ORIGINAL

0000102827

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

2009 SEP 21 A 10: 42

AZ CORP COMMISSION
DOCKET CONTROL

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

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 APPENDIX IN SUPPORT OF INITIAL POST-HEARING BRIEF OF UNS GAS, INC.**

UNS Gas, Inc., through undersigned counsel, files its Appendix in Support of UNS Gas, Inc's' Initial Post-Hearing Brief filed on September 18, 2009.

RESPECTFULLY SUBMITTED this 21st day of September 2009.

UNS Gas, Inc.

By [signature]
Michael W. Patten
Timothy J. Sabo
ROSHKA DEWULF & PATTEN, PLC.
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

and

Philip J. Dion
UniSource Energy Services
One South Church Avenue
Tucson, Arizona 85701

Attorneys for UNS Gas, Inc.

Arizona Corporation Commission
DOCKETED
SEP 21 2009
DOCKETED BY

Original and 13 copies of the foregoing
filed this 21st day of September 2009, with:

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

Copy of the foregoing hand-delivered/mailed
this 21st day of September 2009, to:

Chairman Kristen K. Mayes
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Commissioner Gary Pierce
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Commissioner Sandra D. Kennedy
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Commissioner Paul Newman
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Commissioner Bob Stump
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Nicholas J. Enoch
Jarrett J. Haskovec
Lubin & Enoch, P.C.
349 North Fourth Avenue
Phoenix, Arizona 85003

Daniel W. Pozefsky
Chief Counsel
Residential Utility Consumer Office
1110 West Washington, Suite 220
Phoenix, Arizona 85007

Cynthia Zwick
1940 East Luke Avenue
Phoenix, Arizona 85016

Dwight Nodes, Esq.
Assistant Chief Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Robin Mitchell, Esq.
Kevin Torrey, Esq.
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Steve Olea
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

By Mary Ippolito

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

APPENDIX

IN SUPPORT OF

INITIAL POST-HEARING

BRIEF OF UNS GAS, INC

Volume 1 of 3

1

BEFORE THE ARIZONA CORPORATION COMMISSION

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.	DOCKET NO. G-04204A-08-0571

Direct Testimony of

David G. Hutchens

on Behalf of

UNS Gas, Inc.

November 7, 2008

territory, the related increase in capital expenditures and operating costs, as well as increases related to rising material and labor costs.

Since the end of the 2005 Test Year used in UNS Gas' recently completed rate case, UNS Gas has added over 5,000 customers. As of the end of the June 30, 2008 Test Year, UNS Gas had a customer base of 145,000. We project that the number of UNS Gas customers will increase by, on average, 2.5% annually. In order to meet its growth, UNS Gas has incurred, and will continue to incur, capital expenditures for items such as pipelines, meters and regulators. These items cost significantly more than they did even in 2005.

Also, from the end of the Company's last completed rate case, through the end of the Test Year, UNS Gas has put $54 million in capital expenditures into service to continue providing safe, reliable service to its customers. Operating expenses (excluding gas costs and income taxes) recovered through UNS Gas' current rates are $34.8 million, while operating expenses (excluding gas costs and income taxes) in this current rate filing are $37.7 million. UNS Gas' Test Year original cost rate base ("OCRB") is $182 million.

In summary, the main factors driving this rate case filing are: (i) current rates do not reflect substantial capital investment put into service since the end of the 2005; (ii) UNS Gas has continued to increase its investment in the gas properties attributable to upgrades to provide reliable service to existing customers and increased customer growth; and (iii) the Company's expense levels continue to increase due to rising material costs beyond its control.

2

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

July 8, 2009

($ Thousands)	2008 Actual	2009	2010	2011
Gross Margin	$55,424	$55,532	$64,975	$66,099
Operating Expenses	(34,757)	(37,222)	(40,592)	(42,499)
Operating Income	$20,668	$18,310	$24,383	$23,600
Other Income – Net	150	142	186	418
Interest Expense	(6,640)	(6,391)	(6,332)	(6,556)
Pre-Tax Income	$14,178	$12,061	$18,237	$17,461
Income Tax Exp.	(5,640)	(4,790)	(7,225)	(6,917)
Net Income	$8,538	$7,270	$11,013	$10,544
Ending Common Equity	$96,684	$103,948	$114,961	$120,233
Return on Avg. Equity	9.2%	7.2%	10.1%	9.0%

As my be seen in the table above, UNS Gas now projects that it will earn a ROE of only 10.1% in 2010 even if its rate request is granted in full and is implemented prior to January 2010. Even though the Company has trimmed its forecast of operating expenses and capital expenditures, the reduced sales outlook coupled with the continued use of an historical test year for rate setting purposes will make it very difficult for the Company to earn its cost of capital even if UNS Gas is granted the full rate increase it has requested. Based on this forecast, it should be apparent that the Company requires all of its requested rate increase in order for it to have any opportunity of earnings its cost of capital.

Q. Will UNS Gas have an opportunity to earn its cost of capital if Staff's revenue requirement is adopted?

A. No. The Company estimates that it will be able to earn an ROE of only 6-7% if Staff's revenue requirement is adopted.

3

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

July 8, 2009

($ Thousands)	2008 Actual	2009	2010	2011
Gross Margin	$55,424	$55,532	$64,975	$66,099
Operating Expenses	(34,757)	(37,222)	(40,592)	(42,499)
Operating Income	$20,668	$18,310	$24,383	$23,600
Other Income – Net	150	142	186	418
Interest Expense	(6,640)	(6,391)	(6,332)	(6,556)
Pre-Tax Income	$14,178	$12,061	$18,237	$17,461
Income Tax Exp.	(5,640)	(4,790)	(7,225)	(6,917)
Net Income	$8,538	$7,270	$11,013	$10,544
Ending Common Equity	$96,684	$103,948	$114,961	$120,233
Return on Avg. Equity	9.2%	7.2%	10.1%	9.0%

As my be seen in the table above, UNS Gas now projects that it will earn a ROE of only 10.1% in 2010 even if its rate request is granted in full and is implemented prior to January 2010. Even though the Company has trimmed its forecast of operating expenses and capital expenditures, the reduced sales outlook coupled with the continued use of an historical test year for rate setting purposes will make it very difficult for the Company to earn its cost of capital even if UNS Gas is granted the full rate increase it has requested. Based on this forecast, it should be apparent that the Company requires all of its requested rate increase in order for it to have any opportunity of earnings its cost of capital.

Q. Will UNS Gas have an opportunity to earn its cost of capital if Staff's revenue requirement is adopted?

A. No. The Company estimates that it will be able to earn an ROE of only 6-7% if Staff's revenue requirement is adopted.

4

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

July 8, 2009

($ Thousands)	2008 Actual	2009	2010	2011
Gross Margin	$55,424	$55,532	$64,975	$66,099
Operating Expenses	(34,757)	(37,222)	(40,592)	(42,499)
Operating Income	$20,668	$18,310	$24,383	$23,600
Other Income – Net	150	142	186	418
Interest Expense	(6,640)	(6,391)	(6,332)	(6,556)
Pre-Tax Income	$14,178	$12,061	$18,237	$17,461
Income Tax Exp.	(5,640)	(4,790)	(7,225)	(6,917)
Net Income	$8,538	$7,270	$11,013	$10,544
Ending Common Equity	$96,684	$103,948	$114,961	$120,233
Return on Avg. Equity	9.2%	7.2%	10.1%	9.0%

As my be seen in the table above, UNS Gas now projects that it will earn a ROE of only 10.1% in 2010 even if its rate request is granted in full and is implemented prior to January 2010. Even though the Company has trimmed its forecast of operating expenses and capital expenditures, the reduced sales outlook coupled with the continued use of an historical test year for rate setting purposes will make it very difficult for the Company to earn its cost of capital even if UNS Gas is granted the full rate increase it has requested. Based on this forecast, it should be apparent that the Company requires all of its requested rate increase in order for it to have any opportunity of earnings its cost of capital.

Q. Will UNS Gas have an opportunity to earn its cost of capital if Staff's revenue requirement is adopted?

A. No. The Company estimates that it will be able to earn an ROE of only 6-7% if Staff's revenue requirement is adopted.

5

DATA REQUEST PACKET

Staff's Responses to UNS Gas' Data Requests:

UNSG 2.1	**UNSG 3.10**	**UNSG 3.22**
UNSG 2.2	**UNSG 3.11**	**UNSG 3.39**
UNSG 2.4	**UNSG 3.12**	**UNSG 3.40**
UNSG 3.4	**UNSG 3.13**	**UNSG 3.41**
UNSG 3.5	**UNSG 3.14**	**UNSG 3.57**
UNSG 3.6	**UNSG 3.15**	**UNSG 3.58**
UNSG 3.7	**UNSG 3.20**	**UNSG 3.60**
UNSG 3.9	**UNSG 3.21**	**UNSG 3.65**

UNSG-24

ARIZONA CORPORATION COMMISSION
DOCKET NO. G-04204A-08-0571
STAFF'S RESPONSE TO UNS GAS, INC.'S
THIRD SET OF DATA REQUESTS
August 6, 2009

UNSG 3.6 Refer to the Direct Testimony of Thomas H. Fish, Ph.D., page 5, line 14, where Dr. Fish refers to an "opportunity to recover these prudent costs". Please provide Dr. Fish's estimate (with supporting calculations and workpapers) of the likelihood of UNS Gas actually recovering its prudent costs if all of Staff's recommendations are adopted given observed levels of attrition and regulatory lag for UNS Gas.

RESPONSE: Objection, unduly burdensome. This information is readily available to the Company. The Commission sets rates that are just and reasonable to enable a utility the opportunity to earn its authorized rate of return.

Supplemental Response: Without waiving the objection, the following response is provided: There are no workpapers. Whether the Company recovers its costs is within the Company's control.

RESPONDENT: ROBIN MITCHELL

WITNESS: DR. THOMAS FISH

DATA REQUEST PACKET

RUCO's Responses to UNS Gas' Data Requests:

UNSG 2.25
UNSG 2.48
UNSG 2.55
UNSG 3.2
UNSG 3.13
UNSG 3.16
UNSG 3.18
UNSG 3.20
UNSG 3.21
UNSG 3.22
UNSG 3.31
UNSG 3.34
UNSG 3.35
UNSG 3.36

UNSG 2.48 Does Mr. Smith believe that UNS Gas will actually be able to earn the 8.61% authorized return on equity proposed by RUCO? Please explain and provide any supporting analyses for this conclusion.

Response:

Mr. Smith has applied the rate of return on OCRB recommended by RUCO Witness Rigsby. Whether UNSG will earn a rate of return that is authorized by a regulatory commission is dependent upon numerous factors including management decisions occurring after the test year and the impact of items that are not considered for ratemaking purposes.

Respondent: Ralph C. Smith

Witness: Ralph C. Smith

6

BEFORE THE ARIZONA CORPORATION COMMISSION

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.	DOCKET NO. G-04204A-08-0571

Direct Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

November 7, 2008

In terms of cash flow, when the effects of temporary over- and under-collections of PGA gas costs are removed, it is apparent from the table above that UNS Gas is unable to cover all of its capital expenditures with internal cash flow. While this situation is not unusual for a utility experiencing growth in its service area, the magnitude of the cash shortfall is unusual. As an industry, gas distribution utilities typically fund approximately 80% of their capital expenditures with internal cash flow *after dividends are paid to shareholders*. Although UNS Gas' internal cash flow is expected to fund approximately 70% of capital expenditures over 2008 and 2009, this level of funding assumes that *no dividends are paid* on shareholder capital. If UNS Gas were to pay dividends at a level commensurate with the industry average, which equates to approximately 60% of annual earnings, the internal funding of capital expenditures would drop to approximately 50%, a level far below industry norms that is indicative of weak internal cash flow and a continuing dependence on outside capital.

Q. **Are the debt obligations of UNS Gas rated by any of the major credit rating agencies?**

A. Yes, they are. At the request of the Company, Moody's Investors Service ("Moody's") initiated ratings on UNS Gas in October 2008. A copy of the initial ratings report is attached to my Direct Testimony as Exhibit KCG-1. As discussed in that report, the senior unsecured debt obligations of UNS Gas are rated Baa3.

Q. **What is the significance of a Baa3 credit rating?**

A. Baa3 is the lowest investment-grade credit rating assigned by Moody's, just one notch above the speculative-grade rating of Ba1. Since the cost and availability of credit are much improved for companies with investment-grade ratings relative to companies having speculative-grade ratings, the achievement of an investment-grade rating for UNS Gas was a very important milestone. The level of credit risk as defined by Moody's for each rating category (B and higher) is summarized in the following table:

Rating	Definition
Aaa	Obligations are judged to be of the highest quality, with minimal credit risk.
Aa	Obligations are judged to be of high quality and subject to very low credit risk.
A	Obligations are considered upper-medium grade and are subject to low credit risk.
Baa	Obligations are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics.
Ba	Obligations are judged to have speculative elements and are subject to substantial credit risk.
B	Obligations are considered speculative and are subject to high credit risk.

It should also be noted that with the exception of the Aaa rating, Moody's appends a numerical modifier of 1, 2 or 3 to each of these rating categories. The modifier "1"indicates that the obligation ranks in the higher end of its generic rating category; the modifier "2" indicates a mid-range ranking; and the modifier "3" indicates a ranking in the lower end of that generic rating category. Hence, the Baa3 rating assigned to UNS Gas is considered to be the lowest investment-grade rating assigned by Moody's.

Q. Why is the achievement and maintenance of an investment-grade credit rating important to the Company and its customers?

A. An investment-grade credit rating is important for two reasons. First, it helps to ensure that capital can be raised on reasonable terms even during periods of stress in the financial markets. During periods of financial stress, when investor risk aversion is at its highest, many companies with speculative-grade credit ratings will either be shut out of the credit markets or will be forced to pay extremely high rates of interest on new

	% of Capital Structure	Component Cost	Weighted Average Cost
Long-Term Debt	50.01%	6.49%	3.25%
Common Equity	49.99%	11.00%	5.50%
Total	100.00%		8.75%

VII. ABILITY OF UNS GAS TO EARN ITS COST OF CAPITAL.

Q. Will the rate increase requested by UNS Gas provide the Company with an opportunity to actually earn its cost of capital?

