BEFORE THE ARIZONA CORPORATION COMMISSION

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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.	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

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby files its reply brief on the above-captioned matter.

RESPECTFULLY SUBMITTED this 19th day of June 2007.

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REPLY BRIEF

OF

THE RESIDENTIAL UTILITY CONSUMER OFFICE
(RUCO)

JUNE 19, 2007

UNS GAS RATE CASE
G-04204A-06-0463 et al.

INTRODUCTION

The Residential Utility Consumer Office ("RUCO") hereby replies to the initial brief of UNS Gas, Inc. ("UNSG" or the "Company"). In its Initial Closing Brief, RUCO addressed many of the arguments offered by UNSG in its initial brief. RUCO will not repeat those arguments here.

I. Resolved Issues[1]

- Payroll Expense and Payroll Tax Expense – The Company's brief correctly notes that RUCO's schedules failed to recognize that the Company had previously corrected an error in its schedules. RUCO's Final Schedules, filed concurrently with its Initial Closing Brief, likewise continue to include an adjustment for what the Company has already corrected.
- Accumulated Deferred Income Tax – RUCO proposed adjustments to income tax expense to reflect its recommended rate base adjustments, but erroneously omitted corresponding adjustments to accumulated deferred income taxes. However, RUCO's adjustment to income tax expense includes both the income tax that would be currently due, and that which would be deferred. RUCO did not separate out the income tax effects between current and deferred amounts.

[1] The Company's brief (at 32) correctly identifies that RUCO and the Company agree to the correction regarding RUCO Operating Income Adjustment No. 20, as reflected in the Company Brief's Attachment 1 at 4. This agreement is merely that RUCO's schedules had inadvertently included the adjustment at an amount triple what RUCO's actual adjustment is. RUCO has not conceded its underlying Operating Income Adjustment No. 20 (regarding FERC legal expenses). RUCO merely agrees that its adjustment should only be made in the amount of ($311,051) (as reflected in its final schedules), not ($933,153) as its direct schedules had indicated.

II. Contested Rate Base Issues

A. Plant In Service and Accumulated Depreciation Balances at Date of Acquisition From Citizens

RUCO proposed an adjustment to plant in service and accumulated depreciation based on the Company's inability to substantiate the level of plant and accumulated depreciation that it booked at the time it acquired the gas system from Citizens Utility Company. The Company claims that the document on which RUCO relied, which are in the record as RUCO Exhibit 1, do not include certain electronic files that the Company provided to RUCO during discovery. The only documents that the Company has provided in an effort to substantiate the amounts that it booked at the time of the acquisition are Exhibit RUCO-1 and the electronic files.[2] However, the Company's witness admitted that the electronic files and the Exhibit RUCO-1, taken together, still are not adequate to reconcile to the amounts that UNSG booked at the time of acquisition.[3]

The Company argues that the Commission has long been aware that Citizens' records were insufficient, and that the Commission did not disallow plant because the buyers of Citizens' water utilities were unable to substantiate the amounts they booked.[4] The Company is incorrect. In Arizona-American's first rate case after it acquired Citizens' water properties, Staff proposed a disallowance for certain unsubstantiated plant.[5] The Commission agreed with Staff's adjustment, confirming that the purchaser "became fully responsible for the Citizens assets, and any related records, upon closing

2 UNSG Br. at 12.
3 Tr. at 214 (Kissinger).
4 UNSG Br. at 13.
5 Decision No. 67093 at 7-8.

of the sale.[6] Further, the Company suggests that because the Commission did not establish a requirement in the order relating to its acquisition of Citizens' energy properties that the Company retain Citizens' records, the Commission indicated it anticipated that less documentation might be available from Citizens. But the fact that the Commission did not impose a records retention requirement on UNSG does not relieve UNSG of its obligation to substantiate the level of plant it claims it acquired from Citizens.

