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BEFORE THE ARIZONA CORPORATION C(

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

IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR APPROVAL OF 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 ELECTRIC, INC.	DOCKET NO. E-04204A-06-0783 **STAFF'S NOTICE OF FILING TESTIMONY SUMMARIES**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Testimony Summaries of Ralph C. Smith (Consultant - Larkin & Associates, Inc.); David C. Parcell (Consultant – Technical Associates, Inc.); and Frank W. Radigan (Consultant – Hudson River Energy Group) in the above-referenced matter.

RESPECTFULLY SUBMITTED this 17th day of September 2007.

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Original and thirteen (13) copies of the foregoing filed this 17th day of September 2007 with:

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**SUMMARY OF THE TESTIMONY
OF STAFF WITNESS RALPH C. SMITH
UNS ELECTRIC, INC.
DOCKET NO. E-04204A-06-0783**

I filed Direct and Surrebuttal Testimony in this case. My testimony addresses the following issues:

- The Company's proposed revenue requirement.
- Adjustments to test year data.
- Rate base, including construction work in progress.
- Test year revenues and expenses.
- Depreciation rates.
- Staff's recommendations for features to include in a new Purchased Power and Fuel Adjustment Clause ("PPFAC") for UNS Electric.
- The Company's proposed ratemaking treatment for a new peaking unit, the Black Mountain Generating Station ("BMGS").

My findings and recommendations for each of these areas are as follows:

- The Company's proposed revenue requirement of a base rate increase of $8.5 million is overstated. I recommend that UNS Electric be authorized a base rate increase of approximately $3.688 million on adjusted fair value rate base.

- I, and another Staff witness, David Parcell, describe how Staff has appropriately adjusted the weighted cost of capital, that was developed for application to an original cost rate base ("OCRB"), to derive the fair value rate of return that is applied to the fair value rate base ("FVRB"). Staff's position is that the proposed method of determining the rate of return that is applied to the FVRB is appropriate and is supported by valid economic and financial theory. Moreover, Staff's position is that this method appropriately complies with the guidance provided by the Arizona Court of Appeals in a recent decision involving Chaparral City Water Company.

- My direct testimony describes how UniSource Energy acquired the electric utility from Citizens Communications in August 2003. Consequently, as of the date of the acquisition, the fair value of the assets acquired from Citizens would be equal to the purchase price paid by UniSource. The acquisition of the electric utility was the result of an arm's length transaction between a willing and informed buyer and a willing and informed seller. UniSource has told us in response to data requests, which are cited in my direct testimony, that Reconstructed Cost New ("RCN") information, reconstructed cost new depreciated ("RCND") information, Handy-Whitman Index information, Marshall Index information, and Bureau of Labor Statistics index information was given little or no weight by UniSource in deciding how much to pay for the electric utility. The arm's length transaction that has occurred therefore demonstrates that the RCND was not a good estimate of the "fair value" for this utility as of the date of the acquisition. The price paid in the arm's length transaction would represent the "fair value" of the utility as of the date of acquisition. The price paid was substantially below the original cost depreciated book value. Because the acquisition occurred fairly recently (August 11, 2003), this suggests that using RCN and RCND information to establish the fair value of the utility rate base in the current case could potentially result in a substantial overstatement of fair value rate base under the Commission's traditional methods for determining FVRB.

- A number of adjustments to UNS Electric's proposed original cost and fair value rate base should be made. My Direct and Surrebuttal Testimony describes the following four adjustments to rate base:

  - The removal of Construction Work in Progress ("CWIP"). It is the Commission's longstanding regulatory practice not to allow CWIP in rate base unless there are extraordinary circumstances, such as financial distress. By definition, CWIP is not in service and is not serving customers as of the end of the test year. To the extent that the CWIP is to serve additional customers, it would be considered to be revenue producing; however, the revenues have been annualized only to the end of the test year, not beyond. Similarly, to the extent that the CWIP is expense reducing, reductions to expenses occurring beyond the end of the test year, such as savings in maintenance, have generally not been reflected. Consequently, it would be a mismatch to include CWIP in rate base, since the related post-test year impacts such as increased revenues and reduced expenses enabled by the CWIP have not been quantified and reflected as adjustments to operating income. Finally, UNS Electric has not demonstrated that it is in financial distress or has encountered extraordinary circumstances that would require the inclusion of CWIP in rate base.
  - An increase to rate base for plant that Staff confirmed was in service by the end of the test year, but which had not been accounted for as such by UNS Electric.
  - An adjustment to the amount of cash working capital included in rate base to coordinate with Staff's adjustments to operating expenses.
  - An adjustment to Accumulated Deferred Income Taxes related to expenses such as the Supplemental Executive Retirement Plan ("SERP") and the UniSource Energy Company stock-based compensation that Staff has adjusted.

