equity requested by Citizens.

Q. Based on the mix of capital and component costs of capital you have recommended, what is the overall weighted-average cost of capital you are recommending?

A. The overall cost of capital I recommend using in the Gas Rate Case is 9.05%, as summarized in the following table:

	<u>% of Total</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
	<u>Capital</u>		
Debt	60.0%	7.75%	4.65%
Common Equity	40.0%	11.00%	4.40%
Total	100.0%		9.05%

Q. Does this conclude your testimony?

A. Yes, it does.

SUPPLEMENTAL TESTIMONY OF KEVIN LARSON

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Q: What is the purpose of your supplemental testimony?

A. The purpose of my testimony is to address the questions raised by Commissioner Gleason in his letter to the parties dated April 24, 2003. The questions raised by Commissioner Gleason are repeated below in the same order as they appeared in his letter.

Q. What are the policy implications of a regulated utility loaning money to its parent company in exchange for an interest in a third company where the value of the security is questionable?

A. From a policy perspective, the Commission established AAC R14-2-801 et seq., Public Utility Holding Companies and Affiliated Interest, as a regulation to monitor, control and review transactions between affiliated companies. Certain affiliate transactions, including loans, must be reviewed and approved by the Commission. The Commission reviews the transaction to determine if the transaction would impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service.

In the case of TEP, which is seeking authority to lend up to \$50 million to its parent company to help fund the acquisition of utility properties from Citizens, I believe that a \$50 million loan from TEP would not impair TEP's financial status, its ability to attract capital, or its ability to meet its public service obligation. Under the current rate freeze, TEP is anticipated to generate enough cash flow to fund a \$50 million loan, meet its

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earnings. Would such a graduated structure provide an incentive to maintain as high an equity ratio as possible?

A. As with other corporations, decisions regarding dividend policy appropriately fall within the purview of the regulated company's Board of Directors. The restrictions on TEP dividends contained in prior Commission orders, as well as the proposed Settlement, were the result of voluntary negotiations between TEP's management and other parties to Commission proceedings. As stated previously, UniSource has a natural incentive to preserve its financial well-being and to reduce its cost of capital through its fiduciary duty to shareholders to reduce cost and improve profitability. UniSource believes it would be inappropriate to require additional external "incentives" on dividend policy.

Q. Generally, does a higher equity ratio produce a financially healthier utility which, in turn, allows it to have increased operating funds, incur loans at a lower interest rate and to be better prepared for any unexpected occurrences in the market thus protecting the rate payers?

A. Generally speaking, yes. However, it should be noted that equity capital is the most expensive source of capital. For that reason, most corporations attempt to finance themselves with a reasonable mix of debt and equity capital. Given the cost advantage of debt capital, the impact on a utility's cost of service should be considered in any evaluation of capital structure.

A. Does this conclude your supplemental testimony?

A. Yes.

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2
3 TESTIMONY OF MICHAEL J. DECONCINI, JR.

4 UNISOURCE ENERGY CORPORATION

5 APRIL 28, 2003
6
78 I. INTRODUCTION
9

10 Q. Please state your name and business address.

11 A. My name is Michael J. DeConcini, Jr. My business address is One South Church, Tucson,
12 Arizona, 85701.13 Q. With whom are you employed?
1415 A. I am Senior Vice President of Investments and Planning for UniSource Energy and Senior
16 Vice President and Chief Operating Officer of Energy Resources for Tucson Electric
17 Power Company ("TEP").

18 Q. What are your duties and responsibilities at TEP?

19 A. My areas of responsibility include fuels procurement and management, wholesale power
20 trading and marketing, and power plant operations at TEP. I am also involved in
21 UniSource affiliate investments and strategic direction related to planning and growth
22 opportunities, including acquisitions such as the Citizens Arizona properties, the subject of
23 this case. I have been with TEP/UniSource for 14 years and involved in the wholesale
24 power areas in various positions for 11 of those years.25 Q. What is your educational background?
26

1 A. I have a Bachelor of Science Degree in Finance from Moorhead State University and a
2 Master of Business Administration Degree from Arizona State University.