B. Depreciation and Amortization Rates in Effect Since Last Rate Proceeding

RUCO has proposed an adjustment to accumulated depreciation balances based on the Company's use of improper depreciation rates. The Company claims that the 1994 order set depreciation rates only for the Citizen's Northern Arizona Division, and not for the Santa Cruz Division, and thus the rates from the 1994 order would not apply to the Santa Cruz Division. Further, the Company claims that the Commission only explicitly discussed two depreciation rates, and thus the Decision does not demonstrate the Commission must specifically adopt new depreciation rates for them to become effective.

Decision No. 58664 indicated that Staff and Citizens only disagreed on the appropriate depreciation rates for two accounts.[7] It goes on to resolve those disputes. The Decision then states the level of operating expenses proposed by Citizens and specifically identifies the adjustments to that level of operating expenses that it

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[6] *Id.* At 8.
[7] Decision No. 58664 at 29.

approves, and concludes with a resulting test year operating expense level.[8] Thus, it is clear that the Commission approved the depreciation rates proposed by Citizens, with the changes to two accounts for which it made adjustments. However, the Commission's approval of the settlement agreement in Decision No. 66028 was different. In that decision, the Commission approved a settlement agreement, but it did not approve any particular set of adjustments from the Citizens' original application that included a request for new depreciation rates. Thus, one cannot conclude that the Commission authorized the depreciation rates Citizens had proposed in the underlying rate application.

As the Company points out, Citizens' Santa Cruz Division was indisputably not subject to Decision No. 58664. However, the rate base related to the Company's Santa Cruz operations is relatively small compared to that related to the former Northern Arizona Gas Division.[9] Thus, application of the last depreciation rates approved for the Santa Cruz Division would result in only a small, probably immaterial, further adjustment to RUCO's proposed accumulated depreciation levels.

C. Construction Work in Progress

The Company argues that its Construction Work in Progress ("CWIP") should be included in rate base because most of the CWIP plant is put into service within a year. However, the Company controls the timing of when it files a rate application, and it must decide when is the most appropriate time to file an application. Further, the

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[8] Decision No. 58664 at 34.

[9] There were 7,325 customers in Santa Cruz county, and 131,490 in the rest of the Company's system. Exh. UNSG-15 at 2-3 (G. Smith direct). Thus, only about 5 percent of the customers are in Santa Cruz County.

Commission's past approvals of CWIP in rate base have been reserved for situations when a construction project is so large that it takes several years to complete. Thus, the Company's situation is not the type of extraordinary circumstance for which including CWIP might be appropriate.

The Company also argues that the fact that the Company recognized a negative acquisition adjustment when it acquired the plant from Citizens merits including CWIP at this time. However, the Company's Vice President of Finance and Rates testified that the acquisition adjustment does not make the Company more risky, but instead it reduced risk because it resulted in less debt that was needed to be serviced.[10]

The Company claimed that if the Commission denies CWIP in rate base, the advances related to that CWIP plant should not be deducted from rate base.[11] The Company's brief suggests that RUCO has recently taken such a position in another proceeding. However, a review of RUCO's testimony in the other matter (Exhibit UNSG-36 in this proceeding) reveals another story. RUCO's witness indicated that contributions are generally booked at the time they are received, and from that point they would be netted against plant in service. In that proceeding, the applicant has asked for special treatment to not include the contributions as an offset to rate base during the period it would be under construction, which was expected to be several years.[12] UNSG, however, has indicated that the plant that is the subject of its CWIP request would be completed in less than a year. Thus, there is no need for the special treatment that RUCO had agreed to in the other proceeding.

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[10] Tr. at 976 (Grant).
[11] UNSG Br. at .
[12] Exh. UNSG-36 at pg. 608 (probably two rate cases before the plant is completed).

D. Global Information System Regulatory Asset

The Company argues that the productivity gains from is Global Information Systems ("GIS") demonstrate a ratepayer benefit, and therefore the GIS should be included in rates. The Company's brief cites $1.8 million of claimed productivity gains.[13] However, those productivity savings are not all attributable to the GIS project. Further, that is not an annual level of productivity increase, but is the total increase in productivity savings between August 2003 and the end of the test year.[14] Thus, all of the savings from those total productivity gains has accrued to shareholders, as there have been no rate cases in the interim.

