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BEFORE THE ARIZONA CORPORATION CO

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COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA CORPORATION COMMISSIONON.	DOCKET NO. G-04204A-06-0463
IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. TO REVIEW AND REVISE ITS PURCHASED GAS ADJUSTOR.	DOCKET NO. G-04204A-06-0013
IN THE MATTER OF THE INQUIRY INTO THE PRUDENCE OF THE GAS PROCUREMENT PRACTICES OF UNS GAS, INC.	DOCKET NO. G-04204A-05-0831 **STAFF'S NOTICE OF FILING TESTIMONY SUMMARIES**

Staff of the Arizona Corporation Commission ("Commission") hereby files the Testimony Summaries of David C. Parcell (Consultant - Technical Associates, Inc.); and Steven W. Ruback (Consultant – The Columbia Group) in the above-referenced matter.

RESPECTFULLY SUBMITTED this 18th day of April 2007.

Maureen A. Scott, Senior Staff Counsel
Keith A. Layton, Attorney
Legal Division
Arizona Corporation Commission
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Arizona Corporation Commission
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SUMMARY OF COST OF CAPITAL TESTIMONY
DAVID C. PARCELL
ON BEHALF OF COMMISSION STAFF

Mr. Parcell recommends a cost of capital for UNS Gas of 8.12 percent, determined as follows:

	Percent	Cost	Return
Long-term Debt	55.33%	6.60%	3.65%
Common Equity	44.67%	10.0%	4.47%
Totals	100.00%		8.12%

This contrasts to the 8.80 percent request of UNS Gas.

There are two differences that account for the 8.12 percent recommended by Mr. Parcell and the 8.80 percent requested by UNS Gas. The first difference is the capital structure. Mr. Parcell proposes to use the actual capital structure of UNS Gas as of the test period. UNS Gas advocates the use of a hypothetical capital structure with 50 percent common equity and 50 percent debt. UNS Gas' proposal thus advocates use of more equity than actually exists. Adoption of UNS Gas' proposal would have the effect of increasing the actual return on equity since the authorized return on equity would be applied to an equity base that exceeded the actual equity of the Company.

The second issue is the cost of common equity. Mr. Parcell recommends a return on equity for UNS Gas of 9.5 percent to 10.5 percent, with a mid-point of 10.0 percent. Mr. Parcell arrives at this level by considering the results of three recognized cost of equity methodologies:

Discounted Cash Flow	9.25% - 10.50% (9.88% mid-point)
Capital Asset Pricing Model	9.50% - 10.25% (9.88 % mid-point)
Comparable Earnings	10.0%

These contrast with the 11.0 percent request of UNS Gas. The Company's witness, Mr. Kentton Grant, employs two methodologies – DCF (9.1% - 10.5%) and CAPM (9.9% - 11.7%) – but only gives weight to his CAPM results in his recommendation.

The rebuttal testimony of UNS Gas requests, for the first time, that the Company's weighted cost of capital be applied to a fair value rate base. Mr. Parcell demonstrates, in his surrebuttal testimony, that this is not proper Mr. Parcell proposes that, if a fair value rate base is used, the difference between original cost rate base and fair value rate base be viewed as being financed with zero cost capital.

UNS/Rate Design and Decoupling Summaries prepared by Steven W. Ruback

RATE DESIGN

The Company's principal rate design proposals are the overwhelming increases in fixed customer charges, the corresponding reduction in volumetric charges and seasonal customer charges for the Residential class.

There are several problems with the Company's customer charge proposal. The Company's proposal presents a serious front end loading problem, a decoupling issue and gradualism problem.

The Company's customer charge proposals violate the basic rate design criteria of gradualism. The Company has proposed a staggering increase in the fixed customer charges for all classes of service. The Company has requested to increase the Residential customer charge more than 185%, during the summer period and 57% in the winter period. The remaining classes will also experience sharp customer charge increases.

The Company's proposal to increase the customer charges, specifically in the smaller classes by 81% to over 185% is a classic example of front-end loading. UNS' proposal is extreme because the proposed customer charges are intended to recover all of the proposed increase plus some of the margin recovered in existing volumetric rates. UNS' goal is simply to collect more revenue from fixed charges, independent of usage and to reduce risk.

Moreover, the Company's proposed customer charges are an example of a decoupling mechanism because sharply higher customer charges break the link between revenue and throughput because the customer charge remains the same regardless of throughput.

Lastly, the proposal seasonal rate design should be rejected because customer costs do not vary by season.

DECOUPLING

The Company is proposing a Throughout Adjustment Mechanism (TAM) that would either reduce or increase the collection of volumetric margin revenues to match variations from anticipated usage levels. The TAM will either provide a credit or a surcharge to the existing customer's volumetric rate charge based on usage per customer (UPC). The TAM would allow the Company to collect its anticipated revenues regardless of why average use per customer is different than anticipated. This mechanism would encourage the Company to promote conservation, but the TAM will also discourage conservation because it

implements surcharges that erode any benefits ratepayers may receive due to conservation.

Distribution rates are designed based on normalized volumes. The rates are intended to recover the distribution revenue requirement over normalized weather volumes. When weather is warmer than normalized volumes the Company under-recovers its distribution revenue requirement because warm weather means less heat sensitive sales. Conversely, when the weather is cold, the Company over recovers its distribution revenue requirement.

The existing policy of designing rates over normalized volumes, without a RDM, has been the regulatory policy of the Commission. The consequence of the risk of deviations from normal weather has not precluded the Company from raising capital during its existence. Moreover, the symmetry of under recoveries attributable to warmer than normal weather and over recoveries from colder than normal weather is a traditional and reasonable allocation of weather risk between the Company and ratepayers. Furthermore, whether actual weather is more or less than normal weather, the impact on long term recovery of the distribution revenue requirement will remain unaffected.

The TAM should not be approved because it is piecemeal ratemaking. The TAM deals with variations from expected use per customer. No other items in the ratemaking formula are considered in the TAM. There is no opportunity to search for offsetting adjustments such as cost of service reductions, changes in customer allocation factors and changes in the cost of capital, etc. Piecemeal ratemaking is frowned upon because all of the elements of the ratemaking formula are not considered.

The TAM would change base rates between rate cases. Distribution related costs should be fixed between rate cases to provide a powerful incentive to keep costs down between base rate cases. This is the traditional ratemaking incentive to minimize costs between base rate cases. This is a much better regulatory approach than relying on the Company's good intentions to minimize costs. This is a basic tenant of public utility ratemaking that has been successfully used for a considerable period of time and should not be diluted by the proposed TAM.

Also, the type of costs traditionally recovered in an automatic adjustment clause such as the TAM, are skyrocketing and volatile costs, which if left unrecovered, in a timely manner, could jeopardize a utilities financial heath. Costs which are generally included in an adjustment rider are costs which are (1) large enough to jeopardize a utility's financial health (2) volatile and (3) substantially beyond a utility's control.

The TAM does not meet the three tests for inclusion in an automatic adjustment clause. First, traditional rate making has not left the Company in poor financial health. Second, non –gas costs are relatively stable from year to year and certainly

not volatile to the same extent as gas costs. Third, non-gas costs are within management's control.

I have also reviewed the NARUC resolutions cited by the Company to support a revenue decoupling mechanism. The language of the resolutions does not mention earnings variation attributable to variations from normal weather. The resolution only mentions conservation, efficiency, and weatherization.

For all these reasons, the proposed TAM should be rejected.