



ORIGINAL

DEPARTMENT OF THE ARMY  
UNITED STATES ARMY LEGAL SERVICES AGENCY  
901 NORTH STUART STREET  
ARLINGTON VA 22202-1837



0000065180

32D

REPLY TO  
ATTENTION OF

January 5, 2007

Regulatory Law Office  
U 4142

Subject: In The Matter Of The Filing By Tucson Electric Power Company To Amend Decision No. 62103, Arizona Corporation Commission Docket No. E-01933A-05-0650.

Arizona Corporation Commission  
Docket Control  
1200 West Washington Street  
Phoenix, Arizona 85007

Enclosed for filing with the Arizona Corporation Commission are an original and thirteen copies of the Direct Testimony of Dan L. Neidlinger on behalf of the U.S. Department of Defense in the subject proceeding.

Copies of this filing have been sent in accordance with the attached Certificate of Service. Inquiries concerning this matter may be directed to the undersigned at (703) 696-1644.

Sincerely,

Peter Q. Nyce Jr.  
General Attorney  
Regulatory Law Office

Enclosure

Arizona Corporation Commission  
DOCKETED  
JAN -8 2007

DOCKETED BY *NR*

RECEIVED  
2007 JAN -8 1P 2:11  
AZ CORP COMMISSION  
DOCUMENT CONTROL

**ARIZONA CORPORATION COMMISSION  
TUCSON ELECTRIC POWER COMPANY  
DOCKET NO. E-01933A-05-0650**

**Direct Testimony of Dan L. Neidlinger**

Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

A. My name is Dan L. Neidlinger. My business address is 3020 North 17<sup>th</sup> Drive, Phoenix, Arizona. I am President of Neidlinger & Associates, Ltd., a consulting firm specializing in utility rate economics.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL QUALIFICATIONS AND EXPERIENCE.

A. A summary of my professional qualifications and experience is included in the attached Statement of Qualifications. In addition to the Arizona Corporation Commission ("ACC" or "Commission"), I have presented expert testimony before regulatory commissions and agencies in Alaska, California, Colorado, Guam, Idaho, New Mexico, Nevada, Texas, Utah, Wyoming and the Province of Alberta, Canada.

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. I am appearing on behalf of the Department of Defense ("DOD"). The major DOD installations in Arizona served by Tucson Electric Power Company ("TEP" or the "Company") are Davis Monthan Air Force Base ("DM") located in Tucson and Fort Huachuca ("Fort") located in Sierra Vista. Both installations currently receive service from TEP under Rate Schedule LLP-14.

Q. WHAT IS THE COMBINED ANNUAL ELECTRIC USAGE OF THESE DOD FACILITIES?

A. These military installations are two of the Company's largest customers. Combined annual electric usage for these facilities totals 213,000,000 kilowatt hours (kWh).

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to comment on TEP's ratemaking proposals as outlined in the direct testimony of Mr. James S. Pignatelli, Chairman of the Board, President and Chief Executive Officer of the Company. His testimony describes in general terms two approaches for setting rates subsequent to the termination of the 1999 Settlement Agreement ("Settlement Agreement") on December 31, 2008. Additionally, he presents proposals for implementation of new demand side management ("DSM"), time-of-use ("TOU") and renewable energy ("RES") tariffs.

Q. DID THE DOD PARTICIPATE IN THE HEARINGS THAT ULTIMATELY LED TO THE COMMISSION'S APPROVAL OF THE SETTLEMENT AGREEMENT?

A. Yes. Although the DOD objected to the manner in which the Competitive Transition Charge ("CTC") was calculated and allocated, it welcomed the competitive concepts embodied in the Settlement Agreement and the prospect of vigorous competition for its energy business beginning in the year 2009 – the end of the transition period. Early on, Fort Huachuca reviewed the possibility of competing its load with other energy suppliers but concluded that changing suppliers was not economically beneficial due to the magnitude and unpredictability of the CTC charges. For a variety of reasons, of which the Commission is fully apprised, Arizona has not developed a competitive retail electric market.