Regardless of whether there have been increases in productivity pursuant to the GIS system, the standard for including the GIS in rate base is not merely whether it would benefit customers. As discussed in RUCO's initial brief, the costs of the GIS are properly booked as an expense, and thus would not be recognizable as an asset. Further, despite the Company's contention to the contrary, the Company did recover all of its booked expenses in the years over which the GIS was being developed and over which the costs of the GIS were booked as expenses. The Company has already recovered all the expense of the GIS project.

E. Working Capital

UNSG claims that RUCO's working capital adjustment failed to use a simultaneous equation to compute synchronized interest and current income taxes.[15]

[13] UNSG Br. at 10.
[14] Exh. UNSG-15 at 8-9 (G. Smith direct).
[15] UNSG Br. at 16.

That is not correct. RUCO did not have a separate schedule to compute the synchronization, but it can be seen from RUCO's schedules that the rate base used to calculate the synchronized interest is the same rate base that RUCO is proposing after the interest synchronization. Schedule RLM-3 at line 15, column h computes RUCO's proposed rate base, based in part on its working capital allowance as shown on the same schedule at line 12, column g ($1,200,152). The rate base computed on Schedule RLM-3 ($144,680,196) is the same as that on Schedule RLM-14, line 18, which computes the interest synchronization adjustment that synchronizes the adjusted rate base to reflect the adjusted interest expense for purposes of calculating the interest deduction in the income tax expense calculation (which is shown on lines 3 and 8 of Schedule RLM-14). The resulting interest expense at line 20 ($4,506,788) is a component of RUCO's working capital allowance calculation, as shown on Schedule MDC-2 page 2, line 20, column c. The current income taxes shown on Schedule MDC-2 line 15, column c ($4,391,514) ties to the income tax expense at proposed rates, as shown on Schedule RLM-6, line 8, column e.

The resulting working capital adjustment at Schedule MDC-2 line 30 is the same $1,200,152 that appeared on Schedule RLM-3, line 12, column g. Therefore, the record demonstrates that RUCO did account for synchronized interest in both the working capital and income tax expense.

F. Reconstruction Cost New less Depreciation Rate Base

The Company claims that RUCO improperly calculated its Reconstruction Cost New less Depreciation ("RCND") rate base.[16] RUCO calculated its RCND rate base using the ratio of original cost rate base ("OCRB") to RCND that was exhibited in the Company's original application.[17] This is the same method by which the Commission historically restates its determined OCRB into a RCND rate base. There is nothing improper with this method. Further, UNSG never raised this issue in its rebuttal testimony, thus RUCO was unaware of the Company's objection to it, and RUCO was therefore unable to further develop the record in response to that objection.

III. Operating Income Issues

A. Customer Annualization

The Company claims that the traditional revenue annualization method produces counterintuitive results in "certain situations."[18] However, the traditional model does not produce such results in this instance. The Company's application is based on a test year ending December 31, 2005. Using the traditional revenue annualization method for the test year (which the Company selected) produces a result of an increase in revenue, which is the expected result for a utility that is experiencing year-over-year growth. *RUCO and Staff both proposed identical adjustments* based on the use of the traditional annualization method. It is a reasonable method, and it produces reasonable results for this application. RUCO and Staff's adjustment should therefore be adopted.

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16 UNSG Br. at 17.
17 Exh. RUCO-3 at 9.
18 UNSG Br. At 18.

B. Legal Standard for Expenses

The Company claims that the Commission must permit recovery of all reasonable expenses. However, the Company omits the requirement that it is the utility that has the burden to demonstrate that its level of expense was reasonable.[19] The mere fact that a utility has spent an amount does not make it *per se* reasonable.