A. Yes, I believe it will.

Q. Have you prepared any financial projections that show the impact of the Company's rate request on UNS Gas' earnings?

A. Yes. The following table summarizes the Company's forecast of net income and earned ROE through 2011 assuming that UNS Gas is granted its full rate request and is allowed to implement new rates in December 2009:

($ Thousands)	2008	2009	2010	2011
Gross Margin	$57,388	$58,966	$69,196	$71,115
Operating Expenses	(37,127)	(40,079)	(42,099)	(44,122)
Operating Income	$20,262	$18,887	$27,097	$26,994
Other Income – Net	255	230	224	743
Interest Expense	(6,552)	(6,467)	(6,504)	(6,910)
Pre-Tax Income	$13,964	$12,651	$20,817	$20,826
Income Tax Exp.	(5,539)	(5,012)	(8,247)	(8,250)
Net Income	$8,425	$7,639	$12,571	$12,576
Ending Common Equity	$101,063	$108,703	$121,273	$133,849
Return on Avg. Equity	8.9%	7.3%	10.9%	9.9%

Q. Does this forecast represent the best estimate of earnings available at this point in time?

A. Yes, it does. Although this forecast relies on numerous key assumptions regarding future sales levels, operating expenses, interest rates, tax rates and capital expenditures, it represents management's best estimate at this point in time. I would also note that a very similar forecast was provided to Moody's as part of the credit rating review process for UNS Gas. The only difference between that forecast and the one summarized in the table above relates to the requested level of rate relief, a value that had to be estimated at the time the forecast was provided to Moody's.

Q. Why is it important to provide the Company an opportunity to earn its allowed ROE?

A. If UNS Gas is not allowed to earn its cost of equity capital, there will be little incentive for UniSource Energy to increase its equity investment in UNS Gas through the continued retention of earnings at UNS Gas and through new contributions of capital.

Without this source of capital, UNS Gas would become more dependent on debt capital to fund its capital expenditures, thereby putting further pressure on the Company's creditworthiness. As discussed previously, maintenance of the Company's creditworthiness is essential to the Company's gas procurement program and the ability of UNS Gas to obtain new capital on reasonable terms. Additionally, UNS Gas would likely be forced to file a series of back-to-back rate cases over the next several years in order to improve its earnings and cash flow. Such a scenario would add additional costs to the Company, its customers and the Commission that could otherwise be avoided through a more constructive, and longer-term, approach to rate making.

7

SEE

APPENDIX

"A"

ATTACHED TO BRIEF

8

UNS GAS, INC.'S SUPPLEMENTAL RESPONSE TO RUCO'S FIRST SET OF DATA REQUESTS DOCKET NO. G-04204A-08-0571 May 20, 2009

RUCO 1.88 Refer to Dallas Dukes testimony page 11, lines 7-8. Provide for each project: 1) a description of the project, 2) the projected in service date, 3) and all costs expended to date.

RESPONSE: UNS Gas is in the process of gathering this information and will provide the response to this data request shortly.

RESPONDENT: Regulatory Services

WITNESS: Dallas Dukes

SUPPLEMENTAL RESPONSE: Please see the Excel workbook RUCO 1.88 on the enclosed CD. The Excel file is not identified by Bates numbers.

RESPONDENT: Paula Smith

WITNESS: Dallas Dukes

Uns Project/Task #	Uns GI Project/Description	Balance	Non Revenue Producing	Cost to Date (5/6/09)	Date in Service or Est Date	Comments
250000A	**UNSG Transportation Equip**	-13,553.47	-13,553.47			
DR10000	Vehicle Retirement					
250910A	**Office Furn & Eq - New (Admin)**	649.37	649.37			
DA10046	Security System for Shamrell Office			9,899.58	10/24/07	
250912A	**CompEquip - UNSG**	3,726.80	3,726.80			
DA10011	IT Equipment Purchases - UNSG Flagstaff			30,170.44	04/01/08	
250912B	**Comp Equip- Rep (Admin)**	-2,687.40	-2,687.40			
DA10052	Upgrade To Shamrell Conference Room			16,950.23	03/23/08	
250913A	**Computer Software - New (Admin**	-252.30	-252.30			
DA10060	1213 Installations GasDay Svc Tech			32,196.00	09/02/08	
250915A	**ESRI Upgrade**	2,168.51	2,168.51			
250940A	**Tools,Shop,Gar Eq - New(Admin)**	3,021.49	3,021.49			
DA10042	Repair Equipment, Tapping & Plugging Equipment			126,467.48	11/01/07	
DA10045	High Pressure Nordstrom 400-D Grease Gun			845.76	07/18/07	
DA10056	Hydraulic Squeezer Tools for Training Dept			9,176.20	04/01/08	
250950A	**Laboratory Equip - New (Admin)**	185,730.21	185,730.21			
DA10057	Sensit Gold Combustible Gas Indicators & Trak-it III Combustible Gas Indicators			186,109.24	05/30/08	
250960A	**Power Operated Eq - New(Admin)**	408.80	408.80			Late Adjustment
251200B	**Mains-Repl-Flagstaff**	24,516.26	24,516.26			
DF00082	Service Replacement Flagstaff - Various Locations			88,413.70		
251500B	**Mains - CIP - Flagstaff**	66,981.18	66,981.18			NOT LISTED ON ORIGINAL NON-REVENUE LIST
DF10418	Huntington Drive CIP			51,689.77	03/25/08	
DF10424	4" PE main 7170 Yancey Lane			74,251.20	06/02/08	
251900A	**Structures & Improv-New (Flag)**	26,021.40	26,021.40			
DF10410	Butler Facility Improvements 2008			433,535.68	10/06/08	
251922A	**Trans Eq < 1 Ton - New (Flag)**	44,153.98	44,153.98			
DF10417	Two 2008 Ford 4x4 Rangers Units # 10278 & 10279			42,403.25	06/11/08	
251922B	**Trans Eq < 1 Ton - Rep (Flag)**	42,615.32	42,615.32			
DF10416	2 7X14 Enclosed Trailers Units #90135 &90136			22,376.05	05/20/08	
251923A	**Trans Eq > 1 Ton - New (Flag)**	3,782.09	3,782.09			Late Adjustment
251940A	**Tools,Shop,Gar Eq - New (Flag)**	-23.73	-23.73			Late Adjustment
251950B	**Laboratory Equip - Rep (Flag)**	58.09	58.09			Late Adjustment
251970A	**Comm Equip - New (Flag)**	6,598.36	6,598.36			
DF10423	Radios			6,214.56	07/30/08	
252200A	**Services - Rep - King**	20,661.89	20,661.89			
DH00087	Service Replacements for Lake Havasu			139,196.00	08/05/08	
252376B	**Mains Volun Repl - King**	401.87	401.87			
DH10058	Replace Pipe on Londaon Bridge Rd No. 2			12,351.55	04/23/07	
DH10135	Repl PVC on Catherine			19,097.00	07/22/08	
252501B	**CIP - Lake Havasu**	-10,400.78	-10,400.78			NOT LISTED ON ORIGINAL NON-REVENUE LIST
DH10070	Lower Indain Peak Wash			2,180.51	02/22/07	
DH10097	Havasupai Wash			11,987.23	01/19/08	
DH10099	Kiowa Drain			23,636.30	06/21/08	
DH10100	San Juan Drain			1,352.43	09/27/07	
DH10105	Repl PVC on San Juan Dr			31,593.49	02/23/08	
DH10116	Repl on Hurricane Dr			66,534.20	04/03/08	
DH10117	Repl PVC on Barranca Dr			15,786.70	12/22/08	
DH10119	Repl PVC on Huntington Drive			19,625.34	05/07/08	
DH10129	Replace 2" PVC Main on Nautilus Dr			6,809.33	04/23/08	
DH10132	Repl PVC on Aloha Dr			17,242.11	07/18/08	
252900A	**Structures & Improv-New (King)**	6,531.06	6,531.06			
DK10340	Add New Wall w/3' doors & Planter box			6,661.76	04/30/08	
252922A	**Trans Eq < 1 Ton - New (King)**	20,657.57	20,657.57			
DK10325	2008 Ford 1/2 ton 4x2 Unit # 10276			20,157.96	05/05/08	
252923A	**Trans Eq > 1 Ton - New (King)**	-0.01	-0.01			Late Adjustment
252940A	**Tools,Shop,Gar Eq - New (King)**	4,800.51	4,800.51			
DH10094	Air Hammer for C&M Crew			525.78	05/25/07	
DH10122	Compaction Wheel			4,198.32	04/01/08	
DH10123	LH Coppus Portable Ventilator			464.42	02/14/08	
252950A	**Laboratory Equip - New (King)**	195.00	195.00			Late Adjustment
252960B	**Power Operated Eq - Rep (King)**	69,227.87	69,227.87			
DK10181	2006 Case Backhoe Unit # 00100			64,296.47	03/01/07	
DK10328	2008 Yale Forklift Model GLP06VX Unit # 00160			34,311.50	05/28/08	
252970A	**Comm Equip - New (King)**	97.65	97.65			Late Adjustment
253200B	**Mains-Repl-Prescott**	-1,327.84	-1,327.84			Late Adjustment
253203B	**Mains - Rep - Pres**	-10,683.18	-10,683.18			Late Adjustment
253376B	**Mains Volun Repl - Pres**	62,083.28	62,083.28			

Uns Project/Task #	Uns GI Project/Description	Balance	Non Revenue Producing	Cost to Date (5/6/09)	Date in Service or Est Date	Comments
DP10477	Orchard Ranch Encroachment			1,374.82	01/04/08	
DP10555	YMHE CV PVE Repl Supai			130,120.85	07/16/08	
253380B	**Services Repl - CIP - Prescott**	**0.54**	**0.54**			Late Adjustment
253380C	**Services Repl - CIP - PV**	**88,766.47**	**88,766.47**			
DP00088	Service Repl-CIP-Prescott			645,015.75	09/10/08	
DP00099	Service Repl-CIP-Prescott Valley			37,377.80	09/10/08	
253400S	**Mains-System Improv-Pres**	**265.21**	**265.21**			Late Adjustment
253500B	**Mains - CIP - Prescott**	**849,621.38**	**849,621.38**			NOT LISTED ON ORIGINAL NON-REVENUE LIST
DP10410	Copper Basin CIP Ph 2			750,827.84	12/15/08	
DP10420	Install & Remove mains outside new Hwy widenin Pavement Structure			708,708.90	09/10/08	
DP10489	Downer Trail CIP			94,681.03	03/03/08	
253501B	**Mains - CIP - Prescott Valley**	**-0.07**	**-0.07**			Late Adjustment
253910A	**Office Furn & Eq - New (Pres)**	**15,217.77**	**15,217.77**			
DP10460	5 Drawer Flat File			1,386.85	06/21/07	
DP10590	Map Drawer Cover			649.21	09/12/08	
DP10618	Office Name Plates			3,659.86	1212/08	
253922A	**Trans Eq < 1 Ton - New (Pres)**	**-13,609.79**	**-13,609.79**			Late Adjustment
253923A	**Trans Eq > 1 Ton - New (Pres)**	**760.00**	**760.00**			late adjustment
253940A	**Tools,Shop,Gar Eq - New (Pres)**	**1,998.13**	**1,998.13**			
DP10485	Tensile & Guide Bend Machine, Hydraulic Pump, Plug & Die Set			8,231.66	08/28/07	
DP10533	4" IPS Range Squeeze Tool			760.14	02/01/08	
253940B	**Tools, Shops & Gar Equip Repl Pres**	**-7.86**	**-7.86**			late adjustment
253950A	**Laboratory Equip - New (Pres)**	**-6.74**	**-6.74**			late adjustment
253960A	**Power Operated Eq - New (Pres)**	**122.75**	**122.75**			late adjustment
255200B	**Mains-Repl-Verde Valley**	**545.23**	**545.23**			late adjustment
255500B	**Mains - CIP - Verde**	**5,950.49**	**5,950.49**			NOT LISTED ON ORIGINAL NON-REVENUE LIST
DV10145	Morgan to the Y in Sedona			1,407,586.93	10/30/09	90% COMPLETE WAITING FOR ADOT ROW TO COMPLETE
255910A	**Office Furn & Eq - New (Verde)**	**2,174.27**	**2,174.27**			
DV10152	Advantage Shredder			1,288.00	02/29/08	
DV10165	5 Drawer Cabinet			897.49	02/14/08	
255912A	**Comp Equip - New (Verde)**	**7,626.60**	**7,626.60**			
DV10043	IT Equipment purchases - UNSG Verde Valley			22,708.69	03/15/07	
255922A	**Trans Eq < 1 Ton - New (Verde)**	**7.06**	**7.06**			late adjustment
255923B	**Trans Eq > 1 Ton - Rep (Verde)**	**2,817.25**	**2,817.25**			
255940A	**Tools,Shop,Gar Eq - New(Verde)**	**-276.68**	**-276.68**			late adjustment
255940B	**Tools, Shops & Gar Equip Repl Verde**	**-520.26**	**-520.26**			late adjustment
255950A	**Laboratory Equip - New (Verde)**	**-20.16**	**-20.16**			late adjustment
255970A	**Comm Equip - New (Verde)**	**5,802.40**	**5,802.40**			
DV10169	Kenwood portable radio			5,182.50	06/02/08	
256200A	**Services - Rep - Nog**	**162,003.88**	**162,003.88**			
DS10110	Repl Serviceline Martinez Subdivision			275,587.05	12/11/07	
256376B	**Mains Volun Repl - Nog**	**455,785.02**	**455,785.02**			
DS10074	Coronado Subdivision			415,824.14	11/16/07	
256922A	**Trans Eq < 1 Ton - New (Nog)**	**5,292.22**	**5,292.22**			
DS10012	CC591 Nogales Gas to purchase TEP Unit #5181, new unit #80034			9,473.24	04/02/08	
256922B	**Trans Eq < 1 Ton - Rep (Nog)**	**0.01**	**0.01**			late adjustment
257200B	**Mains-Repl-SL**	**660.08**	**660.08**			
DL10106	Hwy 87 Winslow			16,879.35	08/01/07	
257400S	**Mains-System Improv-Show Low**	**284,881.03**	**284,881.03**			
DL10162	E Adams 6in Stl Reinforcement			162,332.16	06/05/08	
DL10187	N 1st Av & W Adair Dr			37,304.44	07/09/07	
DL10202	4" PE N 24th Dr to N 16th Ave			164,411.28	05/29/08	
DL10215	Holbrook Reinforcement			81,512.80	01/22/08	
DL10234	Snowflake Taylor Loop			42,543.50	03/06/08	
257900A	**Structures & Improv-New SL**	**6,919.91**	**6,919.91**			
DL10119	Show Low Office Carpet			6,919.91	12/03/07	
257940A	**Tools,Shop,Gar Eq - New SL**	**242.62**	**242.62**			
DL10219	Hyd Shore			10,574.27	02/04/08	
DL10225	Metrotech 810 Line Tracer			2,558.73	03/01/08	
DL10228	Machine, Drilling T-101b			14,293.99	02/26/08	
257940B	**Tools,Shop,Gar Eq - Rep SL**	**196.84**	**196.84**			
DL10188	Air Drill			1,260.65	08/11/07	
257950A	**Laboratory Equip - New- SL**	**217.64**	**217.64**			
DL10241	Holiday Detector			3,578.00	04/22/08	
257970A	**Comm Equip- New SL**	**212.52**	**212.52**			late adjustment
		2,439,805.61	2,439,805.61	6,694,219.37		

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 18, 2009

Filed: August 25, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI

(Pages 809 through 929, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

ACC

A. That is 1,504.

Q. And then finally it talks about the total number of disconnects for nonpayment orders in 2008 were 4.1 percent for CARES customers.

