ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
CHAIRMAN
GARY PIERCE
COMMISSIONER
SANDRA D. KENNEDY
COMMISSIONER
PAUL NEWMAN
COMMISSIONER
BOB STUMP
COMMISSIONER

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-08-0571

NOTICE OF FILING
TESTIMONY SUMMARIES

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the Testimony Summaries of Ralph C. Smith, Frank W. Radigan, and William A. Rigsby in the above-referenced matter.

RESPECTFULLY SUBMITTED this 14th day of August, 2009.

Daniel W. Pozefsky
Chief Counsel

AN ORIGINAL AND THIRTEEN COPIES of the foregoing filed this 14th day of August, 2009 with:

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Ernestine Gamble
Secretary to Daniel W. Pozefsky

EXECUTIVE SUMMARY
UNS GAS, INC.
DOCKET NO. G-04204A-08-0571
TESTIMONY OF STAFF WITNESS RALPH C. SMITH

My testimony addresses the following issues, and responds to the testimony of UNS Gas, Inc. ("UNSG", "UNS Gas," or "Company") witnesses on these issues:

- The Company's proposed revenue requirement
- The determination of a Fair Value Rate of Return and its application to Fair Value Rate Base
- RUCO's recommended base revenue increase
- Adjusted Rate base
- Adjusted Test year revenues, expenses, and net operating income

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

The Company's Proposed Revenue Requirement
The Company's proposed revenue requirement of a base rate increase of $9.480 million, or 18.53 percent, is significantly overstated. In its filing, UNSG calculated the same revenue deficiency on its proposed original cost rate base (OCRB) and fair value rate base (FVRB).

UNSG overstated rate base and understated operating income. Additionally, the Company is requesting an excessive rate of return.

UNSG's request for a 9.54 percent overall return on OCRB could be viewed as effectively requesting a return on equity of 12.58 percent on OCRB, as shown on my Attachment RCS-2, Schedule D, page 1, and summarized below:

UNS Gas Proposed to Show Equivalent Requested ROE

Capital Source	Capitalization Percent	Cost Rate	Weighted Avg. Cost of Capital
Long-Term Debt	50.01%	6.49%	3.25%
Common Stock Equity	49.99%	**12.58%**	6.29%
Overall Cost of Capital	100.00%		9.54%

The testimony of RUCO witness William Rigsby addresses RUCO's recommended return on equity and weighted cost of capital to be applied to OCRB.

The Determination of a Fair Value Rate of Return (FVROR) and its Application to FVRB
The Commission's traditional calculation of return on fair value rate base calculation has been called into question by a recent Arizona Court of Appeals ruling involving Chaparral City Water Company. In that ruling, the Arizona Court of Appeals found that Staff's determination of operating income in that case had ignored fair value rate base, and that the Commission must use fair value rate base to set rates per the Arizona Constitution.

That Court of Appeals decision provided some guidance for calculating the return on fair value rate base. For example, at pages 13-14, paragraph 17, the Court of Appeals decision stated that: "... the Commission cannot ignore its constitutional obligation to base rates on a utility's fair value. The Commission cannot determine rates based on the original cost, or OCRB, and then engage in a superfluous mathematical exercise to identify the equivalent FVRB rate of return. Such a method is inconsistent with Arizona law." At page 13, the decision stated that: "If the Commission determines that the cost of capital analysis is not the appropriate methodology to determine the rate of return to be applied to the FVRB, the Commission has the discretion to determine the appropriate methodology."

The Commission reopened Docket No. W-02113A-04-0616 to address such issues in a Chaparral City remand proceeding and, on July 28, 2008, issued Decision No. 70441. In Decision No. 70441, the Commission determined the rate of return on FVRB that was reasonable and appropriate for Chaparral City, noting that there are many methods the Commission can use to determine an appropriate FVROR, including adjusting the weighted average cost of capital ("WACC") to exclude the effect of inflation on the cost of equity, and that the FVROR adopted there fell within the range of recommendations in that proceeding and reflected the Commission's exercise of its expertise and discretion in the ratemaking process.