C. Fleet Fuel Expenses

The Company's brief offers no response to the portion of RUCO's fleet fuel adjustment that is due to a disagreement over the appropriate miles-per-gallon factor to apply to vehicles driven by additional employees added during the test year. In light of the Administrative Law Judge's requirement that all issues not raised in the parties' opening briefs are considered waived,[20] RUCO believes the Company has conceded this portion of RUCO's adjustment.

D. Legal Expenses

The Company's initial brief suggests that if the Commission does not accept the Company's proposed level of legal expenses, it could allow deferral of the Federal Energy Regulatory Commission ("FERC") rate case legal expense through the purchased gas adjustor ("PGA") mechanism. RUCO does not support such a result. Legal costs are booked to a legal expense account, not to accounts related to the underlying legal proceeding. For example, legal costs to defend injury or damage claims are booked to the account for legal expenses, not to an account for injuries and

[19] *See* Decision No. 68487 at 21.
[20] Tr. at 1161.

damages. Thus, it would be inappropriate to defer FERC rate case legal expense for recovery through the PGA.

E. Postage Expense

RUCO's final schedules, submitted at the time it filed its initial closing brief, included the May 14, 2007 increase in postage rates, as it is a known and measurable change that should be recognized.[21] However, as discussed in RUCO's initial brief, factors outside of the known and measurable change in rates and annualizing to end of test year customer numbers should not be considered. There is no reason to recognize that the number of mailings, or the weight of mailings, might vary from year to year. These are no known and measurable changes to the historic test year level of expense.

F. Customer Service Costs

The Company characterizes RUCO's adjustment to the customer service costs as being based on "hypothetical costs based on regional offices used in a previous year."[22] However, RUCO's adjustment is not based on hypothetical costs. It is based on the actual monthly costs UNSG incurred to operate the regional offices.[23] Further, it is not based on costs related to a previous year. RUCO's adjustment is computed based on the costs the Company incurred to operate the regional call centers *during the first four months of the test year.*[24]

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[21] RUCO's surrebuttal schedules had not included this recent postage rate increase.
[22] UNSG Br. At 24.
[23] Exh. RUCO-3 at 21 (Moore direct).
[24] *Id.*

RUCO's disallowance is not based solely on the hefty increase in costs with the consolidation of the call center. It is the combination of both substantial cost increases and increased customer dissatisfaction with the level of customer service that caused RUCO to propose a disallowance of some of the costs of the new call center. The Company's brief does not address the increased level of customer dissatisfaction as evidenced in the level of complaints filed with the Commission.

The Company suggests that an increase in call volumes since the new call center went on-line indicates that the level of customer service has risen. However, increased numbers of calls might just as well indicate that customers have more problems for which they require resolutions. Further, the time frame over which the Company has indicated the number of calls increased goes well beyond the end of the test year.[25] It is not appropriate to permit increased expenses that would relate to call volumes that were achieved after the test year.

G. Unnecessary Expenses

UNSG argues that RUCO has failed to provide a specific explanation as to why certain expenses should be disallowed.[26] But it is the Company's burden to justify that expenses were necessary and at a reasonable level.[27] The Company is mistaken about which party has the burden of proof.

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[25] Mr. Dukes' rebuttal testimony at 30 indicates that call volumes have increased 97 percent, but that testimony does not indicate it applies only to volumes in the test year. Rather, the testimony was filed in March 2007, nearly 15 months after the end of the test year. Further, Mr. Dukes' testimony indicates the increased call volumes are from Unisource Energy Services, not just UNSG. Thus, the figure includes call volumes from other utility affiliates.

[26] UNSG Br. at 26.

[27] Decision No. 68487 at 21.

H. Rate Case Expense

There is no presumption that, just because a utility has spent a certain amount in rate case expenses, they will all be recoverable. Rather, the utility bears the burden of its choices to incur unreasonable levels of rate case expense.[28] RUCO is not aware of another case in which the Commission has authorized recovery of as much rate case expense as the Company is requesting here.[29] Nine hundred thousand dollars is not a reasonable level of rate case expense.