- A number of adjustments to UNS Electric's proposed net operating income should be made. My Direct and Surrebuttal Testimony address 20 adjustments to net operating income, which are summarized in the following table:

Summary of Staff Adjustments to Net Operating Income

Adj. No.	Description	Pre-Tax Revenue or Expense Adjustment	Net Operating Income Increase (Decrease)	Note
C-1	Revenue Adjustment for CARES Discount	$ (52,937)	$ 32,504	
C-2	Remove Depreciation & Property Taxes for CWIP	$ (689,512)	$ 423,374	
C-3	Depreciation & Property Taxes for CWIP Found to be In-Service in the Test Year	$ 26,582	$ (16,322)	
C-4	Fleet Fuel Expense	$ (41,909)	$ 25,733	Note a
C-5	Postage Expense	$ 17,503	$ (10,747)	
C-6	Normalize Injuries and Damages Expense	$ (98,161)	$ 60,273	Note b
C-7	Incentive Compensation Expense	$ (108,517)	$ 66,632	Note c
C-8	Supplemental Executive Retirement Plant (SERP) Expense	$ (83,506)	$ 51,274	
C-9	Stock Based Compensation Expense	$ (82,873)	$ 50,886	
C-10	Property Tax Expense	$ (59,747)	$ 36,686	
C-11	Rate Case Expense	$ (111,667)	$ 68,566	
C-12	Edison Electric Institute Dues	$ (8,470)	$ 5,201	
C-13	Other Membership and Industry Association Dues	$ (6,482)	$ 3,980	
C-14	Interest Synchronization	$ -	$ (177,093)	
C-15	Depreciation Rates Correction	$ (63,105)	$ 38,748	
C-16	Emergency Bill Assistance Expense	$ 20,000	$ (12,280)	
C-17	Markup Above Cost in Charges from Affiliate, SES	$ (10,906)	$ 6,697	
C-18	Bad Debt Expense	$ (155,609)	$ 95,547	
C-19	Remove Double Count from Outside Services-Demand Side Management	$ (17,055)	$ 10,472	
C-20	Correct Year-End Accrual Expense Amount for Out-of-Period Expense	$ (6,256)	$ 3,841	
Total of Staff's Adjustments		$ (1,532,626)	**$ 763,971**	
	Adjusted Net Operating Income per UNS Electric		$ 8,742,011	
	Adjusted Net Operating Income per Staff		$ 9,505,982	

[a]	Modified to utilize pro forma adjusted fleet fuel expense of $605,498 per UNSE witness Dukes' rejoinder testimony at page 2.
[b]	Revised to agree with the revised normalized amount stated in UNSE witness Dukes' rejoinder testimony at page 4
[c]	Modified in response to UNSE witness Dukes' rejoinder testimony at page 7.

- The new depreciation rates proposed by UNS Electric presented in Dr. White's Direct Testimony Attachment REW-2 should be adopted for use in this case, as corrected in the response to data request STF 11.8. The depreciation rates proposed by UNS Electric were generally developed in a manner that is consistent with the Commission's rules for depreciation rates.

- Each of the new depreciation rates proposed by UNS Electric should be clearly broken out between (1) a service life rate and (2) a net salvage rate. By doing this, the depreciation expense related to the inclusion of estimated future cost of removal in depreciation rates can be tracked and accounted for by plant account.

- In my Direct Testimony Staff recommended that a new PPFAC for UNS Electric should be developed along the lines of the APS PSA Plan of Administration Staff proposed for the Arizona Public Service Company in Docket Nos., E-01345A-05-0816 et al, after appropriate adjustments to fit UNS Electric's circumstances. Staff and UNS Electric agree that a new PPFAC for UNS Electric should become effective June 1, 2008, upon expiration of the Company's all requirements power contract with PWCC. The new PPFAC proposed by UNS Electric in Exhibit MJD-3 to Mr. DeConcini's Rebuttal Testimony deviates from Staff's proposal and contains objectionable features such as inclusion of costs that would more appropriately be addressed in base rates, as well as raising other concerns, and should therefore be rejected. Staff's Draft Proposed Plan of Administration for

UNS Electric Purchased Power and Fuel Adjustment Clause (which is a Redline of UNS Electric Exhibit MJD-3) and which was presented in Attachment RCS-7 to my Surrebuttal Testimony should be adopted instead. UNS Electric agrees with the revisions presented in Attachment RCS-7 with the exception of one area. The one remaining issue between Staff and UNS Electric concerning the PPFAC is whether a category of "other costs" should be charged to customers through the PPFAC. For several reasons, Staff recommends that the "other cost" category be excluded form the PPFAC.

- The Black Mountain Generation Station ("BMGS") is a 90 MW peaking plant which is being constructed in Mohave County by an affiliate, and which the Company currently projects will be in service before June 1, 2008 when the current full requirements Power Supply Agreement with PWCC expires. The in-service date for this plant is too far outside of the test year, which ended June 30, 2006, to qualify for base rate treatment in the current UNS Electric rate case. Staff believes that a more reasonable alternative approach to addressing the ratemaking and cash flow impacts of meeting UNS Electric's power supply will need to be developed. UNS Electric's proposed base rate treatment for BMGS in the current case is premature and should be rejected for the reasons described in my testimony, including the uncertainties presently existing with respect to this plant.