3 Q. What is the purpose of your testimony?

4 A. My comments will address comments submitted by the City of Nogales regarding the
5 efficacy of the contract between Citizens and Pinnacle West Capital Corporation effective
6 June 1, 2001 and dated July 16, 2001 ("PWCC Contract"), as well as augment certain
7 issues discussed in the Staff Report regarding the PWCC Contract.
8

9 Q. Please summarize your testimony.

10 A. In short, my testimony demonstrates that the PWCC Contract was prudent at the time it
11 was entered into and provides a fixed price comparable to other alternatives to Citizens but
12 with less operating and financial risk.
13

14
15 **II. PRUDENCE OF PWCC CONTRACT**

16 Q. Please describe the highlights of the PWCC Contract.

17 A. It is a full-requirements, firm power contract at a fixed price of \$58.79/MWh for the term
18 and includes transmission to Citizens receipt points on the WAPA transmission system.
19 Citizens peak load in 2002 was approximately 320 MW with a load factor of 50% and
20 annual growth rate of approximately 3%. The contract does not create stranded costs in a
21 competitive environment as competitive power procured by customers is excluded from
22 the supply agreement.
23

24 Q. Define the term "full requirements".
25
26

1 firm capacity and energy, transmission, losses to Citizens' receipt points, and ancillary
2 services necessary for load-following all of which have value/costs which must be
3 determined.

4 Q. How do you determine such costs?

5 A. Firm energy and capacity are easy to determine for 100% load factor products by using
6 forward price curve data that is readily available. However, taking into account the
7 necessary components to provide load-following ability complicates matters. The only
8 component of the price that is fairly easy to value is network transmission. The remaining
9 value is best estimated by pricing a load-following resource-based alternative.

10 Q. What is the approximate value of the network transmission service embedded in the
11 PWCC Contract?
12

13 A. It is approximately \$3.35/MWh based on 2002 data from Pinnacle West's OATT Network
14 Service Agreement with APS for serving Citizens.
15

16 Q. What were the forward prices for contracts similar to the PWCC Contract entered into
17 during the period that PWCC and Citizens were negotiating?

18 A. There were numerous contracts entered into during this period, the majority of which were
19 in California. California Energy Resource Scheduling, the California state entity which
20 entered into long-term energy contracts on behalf of the load-serving utilities in 2001, has
21 a list of its contracts posted on its website (<http://www.cers.water.ca.gov/contracts.html>).
22 Because California and Arizona had such directly connected markets during this period,
23 these contracts provide a good indication of prices in Arizona and the rest of the
24 Southwest. The table below shows a sample of such fixed price contracts that were
25
26

1 entered into during the same 2001 period that Citizens and PWCC negotiated their
2 agreement. (See the website referred to above for complete contract details).
3

4

Effective Date	Term	Product(s)	Current Price*
5 Mar 23, 2001	Mar 2001-Dec 2011	7x24	\$61.00
6 Mar 2, 2001	Mar 2001-Dec 2004	On-Peak, 7x24	\$119.50
7 Feb 9, 2001	Feb 2001-Dec 2005	On-Peak	\$115/\$127
8 May 24, 2001	May 2001-Jun 2012	On-Peak	\$169

9

10 *Price per Megawatt-hour for current energy delivery as of April, 2003

11 From the Table above and with more detailed analysis of the contracts on the website, one
12 can clearly see that the energy prices for long-term agreements entered into during the first
13 half of 2001 were significantly higher than the price PWCC and Citizens agreed to in the
14 Contract. It is also important to note that: 1) none of the above California contracts is a
15 full-requirements contract like the PWCC Contract, as they are 100% capacity take or pay
16 fixed delivery contracts, and 2) none of the above referenced contracts has been
17 renegotiated.
18