Q. MR. PIGNATELLI CONTENDS THAT THE SETTLEMENT AGREEMENT ENTITLES TEP TO CHARGE MARKET-BASED GENERATION SERVICE RATES BEGINNING JANUARY 2009. DO YOU AGREE?

A. No. I cannot identify any provision in the Settlement Agreement that supports this conclusion. Admittedly, the Settlement Agreement does envision a competitive market for generation services by 2009 but, as previously stated, that market never developed. Accordingly, TEP's customers are now, and will be for the foreseeable future, captive to

Company with no opportunity to select alternative power suppliers. The Fort and DM are both eager to review power supply options but none are available. The Commission, in my view, should continue to set rates for TEP based on cost of service until a truly competitive energy market can be developed at the retail level.

Q. AS AN ALTERNATIVE, THE COMPANY IS PROPOSING COST OF SERVICE RATES THAT INCLUDE THE RECOVERY OF AN \$850 MILLION REGULATORY ASSET AND THE IMPLEMENTATION OF AN ENERGY COST ADJUSTMENT CLAUSE ("ECAC"). WHAT IS YOUR REACTION TO THESE PROPOSALS?

A. The bulk of the \$850 million regulatory asset is based on TEP's calculation of foregone revenues under the rate freeze. Mr. Pignatelli claims that customers owe these monies to the Company since routine rate filings necessary to increase rates were prohibited during the term of the Settlement Agreement. This attempt to "unfreeze" rates is contrary to the Settlement Agreement and the Commission's Decision 62103 that approved the agreement. Moreover, the Commission, to my knowledge, has never approved this type of retroactive ratemaking scheme. As a general rule, earnings and related overall revenue levels of utilities are not (nor should they be) guaranteed by regulatory commissions. This Commission and others have, of course, approved from time to time special purpose revenue recovery mechanisms, such as payment-in-lieu of revenue tariffs, which have been deemed equitable to both the utility and its customers.

Q. WERE TRANSITION-TO-COMPETITION COSTS INCLUDED IN THE \$850 MILLION?

A. Yes. In response to RUCO data request 1.3, the Company stated that transition costs were approximately \$12 million. Decision 62103 explicitly addresses the recovery of these costs. Transition costs are to be deferred and 67% of the total recovered from customers in a future rate proceeding. This is not retroactive ratemaking since the Commission authorized, prospectively, the recovery of the majority of these costs from TEP's customers. However, the Commission has not approved on a prospective basis the recovery from customers of the remaining \$838 million revenue short-fall claimed by the Company in this case.

Q. WHAT ABOUT THE PROPOSED ECAC ADJUSTOR?

A. This proposal needs to be further evaluated in conjunction with a rate case filing. Accordingly, I have no opinion on this proposal at this time. In general, I am not opposed to fuel and purchased power clauses that are reasonably configured and provide incentives to utilities to minimize these costs. I cannot determine at this time whether the Company's proposed ECAC meets these criteria.

Q. HAVE YOU REVIEWED THE COMPANY'S TOU RATE PROPOSALS?

A. Yes. Mr. Pignatelli outlines the Company's plans to modify TOU rate designs and require all new residential and commercial customers to be placed on TOU tariffs. Further, all existing customers receiving service under rate schedules GS-13 and LLP-14 would be transferred to the new TOU rates. Again, these proposals require additional analysis and scrutiny in conjunction with a rate case filing.

Q. WOULD DM AND FORT HUACHUCA BE REQUIRED TO TRANSFER TO THE NEW TOU RATES?

A. Yes. Both of these DOD installations currently receive service under rate schedule LLP-14.

Q. DO YOU HAVE ANY CONCERNS ABOUT THE MANDATORY ASPECTS OF THE COMPANY'S PROPOSALS?

A. Yes. Although the Company contends that the new TOU rates will be revenue neutral, these mandatory rates could produce large increases or decreases in bills for many customers – an undesirable result. Of greater concern is the costing and pricing of the new rates.