My direct testimony in the instant rate case describes RUCO's derivation of the fair value return on fair value rate base calculations in view of the Court of Appeals decision concerning Chaparral and the Commission's Decision No. 70441 in the Chaparral remand case, as described above. Attachment RCS-2, Schedule D, page 2, shows the derivation of four FVROR calculations that were considered by RUCO, including:

- Calculation 1 - Reduce Recommended OCRB-Based Return on Equity for Estimated Inflation
- Calculation 2 - Reduce Recommended OCRB-Based Overall Rate of Return for Estimated Inflation
- Calculation 3 - With Fair Value Rate Base Increment at Zero Cost
- Calculation 4 - With Fair Value Rate Base Increment at 1.25 Percent

My Attachment RCS-2, Schedule A, page 2, in columns A through D, summarizes the resulting revenue deficiencies that would be produced in the current UNSG rate case from each of those FVROR figures, and in Column E shows RUCO's recommended FVROR of 5.38 percent. RUCO's recommendation falls within the range of FVRORs developed using various calculation methods, and is near, but not at the low end of that range. I believe that this information and RUCO's recommended FVROR in the current UNSG rate case that was made after considering these alternatives appropriately fulfills the requirement of the Arizona Constitution that the Commission must base rates on a utility's fair value.

My Attachment RCS-2, Schedule A, page 1, Column D, shows the amount of base rate revenue increase on FVRB of $841,000.

Recommended Base Rate Revenue Increase

On original cost rate base (OCRB) my calculations show a jurisdictional revenue deficiency of $803,000 and $841,000 on FVRB, based on a FVROR of 5.38 percent. I recommend that UNSG be authorized a base rate increase of no more than $841,000 on adjusted FVRB. That is an average revenue increase of approximately 1.63 percent over adjusted test year revenue of $51.674 million.

Adjusted Rate Base

The following adjustments to UNSG's proposed original cost rate base should be made:

Summary of RUCO Adjustments to Rate Base

Adj. No.	Description	Increase (Decrease)	Note
B-1	Construction Work in Progress/Post Test Year Plant	$ (1,527,588)	
B-2	Customer Advances	$ (589,152)	
B-3	Prepayments	$ (95,671)	
B-4	Cash Working Capital	$ -	[a]
B-5	Customer Deposits	$ -	[a]
B-6	Accumulated Deferred Income Taxes	$ (196,256)	
	Total of RUCO Adjustments	$ (2,408,667)	
	UNS Proposed Rate Base (Original Cost)	$ 182,293,106	
	RUCO Proposed Rate Base (Original Cost)	$ 179,884,439	

[a] Schedule is a placeholder for a potential adjustment to be submitted in a later stage filing, such as surrebuttal

The following table summarizes UNS Gas' requested and RUCO's recommend OCRB, reconstruction cost new depreciated (RCND) rate base and FVRB, and the differences:

Summary of Rate Base	UNS Gas	RUCO	Difference
Original Cost Rate Base	$ 182,293,106	$ 179,884,439	$ (2,408,667)
RCND Rate Base	$ 329,266,770	$ 325,871,264	$ (3,395,506)
Fair Value Rate Base	$ 255,779,939	$ 252,877,851	$ (2,902,088)

Adjusted Net Operating Income

The following adjustments to UNSG's proposed revenues, expenses and net operating income should be made:

Summary of RUCO Adjustments to Net Operating Income

Adj No.	Description	Pre-Tax Operating Income or Expense Adjustment	Net Operating Income Adjustment
C-1	Gas Retail Revenue	$ 516,003	$ 316,836
C-2	Depreciation & Property Taxes for CWIP	$ 95,042	$ 58,358
C-3	Incentive Compensation	$ 152,511	$ 93,645
C-4	Stock-Based Compensation Expense	$ 266,399	$ 163,574
C-5	Supplemental Executive Retirement Plan Expense	$ 101,021	$ 62,029
C-6	American Gas Association Dues	$ 16,762	$ 10,292
C-7	Outside Services Legal Expense	$ 217,674	$ 133,656
C-8	Fleet Fuel Expense	$ 471,826	$ 289,711
C-9	Rate Case Expense	$ 158,333	$ 97,220
C-10	Interest Synchronization	$ -	$ (30,215)
C-11	Property Tax Expense	$ 230,913	$ 141,785
C-12	2010 Pay Increase	$ 250,622	$ 153,887
Total of RUCO's Adjustments to Net Operating Income		$ 2,477,106	$ 1,490,778
	Company Proposed Net Operating Income	$ -	$ 11,600,004
	Rounding	$ -	$ -
	Adjusted Net Operating Income per RUCO		$ 13,090,782