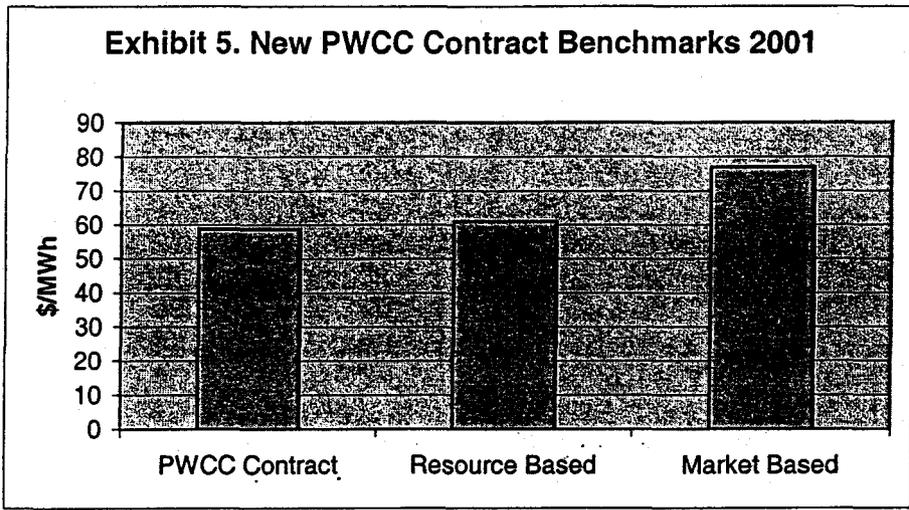
19 Q. If you were to price a load-following resource-based alternative based on the forward
20 market prices in April of 2001, what price range would you have thought appropriate?
21

22 A. UniSource looked at analyzing the price for a contract similar to the PWCC Contract in
23 two ways. First, utilizing a resource-based alternative, and second, using a market-only
24 alternative. The price range for these two options was approximately \$60 to \$80/MWh.
25

26 Q. Please describe the resource-based analysis.

- 1 A. TEP analyzed what a fully dispatchable combined cycle would cost Citizens to serve its
2 load assuming immediate availability and full access to economic market purchases and
3 sales using forward gas prices based on the same mid-May 2001 TEP forecast and
4 standard plant operating assumptions. This analysis resulted in wholesale delivered price,
5 including the network transmission costs to Citizens' receipt points, of approximately
6 \$60/MWh. The analysis was performed using TEP's ProMod production modeling
7 program and the assumptions delineated in Exhibit 1.
8
- 9 Q. Why is the resource-based price so much lower than the contracts entered into in
10 California?
- 11 A. The resource-based analysis included the assumption that the capacity (plant) would be
12 immediately available which would not have been feasible at the time. Due to the
13 necessary time to permit and build a new plant, the California contracts reflected market-
14 based prices for the first 2 years which put upward pressure on the term contract prices.
15
- 16 Q. Please describe your market-based analysis.
- 17 A. Using forward prices as of mid-May 2001 from TEP's own historical forecast and Citizens
18 hourly load shape and assuming that all of Citizens power would be procured from the
19 market, the average price for firm energy and the network transmission costs to Citizens'
20 receipt points would be approximately \$80/MWh.
21
- 22 Q. How do these two options compare to the PWCC Contract with all of its components?
- 23 A. These alternatives place much more risk on Citizens and its retail customers as they
24 require Citizens to manage the deliverability and availability of fuel and/or market power
25 purchases, market price risk of gas and/or power, operational risks of resources and the
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III. CURRENT VALUATION OF THE PWCC CONTRACT

Q. Are the current forward prices as quoted at the Palo Verde Hub a good benchmark for what Citizens should be paying for its power?

A. No. The current forward prices at Palo Verde represent a 100% capacity factor, take or pay energy price that has very little resemblance to the full-requirements, load-following, approximately 50% capacity factor nature of Citizens' load. In addition to these items, the demand of Citizens' retail customers is heavily weighted to hot summer months which generally produce the highest market power prices in the Southwestern U.S., including Arizona.