What is the new number on that, Mr. Dukes?

A. 5.7 percent.

Q. Okay. With those changes, that is the company's Exhibit UNSG-27 regarding the CARES disconnections for those two calendar years; is that correct?

A. Yes, sir.

MR. DION: Your Honor, at this point I would just ask to move the admission of UNSG-27 as amended.

ACALJ NODES: Why don't we just take all of these up at once at the end.

MR. DION: That's fine. That's fine.

Q. BY MR. DION: Why don't I move then to what has been marked as UNSG-42.

Do you have a copy of that in front of you, Mr. Dukes?

A. Yes, I do.

Q. And can you tell me what that particular exhibit is?

A. It's a response to RUCO data request 1.88. Actually it's a supplemental response that included, and in this particular exhibit, it has a printout of the Excel

Q. And that is the foreclosure rate as provided by RUCO through RealtyTrac; is that correct?

A. Yes.

Q. And the company doesn't have any objection to that; is that correct?

A. No.

MR. DION: Your Honor, I don't have any more questions for Mr. Dukes.

ACALJ NODES: All right. Mr. Pozefsky, any questions?

MR. POZEFSKY: Yeah, just briefly.

CROSS-EXAMINATION

BY MR. POZEFSKY:

Q. On one of these exhibits, Mr. Dukes -- I think it's UNSG-42, the response to RUCO data request 1.88.

A. Yes.

Q. Do you have that there?

A. I do.

Q. I just want to be clear on something.

If you look at that Excel spreadsheet, it looks like you have entities for both nonrevenue-producing and, I'm assuming, revenue-producing, but that is not what I want to ask you about.

Highlighted entities under nonrevenue producing, are those the projects that you are requesting recovery of; that is how this works?

A. Highlighted? The highlighted areas on there -- and it's tough to tell in this black-and-white copy -- if you look to the far-left column where it says "comments," those were not listed on the original nonrevenue list, and those are not being requested in rate base.

Q. Okay. Well, let me ask you -- we will cut to the chase -- if you get down to the balance on the second page, there is a $2.4 million balance.

Is that the balance that you are requesting recovery on on these post-test year additions?

A. No, it's 1.5. When this was put together -- primarily these are blanket work orders, so some of the things included in these blanket work orders were excluded from our original request of 1.5 million. Those that are highlighted say "not listed on original"; if you subtract those, it will -- that 2.4 is 1.5 million.

I just -- I didn't alter it since it was already provided as a RUCO data request.

Q. So really as I look at this there is only one item that doesn't look like it's 100 percent complete. It's on that third page. The description is "Morgan to the Y in Sedona."

A. Correct, and that was not included in the original request.

Q. Okay. That is what I wanted to get at. Okay. Thank you, sir. That is all I have.

ACALJ NODES: Ms. Mitchell, any questions?

MS. MITCHELL: Thank you.

CROSS-EXAMINATION

BY MS. MITCHELL:

Q. If you could look at UNSG-44. It's the CARES customer analysis.

A. I have it, ma'am.

Q. At the bottom it discusses the rate impact?

A. Yes.

Q. And the first sentence says, "The rate impact on non-CARES customers of current CARES programs and participation rate is approximately $4 per customer annually."

The $4 per customer, is that just a $4 impact on a residential customer or is that spread out across all rate classes?

A. For this purpose that was just $4 on an average residential customer.

The actual dollar impact was approximately less

9

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Plant would never be included in rate base, which is simply inconsistent with prior Commission decisions. Staff and RUCO provide no data or analysis to support their speculative allegations of reduced expenses.

Q. How did UNS Gas determine which plant was revenue-neutral?

A. The Plant accounting group and operational personnel of UNS Gas reviewed the projects and indentified investments that had been made in projects that would not produce additional revenue and that would have been invested in regardless of customer growth.

Q. What plant is included in the Company's proposed Post Test Year Plant?

A. For example, we included communication equipment, vehicles, tools, power equipment and natural gas detector equipment, which are all necessary to serve the existing customer base. We also include service and main replacements to ensure safe and reliable service to our existing customers.

Q. When did the Company make the investments in these projects?

A. The Company completed its investments in these projects before the end of the test year. The projects were simply not in service by the end of the test year – but they are, or will be, in service when rates resulting from this proceeding become effective.

B. Customer Advances.

Q. What is the basis for Dr. Fish and Mr. Smith's removal of the Company's Customer Advances adjustment?

A. Their primary arguments for exclusion of the Company's adjustment is that Customer Advances are non-investor supplied capital and that is the required treatment based on the sample schedule B-1, Commission rule A.A.C R 14-2-103.

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 18, 2009

Filed: August 25, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI

(Pages 809 through 929, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

ACC

Highlighted entities under nonrevenue producing, are those the projects that you are requesting recovery of; that is how this works?

A. Highlighted? The highlighted areas on there -- and it's tough to tell in this black-and-white copy -- if you look to the far-left column where it says "comments," those were not listed on the original nonrevenue list, and those are not being requested in rate base.

Q. Okay. Well, let me ask you -- we will cut to the chase -- if you get down to the balance on the second page, there is a $2.4 million balance.

Is that the balance that you are requesting recovery on on these post-test year additions?

A. No, it's 1.5. When this was put together -- primarily these are blanket work orders, so some of the things included in these blanket work orders were excluded from our original request of 1.5 million. Those that are highlighted say "not listed on original"; if you subtract those, it will -- that 2.4 is 1.5 million.

I just -- I didn't alter it since it was already provided as a RUCO data request.

Q. So really as I look at this there is only one item that doesn't look like it's 100 percent complete. It's on that third page. The description is "Morgan to the Y in Sedona."

A. Correct, and that was not included in the original request.

Q. Okay. That is what I wanted to get at. Okay. Thank you, sir. That is all I have.

ACALJ NODES: Ms. Mitchell, any questions?

MS. MITCHELL: Thank you.

CROSS-EXAMINATION

BY MS. MITCHELL:

Q. If you could look at UNSG-44. It's the CARES customer analysis.

A. I have it, ma'am.

Q. At the bottom it discusses the rate impact?

A. Yes.

Q. And the first sentence says, "The rate impact on non-CARES customers of current CARES programs and participation rate is approximately $4 per customer annually."

The $4 per customer, is that just a $4 impact on a residential customer or is that spread out across all rate classes?

A. For this purpose that was just $4 on an average residential customer.

The actual dollar impact was approximately less

10

DATA REQUEST PACKET

Staff's Responses to UNS Gas' Data Requests:

UNSG 2.1	UNSG 3.10	UNSG 3.22
UNSG 2.2	UNSG 3.11	UNSG 3.39
UNSG 2.4	UNSG 3.12	UNSG 3.40
UNSG 3.4	UNSG 3.13	UNSG 3.41
UNSG 3.5	UNSG 3.14	UNSG 3.57
UNSG 3.6	UNSG 3.15	UNSG 3.58
UNSG 3.7	UNSG 3.20	UNSG 3.60
UNSG 3.9	UNSG 3.21	UNSG 3.65

UNSG-24

UNSG 3.9 Arizona Administrative Code R14-2-103.A.3.1 defines "prudently invested" as "Investments which under ordinary circumstances would be deemed reasonable and not dishonest or obviously wasteful. All investments shall be presumed to have been prudently made, and such presumptions may be set aside only by clear and convincing evidence that such investments were imprudent, when viewed in the light of all relevant conditions known or which in the exercise of reasonable judgment should have been known, at the time such investments were made." Under this standard, does Staff believe that the projects included within UNS Gas' requested Post Test Year Non-Revenue Producing Plant are prudently invested? If the answer is no, please specify each project that is not prudently invested and explain why.

RESPONSE: Dr. Fish has not concluded that the requested Post Test Year Non-Revenue Producing Plant are not prudently invested. Also see response to UNSG 3.23.

RESPONDENT: DR. THOMAS FISH

WITNESS: DR. THOMAS FISH

DATA REQUEST PACKET

RUCO's Responses to UNS Gas' Data Requests:

UNSG 2.25
UNSG 2.48
UNSG 2.55
UNSG 3.2
UNSG 3.13
UNSG 3.16
UNSG 3.18
UNSG 3.20
UNSG 3.21
UNSG 3.22
UNSG 3.31
UNSG 3.34
UNSG 3.35
UNSG 3.36

THIRD SET OF DATA REQUESTS
FROM UNS GAS, INC.
TO RESIDENTIAL UTILITY CONSUMER OFFICE
(DOCKET NO. G-04204A-08-0571)

UNSG 3.2 Arizona Administrative Code R14-2-103.A.3.l defines "prudently invested" as "Investments which under ordinary circumstances would be deemed reasonable and not dishonest or obviously wasteful. All investments shall be presumed to have been prudently made, and such presumptions may be set aside only by clear and convincing evidence that such investments were imprudent, when viewed in the light of all relevant conditions known or which in the exercise of reasonable judgment should have been known, at the time such investments were made." Under this standard, does RUCO believe that the projects included within UNS Gas' requested Post Test Year Non-Revenue Producing Plant are prudently invested? If the answer is no, please specify each project that is not prudently invested and explain why.

RESPONSE:

RUCO has not conducted a prudence evaluation of UNSG's post test year plant in the current UNSG rate case and thus cannot opinion as to whether UNSG's request would pass muster under a prudence investigation. RUCO is not aware of any facts in the current UNSG rate case that would demonstrate that the post test year plant was imprudent, and RUCO witness Smith has recommended the removal of UNSG's request for post test year plant not on grounds that it was imprudent but rather for the reasons described in his testimony. For a number of reasons, including the following, RUCO does not support UNS Gas' request for rate base inclusion of CWIP/post test year plant in the current case:

1) Inclusion of CWIP/post test year plant in rate base is an exception to the Commission's normal practice, and UNS Gas has not made a convincing showing of why it requires such an exceptional ratemaking treatment.

UNSG 3.2 **(Continued)**

2) The CWIP/post test year plant was not in service at the end of the test year. As of June 30, 2008, the construction projects were not serving customers.

3) The Company has not demonstrated that its June 30, 2008 CWIP balance was for non-revenue producing and non-expense reducing plant. Much of the construction appears to be for mains and services and transportation equipment which can be related to serving customer growth, and/or can reduce expenses for maintenance.

4) Revenues have not been extended beyond the test year to correspond with customer growth. Hence, including the investment in rate base, without recognizing the continued customer growth that it supports, would be imbalanced. Similarly, expenses have not been reduced for reduced maintenance that could result after the test year from the new or replacement plant that was placed into service after the end of the test year; consequently, it would be imbalanced to include the plant but no expense reductions.

RESPONDENT: Ralph C. Smith

WITNESS: Ralph C. Smith

11

DATA REQUEST PACKET

Staff's Responses to UNS Gas' Data Requests:

UNSG 2.1	UNSG 3.10	UNSG 3.22
UNSG 2.2	UNSG 3.11	UNSG 3.39
UNSG 2.4	UNSG 3.12	UNSG 3.40
UNSG 3.4	UNSG 3.13	UNSG 3.41
UNSG 3.5	UNSG 3.14	UNSG 3.57
UNSG 3.6	UNSG 3.15	UNSG 3.58
UNSG 3.7	UNSG 3.20	UNSG 3.60
UNSG 3.9	UNSG 3.21	UNSG 3.65

UNSG-24

UNSG 3.7 Refer to the Direct Testimony of Thomas H. Fish, Ph.D., page 16, lines 3-5, where Dr. Fish states "Presumably, the investment was made in order to increase the Company's efficiency/productivity and hence reduce the costs of providing service such as maintenance cost."

a. Please provide the basis and supporting information for this statement.

b. Did Dr. Fish review the purposes of the specific items of plant included within UNS Gas' request for Post Test Year Non-Revenue Producing Plant?

c. Does Dr. Fish contend that the only reason a utility would invest in Non-Revenue Producing Plant is to increase efficiency/productivity?

d. Does Dr. Fish acknowledge that a utility might invest in Non-Revenue Producing Plant in order to maintain or improve quality of service?

e. Does Dr. Fish acknowledge that a utility might invest in Non-Revenue Producing Plant in order to meet regulatory requirements?

f. Does Dr. Fish acknowledge that a utility might invest in Non-Revenue Producing Plant in order to maintain or improve safety?

g. Please provide Dr. Fish's calculations of the estimated reduced costs of providing service in connection with the Post Test Year Non-Revenue Producing Plant.

h. Is Dr. Fish's statement regarding "reduc[ed]... costs of providing service" net of incremental depreciation expense associated with the Non-Revenue Producing Plant? If the answer is yes, please explain why Dr. Fish believes the efficiency gains exceed the incremental depreciation expense.

i. Does Dr. Fish dispute that the Post Test Year Plant requested to be included in rate base was Non-Revenue Producing? If so, please set forth each and every basis for that position and include all workpapers that provide support for Staff's belief.

j. Does Dr. Fish dispute that the Post Test Year Plant requested to be included in rate base was not related to customer growth? If so, please set forth each and every basis for that position and include all workpapers that provide support for Staff's belief.

RESPONSE:

a. See the Company work papers accompanying this Company proposed pro forma adjustment.

b. The Company work papers listed and identified the expenditures but did not provide detail as to the purposes of the investment or the specific date the investment was undertaken. Also see response to UNSG 3.23 for additional information concerning this issue.

c. Objection, this data request mischaracterizes Dr. Fish's testimony. Without waiving the objection, the following response is provided: No. Dr. Fish considers the general terms efficiency/productivity to encompass such requirements as safety, quality of service, and regulatory requirements.

d. Dr. Fish acknowledges that a utility might do so.

e. Dr. Fish acknowledges that a utility might do so.

f. Dr. Fish acknowledges that a utility might do so.

g. Dr. Fish has not performed such calculations; the Company did not provide this information.

h. Objection, vague and ambiguous. This question is unclear. Without waiving the objection, the following response is provided: Dr. Fish hopes that the Company would attempt to increase its efficiency and reduce its costs. Dr. Fish has not investigated the Company's productivity and the Company refused to provide requested depreciation information. See response to UNSG 3.23, UNSG 3.7.a and UNSG 3.7.b.

i. Objection, this data request mischaracterizes Dr. Fish's testimony. The Company did not provide information that would allow this determination to be made in its work papers associated with this pro forma adjustment. In addition, the Company did not answer data requests that would have provided a basis for analysis of this issue. See response to UNSG 3.23 and UNSG 3.7.h.

j. **No. Dr. Fish relied on the Company's growth estimate of 2.5% per year.**

RESPONDENT: **DR. THOMAS FISH**

WITNESS: **DR. THOMAS FISH**

12

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

maintenance cost, if that is why you are replacing it, because of a maintenance problem.