I. Non-recurring Union Training

The Company objects to RUCO's disallowance of a non-recurring union training program because it expects the Company's overall training costs to increase based on increasing levels of employees and new, post-test year regulatory requirements.[30] But the Commission is not attempting to establish a level of future training costs. RUCO has only removed the one unique training program that was non-recurring. RUCO's adjustment still recognizes ongoing training costs for recovery in rates.

J. Supplemental Employee Retirement Plan ("SERP")

The Company argues that it should not be held to the standard set by the Commission in early 2006 in its Decision on Southwest Gas Company's rate case, because that decision was issued after the test year in this case and it would be unfair

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[28] Decision No. 67093 at 19-20; Decision No. 69440 at 12.
[29] Tr. at 649 (Moore).
[30] UNSG Br. at 31.

to hold the Company to this "unexpected standard."[31] First, UNSG cannot claim it would not expect the Commission to apply same standard here. The Commission's Decision in the Southwest Gas case was issued in February 2006, barely 40 days after UNSG's test year ended and nearly five months before the Company even filed its application. Second, the Company's recommended standard would make it impossible for the Commission to ever establish a new policy that a type of expenses should be disallowed. For example, when the Commission adopted the standard in the Southwest Gas matter, it applied that standard to Southwest Gas, even though the Commission may not have held that policy during the test year in Southwest Gas' case. If the Commission were prohibited from disallowing expenses because a utility was not previously on notice that the Commission would not permit recovery of such expenses, the Commission could never disallow an expense that it had not previously disallowed. Such a policy would be severely undercut the Commission's authority to determine just and reasonable rates.

The Company suggests that by disallowing SERP costs, the Commission would be allowing the Internal Revenue Code ("IRC") to dictate what compensation costs should be recovered.[32] RUCO is not suggesting that the Commission blindly defer to any IRC determination of what compensation costs should be. To the contrary, RUCO is recommending that the Commission reaffirm its own prior determination[33] that compensation that is so excessive that it surpasses the level that would qualify for tax

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[31] UNSG Br. At 28.
[32] UNSG Br. At 29.
[33] Decision No. 68487 at 19.

deductibility under the IRC is also so excessive that it should not be imposed on captive utility customers.

IV. Cost of Equity Capital

RUCO disagrees with the arguments set forth in the Company's initial post-hearing brief on RUCO's recommended cost of equity capital. The Company argues that RUCO places too much reliance on near-term analyst growth forecasts.[34] Yet unlike the Company's witness in this case, RUCO's witness did not take analyst's forecasts at their face value.[35] Instead, RUCO's witness used historical earnings as a benchmark on which he evaluated analysts' projections of future growth.[36]

The Company's argument[37] that the Commission has rejected the FERC DCF model, which was once advocated by Dr. Thomas Zepp in a case that involved Arizona Water Company's Eastern Group, is both misleading and erroneous. The FERC methodology RUCO advocates in this case is not the same methodology that was actually used by Dr. Zepp in the Arizona Water Company Eastern Group case.[38] In that case Dr. Zepp averaged the near-term growth forecasts for the entire water utility industry rather than an average of near-term growth forecasts of sample companies. As stated on page 22 of Decision No. 66849, Dr. Zepp's method of including the entire water utility industry creates a mismatch between the expected dividend growth rate and the expected dividend yield, thereby producing a less accurate cost of equity

34 UNSG Br. at 34.
35 Exh. RUCO-7 at 21 (Rigsby direct).
36 Exh. RUCO-7 at 21 (Rigsby direct).
37 *See* UNSG Br. at 34.
38 *See* Decision No. 66849 at 22.

estimation. The fact that UNSG is an energy company, as opposed to a water utility, provides an even more compelling reason why the Commission should consider the FERC methodology of weighting the near-term growth component more heavily than the long-term component in the multi-stage model should the Commission choose to adopt the Company's methodology. If anything, Decision No. 66849 supports RUCO's arguments that it is not realistic to expect growth rates to converge towards the industry average, given the fact that the Commission rejected the use of industry averages in Dr. Zepp's multi-stage DCF model. Decision No. 66849 further rejects several of the additional risk arguments (i.e. company size and historical test year) that the Company's witness has advocated in this proceeding. Most significantly, the argument that small size results in increased risk should be given no weight, given the fact that the Company's parent, Unisource Energy, is publicly traded on the New York Stock Exchange and has direct access to the capital markets.