Q. What do you consider Citizens' likely alternative to the PWCC Contract for serving its load?

A. TEP has analyzed a resource-based alternative we believe would be the most likely and comparative alternative to a full-requirements contract like the PWCC Contract. The most obvious choice for a resource-based generation alternative to serve Citizens' load is a new

1 Combined-Cycle unit with sufficient capacity to cover Citizens' load. These new units
2 have a heat rate in the range of 7,000 Btu/kW at 100% load and a capital installation cost
3 in the range of \$600 to \$700/kW. TEP has estimated the current forward gas prices for the
4 remainder of the PWCC Contract term at approximately \$4.30/mmBtu for delivery at the
5 Permian Basin. The delivered gas price includes transportation, fuel (losses), usage
6 charges and taxes. Also included are transmission charges and losses.
7

8
9 Exhibit 2 details the all-in costs of gas and the expected all-in cost of providing a 50%
10 capacity factor load like Citizens from a combined cycle plant. This all-in cost based on
11 these assumptions alone amounts to \$66/MWh. When the resource is utilized as part of a
12 system that optimizes generation dispatch through market sales and purchases, it brings the
13 total cost down to roughly \$54/MWh. Both of these prices include network transmission
14 to Citizens' receipt points. This was modeled using TEP's ProMod program in late March
15 using assumptions listed in Exhibit 3.
16

17 Q. How does this option compare to the PWCC Contract?

18 A. A resource alternative has much more risk associated with it including deliverability and
19 availability of fuel and/or market power purchases, market price risk of gas and/or power,
20 operational risks of resources and the risk of stranded costs associated with competitive
21 direct access. Further, the price does not contain the costs associated with all of the
22 ancillary services necessary to compare directly to the PWCC Contract as previously
23 discussed.
24
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BEFORE THE ARIZONA CORPORATION COMMISSION

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- MARC SPITZER
CHAIRMAN
- JIM IRVIN
COMMISSIONER
- WILLIAM A. MUNDELL
COMMISSIONER
- JEFF HATCH-MILLER
COMMISSIONER
- MIKE GLEASON
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC DIVISION OF CITIZENS COMMUNICATIONS COMPANY TO CHANGE THE CURRENT PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE RATE, TO ESTABLISH A NEW PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE BANK, AND TO REQUEST APPROVED GUIDELINES FOR THE RECOVERY OF COSTS INCURRED IN CONNECTION WITH ENERGY RISK MANAGEMENT INITIATIVES.

Docket No. E-01032C-00-0751

IN THEMATTER OF THE APPLICATION OF CITIZENS COMMUNICATIONS COMPANY, ARIZONA GAS DIVISION, FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES DESIGNED TO PROVIDE SUCH RATE OF RETURN.

Docket No. G-01032A-02-0598

IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS COMMUNICATIONS COMPANY AND UNISOURCE ENERGY CORPORATION FOR THE APPROVAL OF THE SALE OF CERTAIN ELECTRIC UTILITY AND GAS UTILITY ASSETS IN ARIZONA, THE TRANSFER OF CERTAIN CERTIFICATES OF CONVENIENCE AND NECESSITY FROM CITIZENS COMMUNICATIONS COMPANY TO UNISOURCE ENERGY CORPORATION, THE APPROVAL OF THE FINANCING FOR THE TRANSACTIONS AND OTHER RELATED MATTERS.

Docket No. E-01933A-02-0914
Docket No. E-01032C-02-0914
Docket No. G-01032A-02-0914

1 division has accrued a liability of approximately \$135 million in
2 unrecovered power costs. In the PPFAC case, Citizens had sought
3 recovery of these costs through its Purchased Power and Fuel Adjustor
4 Clause ("PPFAC"). Recovery of the unrecovered power costs would result
5 in an approximate 45% increase in customers' rates.

6
7 Q. How does the settlement agreement mitigate this situation?

8 A. As part of UniSource's purchase of the Citizens gas and electric properties
9 UniSource has agreed to forfeit any right to recover any of the \$135 million
10 electric power cost liability, and hold ratepayers completely harmless from
11 the impacts of the dysfunctional power markets of 2000 and 2001. This
12 term of the agreement also has the effect of reducing generation stranded
13 costs to zero.