Q. If it was to avoid a potential leak situation, would it reduce maintenance expense?

A. Sure. You are reducing anticipated maintenance expense.

Q. And for a gas system, isn't it important to try to keep your plant to the point where it's not leaking?

A. It doesn't look good when you blow up your customers. It's not a good thing to do. You don't do that. Safety is a very good thing to invest in.

Q. And you don't believe that the company should reduce its leak monitoring practices simply because it put in some new pipeline?

A. Oh, no. As a matter of fact, I think the company -- based on testimony I heard this morning, I think the company ought to be proud of its history in terms of its safety, according to Mr. Hanson's testimony.

Q. Do you dispute -- let me ask you this: Are you disputing that the company's post-test nonrevenue plant could improve system reliability?

A. That it could, no.

MS. MITCHELL: I need to lodge an objection. I don't know if we have all agreed that your post-test plant is nonrevenue producing. I just thought that was what the

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 18, 2009

Filed: August 25, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI

(Pages 809 through 929, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

ACC

Q. Yes. Would it be your position that the company should reduce leak monitoring inspections simply because it has replaced a section of pipeline?
A. I didn't get the word before monitoring.
Q. Leak, l-e-a-k.
A. Oh, I don't think so, but replacing pipe in and of itself would tend to solve some leak issues.
Q. Do you dispute that the company's requested post-test year plant could have improved system reliability?
A. In a general sense I don't dispute that.
Q. All right. And do you disagree that the post-test plant improvements could also improve service to existing customers?
A. They could improve service to existing customers, and they could also support providing service to new customers.
Q. With respect to pipeline replacement, if it was intended to reduce leaks, isn't it fair to say that reduced leaks reduce gas loss?
A. I would hope so.
Q. And that reduced gas loss would translate to a lower PGA rate eventually, wouldn't it?
A. It could.
Q. And that lower rate is passed on directly to

13

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

maintenance cost, if that is why you are replacing it, because of a maintenance problem.

Q. If it was to avoid a potential leak situation, would it reduce maintenance expense?

A. Sure. You are reducing anticipated maintenance expense.

Q. And for a gas system, isn't it important to try to keep your plant to the point where it's not leaking?

A. It doesn't look good when you blow up your customers. It's not a good thing to do. You don't do that. Safety is a very good thing to invest in.

Q. And you don't believe that the company should reduce its leak monitoring practices simply because it put in some new pipeline?

A. Oh, no. As a matter of fact, I think the company -- based on testimony I heard this morning, I think the company ought to be proud of its history in terms of its safety, according to Mr. Hanson's testimony.

Q. Do you dispute -- let me ask you this: Are you disputing that the company's post-test nonrevenue plant could improve system reliability?

A. That it could, no.

MS. MITCHELL: I need to lodge an objection. I don't know if we have all agreed that your post-test plant is nonrevenue producing. I just thought that was what the

14

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

maintenance cost, if that is why you are replacing it, because of a maintenance problem.

Q. If it was to avoid a potential leak situation, would it reduce maintenance expense?

A. Sure. You are reducing anticipated maintenance expense.

Q. And for a gas system, isn't it important to try to keep your plant to the point where it's not leaking?

A. It doesn't look good when you blow up your customers. It's not a good thing to do. You don't do that. Safety is a very good thing to invest in.

Q. And you don't believe that the company should reduce its leak monitoring practices simply because it put in some new pipeline?

A. Oh, no. As a matter of fact, I think the company -- based on testimony I heard this morning, I think the company ought to be proud of its history in terms of its safety, according to Mr. Hanson's testimony.

Q. Do you dispute -- let me ask you this: Are you disputing that the company's post-test nonrevenue plant could improve system reliability?

A. That it could, no.

MS. MITCHELL: I need to lodge an objection. I don't know if we have all agreed that your post-test plant is nonrevenue producing. I just thought that was what the

company had alleged, but I think that is an issue that may be in dispute.

You said, do you agree that the company's test-year is nonrevenue producing. I don't think that it's been proved that it's nonrevenue producing.

ACALJ NODES: Do you want to rephrase?

Q. BY MR. PATTEN: I will just ask this: Is the post-test plant that the company is requesting be included in rate base something that can improve system reliability?

A. The company -- I would suspect that the company is not going to make ample investment unless they determine that it's necessary for safety or for system reliability or for system enhancement or for growth.

If you look at the company's response to, I believe it's ST3-1, that identifies the reasons for those capital investments, the confidential, and the majority of those are for growth but there is also system enhancement and capital improvement.

So I don't argue with that at all.

Q. And with respect to the post test-year plant that the company is seeking to include in rate base, would you agree that it also would improve service to existing customers?

A. Would I argue that it would improve?

Q. Yes.

A. I couldn't argue that based on my analysis because I didn't look into that. But I also could not argue that it would not.

Q. Fair enough.

Let me ask you about customer advances, and if you could turn to page 17 and 18 of your direct testimony.

A. Okay.

Q. You there?

A. I am.

Q. All right. Now, you oppose UNS Gas' customer advances adjustment; correct?

A. That's right.

Q. And you understand that those advances are related to plant that is not in rate base; correct?

A. That's right.

Q. All right. Let me ask you a somewhat hypothetical question here.

Let's suppose the utility has a rate base of $100. All right?

A. All right.

Q. If the utility receives an advance and uses the advance to pay for plant but that plant is not in service, the utility's rate base is still -- it's not less than $100, is it?

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 18, 2009

Filed: August 25, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI

(Pages 809 through 929, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

ACC

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

Q. Yes. Would it be your position that the company should reduce leak monitoring inspections simply because it has replaced a section of pipeline?

A. I didn't get the word before monitoring.

Q. Leak, l-e-a-k.

A. Oh, I don't think so, but replacing pipe in and of itself would tend to solve some leak issues.

Q. Do you dispute that the company's requested post-test year plant could have improved system reliability?

A. In a general sense I don't dispute that.

Q. All right. And do you disagree that the post-test plant improvements could also improve service to existing customers?

A. They could improve service to existing customers, and they could also support providing service to new customers.

Q. With respect to pipeline replacement, if it was intended to reduce leaks, isn't it fair to say that reduced leaks reduce gas loss?

A. I would hope so.

Q. And that reduced gas loss would translate to a lower PGA rate eventually, wouldn't it?

A. It could.

Q. And that lower rate is passed on directly to

15

DATA REQUEST PACKET

Staff's Responses to UNS Gas' Data Requests:

UNSG 2.1	UNSG 3.10	UNSG 3.22
UNSG 2.2	UNSG 3.11	UNSG 3.39
UNSG 2.4	UNSG 3.12	UNSG 3.40
UNSG 3.4	UNSG 3.13	UNSG 3.41
UNSG 3.5	UNSG 3.14	UNSG 3.57
UNSG 3.6	UNSG 3.15	UNSG 3.58
UNSG 3.7	UNSG 3.20	UNSG 3.60
UNSG 3.9	UNSG 3.21	UNSG 3.65

UNSG-24

ARIZONA CORPORATION COMMISSION
DOCKET NO. G-04204A-08-0571
STAFF'S RESPONSE TO UNS GAS, INC.'S
THIRD SET OF DATA REQUESTS
July 7, 2009

UNSG 3.7 Refer to the Direct Testimony of Thomas H. Fish, Ph.D., page 16, lines 3-5, where Dr. Fish states "Presumably, the investment was made in order to increase the Company's efficiency/productivity and hence reduce the costs of providing service such as maintenance cost."

a. Please provide the basis and supporting information for this statement.

b. Did Dr. Fish review the purposes of the specific items of plant included within UNS Gas' request for Post Test Year Non-Revenue Producing Plant?

c. Does Dr. Fish contend that the only reason a utility would invest in Non-Revenue Producing Plant is to increase efficiency/productivity?

d. Does Dr. Fish acknowledge that a utility might invest in Non-Revenue Producing Plant in order to maintain or improve quality of service?

e. Does Dr. Fish acknowledge that a utility might invest in Non-Revenue Producing Plant in order to meet regulatory requirements?

f. Does Dr. Fish acknowledge that a utility might invest in Non-Revenue Producing Plant in order to maintain or improve safety?

g. Please provide Dr. Fish's calculations of the estimated reduced costs of providing service in connection with the Post Test Year Non-Revenue Producing Plant.

h. Is Dr. Fish's statement regarding "reduc[ed]... costs of providing service" net of incremental depreciation expense associated with the Non-Revenue Producing Plant? If the answer is yes, please explain why Dr. Fish believes the efficiency gains exceed the incremental depreciation expense.

i. Does Dr. Fish dispute that the Post Test Year Plant requested to be included in rate base was Non-Revenue Producing? If so, please set forth each and every basis for that position and include all workpapers that provide support for Staff's belief.

j. Does Dr. Fish dispute that the Post Test Year Plant requested to be included in rate base was not related to customer growth? If so, please set forth each and every basis for that position and include all workpapers that provide support for Staff's belief.

RESPONSE:

a. **See the Company work papers accompanying this Company proposed pro forma adjustment.**

b. **The Company work papers listed and identified the expenditures but did not provide detail as to the purposes of the investment or the specific date the investment was undertaken. Also see response to UNSG 3.23 for additional information concerning this issue.**

c. **Objection, this data request mischaracterizes Dr. Fish's testimony. Without waiving the objection, the following response is provided: No. Dr. Fish considers the general terms efficiency/productivity to encompass such requirements as safety, quality of service, and regulatory requirements.**

d. **Dr. Fish acknowledges that a utility might do so.**

e. **Dr. Fish acknowledges that a utility might do so.**

f. **Dr. Fish acknowledges that a utility might do so.**

g. **Dr. Fish has not performed such calculations; the Company did not provide this information.**

h. **Objection, vague and ambiguous. This question is unclear. Without waiving the objection, the following response is provided: Dr. Fish hopes that the Company would attempt to increase its efficiency and reduce its costs. Dr. Fish has not investigated the Company's productivity and the Company refused to provide requested depreciation information. See response to UNSG 3.23, UNSG 3.7.a and UNSG 3.7.b.**

i. **Objection, this data request mischaracterizes Dr. Fish's testimony. The Company did not provide information that would allow this determination to be made in its work papers associated with this pro forma adjustment. In addition, the Company did not answer data requests that would have provided a basis for analysis of this issue. See response to UNSG 3.23 and UNSG 3.7.h.**

j. **No. Dr. Fish relied on the Company's growth estimate of 2.5% per year.**

RESPONDENT: **DR. THOMAS FISH**

WITNESS: **DR. THOMAS FISH**

16

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

maintenance cost, if that is why you are replacing it, because of a maintenance problem.

Q. If it was to avoid a potential leak situation, would it reduce maintenance expense?

A. Sure. You are reducing anticipated maintenance expense.

Q. And for a gas system, isn't it important to try to keep your plant to the point where it's not leaking?

A. It doesn't look good when you blow up your customers. It's not a good thing to do. You don't do that. Safety is a very good thing to invest in.

Q. And you don't believe that the company should reduce its leak monitoring practices simply because it put in some new pipeline?

A. Oh, no. As a matter of fact, I think the company -- based on testimony I heard this morning, I think the company ought to be proud of its history in terms of its safety, according to Mr. Hanson's testimony.

Q. Do you dispute -- let me ask you this: Are you disputing that the company's post-test nonrevenue plant could improve system reliability?

A. That it could, no.

MS. MITCHELL: I need to lodge an objection. I don't know if we have all agreed that your post-test plant is nonrevenue producing. I just thought that was what the

17

DATA REQUEST PACKET

Staff's Responses to UNS Gas' Data Requests:

UNSG 2.1	UNSG 3.10	UNSG 3.22
UNSG 2.2	UNSG 3.11	UNSG 3.39
UNSG 2.4	UNSG 3.12	UNSG 3.40
UNSG 3.4	UNSG 3.13	UNSG 3.41
UNSG 3.5	UNSG 3.14	UNSG 3.57
UNSG 3.6	UNSG 3.15	UNSG 3.58
UNSG 3.7	UNSG 3.20	UNSG 3.60
UNSG 3.9	UNSG 3.21	UNSG 3.65

UNSG-24

UNSG 3.10 Prior to the filing of the Direct Testimony of Thomas H. Fish, Ph.D., did Dr. Fish review the following Commission decisions regarding Post-Test Year Plant?

a. Rio Rico Utilities, Inc, Decision No. 67279 (October 5, 2004);
b. Arizona Water Company, Decision No. 66849 (March 19, 2004);
c. Bella Vista Water Company, Inc., Decision No. 65350 (November 1, 2002);
d. Arizona-American Water Company, Decision No. 68864 (July 28, 2006); and
e. Chaparral City Water Company, Decision No. 68176 (Sept. 30, 2005).

RESPONSE: **Objection, this data request is not relevant. Staff would also note that each Commission decision is based on the facts unique to that underlying docket. Each ACC decision stands on its own merits and no ACC decision creates a precedent.**

Supplemental Response: Without waiving the objection, the following response is being provided: Dr. Fish did not review these decisions.

RESPONDENT: ROBIN MITCHELL,

WITNESS: DR. THOMAS FISH

18

DATA REQUEST PACKET

Staff's Responses to UNS Gas' Data Requests:

UNSG 2.1	UNSG 3.10	UNSG 3.22
UNSG 2.2	UNSG 3.11	UNSG 3.39
UNSG 2.4	UNSG 3.12	UNSG 3.40
UNSG 3.4	UNSG 3.13	UNSG 3.41
UNSG 3.5	UNSG 3.14	UNSG 3.57
UNSG 3.6	UNSG 3.15	UNSG 3.58
UNSG 3.7	UNSG 3.20	UNSG 3.60
UNSG 3.9	UNSG 3.21	UNSG 3.65

UNSG-24

ARIZONA CORPORATION COMMISSION
DOCKET NO. G-04204A-08-0571
STAFF'S RESPONSE TO UNS GAS, INC.'S
THIRD SET OF DATA REQUESTS
August 6, 2009

UNSG 3.11 In Rio Rico Utilities, Inc Decision No. 67279 (October 5, 2004), the Commission included non-revenue producing Post Test Year Plant in rate base. Please explain how UNS Gas' request for Post Test Year Non-Revenue Producing Plant materially differs from the post test year plant approved in Decision No. 67279.