Q. PLEASE EXPLAIN.

A. Historically, TEP's cost allocation methods have led to rate designs that do not properly reflect the cost of providing service. For example, Fort Huachuca's annual power bill under Arizona Public Service Company's ("APS") Rate Schedule E-34, the rate

comparable to LLP-14, would be approximately \$1.5 million or 20% less than its current annual bill from TEP. This large differential in rates cannot be attributed solely to differences in cost structures between TEP and APS. The primary reason for this large variance, in my view, can be found in the differences in costing methods used by these two utilities in setting rates. TEP's LLP-14 customers should not be required to take service under a revised TOU rate that is based on faulty costing methods.

Q. WOULD THE DOD INSTALLATIONS YOU REPRESENT CONSIDER ADOPTING TOU RATES THAT WERE BASED ON REVISED COSTING METHODS?

A. Yes. DM and Fort Huachuca would both consider adopting TOU rates that were properly designed and which provided cost-based incentives to modify on-peak usage patterns.

Q. DID THE COMMISSION RECENTLY ADOPT RES RULES AND PROPOSED TARIFFS?

A. Yes. The rules are currently awaiting certification by the Arizona Secretary of State. Subsequent to certification, electric utilities will file compliance plans and a proposed RES tariff with the Commission for cost recovery as well as a tariff covering customer self-directed renewable options. Under the latter tariff, certain customers could apply to receive funds from the utility to install distributed renewable energy resources.

Q. IS FORT HUACHUCA CURRENTLY EVALUATING RENEWABLE PROJECTS?

A. Yes. The Fort is evaluating solar and wind projects that may qualify for funding from TEP under this tariff.

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

## DAN L. NEIDLINGER

### SUMMARY STATEMENT OF QUALIFICATIONS

#### **I. General:**

Mr. Neidlinger is President of Neidlinger & Associates, Ltd., a Phoenix consulting firm specializing in utility rate economics and financial management. During his consulting career, he has managed and performed numerous assignments related to utility ratemaking and energy management.

#### **II. Education:**

Mr. Neidlinger was graduated from Purdue University with a Bachelor of Science degree in Electrical Engineering. He also holds a Master of Science degree in Industrial Management from Purdue's Krannert Graduate School of Management. He is a licensed Certified Public Accountant in Arizona and Ohio.

#### **III. Consulting Experience:**

Mr. Neidlinger has presented expert testimony on financial, accounting, cost of service and rate design issues in regulatory proceedings throughout the western United States involving companies from every segment of the utility industry. Testimony presented to these regulatory bodies has been on behalf of commission staffs, applicant utilities, industrial intervenors and consumer agencies. He has also testified in a number of civil litigation matters involving utility ratemaking and once served as a Special Master to a Nevada court in a lawsuit involving a Nevada public utility.

Mr. Neidlinger has performed feasibility studies related to energy management including cogeneration, self-generation, peak shaving and load-shifting analyses for clients with large electric loads. In addition, he has consulted with U.S. Army installations on privatization of utility systems and assisted these and other consumer clients in contract negotiations with utility providers of electric, gas and wastewater service.

Mr. Neidlinger has extensive experience in the costing and pricing of utility services. During his consulting career, he has been responsible for the design and implementation of utility rates for numerous electric, gas, water and wastewater utility clients ranging in size from 50 to 25,000 customers.

#### **IV. Professional Affiliations:**

Professional affiliations include the American Institute of Certified Public Accountants.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Direct Testimony of Dan L. Neidlinger on behalf of the United States Department of Defense was sent to the parties on the attached service list either by United Parcel Service Next Day Air or by first class mail, postage prepaid on January 5, 2007.

Dated at Arlington County, Virginia, this 5th day of January 2007.

  
PETER Q. NYCE, JR.