14
15 Q. Does this mean that Citizens electric customers will experience no change
16 in rates?

17 A. No. Although Citizens' power is now supplied on a fixed rate contract,
18 which protects customers from market fluctuations, the fixed cost of the
19 power in the contract exceeds the cost of power that is embedded in
20 current electric rates. Pursuant to the terms of the PPFAC, the
21 incremental cost generally is recoverable through the PPFAC. This
22 incremental cost will increase electric commodity rates per kwh by
23 \$0.01824, or approximately 22%.

1 Q. If the electric properties did not transfer to UniSource, would Citizens
2 ratepayers still experience a rate increase?

3 A. Yes. The fixed cost of the power is the same whether Citizens retains
4 ownership of the electric operations or transfers them to UniSource.
5 Because Citizens, as yet, has not flowed through the fixed contract price
6 to ratepayers, a 22% increase for the going-forward cost of power would
7 still be necessary, absent the sale to UniSource. The advantage of the
8 settlement agreement is that the necessary increase is limited to the going
9 forward incremental cost of power and does not include recovery of the
10 \$135 million liability. Absent this agreement the rate increase would be
11 45% rather than 22%.

12
13 Q. What other terms of the settlement agreement benefit Citizens' electric
14 customers?

15 A. The electric customers will experience a permanent write down of
16 \$93,624,000 in electric rate base. As a result, in future rate cases the
17 level of investment for which UniSource is allowed to recover and earn a
18 return will be \$93.6 million less than it otherwise would be in Citizens'
19 hands. The reduction in annual electric revenue requirement as a result of
20 this write down is approximately \$17 million.

21
22 The agreement also provides for a three year rate moratorium for electric
23 customers. UniSource is precluded from seeking a rate increase during

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MARC SPITZER - Chairman
JIM IRVIN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON

IN THE MATTER OF THE APPLICATION OF
THE ARIZONA ELECTRIC DIVISION OF
CITIZENS COMMUNICATIONS COMPANY
TO CHANGE THE CURRENT PURCHASED
POWER AND FUEL ADJUSTMENT CLAUSE
BANK, AND TO REQUEST APPROVED
GUIDELINES FOR THE RECOVERY OF
COSTS INCURRED IN CONNECTION WITH
ENERGY RISK MANAGEMENT ACTIVITIES.

DOCKET NO. E-01032C-00-0751

IN THE MATTER OF THE APPLICATION OF
CITIZENS COMMUNICATIONS COMPANY,
ARIZONA GAS DIVISION, FOR A HEARING
TO DETERMINE THE FAIR VALUE OF ITS
PROPERTIES FOR RATEMAKING PURPOSES,
TO FIX A JUST AND REASONABLE RATE OF
RETURN THEREON, AND TO APPROVE RATE
SCHEDULES DESIGNED TO PROVIDE SUCH
RATE OF RETURN.

DOCKET NO. G-01032A-02-0598

IN THE MATTER OF THE APPLICATION OF
CITIZENS COMMUNICATIONS COMPANY
AND UNISOURCE ENERGY CORPORATION
FOR APPROVAL FOR THE SALE OF CERTAIN
ELECTRIC UTILITY AND GAS UTILITY
ASSETS IN ARIZONA, THE TRANSFER OF
CERTAIN CERTIFICATES OF CONVENIENCE
AND NECESSITY FROM CITIZENS COMMUN-
ICATIONS COMPANY TO UNISOURCE
ENERGY CORPORATION, THE APPROVAL
OF THE FINANCING FOR THE TRANS-
ACTIONS AND OTHER RELATED MATTERS.

DOCKET NO. E-01933A-02-0914
E-01032C-02-0914
G-01032A-02-0914

STAFF'S NOTICE OF FILING
JOINT STAFF REPORT

Staff of the Utilities Division ("Staff") of the Arizona Corporation Commission
("Commission") hereby files its Joint Staff Report in the above-captioned matters.

...

...