RESPONSE: Objection, this data request is not relevant. Staff would also note that each Commission decision is based on the facts unique to that underlying docket. Each ACC decision stands on its own merits and no ACC decision creates a precedent. **Supplemental Response: Without waiving the objection, the following response is being provided: See response to 3.10**

RESPONDENT: **ROBIN MITCHELL,**

WITNESS: **DR. THOMAS FISH**

UNSG 3.12 In Arizona Water Company Decision No. 66849 (March 19, 2004), the Commission included non-revenue producing Post Test Year Plant in rate base. Please explain how UNS Gas' request for Post Test Year Non-Revenue Producing Plant materially differs from the post test year plant approved in Decision No. 66849.

RESPONSE: Objection, this data request is not relevant. Staff would also note that each Commission decision is based on the facts unique to that underlying docket. Each ACC decision stands on its own merits and no ACC decision creates a precedent. **Supplemental Response: Without waiving the objection, the following response is being provided: See response to 3.10**

RESPONDENT: ROBIN MITCHELL,

WITNESS: DR. THOMAS FISH

UNSG 3.13 In Bella Vista Water Company, Inc. Decision No. 65350 (November 1, 2002), the Commission included non-revenue producing Post Test Year Plant in rate base. Please explain how UNS Gas' request for Post Test Year Non-Revenue Producing Plant materially differs from the post test year plant approved in Decision No. 65350.

RESPONSE: Objection, this data request is not relevant. Staff would also note that each Commission decision is based on the facts unique to that underlying docket. Each ACC decision stands on its own merits and no ACC decision creates a precedent. **Supplemental Response: Without waiving the objection, the following response is being provided: See response to 3.10.**

RESPONDENT: ROBIN MITCHELL, DR. THOMAS FISH

WITNESS: DR. THOMAS FISH

UNSG 3.14 In Arizona-American Water Company Decision No. 68864 (July 28, 2006), the Commission included non-revenue producing Post Test Year Plant in rate base. Please explain how UNS Gas' request for Post Test Year Non-Revenue Producing Plant materially differs from the post test year plant approved in Decision No. 68864.

RESPONSE: Objection, this data request is not relevant. Staff would also note that each Commission decision is based on the facts unique to that underlying docket. Each ACC decision stands on its own merits and no ACC decision creates a precedent. **Supplemental Response: Without waiving the objection, the following response is being provided: See response to 3.10.**

RESPONDENT: **ROBIN MITCHELL, DR. THOMAS FISH**

WITNESS: **DR. THOMAS FISH**

UNSG 3.15 In Chaparral City Water Company Decision No. 68176 (Sept. 30, 2005), the Commission included non-revenue producing Post Test Year Plant in rate base. Please explain how UNS Gas' request for Post Test Year Non-Revenue Producing Plant materially differs from the post test year plant approved in Decision No. 68176.

RESPONSE: Objection, this data request is not relevant. Staff would also note that each Commission decision is based on the facts unique to that underlying docket. Each ACC decision stands on its own merits and no ACC decision creates a precedent. **Supplemental Response: Without waiving the objection, the following response is being provided: See response to 3.10.**

RESPONDENT: **ROBIN MITCHELL**

WITNESS: **DR. THOMAS FISH**

19

Doc

BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED

NOV 01 2002

DOCKETED BY

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF BELLA VISTA WATER CO., INC. AN ARIZONA CORPORATION TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATE MAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES AND TARIFFS DESIGNED TO DEVELOP SUCH RETURN.

DOCKET NO. W-02465A-01-0776

DECISION NO. 65350

OPINION AND ORDER

DATE OF HEARING:	July 25 and 26, 2002 August 16, 2002
PLACE OF HEARING:	Tucson, Arizona
ADMINISTRATIVE LAW JUDGE:	Jane L. Rodda
APPEARANCES:	Mr. William Sullivan, MARTINEZ & CURTIS, P.C., on behalf of Bella Vista Water Company, Inc.; Mr. Daniel W. Pozefsky, Staff Attorney, on Behalf of the Residential Utility Consumer Office; Mr. Jason Gellman, Staff Attorney, Legal Divison, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

Procedural Background

Bella Vista Water Company, Inc. ("Bella Vista" or "Company") provides water utility services to approximately 6,659 residential and commercial customers in and around the City of Sierra Vista, in Cochise County, Arizona. Bella Vista filed an application to increase its rates with the Arizona Corporation Commission ("Commission") on September 28, 2001. The Company filed an amendment to its application on October 16, 2001. The Company used a test year of December 31, 2000. The Commission authorized Bella Vista's current rates in Decision No. 61730 (June 4.

S-3

available prior to filing. Staff states that while pro forma adjustments are allowed, when appropriate, the starting point for determining rate base, revenues and expenses is the test year that the Company chooses when it files its case. Staff states that pro forma adjustments are defined in A.A.C. R14-2-103(A)(3)(i) as "adjustments to actual test year results and balances to obtain a more normal relationship between revenues, expenses and rate base." A.A.C. R14-2-103(A)(3)(h) defines Original Cost Rate Base as the "depreciated original cost, prudently invested, of the property (exclusive of contributions and/or advances in aid of construction) at the end of the test year, used or useful, plus a proper allowance for working capital and including all applicable pro forma adjustments." Staff defines the issue in this case as whether the pro forma adjustments to rate base also includes known and measurable changes to revenues and expenses. In this case, Staff argues, the Company has failed to quantify the effects of post-test year plant on revenues and expenses and failed to apply the matching principle.

Staff testified that it is incorrect to assume that because plant additions do not provide service to new customers, the impact is revenue neutral. Staff stated that new plant may improve system reliability resulting in lower expenses and increased revenues. Further, Staff argues no extraordinary circumstances justify including the plant into rate base.

Staff argues it is the Company's burden to show that the post-test year plant will not add to revenues, not Staff's burden to show it would not. Staff believes the Company could not substantiate its claim the additions are revenue neutral because it is impossible to quantify the impacts this post-test year plant will have on revenues and expenses. Staff states that the Company's argument that the need for the plant to ameliorate vulnerability to drought conditions and the fact that curtailment on the Rail Oaks system was less severe in 2002 than in 2000 can have an impact on revenues. Further, Staff argues, the new plant could make the system more reliable and thus more attractive to growth which could impact revenue.

Staff argues that because the majority of plant was not in service until the latter half of 2001, there is no way to quantify the impacts on revenues or operating expense. Staff argues that because the Company could not quantify the impacts of the new plant on revenues and expense, and because the impacts are not known and measurable, it is improper to include the post-test year plant. Staff

20

Doc

BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED

NOV 0 1 2002

DOCKETED BY

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF BELLA VISTA WATER CO., INC. AN ARIZONA CORPORATION TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATE MAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES AND TARIFFS DESIGNED TO DEVELOP SUCH RETURN.

DOCKET NO. W-02465A-01-0776

DECISION NO. 65350

OPINION AND ORDER

DATE OF HEARING:	July 25 and 26, 2002 August 16, 2002
PLACE OF HEARING:	Tucson, Arizona
ADMINISTRATIVE LAW JUDGE:	Jane L. Rodda
APPEARANCES:	Mr. William Sullivan, MARTINEZ & CURTIS, P.C., on behalf of Bella Vista Water Company, Inc.; Mr. Daniel W. Pozefsky, Staff Attorney, on Behalf of the Residential Utility Consumer Office; Mr. Jason Gellman, Staff Attorney, Legal Divison, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

Procedural Background

Bella Vista Water Company, Inc. ("Bella Vista" or "Company") provides water utility services to approximately 6,659 residential and commercial customers in and around the City of Sierra Vista, in Cochise County, Arizona. Bella Vista filed an application to increase its rates with the Arizona Corporation Commission ("Commission") on September 28, 2001. The Company filed an amendment to its application on October 16, 2001. The Company used a test year of December 31, 2000. The Commission authorized Bella Vista's current rates in Decision No. 61730 (June 4,

S-3

argues that the Far West Water & Sewer Rate case, the Paradise Valley Water Company rate case and the Gold Canyon Sewer rate case, relied on by the Company as support for including post-test year plant, are distinguishable from the current case. Staff argues under Arizona case law, the Commission has discretion to consider pro forma adjustments and it may include those adjustments into rate base, but there is no requirement that it must include post-test year plant. See Consol. Water Util., Ltd v. Arizona Corp. Comm'n, 178 Ariz. 478, 483-84, 875 P.2d 137, 142-43 (App. 1994) and Litchfield Park Serv. Co. v. Arizona Corp. Comm'n, 178 Ariz. 431, 437-38, 874 P.2d 988, 994-95 (App. 1994).

Resolution

Court decisions have confirmed the Commission has broad authority to determine fair value. While this Commission utilizes the historic test year as a starting point, the rules permit, and in the past we have allowed, pro forma adjustments in order to more accurately reflect reality during the period the rates will be in effect. In Decision No. 62993 (November 3, 2000), in which the Commission considers its Water Task Force's Report, the Commission approved Staff's request to order Staff to develop a policy with specific requirements for expense changes, revenue changes, and plant additions that occur after the test year. At that time, in connection with its recommendations concerning a future test year, Staff stated:

> Staff believes there is no need to change the present method used by the Commission. At present, the Commission employs an historic test year but does allow for pro forma additions for known and measurable costs. It is Staff's opinion that this is a very good combination of both historic and future test years. Presently, this is done on a case-by-vase basis.

Staff thought the process could be improved and sought authorization to develop a policy that would include, but not be limited to:

a. Method of matching new expenses with new revenues.

b. Revenue neutral plant, i.e. plant to serve existing, not future customers.

c. Revenue neutral plant will be installed within a specific time frame, preferably one year.

d. Revenue neutral plant is necessary to provide proper and adequate service to existing customers.

Staff has not yet developed such policy. Until a comprehensive policy can be established and

21

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF CHAPARRAL CITY WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO. W-02113A-04-0616 DECISION NO. 68176 **OPINION AND ORDER**

DATE OF PRE-HEARING CONFERENCE:	May 26, 2005
DATE OF HEARING:	May 31, June 1, June 6 and June 8, 2005
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Teena Wolfe
IN ATTENDANCE:	Kristen K. Mayes, Commissioner
APPEARANCES:	Norman D. James and Jay L. Shapiro, FENNEMORE CRAIG, on behalf of Chaparral City Water Company; Daniel Pozefsky, on behalf of the Residential Utility Consumer Office; and David Ronald, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

I. INTRODUCTION

A. Procedural History

On August 24, 2004, Chaparral City Water Company ("Chaparral City" or "Company") filed with the Arizona Corporation Commission ("Commission") an application for a determination of the current fair value of its utility plant and property and for increases in its rates and charges for utility neutral as it was not needed during the test year (Moe Dt. at 10), and is recommending its exclusion from test year plant in service. Staff asserts that because the Shea WTP expansion increases treatment capacity, increased revenues from water sales are possible, and that no corresponding increase in test year revenues was made to account for this possibility; that the Company was able to meet peak demand in the test year using groundwater as a supplement to its CAP allocation; and that the Company will benefit more than the ratepayers from the additional protection against outages that the increased treatment capacity will provide. However, it appears that if the expansion had been placed in service during the test year, just three months earlier, Staff would have allowed it in rate base (*see* Bourassa Rj. at Exhibit TJB-2, Staff Data Response 3-17).

As Staff argued on brief in support of its recommendation to include the post-test year Fountain Hills Boulevard transmission main in rate base, inclusion of post-test year plant always causes some mismatch between revenues and expenses, even if post-test year plant is revenue neutral, used and useful, and the value of the additions is known (*see* Staff Cl. Br. at 2-3). Therefore, even though quantification of the inevitable mismatch may not be possible, the significance of the mismatch requires careful consideration (*see id.*). Given that ninety percent of the Company's water supply comes from CAP water, which must be treated before it can be delivered to customers for potable purposes, the ability of the Company to reliably treat its test year CAP water supply is an important factor that weighs heavily in our consideration of whether to include the Shea WTP expansion in rate base. We find that the weight of the evidence in this proceeding supports the Company's assertion that the Shea WTP expansion, which the Company paid for during the test year, and has been used and useful since March of 2004, allows the Company to reliably meet test year peak demands during the summer months with CAP water, which is a renewable resource we wish to encourage, while retaining the ability to take individual modules off line for repairs and to meet emergency needs. We find credible the Company's assertion that prior to the Shea WTP expansion,

22

21

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MARC SPITZER, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON
KRISTIN K. MAYES

Arizona Corporation Commission
DOCKETED

OCT 0 5 2004

DOCKETED BY nR

IN THE MATTER OF THE APPLICATION OF RIO RICO UTILITIES INC. FOR PERMANENT INCREASES FOR WATER AND WASTEWATER UTILITY SERVICE.

DOCKET NO. WS-02676A-03-0434

DECISION NO. 67279

OPINION AND ORDER

DATE OF HEARING:	June 3 and 4, 2004
PLACE OF HEARING:	Tucson, Arizona
DATE OF PUBLIC COMMENT:	September 21, 2004
PLACE OF PUBLIC COMMENT	Rio Rico, Arizona
ADMINISTRATIVE LAW JUDGE:	Jane L. Rodda
IN ATTENDANCE:	Marc Spitzer, William Mundell
APPEARANCES:	Mr. Jay Shapiro, Fennemore Craig, on behalf of Rio Rico Utilities Inc.; Mr. Daniel Pozefsky, Attorney for the Residential Utility Consumer Office; and Mr. David Ronald, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

Rio Rico Utilities Inc. ("Rio Rico" or "Company") provides utility service to approximately 4,200 water and 1,500 wastewater customers in the community of Rio Rico in Santa Cruz County, Arizona.

On June 25, 2003, Rio Rico filed an application with the Arizona Corporation Commission ("Commission") to raise the rates for both water and wastewater service. On July 25, 2003, the Commission's Utilities Division Staff ("Staff") notified the Company that its application was not sufficient under A.A.C. R14-2-103. On August 4, 2003, Rio Rico provided additional information in year. In that case, the Commission found that "the preponderance of evidence indicates there is no material mismatch between the plant investment, revenues and expenses." Decision No. 65350 at p 11.