SERVICE LIST, TEP Docket No. E-01933A-05-0650

Michael W. Patten  
Roshka Heyman & Dewulf  
One Arizona Center  
400 East Van Buren Street, Suite 800  
Phoenix, AZ 85004

Scott S. Wakefield, Chief Counsel  
Residential Utility Consumer Office  
1110 West Washington, Suite 220  
Phoenix, AZ 85007

Walter W. Meek, President  
Arizona Utility Investors Association  
2100 N. Central Avenue, Suite 210  
Phoenix, AZ 85004

Dan Neidlinger  
Neidlinger & Assoc  
3020 N. 17<sup>th</sup> Drive  
Phoenix, AZ 85015

C. Webb Crockett  
FENNEMORE CRAIG, PC  
3003 North Central Avenue  
Suite 2600  
Phoenix, AZ 85012-2913

Nicholas J. Enoch  
Lubin & Enoch, PC  
349 North Fourth Avenue  
Phoenix, AZ 85003

Timothy M. Hogan  
Arizona Center for Law in the Public Interest  
202 E. McDowell Road, Suite 153  
Phoenix, AZ 85004

David Berry  
Western Resource Advocates  
P.O. Box 1064  
Scottsdale, AZ 85252-1064

Eric Guidry  
Energy Program Staff Attorney  
Western Resource Advocates  
2260 Baseline Road, Suite 200  
Boulder, CO 80302

Jane L. Rodda  
Administrative Law Judge  
ARIZONA CORPORATION COMMISSION  
400 West Congress, Suite 218  
Tucson, AZ 85701

Peter Q. Nyce, Jr.  
Regulatory Law Office  
U.S. Army Legal Services Agency  
901 N. Stuart St., Ste. 713  
Arlington, VA 22203-1837

S. David Childers  
Low & Childers  
2999 N. 44<sup>th</sup> St., Ste. 250  
Phoenix, AZ 85018

David Couture.  
1 South Church Avenue  
Suite 1820  
Tucson, AZ 85701-1014

Daniel D. Haws  
OSJA, ATTN: ATZS-JAD  
USA Intelligence Center and  
Ft. Huachuca  
Ft. Huachuca, AZ 85613-6000

Raymond S. Heyman  
Unisource Energy Corporation  
One South Church Ave., Suite 1820  
Tucson, AZ 85701

Michelle Livengood  
Tucson Electric Power Company  
One South Church Ave., Suite 220  
Tucson, AZ 85701

Barbara A. Klemstine  
Brian Brumfield  
Arizona Public Service  
PO Box 53999  
Mail Station 9708  
Phoenix, AZ 85072-3999

Jeff Schlegal  
SWEETP Arizona Representative  
1167 W. Samalayuca Dr.  
Tucson, AZ 85704-3224

Thomas L. Mumaw  
Karilee S. Ramaley  
Arizona Public Service Company  
400 North 5<sup>th</sup> Street, MS 8695  
Phoenix, AZ 85004

Deborah A. Scott  
Robert Metli  
Snell & Wilmer LLP  
One Arizona Center  
400 East Van Buren  
Phoenix, AZ 85004-2202

Lawrence Robertson  
Munger Chadwick  
333 N. Wilmot Road, Ste. 300  
Tucson, AZ 85621

Mr. Christopher Kempley, Chief Counsel  
Legal Division  
ARIZONA CORPORATION COMMISSION  
1200 West Washington Street  
Phoenix, AZ 85007

Mr. Ernest Johnson, Director  
Utilities Division  
ARIZONA CORPORATION COMMISSION  
1200 West Washington Street  
Phoenix, AZ 85007

Arizona Reporting Service  
2627 N. Third Street, Ste. Three  
Phoenix, AZ 85004-1003

Greg Patterson  
916 West Adams, Suite 3  
Phoenix, AZ 85007

Law Offices of Christopher Hitchcock  
P.O. Box AT  
Bisbee, AZ 85603-0115