PPFAC rate which will reflect only actual power costs after the date of the Decision, resulting in a new adjustor rate of \$0.01825 per kWh. However, UniSource is attempting to negotiate for lower power costs, and if successful, will pass on sixty (60) percent of any savings to customers pursuant to the Settlement Agreement.

- UniSource agreed to several limitations related to the financing of the sale and transfer of the gas and electric assets. First among these is if a loan from TEP to UniSource becomes part of the financing, the loan would be at a higher interest rate than UniSource originally requested, resulting in more interest income to TEP, ultimately benefiting TEP ratepayers. Second, the loan from TEP would be for four years rather than the ten years that UniSource originally requested, reducing the length of time that TEP's funds are at risk. Third, the Settlement Agreement places dividend restriction on the New Companies and tightens the current dividend restriction on TEP. This restriction was agreed upon to protect the earnings of the regulated Arizona utility from the possibility of failed ventures of the parent, UniSource. Finally, the Settlement Agreement contains a condition to hold TEP's ratepayers harmless from any increases in TEP's cost of capital as a result of the loan to UniSource. Taken together, these restrictions significantly reduce risk to the current TEP ratepayers and the ratepayers of the New Companies.

Staff respectfully urges the Commission to adopt the Settlement Agreement without significant modification. There may be elements that one would desire to change individually. Indeed, during negotiations, Staff at times bargained for different or additional concessions. However, the Settlement Agreement *taken as a whole* reasonably balances diverse interests, is fair to ratepayers and consistent with the public interest.

Ultimately, in Staff's opinion, the electric and gas rate increases being recommended for approval herein pursuant to the Settlement Agreement *are no higher than*, and in all likelihood, *lower than*, what would eventually have been allowed in the way of rate relief at the ACC or appellate court level. Staff would note that if the transaction is terminated because UniSource

1 discussed, it would have been unreasonably cumbersome for Staff to negotiate with the Joint
2 Applicants with all other parties present. Therefore, Staff indicated that it would continue
3 negotiations with Citizens and UniSource and that the other parties should attempt to come to an
4 agreement with the applicants on an individual basis. On March 31st, Staff held a final meeting
5 with the intervenors explaining the main points of the proposed Settlement Agreement and
6 responded to the questions and concerns of the individual intervenors.

7
8 **Summary of the Benefits of the Settlement Agreement**

9 In later portions of this Report, Staff will detail the many benefits of the Settlement
10 Agreement. However, at the outset, we will summarize those benefits that are especially notable.
11 In general, Staff believes that a number of benefits would be difficult or impossible to achieve and
12 pass on to the ratepayers within the context of a normal rate case and sale of asset proceedings.

13
14 By far, the single most significant benefit is the "forgiveness" or permanent writedown of
15 the "under-recovered" purchased power costs included within the AED's PPFAC bank balance at
16 the time of the closing of the asset purchase transaction. The current balance is \$124.0 million
17 and rising. It is estimated to reach at least \$135 million by July 28, 2003. The forgiveness of this
18 amount by UniSource saves the AED's residential customers approximately \$12 per month.

19
20 The Settlement Agreement also includes a provision whereby the ratepayers will benefit
21 immediately if UniSource is able to renegotiate its purchased power contract with Pinnacle West
22 Energy. Pursuant to the Agreement, 60 percent of the savings from the renegotiated contract will
23 flow through to the ratepayers. In contrast, because Tucson Electric Power Company and

1 Arizona Public Service Company do not currently have a purchased power or fuel adjustor
2 mechanism in place, they are able to keep any savings from renegotiated power and fuel
3 contracts. Their customers would only receive such a benefit after a full rate case.