It is clear that Commission rules contemplate that there are circumstances where pro forma adjustments to allow for plant placed in service post test year to be included in rate base. In this case, the post test year plant in question was in service by October 2003 when Staff inspected the facilities. TR p 264. The new wastewater plant totaling $313,658 was the replacement for the Lift Station No. 2 force main. This replacement was not an "upsize" and was required because the Company had been experiencing breakages and spills with the old force main.[1] TR pp 261-263. The water division post test year plant constituted a 12 inch main and new booster plant totaling $587,169. The Company had been experiencing customer complaints of low pressure. TR p. 263. The preponderance of evidence indicates that the post test year plant that the Company seeks to include in rate base was installed to serve existing test year customers, was required for system reliability and that there would not be a material impact on revenue or expenses. In this case, it is fair and reasonable to include the post test year plant in rate base.

Property Tax Expense

Positions of the Parties

Rio Rico and Staff agree that Property Tax Expense should be determined based on proposed revenue increases within the Arizona Department of Revenue ("ADOR") formula. RUCO advocates using only historical revenue levels.

Rio Rico argues that the Commission has repeatedly utilized the proposed revenue increase to determine the appropriate level of Property Tax Expense. See *Arizona Water Company*, Decision No. 64282 (December 28, 2001) at 12-13; Decision No. 65350 (November 1, 2002) at 16; and *Arizona-American Water Company*, Decision No. 67093 (June 30, 2004) at 9-10. The Company argues that since the Commission is setting rates on a going-forward basis, it does not make sense to use the historic years 2000, 2001 and 2002, as proposed by RUCO, as ADOR will never again use those

[1] The Company had adjusted rate base to reflect the retirement of the force main which was retired after the end of the test year. Both Staff and RUCO removed the retried force main from rate base. Moore Direct (RUCO-1) at RLM 3, page 9 of 9; Rogers Dir. (Ex S-1) at DDR-4, line 11.

23

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
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 ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	)))))))	DOCKET NO. G-04204A-08-0571

REDACTED DIRECT

TESTIMONY

OF

RALPH C. SMITH

ON BEHALF OF THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JUNE 8, 2009

Q. Is inclusion of CWIP in rate base up to the discretion of the Commission?

A. Yes, it is. RUCO's understanding is, in specific instances, the Commission has allowed a utility to include CWIP in rate base, but the Commission's general practice has been to not allow CWIP to be included in rate base. As such, the Commission denied the Company's request for CWIP in rate base in its last rate case.[4]

Q. Does RUCO agree with the proposal of UNS Gas to include CWIP in rate base in the current case?

A. No. In general, RUCO does not favor inclusion of CWIP in rate base unless the utility demonstrates compelling reasons to justify this exceptional ratemaking treatment. For a number of reasons, including the following, RUCO does not support UNS Gas' request for rate base inclusion of CWIP/post test year plant in the current case:

1) Inclusion of CWIP in rate base is an exception to the Commission's normal practice, and UNS Gas has not met its burden of proof showing why it requires such an exceptional ratemaking treatment.

2) The CWIP was not in service at the end of the test year. As of June 30, 2008, the construction projects were not serving customers.

3) The Company has not demonstrated that its June 30, 2008 CWIP balance was for non-revenue producing and non-expense reducing plant. Much of the construction

[4] Decision No. 70011, Docket No. G-04204A-06-0463

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
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

SURREBUTTAL

TESTIMONY

OF

THOMAS H. FISH, PH.D.

ON BEHALF OF

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 29, 2009

Q. What was the Company's response?

A. The Company witness, Mr. Dukes, proposed that certain post-test year Plant in Service should remain in rate base. He stated (page 5, lines 6-8 of his Rebuttal Testimony) that "The Plant accounting group and operational personnel of UNS Gas reviewed the projects and identified investments that had been made in projects that would not produce additional revenue and that would have been invested in regardless of customer growth." The Company argues that it is not fair to have made the capital investment, which the Company alleges is necessary for the provision of service and, due to unfortunate timing, not be allowed to include it in rate base.

Q. Is the inclusion of post-test year plant up to the discretion of the Commission?

A. Yes. There are specific instances where the Commission has allowed a utility to include post-test year plant in rate base. Typically, Staff does not recommend the inclusion of post-test year plant in rate base.

Q. Are there instances where Staff has recommended the inclusion of post-test year plant?

A. Although Staff typically does not recommend the inclusion of post-test year plant in rate base unless the utility has demonstrated a compelling need, Staff has recognized the following situations that may warrant the inclusion of post-test-year plant:

- When the magnitude of the investment relative to the utility's total investment is such that not including the post-test year plant in the cost of service would jeopardize the utility's financial health;
- When the cost of the post-test year plant is significant and substantial;
- The net impact on revenue and expenses for the post-test year plant is known and insignificant, or is revenue neutral; and

24

Dee

BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED
NOV 01 2002
DOCKETED BY

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF BELLA VISTA WATER CO., INC. AN ARIZONA CORPORATION TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATE MAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES AND TARIFFS DESIGNED TO DEVELOP SUCH RETURN.

DOCKET NO. W-02465A-01-0776

DECISION NO. 65350

OPINION AND ORDER

DATE OF HEARING:	July 25 and 26, 2002 August 16, 2002
PLACE OF HEARING:	Tucson, Arizona
ADMINISTRATIVE LAW JUDGE:	Jane L. Rodda
APPEARANCES:	Mr. William Sullivan, MARTINEZ & CURTIS, P.C., on behalf of Bella Vista Water Company, Inc.; Mr. Daniel W. Pozefsky, Staff Attorney, on Behalf of the Residential Utility Consumer Office; Mr. Jason Gellman, Staff Attorney, Legal Divison, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

Procedural Background

Bella Vista Water Company, Inc. ("Bella Vista" or "Company") provides water utility services to approximately 6,659 residential and commercial customers in and around the City of Sierra Vista, in Cochise County, Arizona. Bella Vista filed an application to increase its rates with the Arizona Corporation Commission ("Commission") on September 28, 2001. The Company filed an amendment to its application on October 16, 2001. The Company used a test year of December 31, 2000. The Commission authorized Bella Vista's current rates in Decision No. 61730 (June 4,

S-3

approved by the Commission, we believe the current case-by-case analysis should be continued. In this case, all of the plant was installed within a year and three days of the end of the test year, with much of it earlier than that. Furthermore, the preponderance of evidence indicates there is no material mismatch between the plant investment, revenues and expenses.

No party argues that the post-test year plant in question was not necessary or was not used and useful at the time of the hearing. The Company presented evidence that the plant would not materially affect revenues and expenses. It recognized that the new plant must be maintained and the new wells and booster station will cause the Company to incur additional power costs and there will be additional testing costs associated with the new wells, but believed these costs should be somewhat offset by the nominal power savings associated with the improvements to the four booster stations at Well #18. The Company did not seek to adjust expenses associated with these costs. There was a suggestion that increased reliability to the Rail Oaks system which had experienced curtailments in the past, may increase revenues. We find this possibility insufficient to overcome either the evidence that the impact on revenues will be nominal or the burden that would result from excluding the plant. Staff's engineer testified he believed any impact on revenues and expenses would be nominal.

We believe that it is not in the public interest for Bella Vista to incur the expense associated with another rate case to begin earning a return on plant that is being dedicated to provide service to existing customers. We do not want to discourage companies like Bella Vista from proactively addressing system reliability needs. The Company relied on past Commission decisions that allowed post-test year plant in determining the timing of its rate application. We do not agree with Staff and RUCO that the Commission has always required extraordinary circumstances to allow post-test year plant. Until this Commission establishes a clear policy concerning post-test year plant, we do not believe it is fair to refuse to consider post-test year plant when the majority of evidence indicates that there will not be a material mismatch between revenues and expenses and the investment in the plant.[3]

[3] We concur with Staff that the Company has the burden to demonstrate that the post-test year plant is revenue neutral, but believe, based on the totality of evidence in this case, that the Company has met that burden.

25

21

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission
DOCKETED

OCT 0 5 2004

DOCKETED BY nr

MARC SPITZER, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF RIO RICO UTILITIES INC. FOR PERMANENT INCREASES FOR WATER AND WASTEWATER UTILITY SERVICE.	DOCKET NO. WS-02676A-03-0434 DECISION NO. 67279 **OPINION AND ORDER**

DATE OF HEARING:	June 3 and 4, 2004
PLACE OF HEARING:	Tucson, Arizona
DATE OF PUBLIC COMMENT:	September 21, 2004
PLACE OF PUBLIC COMMENT	Rio Rico, Arizona
ADMINISTRATIVE LAW JUDGE:	Jane L. Rodda
IN ATTENDANCE:	Marc Spitzer, William Mundell
APPEARANCES:	Mr. Jay Shapiro, Fennemore Craig, on behalf of Rio Rico Utilities Inc.; Mr. Daniel Pozefsky, Attorney for the Residential Utility Consumer Office; and Mr. David Ronald, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

Rio Rico Utilities Inc. ("Rio Rico" or "Company") provides utility service to approximately 4,200 water and 1,500 wastewater customers in the community of Rio Rico in Santa Cruz County, Arizona.

On June 25, 2003, Rio Rico filed an application with the Arizona Corporation Commission ("Commission") to raise the rates for both water and wastewater service. On July 25, 2003, the Commission's Utilities Division Staff ("Staff") notified the Company that its application was not sufficient under A.A.C. R14-2-103. On August 4, 2003, Rio Rico provided additional information in

Resolution

The Arizona Administrative Code R14-2-103.A.3.h provides that "original cost rate base" should include all "applicable pro forma adjustments." "Pro forma Adjustments" are "adjustments to actual test year results and balances to obtain a normal or more realistic relationship between revenues, expenses and rate base." A.A.C. 414-2-103.A.3.i.

The Commission considers whether the inclusion of post test year plant is appropriate on a case-by-case basis. In the past, the Commission has allowed the inclusion of post test year plant in circumstances where the new plant is revenue neutral and there is no evidence of a material mismatch between revenue and expenses and where the post test year plant is required for system reliability or to provide adequate service.

In *Arizona Water Company*, Decision No. 66849, the Commission found that "[b]ased on Commission precedent, including Arizona Water's Northern Group rate case (Decision No. 64282), Staff agrees that post-test year plant additions for up to one year may be included in rate base." Decision No. 66849 at p 3. In Decision No. 66849, the hearing and the time clock were extended to enable Staff and RUCO the opportunity to analyze Arizona Water's post-test year plant additions. Id. In the *Arizona Water Northern Group* case, Decision No. 64282, the Commission adopted Staff's proposal to include plant additions for up to twelve months following the end of the test year (the company in that case had sought additions that were placed in service up to 15 months after the end of the test year). Decision No. 64282 pp 3-5.

In the *Paradise Valley Water Company* case, Decision No. 61831, the test year ended June 30, 1998, but the company was seeking post test year plant in service through March 31, 1999. The Commission adopted the Staff and Company agreed-upon level of post-test year plant additions, but it expressed concerns about the ability of parties to review and audit the effects of post test year plant, and ordered that in its next rate case, the Company should limit its adjustments to add post test year plant to include only that plant that is used and useful and in service within 90 days of the date that the rate application is deemed sufficient. Decision No. 61831 pp 3-4.

In the *Bella Vista Water Company* case, Decision No. 65350, the Commission allowed the inclusion of post test year plant that was installed within a year and three days of the end of the test

26

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Plant would never be included in rate base, which is simply inconsistent with prior Commission decisions. Staff and RUCO provide no data or analysis to support their speculative allegations of reduced expenses.

Q. How did UNS Gas determine which plant was revenue-neutral?

A. The Plant accounting group and operational personnel of UNS Gas reviewed the projects and indentified investments that had been made in projects that would not produce additional revenue and that would have been invested in regardless of customer growth.

Q. What plant is included in the Company's proposed Post Test Year Plant?

A. For example, we included communication equipment, vehicles, tools, power equipment and natural gas detector equipment, which are all necessary to serve the existing customer base. We also include service and main replacements to ensure safe and reliable service to our existing customers.

Q. When did the Company make the investments in these projects?

A. The Company completed its investments in these projects before the end of the test year. The projects were simply not in service by the end of the test year – but they are, or will be, in service when rates resulting from this proceeding become effective.

B. Customer Advances.

Q. What is the basis for Dr. Fish and Mr. Smith's removal of the Company's Customer Advances adjustment?

A. Their primary arguments for exclusion of the Company's adjustment is that Customer Advances are non-investor supplied capital and that is the required treatment based on the sample schedule B-1, Commission rule A.A.C R 14-2-103.

27

BEFORE THE ARIZONA CORPORATION COMMISSION

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

EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

Q. Yes.

A. I couldn't argue that based on my analysis because I didn't look into that. But I also could not argue that it would not.

Q. Fair enough.

Let me ask you about customer advances, and if you could turn to page 17 and 18 of your direct testimony.

A. Okay.

Q. You there?

A. I am.

Q. All right. Now, you oppose UNS Gas' customer advances adjustment; correct?

A. That's right.

Q. And you understand that those advances are related to plant that is not in rate base; correct?

A. That's right.

Q. All right. Let me ask you a somewhat hypothetical question here.

Let's suppose the utility has a rate base of $100. All right?

A. All right.

Q. If the utility receives an advance and uses the advance to pay for plant but that plant is not in service, the utility's rate base is still -- it's not less than $100, is it?

A. That is -- let me make sure I understand.
We have a rate base of $100.
Q. Right.
A. And the contribution and aid of construction of, say, 100.
Q. And an advance, we'll just -- let's say of $10.
A. All right, $10. And then an investment that is made, a capital investment of $10 that has not been in rate base.
Q. Right. After that point what would be the value of the plant in the ground in rate base?
A. The accounting treatment, if I recall, would be around $90, that you would actually have a reduction.
Q. What would be the value of the plant in the ground that is in rate base?
A. The accounting value or the economic value?
Q. The actual economic value of it.
A. The economic value would still be $100.
Q. And that would be the company had invested $100 in the rate base?
A. The $10 is an offset against the --
Q. Right, for a plant that is not in rate base?
A. Right.
Q. Right. Could you turn to your surrebuttal at page 3?

28

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

A. That is -- let me make sure I understand.
We have a rate base of $100.
Q. Right.
A. And the contribution and aid of construction of, say, 100.
Q. And an advance, we'll just -- let's say of $10.
A. All right, $10. And then an investment that is made, a capital investment of $10 that has not been in rate base.
Q. Right. After that point what would be the value of the plant in the ground in rate base?
A. The accounting treatment, if I recall, would be around $90, that you would actually have a reduction.
Q. What would be the value of the plant in the ground that is in rate base?
A. The accounting value or the economic value?
Q. The actual economic value of it.
A. The economic value would still be $100.
Q. And that would be the company had invested $100 in the rate base?
A. The $10 is an offset against the --
Q. Right, for a plant that is not in rate base?
A. Right.
Q. Right. Could you turn to your surrebuttal at page 3?