EXECUTIVE SUMMARY
UNS GAS, INC.
DOCKET NO. G-04204A-08-0571
SURREBUTTAL TESTIMONY OF RUCO WITNESS RALPH C. SMITH

My testimony addresses the following issues, and responds to the rebuttal testimony of UNS Gas, Inc. ("UNSG", "UNS Gas," or "Company") witnesses on these issues:

- The Company's proposed revenue requirement
- The determination of a Fair Value Rate of Return and its application to Fair Value Rate Base
- RUCO's recommended base revenue increase
- Adjusted Rate base
- Adjusted Test year revenues, expenses, and net operating income

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

The Company's Proposed Revenue Requirement
The Company had originally proposed a revenue requirement of a base rate increase of $9.480 million, or 18.53 percent. In its rebuttal, UNSG calculated a base rate increase that is approximately $146,000 higher than its original request, but indicated that it is not requesting a revenue requirement higher than proposed in its original Application. The Company's requested rate increase is significantly overstated.

UNSG overstated rate base and understated operating income. Additionally, the Company is requesting an excessive rate of return. The direct and rebuttal testimony of RUCO witness William Rigsby addresses RUCO's recommended return on equity and weighted cost of capital to be applied to OCRB.

The Determination of a Fair Value Rate of Return (FVROR) and its Application to FVRB
The Commission's traditional calculation of return on fair value rate base calculation has been called into question by a recent Arizona Court of Appeals ruling involving Chaparral City Water Company. In that ruling, the Arizona Court of Appeals found that Staff's determination of operating income in that case had ignored fair value rate base, and that the Commission must use fair value rate base to set rates per the Arizona Constitution.

That Court of Appeals decision provided some guidance for calculating the return on fair value rate base. For example, at pages 13-14, paragraph 17, the Court of Appeals decision stated that: "... the Commission cannot ignore its constitutional obligation to base rates on a utility's fair value. The Commission cannot determine rates based on the original cost, or OCRB, and then engage in a superfluous mathematical exercise to identify the equivalent FVRB rate of return. Such a method is inconsistent with Arizona law." At page 13, the decision stated that: "If the Commission determines that the cost of capital analysis is not the appropriate methodology to determine the rate of return to be applied to the FVRB, the Commission has the discretion to determine the appropriate methodology."

The Commission reopened Docket No. W-02113A-04-0616 to address such issues in a Chaparral City remand proceeding and, on July 28, 2008, issued Decision No. 70441. In Decision No. 70441, the Commission determined the rate of return on FVRB that was reasonable and appropriate for Chaparral City, noting that there are many methods the Commission can use to determine an appropriate FVROR, including adjusting the weighted average cost of capital ("WACC") to exclude the effect of inflation on the cost of equity, and that the FVROR adopted there fell within the range of recommendations in that proceeding and reflected the Commission's exercise of its expertise and discretion in the ratemaking process.

Attachment RCS-2, Schedule D, page 2, to my direct testimony showed the derivation of four FVROR calculations that were considered by RUCO, including:

- Calculation 1 - Reduce Recommended OCRB-Based Return on Equity for Estimated Inflation
- Calculation 2 - Reduce Recommended OCRB-Based Overall Rate of Return for Estimated Inflation
- Calculation 3 - With Fair Value Rate Base Increment at Zero Cost
- Calculation 4 - With Fair Value Rate Base Increment at 1.25 Percent

My surrebuttal testimony in the instant rate case elaborates upon RUCO's derivation of the fair value return on fair value rate base calculations in view of the Court of Appeals decision concerning Chaparral and the Commission's Decision No. 70441 in the Chaparral remand case, as described above.

Adjusted Rate Base
The following adjustments to UNSG's proposed original cost rate base should be made:

- UNSG's proposed rate base increase for post test year plant should be rejected for the reasons stated in my Direct and Surrebuttal Testimony.
- UNSG's proposed increase to rate base related to removing a portion of the cost-free, non-investor supplied capital in the form of Customer Advances should be rejected for the reasons stated in my Direct and Surrebuttal Testimony.
- UNSG's attempt in its Rebuttal Testimony to increase the amount of Cash Working Capital in rate base by over $2 million for a post-test year change in the payment lag for purchased gas expense in retaliation to a Staff recommendation is one-sided and should be rejected for the reasons stated in my Surrebuttal Testimony.
- The adjustments to the specific components of Accumulated Deferred Income Taxes shown in Attachment RCS-2, Schedule B-2, filed with my Direct Testimony should be adopted for the reasons stated in my Direct and Surrebuttal Testimony. That adjustment decreases rate base by $423,669.
- If the Commission deems that the debit-balance ADIT of $170,414 related to the Accrued Vacation and Accrued Pension Liabilities should be included in rate base, then the corresponding balances in the Accrued Vacation and Accrued Pension Liability accounts, amounting to $441,483, should reduce rate base, to recognize this non-investor supplied cost-free capital, for a net reduction to rate base for these accrued liability items of $271,069.

Adjusted Net Operating Income
The following adjustments to UNSG's proposed revenues, expenses and net operating income should be made:

- UNSG's proposed revenue annualization, which attempts to decrease test year revenue, should be rejected for the reasons stated in my Direct and Surrebuttal Testimony.
- The adjustments to Incentive Compensation Expense, Stock-Based Compensation, and Supplemental Executive Retirement Plan Expense recommended in my Direct Testimony should be made for the reasons stated in my Direct and Surrebuttal Testimony.
- UNSG's expense for the gas utility industry association, the American Gas Association, should be reduced by 40 percent, not the 4 percent proposed by UNSG, for the reasons stated in my Direct and Surrebuttal Testimony.
- A normalized allowance for UNSG's non-rate case Outside Legal Expense should be determined that takes into account changed circumstances and does not rely primarily on backward-looking historical information, as described in my Direct and Surrebuttal Testimony.
- UNSG's Fleet Fuel Expense for the test year was abnormally high, reflecting extreme high levels of gasoline prices, as described in my Direct and Surrebuttal Testimony. A normalized level should be used for ratemaking purposes, based on average usage and average prices for the period January 2006 through June 2009, as described in my Surrebuttal Testimony and shown on Attachment RCS-7, Schedule C-8 Revised.
- UNSG's proposed Rate Case Expense is excessive in comparison to the Commission allowed amounts in the last UNS Gas and the last UNS Electric rate cases. Rate Case Expense charged to UNSG's ratepayers should be limited to n annual allowance of $100,000 based on a total amount of $300,000 normalized over a three-year period as described in my Direct and Surrebuttal Testimony.
- UNSG's proposed increase to test year expense for a projected 2010 pay increase should be rejected for the reasons stated in my Direct and Surrebuttal Testimony.
- A known and measureable postage rate increase occurred in May 2009. The amount of postage expense increase of approximately $22,000 corresponding with RUCO's recommended level of test year customers is shown on Attachment RCS-7, Schedule C-13.

EXECUTIVE SUMMARY
UNS GAS, INC.
DOCKET NO. G-04204A-08-0571
DIRECT TESTIMONY OF RUCO WITNESS FRANK RADIGAN

1) The Company's proposed cost of service study uses a Commission accepted method to allocate costs. The Company has proposed to allocate costs on an across the board basis except for the CARES customers who receive no increase. In these uncertain economic times an equal sharing of the rate increase is reasonable. The proposed revenue allocation is shown on Exhibit 3 and summarized below:

Class of Service	Present Revenue	Proposed Revenue	Proposed Increase	Proposed Percent Increase
Residential Service	$36,600,943	$37,190,974	$590,030	1.6%
Commercial Gas Service	$9,910,680	$10,076,399	$165,720	1.7%
Industrial Gas Service	$246,712	$250,838	$4,125	1.7%
Public Authority Gas Servic	$1,778,118	$1,807,850	$29,732	1.7%
Special Gas Light Service	$66,940	$68,059	$1,119	1.7%
Irrigation Service	$33,865	$34,431	$566	1.7%
Transportation Customers	$3,036,509	$3,086,270	$49,761	1.6%
Total	$51,673,767	$52,514,821	$841,054	1.6%

2) The Company's proposal not to increase the rates for the CARES customers is reasonable and abides by recent Commission treatment to these customers of holding them harmless from rate increase.

3) The Company's proposed rate design that would phase in a 65% increase in the residential customer charge over three years should be rejected. Instead, the proposed increase in the customer charges for what the Company describes as Year 1 are reasonable as they increase

rates towards the indicated cost of service but do not overly increase rates. My proposed customer charges are summarized in the table below.