4
5 The Settlement Agreement will also benefit customers by the reduction of the requested
6 increase in gas rates from \$21.0 million as originally requested by Citizens (or UniSource's
7 original proposal contained within the Joint Application of \$16.6 million) to approximately \$15.2
8 million per the Settlement Agreement. The reductions result primarily from UniSource's
9 willingness to recognize the *purchase price* of the assets in rate base rather than the *book value* of
10 the assets. Additional reductions were achieved when UniSource agreed to a further \$10.0
11 million permanent agreed-upon disallowance from rate base and related depreciation expense due
12 to Build-Out Program excesses. Although in the past, the Commission has removed plant that
13 was not used or useful from rate base or deferred its recovery, it has not reduced rate base due to
14 the market value of a utility's assets. Thus, this voluntary, permanent reduction in rate base
15 would be unlikely outside of these dockets.

16
17 It is also problematic for a utilities commission to limit a utility's right to file for rate
18 increases. However, a three-year moratorium on the AED and AGD rates was achieved through
19 the Settlement Agreement.

20
21 Electric competition remains at the forefront of Arizona regulatory issues. The Settlement
22 Agreement contains a provision whereby within four months of approval of the Agreement,
23 UniSource will file a plan to open the AED's service territory to retail electric competition by

1 as a discussion of why Staff believes the Settlement Agreement regarding gas rate and accounting
2 issues is "in the public interest."
3

4 **Gas Rate Case Background**

5 On August 6, 2002, Citizens Communications Company (formerly known as "Citizens
6 Utilities Company") filed a base rate application that sought to increase Arizona retail base gas
7 rates by \$21,005,521. The requested increase equated to an average overall increase of 28.9
8 percent for all retail customers. Further, with its filing Citizens sought to combine, or consolidate,
9 its Northern Arizona Gas and Santa Cruz Gas Divisions' operations for rate or tariff purposes.
10

11 The August 2002 filing was the first Citizens gas base rate filing made since October 18,
12 1995. Citizens' 1995 filing culminated in a relatively modest \$2.7 million (6.0 percent) increase
13 in the Northern Arizona Gas Division's rates. Significantly, during the nearly eight-year span
14 since Citizens' last Arizona gas rate case, the Company invested approximately \$133 million in
15 gas plant. This significant investment in gas plant is the primary contributor to the near-tripling
16 of rate base that Citizens was requesting within its August 2002 rate filing versus what had been
17 requested within its 1995 gas rate case. As discussed in a separate section below, the majority of
18 Citizens' plant additions during the noted eight-year period is attributable to the Company's
19 Arizona Build Out Program – a program designed to expand Citizens' gas service to relatively
20 remote, low density and high-cost-to-serve areas.
21

22 Because of the size and complexity of Citizens' 2002 base rate filing, in conjunction with
23 other regulatory projects which were straining the internal resources of the Utilities Division

1 expenses being assigned/allocated to Arizona utility properties. In this case, Citizens did
2 a very thorough job of removing administrative office expenses that the ACC had
3 previously disallowed, and furthermore, "capped" the total administrative office expense
4 level to the amount found acceptable *in the 1993 rate case (i.e., \$1.2 million)*. In other
5 words, Citizens has capped its administrative offices expense to a level found reasonable
6 by the ACC nearly a decade ago.

- 7
- 8 • Depreciation Expense: In the 1990s, Citizens occasionally sought to *increase* its
9 depreciation rates for energy properties owned in Arizona. In the instant case, Citizens
10 has proposed to *reduce* its Arizona gas depreciation rates. Further, Staff found the
11 depreciation study presented by Citizens in this case to be well documented employing
12 assumptions generally thought to be reasonable.

13

14 In short and in sum, the Citizens application made in August 2002 is not "typical" of the
15 rate filings it made throughout the 1990s inasmuch as a much more balanced test year approach is
16 being proposed. Further, Citizens incorporated many ACC-adopted adjustments that it had
17 routinely fought and lost throughout the 1990s. Thus, the very significant increase being
18 proposed by Citizens within its August 2002 rate filing was being justified primarily by the
19 significant dollars the Company had invested within the Arizona Build Out Program. Its
20 requested increase was not being significantly "exaggerated" by reflection of the many
21 adjustments it had previously proposed – and which the ACC routinely rejected – in rate
22 applications occurring throughout the 1990s.