29

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

A. That is -- let me make sure I understand.
We have a rate base of $100.
Q. Right.
A. And the contribution and aid of construction of, say, 100.
Q. And an advance, we'll just -- let's say of $10.
A. All right, $10. And then an investment that is made, a capital investment of $10 that has not been in rate base.
Q. Right. After that point what would be the value of the plant in the ground in rate base?
A. The accounting treatment, if I recall, would be around $90, that you would actually have a reduction.
Q. What would be the value of the plant in the ground that is in rate base?
A. The accounting value or the economic value?
Q. The actual economic value of it.
A. The economic value would still be $100.
Q. And that would be the company had invested $100 in the rate base?
A. The $10 is an offset against the --
Q. Right, for a plant that is not in rate base?
A. Right.
Q. Right. Could you turn to your surrebuttal at page 3?

30

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Do you agree with Mr. Smith's statement that customer advances are non-investor supplied capital?

A. Yes. That is exactly why they should be deducted from rate base at some point – so that the Company does not earn a return on investments it does not make. In other words, advances should neither increase nor decrease rate base – the net impact should be zero.

However, Staff and RUCO recognize the advances (the deduction from rate base) much earlier than the addition to plant in service (the addition to rate base). It is this mismatch that I disagree with. Under Staff's and RUCO's approach, because the advances are recognized too soon, and the result is that pre-existing rate base is reduced by the amount of the advance. Thus, Staff's and RUCO's rate bases doe not accurately reflect UNS Gas' level of investment.

Q. Can you provide an example?

A. Yes. Assume a utility has a rate base of $100,000,000 at a point in time ("Day One"). On Day Two, the utility receives an advance of $10,000,000 for new plant for a new development. One year later (i.e., on Day 367), the utility spends the full amount of the advance on the new plant. The new plant facilities are then placed into service following another year (i.e., on Day 732). The utility adds no other plant between Day One and Day 732. Under Staff's and RUCO's approaches, at Day One, the utility's rate base is $100,000,000. On Day Two, the utility's rate base drops to $90,000,000 – even though the utility's investment in rate base has not changed. Ten million dollars in existing rate base is just wiped out. This $10,000,000 reduction to pre-existing investment remains in place until the plant funded by the advances is placed into service on Day 732. At that point, the utility's rate base finally goes back to $100,000,000 – where it should have been all along.

Q. In your example, wouldn't the Company have the use of the $10,000,000 from Day 2 through Day 367 as non-investor capital?

A. Yes. And during that period it would be appropriate to recognize the portion to the advance not used as "zero" cost capital or even as a reduction in rate base to assure that the non investor supplied capital is being properly recognized. But the Company is requesting differing and fair treatment for the period between Day 367 and Day 732. A test year established in that period is where the mismatch takes place. The advance is already spent, so there is "NO" zero cost capital and the new facility is <u>not</u> in rate base. That is when the Utility is only getting rate base treatment for $90,000,000 when it should properly be getting rate base treatment for $100,000,000.

Q. Can't the Company avoid this problem by selecting a different test year?

A. No. In the simplified example above, the utility could avoid the problem only by selecting a test year ending after Day 732. But in reality, UNS Gas is constantly receiving advances, investing those advances in specific projects, and adding related plant. In other words, the receipt of advances is not a one-time event – it is a constant flow. Thus, there is no test year that UNS Gas could select that would avoid this problem.

Moreover, any suggestion that UNS Gas could avoid the problem by selecting its test year ignores the fact that Staff rejected UNS Gas' originally proposed test year and then allowed UNS Gas to use the current test year instead.

Q. Is there support in Commission decisions for the Company's approach?

A. Yes. In Decision No. 69914 (Sept. 27, 2008)(at page 29, lines 7-13), the Commission allowed Arizona-American Water Company similar treatment for contributions associated with hook-up fees pertaining to a specific surface water treatment plant.

31

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Do you agree with Mr. Smith's statement that customer advances are non-investor supplied capital?

A. Yes. That is exactly why they should be deducted from rate base at some point – so that the Company does not earn a return on investments it does not make. In other words, advances should neither increase nor decrease rate base – the net impact should be zero.

However, Staff and RUCO recognize the advances (the deduction from rate base) much earlier than the addition to plant in service (the addition to rate base). It is this mismatch that I disagree with. Under Staff's and RUCO's approach, because the advances are recognized too soon, and the result is that pre-existing rate base is reduced by the amount of the advance. Thus, Staff's and RUCO's rate bases doe not accurately reflect UNS Gas' level of investment.

Q. Can you provide an example?

A. Yes. Assume a utility has a rate base of $100,000,000 at a point in time ("Day One"). On Day Two, the utility receives an advance of $10,000,000 for new plant for a new development. One year later (i.e., on Day 367), the utility spends the full amount of the advance on the new plant. The new plant facilities are then placed into service following another year (i.e., on Day 732). The utility adds no other plant between Day One and Day 732. Under Staff's and RUCO's approaches, at Day One, the utility's rate base is $100,000,000. On Day Two, the utility's rate base drops to $90,000,000 – even though the utility's investment in rate base has not changed. Ten million dollars in existing rate base is just wiped out. This $10,000,000 reduction to pre-existing investment remains in place until the plant funded by the advances is placed into service on Day 732. At that point, the utility's rate base finally goes back to $100,000,000 – where it should have been all along.

32

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Do you agree with Mr. Smith's statement that customer advances are non-investor supplied capital?

A. Yes. That is exactly why they should be deducted from rate base at some point – so that the Company does not earn a return on investments it does not make. In other words, advances should neither increase nor decrease rate base – the net impact should be zero.

However, Staff and RUCO recognize the advances (the deduction from rate base) much earlier than the addition to plant in service (the addition to rate base). It is this mismatch that I disagree with. Under Staff's and RUCO's approach, because the advances are recognized too soon, and the result is that pre-existing rate base is reduced by the amount of the advance. Thus, Staff's and RUCO's rate bases doe not accurately reflect UNS Gas' level of investment.

Q. Can you provide an example?

A. Yes. Assume a utility has a rate base of $100,000,000 at a point in time ("Day One"). On Day Two, the utility receives an advance of $10,000,000 for new plant for a new development. One year later (i.e., on Day 367), the utility spends the full amount of the advance on the new plant. The new plant facilities are then placed into service following another year (i.e., on Day 732). The utility adds no other plant between Day One and Day 732. Under Staff's and RUCO's approaches, at Day One, the utility's rate base is $100,000,000. On Day Two, the utility's rate base drops to $90,000,000 – even though the utility's investment in rate base has not changed. Ten million dollars in existing rate base is just wiped out. This $10,000,000 reduction to pre-existing investment remains in place until the plant funded by the advances is placed into service on Day 732. At that point, the utility's rate base finally goes back to $100,000,000 – where it should have been all along.

33

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Do you agree with Mr. Smith's statement that customer advances are non-investor supplied capital?

A. Yes. That is exactly why they should be deducted from rate base at some point – so that the Company does not earn a return on investments it does not make. In other words, advances should neither increase nor decrease rate base – the net impact should be zero.

However, Staff and RUCO recognize the advances (the deduction from rate base) much earlier than the addition to plant in service (the addition to rate base). It is this mismatch that I disagree with. Under Staff's and RUCO's approach, because the advances are recognized too soon, and the result is that pre-existing rate base is reduced by the amount of the advance. Thus, Staff's and RUCO's rate bases doe not accurately reflect UNS Gas' level of investment.

Q. Can you provide an example?

A. Yes. Assume a utility has a rate base of $100,000,000 at a point in time ("Day One"). On Day Two, the utility receives an advance of $10,000,000 for new plant for a new development. One year later (i.e., on Day 367), the utility spends the full amount of the advance on the new plant. The new plant facilities are then placed into service following another year (i.e., on Day 732). The utility adds no other plant between Day One and Day 732. Under Staff's and RUCO's approaches, at Day One, the utility's rate base is $100,000,000. On Day Two, the utility's rate base drops to $90,000,000 – even though the utility's investment in rate base has not changed. Ten million dollars in existing rate base is just wiped out. This $10,000,000 reduction to pre-existing investment remains in place until the plant funded by the advances is placed into service on Day 732. At that point, the utility's rate base finally goes back to $100,000,000 – where it should have been all along.

34

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Do you agree with Mr. Smith's statement that customer advances are non-investor supplied capital?

A. Yes. That is exactly why they should be deducted from rate base at some point – so that the Company does not earn a return on investments it does not make. In other words, advances should neither increase nor decrease rate base – the net impact should be zero.

However, Staff and RUCO recognize the advances (the deduction from rate base) much earlier than the addition to plant in service (the addition to rate base). It is this mismatch that I disagree with. Under Staff's and RUCO's approach, because the advances are recognized too soon, and the result is that pre-existing rate base is reduced by the amount of the advance. Thus, Staff's and RUCO's rate bases doe not accurately reflect UNS Gas' level of investment.

Q. Can you provide an example?

A. Yes. Assume a utility has a rate base of $100,000,000 at a point in time ("Day One"). On Day Two, the utility receives an advance of $10,000,000 for new plant for a new development. One year later (i.e., on Day 367), the utility spends the full amount of the advance on the new plant. The new plant facilities are then placed into service following another year (i.e., on Day 732). The utility adds no other plant between Day One and Day 732. Under Staff's and RUCO's approaches, at Day One, the utility's rate base is $100,000,000. On Day Two, the utility's rate base drops to $90,000,000 – even though the utility's investment in rate base has not changed. Ten million dollars in existing rate base is just wiped out. This $10,000,000 reduction to pre-existing investment remains in place until the plant funded by the advances is placed into service on Day 732. At that point, the utility's rate base finally goes back to $100,000,000 – where it should have been all along.

35

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

A. Okay.

Q. And lines 9 through 13?

A. Okay.

Q. Now, you refer to a rule there that requires that those funds be deducted from rate base.

What portion of that rule --

A. I didn't bring my -- I didn't bring that section with me.

Q. Okay. So off the top of your head you don't recall?

A. I don't recall. I have referred to it, but I simply -- my case isn't that big.

Q. All right.

A. I didn't have room to bring it.

Q. Now, are you contending that the Commission lacks any discretion or power to approve UNS Gas' customer advance adjustment?

A. In my estimation the Commission can pretty much do what it -- and when it renders its decision, it's going to look at the facts and the situation. If it decides that the facts and the situation warrants that they should remove that $600,000, then I would suspect that it will probably -- the Commission will do so; otherwise, I suspect if the Commission determines that it does not warrant it, that it will tell you to do that too.

But the answer to your question is, the Commission, in my understanding, has the power to do that and the circumstances if it feels it's necessary and in the public interest to do it.

Again, that is just my understanding. I wouldn't presume to speak about what the Commission is going to do.

Q. Let's talk about working capital. Could you turn to page 18 of your direct?

A. Sure.

Q. And on page 18 of your direct you propose an adjustment to cash working capital; correct?

A. That's correct.

Q. And that adjustment is based on what you believe to be an abnormal pay structure of twice monthly payments to BP Gas?

A. It's based on the lead-lag study and the timing difference between the receipt of an obligation to pay and payment of that obligation.

Q. And you identified, in your testimony at line 7, it as an abnormal pay structure; is that correct?

A. Yes. As a matter of fact the BP payment structure is different than I saw for any other accounts payable, and we looked at a lot of those.

Q. Does that include payroll?

A. Payroll, I don't know that the company prepays, I

36

BEFORE THE ARIZONA CORPORATION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY FOR APPROVALS ASSOCIATED WITH A TRANSACTION WITH THE MARICOPA COUNTY MUNICIPAL WATER CONSERVATION DISTRICT NUMBER ONE.

DOCKET NO. W-01303A-05-0718

DECISION NO. 69914

OPINION AND ORDER

DATE OF HEARING: March 2, 2006 (Pre-hearing Conference); August 1, 2006, September 14, 2006 (Procedural Conferences); December 21, 2006 and March 15, 2007 (Pre-hearing Conferences); March 19, 20, 21 and 26, 2007 (Hearing).

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Teena Wolfe

APPEARANCES: Kristin K. Mayes, Commissioner, Arizona Corporation Commission

Keith A. Layton, Kevin Torrey and Charles Hains, Staff Attorneys, Legal Division, on behalf of the Arizona Corporation Commission's Utilities Division;

Scott Wakefield, Chief Counsel, and Daniel Pozefsky, Staff Counsel, on behalf of the Residential Utility Consumer Office;

Craig A. Marks, CRAIG A. MARKS, P.L.C., on behalf of Arizona-American Water Company;

Michele L. Van Quathem, RYLEY, CARLOCK & APPLEWHITE, P.A., on behalf of Pulte Homes Corporation;

Jeffrey W. Crockett and Bradley S. Carroll, SNELL & WILMER, L.L.P., on behalf of CHI Construction Company, Inc., Courtland Homes, Inc., Taylor Woodrow/Arizona, Inc., and Fulton Homes Corporation;

RUCO-2

Project in rate base, whichever comes first, shall be, and hereby is, approved.

IT IS FURTHER ORDERED that Arizona-American Water Company's request for authority to defer post in-service depreciation expense in excess of the associated amortization of contributions approved in the previous Ordering Paragraph, and to propose, as part of its 2008 Agua Fria Water District rate case filing, specific accounting entries to meet this objective, shall be, and is hereby, approved.

IT IS FURTHER ORDERED that Arizona-American Water Company's request for authorization to exclude from rate base the contribution balance of hook-up fees directly related to the White Tanks Project collected subsequent to the effective date of this Decision over the aggregate of (1) construction expenditures (including development, site acquisition, design, company labor, overheads, and allowance for funds used during construction) for the same period that are included in rate base and (2) any costs deemed imprudently incurred from contributions used to calculate rate base until December 31, 2015, shall be, and hereby is, approved.

IT IS FURTHER ORDERED that Arizona-American Water Company is hereby authorized to file, as part of its 2008 Agua Fria Water District rate case filing, a proposal to adjust the Water Facilities Hook-Up Fee Tariff approved herein. If such a proposal is filed, it shall include information necessary to allow the Commission to adjust the Water Facilities Hook-Up Fee Tariff as necessary, based on the best information available at the time, including, but not limited to, the following:

1) Actual to-date and remaining plant costs;
2) The effects of any third-party treatment contracts;
3) Actual hook-up fee collections;
4) Revised projected customer additions and meter preferences; and
5) Future Agua Fria Water District capital requirements.