The Company argues that RUCO's cost of equity estimation should be rejected because Mr. Rigsby did not use a multi-stage version of the DCF formula in his cost of equity analysis.[39] While it is true that the Commission has approved Staff recommendations based on both multi-stage and single-stage models, the Commission has also approved equity recommendations based on only the single-stage model that RUCO used in this case. In Southwest Gas's recent rate case, the Commission adopted its Staff witness Stephen Hill's cost of equity recommendation.[40] RUCO witness Mr. Rigsby's recommendation in this case incorporated the very same assumptions and methods that Mr. Hill used in his DCF model to estimate a cost of

[39] UNSG Br. at 35.
[40] Decision No. 68487 at 29.

equity capital for Southwest Gas.[41] Further, the Commission this week adopted a return on equity for Arizona Public Service Company that was based only on the single-stage DCF model that RUCO has used in this case.[42]

The Company's argument opposing RUCO's use of geometric means in analysis of the CAPM should be given no weight. The Company is simply opposed to an averaging method that presents a truer picture of how a Company has performed in the past and also provides balance to an arithmetic mean that may be predictive of future performance.

A. Fair Value Rate of Return

UNSG's brief responds to Staff's substantive proposal to address the issue that was raised in the Chaparral City Water Company appeal, but never responds to RUCO's proposal that the Commission should reject the Company's proposal on procedural grounds. The Company did not make its proposal to apply the Weighted Average Cost of Capital ("WACC") to its Fair Value Rate Base ("FVRB") until its rebuttal testimony was filed. As a result, parties did not have sufficient time to undertake analysis of the proposal and determine appropriate response.[43] It would be unfair for the Commission to adopt the Company's proposal when the other parties did not have adequate opportunity to analyze it and provide a well-reasoned response, due to the Company's rebuttal modification to its application.

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[41] Exh. RUCO-7 at 17 (Rigsby direct).
[42] Decision No. _______ in Docket No. E-01345A-05-0816 *et al.*, (adopted at Open Meeting June 19, 2007)
[43] Exh. RUCO-6 at 5 (Diaz Cortez surrebuttal).

V. Changes in Purchased Gas Adjustor

RUCO has agreed with the Company's proposal to increase the interest rate that would be applied to the balance of the purchased gas adjustor ("PGA") account to LIBOR plus 1.5 percent. However, the Company maintains that an even higher interest rate (the Company's authorized weighted average cost of capital) should be used when the balance exceeds a certain level. The Company acknowledges that the existing PGA interest rate "may not have been created with the intent that it reflect the actual cost of borrowing" because it was expected that the PGA balance would be close to zero.[44] While the cost of gas has increased since the PGA was last modified, RUCO's proposal to alter the PGA would still result in the PGA balance remaining low. Thus, there is no need to provide an increased interest rate.

VI. Rate Design/Decoupling Mechanism

RUCO doesn't disagree that monthly charge should be increased—the issue is how much. The current monthly service charge for residential customers is $7.00; the Company proposes to increase this to an average of $17.00.[45] RUCO proposed a fixed monthly charge of $8.13. UNSG believes that RUCO's increase in the fixed charge fails to address the matter to any "material degree."[46] But looking at the raw number of the monthly fixed charge does not tell the whole story. RUCO's revenue requirement was nearly $7 million lower than Company's to begin with. Much of the difference between

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44 UNSG Br. At 63.

45 The Company originally proposed to have different fixed charges in the winter and summer. The Company's proposed service charge averaged $17 over the course of the year. In its initial post-hearing brief, the Company indicated it would accept a year-round monthly customer charge of $17. (see UNSG Br. At 46).