SUMMARY OF THE TESTIMONY
OF STAFF WITNESS DAVID C. PARCELL
UNS ELECTRIC, INC.
DOCKET NO. E-04204A-06-0783

I filed Direct and Surrebuttal Testimony in this case. My testimony addresses the following issues:

- Capital Structure,
- Cost of Debt,
- Cost of Common Equity, and
- Total Cost of Capital.

My findings and recommendations are as follows:

	Percent	Cost	Return
Short-term Debt	3.96%	6.36%	0.25%
Long-term Debt	47.21%	8.16%	3.85%
Common Equity	48.83%	9.5-10.5%	4.64-5.13%
Total Cost of Capital			8.74-9.23%
			8.99% mid-point

This contrasts with the cost of capital request in UNS Electric's application of 9.89 percent, which includes a cost of common equity of 11.80 percent.

I use the actual test period (June 30, 2006) capital structure and cost rates of long-term and short-term debt. This contrasts with a June 30, 2007 capital structure proposed by UNS Electric. However, the difference in dates does not make a material difference in the respective capital structures as proposed by myself and UNS Electric, as the common equity ratio proposed by the Company is 48.85 percent versus 48.83 percent proposed by me. There are no disputes between the Company and myself on the costs of long-term and short-term debt.

The primary cost of capital dispute between my testimony and that of UNS Electric is the cost of common equity. I use three methodologies to estimate the cost of common equity for the Company:

	Range	
Discounted Cash Flow	9.5-10.5%	10.25% mid-point
Capital Asset Pricing Model	10.0-10.5%	10.25% mid-point
Comparable Earnings	10.0%	

Based upon the results of these analyses, I conclude that the fair cost of equity for UNS Electric is a range of 9.5 percent to 10.5 percent, with a mid-point of 10.0 percent.

SUMMARY OF THE TESTIMONY
OF STAFF WITNESS FRANK RADIGAN
UNS ELECTRIC, INC.
DOCKET NO. E-04204A-06-0783

I have filed Direct, Rebuttal and Surrebuttal Testimony in this case.

My testimony addresses the class cost of service study (CCOSS), the revenue allocation amongst service classes and the rate design.

All parities agree that the allocation of purchased power is the single largest factor driving the results of the cost of service study. The central area of contention in allocating purchased power costs is the pricing of the current power supply contract with Pinnacle West Capital Corporation. UNS proposed that the contract be allocated 40% on average and peaks and 60% on energy. I disagreed with the utility because they could provide no proof that its allocation method is consistent with the cost incurred. UNS did not use the COSS directly to allocate revenues. I recommended that the COSS not be used for revenue allocation purposes and that any revenue increase be allocated on an equal percentage basis.

UNS used the results of it allocation to design the purchased power component for each of the service classifications. I used the contract pricing which is a simple cent per kWh charge (for all usage regardless time of year or day) to design rates. UNS contents that the choice of method will provide guidance in future cases. I disagreed given that the Pinnacle West contract is going to expire soon and Staff Witness Smith has recommended that a new PPFAC be developed along the lines of the APS PSA Plan. Thus, any change made here will be supplemented by the newly developed PPFAC.

There are several rate design issues where the parties agree and several where they still disagree.

Staff and UNS agree that the customer charge for Residential customers should be increased from $6.40 per month to $7.70 per month. For small General customers, both parties agree that the customer charge should be increased form $10 per month to $12 per month. Both charges are at levels indicated by the COSS. Staff and UNS also agree on the level of miscellaneous service fees, increase the threshold under which a customer will be placed on the Large General Service Class, the rate differentials for the different TOU periods and the selection of the TOU periods themselves.

There are still some areas of rate design where the parties disagree. One is whether the TOU rates should be mandatory. While agreeing that TOU rates do serve a purpose as a price signal for customers to shift to off-peak usage, I recommended that TOU rates not be mandatory given that the energy usage for most customers is so small that it would not justify the added expense of installing a TOU meter.

I disagreed that the time was right for the full merger of the differential in rates for the customers in Mohave County and Santa Cruz County. Given that the rates for the Company are increasing overall I believe it not proper to give one set of customers a rate decrease while all other customers are getting a rate increase. Instead, I recommended that the rates be merged over two rate cases instead of one.

I also recommended against the introduction of inclining block rates at this time as I found it impractical given all of the other rate design changes being made and the small rate increase being recommended. For example, to implement an inkling block rate structure for the Small General Service Class would have resulted in a wide variety of rate impacts, with some customers receiving decrease and some customers receiving large increases.

I also disagreed with the Company's proposal to decrease the differential in the demand charges for large service customers. The CCOSS does not break down cost of service data for customers taking service at <69 kV and those at >69 kV. Neither in discovery or any filing in this case has the Company been able to provide any cost justification for changing the current rate structure. Given the lack of justification on the Company's part, I recommended no realignment of the demand charge differential at this time.