23

1 **Citizens' Cost of Capital Proposal**

2

Description	Capital Ratio	Cost Rate	Weighted Cost	Tax Conversion Factor	Before-Tax COC
Equity	.5000	11.00%	5.50%	1.665640	9.161%
Long Term Debt	.5000	6.70%	3.35%		3.350%
Total	1.000		8.85%		12.511%

3
4 **UniSource's Settlement Cost of Capital**

5

Description	Capital Ratio	Cost Rate	Weighted Cost	Tax Conversion Factor	Before-Tax COC
Equity	.4000	11.00%	4.40%	1.665640	7.329%
Long-Term Debt	.6000	7.75%	4.65%		4.650%
Total	1.000		9.05%		11.979%

6
7 As can be gleaned from the table above, Citizens' higher equity ratio assumption – with its
8 attendant tax ramifications – causes its proposed “true” or “before-tax” cost of capital to be higher
9 than that being utilized in the development of rates being proposed within the Settlement
10 Agreement. Further, we note that Citizens had lowered the common equity return that it thought
11 to be justified in light of the significant increase it was requesting within its August 2002 rate
12 filing. Specifically, Citizens presented testimony that purported to justify a 12.0 percent return on
13 equity, but reflected only an 11.0 percent return on equity within the development of its retail cost

- 1 • Customers will experience stability in power costs for the next five years (the remaining
2 life of the New Contract).
- 3
- 4 • Customers will have the ability to choose alternative power suppliers in less than two
5 years because the Settlement Agreement requires that the service territories for the present
6 AED/the future ElecCo be open to retail electric competition by December 31, 2004.
- 7
- 8 • If customers find lower alternative power prices, they will be able to benefit from those
9 prices without the burden of stranded costs.
- 10
- 11 • An incentive in the Settlement Agreement provides for electric customers to receive sixty
12 (60) percent of any savings as a result of any successful renegotiations with Pinnacle West
13 Capital Corporation ("PWCC") of the New Contract.
- 14
- 15 • The increase in electric rates will reflect only future actual power costs, resulting in a new
16 adjustor rate of \$0.01825 per kWh.
- 17

18 In Summary, customers will be better off under the Settlement Agreement than under any
19 of the expected outcomes of the PPFAC case.

20

21 Electric PPFAC Case Background

22 The Settlement Agreement and acquisition by UniSource of Citizens electric assets will
23 resolve all issues from Citizens' PPFAC case, Docket No. E-01032C-00-0751, in which Citizens

1 requested major changes to its PPFAC. Citizens had originally requested full recovery of the
2 under-recovered balance for purchase power costs that Citizens incurred. These costs were
3 mainly due to a contract signed between Citizens and APS in 1995 (hereinafter referred to as the
4 Old Contract). Citizens had requested a rate increase to collect the under-recovered balance
5 (approximately \$87 million as of June 2001) over a seven-year period. Citizens also requested
6 recovery of all purchased power costs related to a new agreement that was negotiated between
7 Citizens and PWCC effective June 1, 2001 (hereinafter referred to as the New Contract), plus a
8 six (6) percent carrying charge for the under-recovered balance from the Old and New Contract.
9 This total under-recovery is projected to be at least \$135 million by July 28, 2003. In addition,
10 Citizens requested an increase in the adjustor rate from \$0.000 per kWh to \$0.01825 per kWh to
11 accommodate the costs of purchased power under the New Contract, as well as to reflect
12 increased transmission costs.

13
14 The foregoing requests, taken together, would have resulted in an adjustment factor
15 sufficient to cover the costs of the New Contract plus the total amount projected to be under-
16 recovered as of July 2003 (plus future carrying costs) of approximately \$.0320 per kWh .

17 ...

18 The major issues in the PPFAC case were whether Citizens should be allowed to collect
19 all of its under-recovered balance, and whether costs under the New Contract should be fully
20 recoverable. While there was no order in the PPFAC case, it is likely that the Commission's
21 decision would have been influenced by the positions supported by the Company, by Staff, and by
22 others. The Company requested recovery of its under-recovered PPFAC balance over seven years