46 UNSG Br. At 44.

the fixed charges proposed by the Company, Staff and RUCO ($17.00, $8.50 and $8.13, respectively) is due to different revenue requirements proposed by the parties. The Company proposes a revenue increase of 20.7%[47], Staff proposes approximately 7%[48], RUCO proposes 5.78%.[49] The more meaningful comparison is to examine the percentage of total revenue that would be recovered through fixed charges. Currently, the Company recovers 25 percent of its revenue through fixed charges. The Company's proposal is to recover 51 percent of its revenue through fixed charges, an increase of 104 percent.[50] Staff proposes to recover 30 percent of revenue through the fixed charges[51], an increase of 20 percent.[52] Though RUCO's revenue requirement and monthly fixed charge are slightly lower than Staff's, RUCO is actually proposing a greater percentage of revenue be recovered through the fixed charge – 36 percent. RUCO's 44 percent[53] increase in the portion of the revenue requirement recovered through fixed charges is a material step to address the issue.

The Commission has never adopted a policy that all fixed costs must be recovered through fixed rates. To the contrary, the Commission has long recognized that there are many factors that must be considered in designing appropriate rates, including encouraging conservation and gradualism. Further, Staff witness Ruback testified that a straight fixed-variable rate design is not appropriate for a gas distribution company.[54]

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[47] UNSG Final Schedule A-1.
[48] Exh. S-25 at 4 (R. Smith direct).
[49] RUCO's Final Schedule RLM-1.
[50] 51% - 25% / 25% = 104%.
[51] Tr. at 822 (R. Smith).
[52] 30% - 25% / 25% = 20%.
[53] 36% - 25% / 25% = 44%.
[54] Exh. S-23 at 9 (Ruback direct).

The Company claims that decreasing its commodity charges (from 30 cents to about 18 cents per therm) will not stifle customers' incentive to conserve gas, because the cost of the gas itself is collected through a volumetric charge.[55] The Company indicates that its proposal will result in a decrease in the overall volumetric charge (margin plus cost of gas) of approximately 13 percent.[56] RUCO never claimed that the shift of significant revenues to the volumetric charges would eliminate a conservation incentive. But clearly, a 13 percent decrease in the overall volumetric charge would dampen customers' motivation to conserve.

The Company claims that the Throughput Adjuster Mechanism ("TAM") aligns its goals of conservation with its interest in collecting authorized rate of return, and that no other party has proposed a means to align those two interests.[57] But there is no need to adopt a mechanism to align those interests, because the Company indicated that its support for DSM programs is not dependent on whether the Commission authorizes the TAM.[58] There is no need for other parties to propose alternative mechanisms, when the Company itself has conceded its own behavior will not be affected by the Commission's decision on the TAM.

The Company attempts to distinguish its TAM from the Conservation Margin Tracker ("CMT") that Southwest Gas recently proposed and that was rejected by the Commission. While there are some differences between the two proposals, the Commission's rejection of Southwest Gas's CMT was based on a characteristic that is also possessed by UNSG's TAM. The Commission clearly indicated that it was

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55 UNSG Br. At 49.
56 UNSG Br. At 49.
57 UNSG Br. at 51, 53.
58 Tr. at 480-81 (Erdwurm).

rejecting the CMT because it essentially guaranteed the utility recovery of its authorized revenues. The Commission indicated:

> The Company is requesting that customers provide a guaranteed method of recovering authorized revenues, thereby virtually eliminating the Company's attendant risk. Neither law nor sound policy requires such a result....[59]

The TAM has the same feature as the CMT did—it relieves the Company of all risk related to the recovery of its authorized revenues. The Commission rejected Southwest Gas' CMT on that basis, and it should reject UNSG's TAM for the same reason.

CONCLUSION

The Commission should increase the Company's revenue by no more than $2.7 million, and adopt a rate design that recovers no more than 36 percent of revenue through fixed monthly charges. The Commission should also reject the Company's TAM proposal.

[59] Decision No. 68487 at 34.