	Present	Proposed	Increase	% Increase
Residential	$ 8.50	$ 10.00	$ 1.50	18%
Small Commercial & Industrial	13.50	15.50	2.00	15%
Large Commerical and Industrial	100.00	105.00	5.00	5%
Irrigation Service	13.50	15.50	2.00	15%

4) The impact for a Residential Customer from this proposed revenue allocation and rate design is as follows. The customer charge is proposed to increase from $8.50 per month to $10 per month and the commodity charge is proposed to decrease slightly from $0.3270 pr therm to $0.3027 per therm. The average bill for the Residential Class is 45 therms per month and a customer with such average usage will see an increase of 1.7%, which is the class average increase. Detailed bill impacts from each class are shown on Schedule H-4 of Exhibit 3 to my testimony.

EXECUTIVE SUMMARY
UNS GAS, INC.
DOCKET NO. G-04204A-08-0571
SURREBUTTAL TESTIMONY OF RUCO WITNESS FRANK RADIGAN

The Company's proposed rate design that would phase in a 65% increase in the residential customer charge over three years should be rejected. The Company has presented no new evidence in its rebuttal testimony. The main argument is that the $5.50 increase that it wishes to impose is relatively small in absolute terms and the rate shock is ameliorated by the phase in over three years. In this testimony and my initial testimony I disagreed with a phase-in in order to avoid customer complaints and agreed to an 18% increase, $1.5 per month for Residential customers. I view this increase at the top of an acceptable bill impact range given that RUCO is recommending a 1.6% overall increase.

DOCKET NO. G-04204A-08-0571

RATE APPLICATION

SUMMARY OF THE TESTIMONY OF WILLIAM A. RIGSBY, CRRA

ON BEHALF OF THE RESIDENTIAL UTILITY CONSUMER OFFICE

The following is a summary of the significant issues set forth in both the direct and the surrebuttal testimony of RUCO witness William A. Rigsby, on UNS Gas, Inc.'s ("UNSG" or the "Company") application for a permanent rate increase for the Company's natural gas distribution operations in northern Arizona and Santa Cruz County. A full discussion of the cost of capital issues associated with UNSG's request for rate relief and the underlying theory and rationales for Mr. Rigsby's recommendations are contained in the referenced documents. The significant issues associated with the case are as follows:

<u>Original Cost of Equity Capital</u> – The Residential Utility Consumer Office ("RUCO") recommends an 8.61 percent original cost of equity capital for UNSG. This 8.61 percent original cost figure is based on the results obtained in a cost of equity analysis, which employed both the Discounted Cash Flow ("DCF") and Capital Asset Pricing Model ("CAPM") methodologies. RUCO's recommended 8.61 percent figure is 239 basis points lower than the Company-proposed cost of equity capital of 11.00 percent.

<u>Cost of Debt</u> – Based on a review of the costs associated with UNSG's various debt instruments, RUCO recommends that the Company-proposed 6.49 percent

cost of debt be adopted by the Arizona Corporation Commission ("ACC" or "Commission").

Capital Structure – RUCO recommends that the Company-proposed capital structure, which is comprised of 50.01 percent debt and 49.99 percent common equity, be adopted by the Commission.

Original Cost Rate of Return – Based on the results of RUCO's recommended capital structure, original cost of equity capital, and debt analyses, RUCO recommends a 7.55 percent original cost rate of return ("OCROR") for UNSG. This figure represents the weighted average cost of RUCO's recommended 8.61 percent original cost of equity capital and RUCO's 6.49 percent recommended cost of debt. RUCO's recommended 7.55 percent OCROR is 120 basis points lower than the Company-proposed unadjusted 8.75 percent weighted average cost of capital.

Fair Value Rate of Return – RUCO is recommending a 5.38 percent fair value rate of return ("FVROR") which is 217 basis points lower than RUCO's recommended 7.55 percent OCROR. In arriving at this 5.38 percent FVROR figure, RUCO considered a range of possible returns that could be applied to the Company's fair value rate base. The method that RUCO used to arrive at its recommended 5.38 percent FVROR comports with the provisions of Decision No.

70441, dated July 28, 2008, that resulted from a prior remand proceeding which involved Chaparral City Water Company. The methodology that RUCO relied on to arrive at its recommended FVROR figure is explained fully in the testimony of RUCO witness Ralph Smith.