IT IS FURTHER ORDERED that Arizona-American is hereby authorized to file, as part of its 2008 Agua Fria Water District rate case filing, a proposed mechanism to defer and subsequently recover Operations and Maintenance Expense incurred for the White Tanks Project until such expenses can be placed in base rates.

37

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

this is what he testified to, this is what he testified to. And I wouldn't presume to say this isn't true because I don't know that it isn't true.

I'm saying, I can't imagine a provider, a company like British Petroleum who is selling to a regulated monopoly that is going to be so fearful of getting paid. You know, BP could come in here and say, look, we are worried about getting paid. Is there anything you can do, Commission, to help us? Did they do that? I don't know.

But there are a lot things you can hypothesize about, and again, this is obviously what the company chose to do.

Q. You are not a gas procurement expert, are you?

A. No, I don't procure gas.

Q. And you did not conduct a survey of available credit terms for large gas purchases, did you?

A. No, I did not.

Q. All right. Is it fair to say that the cost of gas is by far the single biggest expenditure of the company over the course of a year?

A. In the test year it certainly was.

Q. Okay. And is there any other vendor that the company deals with with which the company has to have that much credit?

A. No.

Q. And do you have any idea of the size of gas costs relative to any other particular cost of the company?

A. The PGA -- if I recall correctly, the purchase gas costs was about two-thirds -- if I recall correctly it was around two-thirds of the total cost, gross cost.

Q. All right.

A. If I recall approximately. So it was by far the largest.

Q. Okay. Let's turn to customer annualization.

A. Okay.

Q. Let's turn to page 20 of your direct testimony.

A. Okay.

Q. And you disagreed with the company's customer annualization methodology; correct?

A. In this case, absolutely.

Q. And this is the first regulatory proceeding in which you have provided testimony on residential customer annualization; correct?

A. Residential customer annualization, yes, it is.

Q. Let me just ask: Do you agree with the statement that "The purpose of annualization is to recognize changes that occurred during the test year as if those events had been reflected in the entire year"?

A. Read that again, would you please.

Q. "The purpose of annualization is to recognize

38

BEFORE THE ARIZONA CORPORATION COMMISSION

<u>COMMISSIONERS</u>
KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

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

Rejoinder Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

August 5, 2009

2008, the Company has started purchasing gas from other suppliers. However, it should be noted that other suppliers are not providing generous amounts of credit to UNS Gas. BP Energy still provides more trade credit to UNS Gas than any of the other gas suppliers the Company is now doing business with.

Q. Do you agree with Dr. Fish that the credit terms extended by BP Energy were "not realistic" and "not representative of normal credit terms"?

A. No. As stated above, BP Energy has extended more trade credit to UNS Gas than any other supplier. Credit terms are negotiated between a buyer and seller as part of the contracting process. Since BP Energy was the Company's sole gas supplier during the test year, and since UNS Gas' credit profile is weaker than most gas utilities, it should not be surprising that UNS Gas would bump up against this credit limit during peak periods of gas usage. While the acceleration of payments to third party providers is not a very common practice, in the case of UNS Gas is was a cheaper alternative relative to posting cash collateral or providing a letter of credit.

Q. Do you agree with Dr. Fish that the Company's customers should not be responsible for the incremental cost of providing credit support?

A. No. The Company makes no profit on the sale of natural gas procured in the wholesale market for retail customers. Since the Company is providing a valuable gas procurement service that benefits its retail customers with no mark-up, it is hard to understand why Dr. Fish believes that credit support costs incurred for gas procurement should not be recouped by the Company.

39

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

mean, outside of the normal payroll. You normally pay after work is performed, if that is what you are asking me.

Q. Is payroll paid twice a month?

A. I don't know. I presume some people are probably paid twice a month; some may be paid weekly; some may be paid monthly.

Q. Do you know whether the payroll company that issues the checks, whether it be ADP or some other company, needs to receive that money in advance to actually issuing checks?

A. I don't think that as a company that ADP would actually receive the money. The bank would receive the money. The account -- again, the special payroll account would receive the money, but I don't think ADP needs that money; they just need to know that the check that they issue on behalf of the company, actually the money is there in the account. That is what they need to know.

Q. You don't dispute that there were twice-monthly payments to BP during the test year for those three months, do you?

A. No. As a matter of fact Staff does not -- we don't -- I don't dispute what the company told me. I have no reason to doubt the honesty of the company.

Q. And, in fact, I think you testified earlier today that further review on that issue you realize that those twice-monthly payments have continued into the following year; is that correct?

A. My recollection is, yeah, but that is subject to check. I would have to look. My recollection is that they are, but, I mean, the following winter.

This was kind of -- I thought about this quite a bit. Mr. Dukes suggested that it continue through into the summer, but I don't recall seeing that. I don't know. If British Petroleum were paid into the summer when the actual purchase of gas had dropped significantly, then that would imply that somehow or other either one, they changed the term that it's below $10 million as the threshold or they never got caught up, the company.

Q. But you understand --

A. But again, I don't know. That is just what he said the day before yesterday.

Q. And you don't have any reason to dispute what Mr. Dukes stated?

A. No, I don't.

Q. All right. And do you understand that those twice-monthly payments are necessary to continue to receive sufficient credit from BP for those gas purchases?

A. My understanding is that management determined to pay it that way in order to meet its obligation to serve.

40

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

that further review on that issue you realize that those twice-monthly payments have continued into the following year; is that correct?

A. My recollection is, yeah, but that is subject to check. I would have to look. My recollection is that they are, but, I mean, the following winter.

This was kind of -- I thought about this quite a bit. Mr. Dukes suggested that it continue through into the summer, but I don't recall seeing that. I don't know. If British Petroleum were paid into the summer when the actual purchase of gas had dropped significantly, then that would imply that somehow or other either one, they changed the term that it's below $10 million as the threshold or they never got caught up, the company.

Q. But you understand --

A. But again, I don't know. That is just what he said the day before yesterday.

Q. And you don't have any reason to dispute what Mr. Dukes stated?

A. No, I don't.

Q. All right. And do you understand that those twice-monthly payments are necessary to continue to receive sufficient credit from BP for those gas purchases?

A. My understanding is that management determined to pay it that way in order to meet its obligation to serve.

41

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
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

SURREBUTTAL

TESTIMONY

OF

THOMAS H. FISH, PH.D.

ON BEHALF OF

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 29, 2009

Q. Did the Company address Staff's cash working capital pro forma adjustment in its Rebuttal Testimony?

A. Yes. In his Rebuttal Testimony, Mr. Dukes made an additional cash working capital adjustment from his original \$97,967 to \$2,183,948. On page 8, lines 14-19, Mr. Dukes states:

> "The payment lag is actually much shorter than the 35 days used by Staff. In fact, the payments made to that vendor early in the test year were not reflective of payment terms later in the test year or of the current payment terms. The Company's payment terms were altered during the test year because of credit limitations. The vendor now requires the Company to make payments twice a month and those payment requirements continue today and for the foreseeable future."

Mr. Dukes goes on to say, page 8, lines 23-27:

> "In the Company's original filing, the new payment terms were only partially reflected in the Company's lead lag study. The changed payment schedule remains in place and is therefore a "known and measurable" change. Thus the Company is making an alternative adjustment in its rebuttal filing to fully reflect all purchased gas payments to that vendor with the proper payment lags."

Q. Should the Company's rate payers be responsible for the incremental cost of purchased gas associated with the timing of the payments?

A. No. Staff's position is that the Company's 12-day payments (including 7.5 day mid-point correction) is not realistic and is not representative of normal credit terms. Although the Company may accept these terms from BP, such terms are not normal or reasonable. UNS has the discretion to obtain more favorable terms and conditions from another supplier.

42

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
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

SURREBUTTAL

TESTIMONY

OF

THOMAS H. FISH, PH.D.

ON BEHALF OF

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 29, 2009

Q. Did the Company address Staff's cash working capital pro forma adjustment in its Rebuttal Testimony?

A. Yes. In his Rebuttal Testimony, Mr. Dukes made an additional cash working capital adjustment from his original $97,967 to $2,183,948. On page 8, lines 14-19, Mr. Dukes states:

> "The payment lag is actually much shorter than the 35 days used by Staff. In fact, the payments made to that vendor early in the test year were not reflective of payment terms later in the test year or of the current payment terms. The Company's payment terms were altered during the test year because of credit limitations. The vendor now requires the Company to make payments twice a month and those payment requirements continue today and for the foreseeable future."

Mr. Dukes goes on to say, page 8, lines 23-27:

> "In the Company's original filing, the new payment terms were only partially reflected in the Company's lead lag study. The changed payment schedule remains in place and is therefore a "known and measurable" change. Thus the Company is making an alternative adjustment in its rebuttal filing to fully reflect all purchased gas payments to that vendor with the proper payment lags."

Q. Should the Company's rate payers be responsible for the incremental cost of purchased gas associated with the timing of the payments?

A. No. Staff's position is that the Company's 12-day payments (including 7.5 day mid-point correction) is not realistic and is not representative of normal credit terms. Although the Company may accept these terms from BP, such terms are not normal or reasonable. UNS has the discretion to obtain more favorable terms and conditions from another supplier.

43

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

this is what he testified to, this is what he testified to. And I wouldn't presume to say this isn't true because I don't know that it isn't true.

I'm saying, I can't imagine a provider, a company like British Petroleum who is selling to a regulated monopoly that is going to be so fearful of getting paid. You know, BP could come in here and say, look, we are worried about getting paid. Is there anything you can do, Commission, to help us? Did they do that? I don't know.

But there are a lot things you can hypothesize about, and again, this is obviously what the company chose to do.

Q. You are not a gas procurement expert, are you?

A. No, I don't procure gas.

Q. And you did not conduct a survey of available credit terms for large gas purchases, did you?

A. No, I did not.

Q. All right. Is it fair to say that the cost of gas is by far the single biggest expenditure of the company over the course of a year?

A. In the test year it certainly was.

Q. Okay. And is there any other vendor that the company deals with with which the company has to have that much credit?

A. No.

44

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

David G. Hutchens

on Behalf of

UNS Gas, Inc.

July 8, 2009

III. GAS PROCUREMENT ISSUES.

Q. Please provide an overview of the Direct Testimony of Commission Staff Witness Ms. Beale.

A. Ms. Beale conducted a prudency review of the Company's gas procurement operations. Her review encompassed gas procurement activities for the period of January 2006 through June 2008. Ms. Beale also reviewed the UNS Gas decision to terminate its full requirements service arrangement with BP Energy, the Company's purchased gas adjustor ("PGA") bank balances, pipeline capacity planning, and purchasing strategies and policies.

Q. Please summarize Ms. Beale's findings.

A. Ms. Beale found the purchase prices for natural gas to be reasonable and the quantity of pipeline capacity purchased to be prudent. She deemed the decision to terminate the agreement with BP Energy to be rational and identified several benefits to UNS Gas customers. Ms. Beale was able to reconcile over $240 million of PGA costs over the review period to within $10,000. Finally, Ms. Beale found the Company's strategies and policies to be generally reasonable.

Q. Did Ms. Beale offer recommendations in her Direct Testimony?

A. Yes. Ms. Beale made ten recommendations with respect to UNS Gas' procurement practices in her Direct Testimony; I will respond to each of those recommendations.

Q. Please comment on Ms. Beale's first and second recommendations that UNS Gas seek potential counterparties to optimize excess pipeline capacity and its use of Asset Management Agreements.

A. UNS Gas agrees to continue to seek opportunities to extract value from excess pipeline capacity. UNS Gas began using Asset Management Agreements in March of 2009 for

Transwestern pipeline capacity. Instead of executing a long-term Asset Management Agreement, UNS Gas limited the terms of its Agreements to single months so that other counterparties could be approached regarding the optimization of capacity. The result of this limited term was that UNS Gas received another offer in May of 2009 through a new Asset Management Agreement that increased the profit sharing percentage for UNS Gas. To date, Asset Management Agreements have been executed with two different counterparties. In order to increase the potential number of bidders to provide Asset Management Agreements, UNS Gas is developing its own preferred Asset Management Agreement for use in a more expansive request-for-proposal ("RFP") format.

Q. Please comment on Ms. Beale's third recommendation for UNS Gas to include supplemental pipeline commodity imbalance information its monthly PGA report to the Commission.

A. We concur that including the *UNS Gas Core Market/System Supply Imbalance Report* (the "Imbalance Report") may be useful information in reconciling PGA costs reported in the monthly report which UNS Gas files with the Commission. UNS Gas agrees to provide the Imbalance Report as a supporting document to its monthly PGA filing.

Q. What is your response to Ms. Beale's fourth recommendation to conduct gas procurement training to Energy Settlements and Billing personnel?

A. The Energy Settlements personnel have been a part of the BP Energy full requirements process since UniSource Energy Corporation acquired Citizens Utilities Company's ("Citizens") Arizona gas and electric assets. The amount and scope of transactions employed by UNS Gas became more transparent as the responsibility for optimization of UNS Gas' load shifted from BP Energy to internal personnel. Additionally, the particular Energy Settlements employees assigned to UNS Gas have shifted during the past few years. We agree with the recommendation to conduct training for the Energy Settlements department employees on long-term hedging, day-ahead procurement, and pipeline capacity optimization.

Q. What is your response to Ms. Beale's fifth recommendation regarding the consideration of purchasing during traditional hurricane months?

A. We agree that UNS Gas should continue to evaluate gas purchasing opportunities during the traditional hurricane months. The Gas Price Stabilization Policy, while placing a hold on non-discretionary hedging during the months of August through October, does not prohibit discretionary hedging during those times. If it is determined that a hedge should be executed during those months, UNS Gas personnel may execute the hedge after receiving approval from the Risk Management Committee. This approval process is outlined in the Gas Price Stabilization Policy.

Q. What is your response to Ms. Beale's sixth recommendation that UNS Gas document instances when it deviates from its monthly forward hedge transaction plan?

A. We agree with the recommendation for UNS Gas to continue its policy of documenting occurrences of hedge plan deviations. The example given by Ms. Beale citing an instance of deviation from UNS Gas' forward monthly hedge plan was from an execution date of November of 2005. At that time, UNS Gas had already executed the non-discretionary hedges (under the legacy hedging policy from Citizens of three hedge events in January, March, and July) for 2005. The hedge instance in November of 2005 was a discretionary hedge meant only to hedge the balance of the winter season. The request for this discretionary hedge, and the Risk Management Committee approval, were documented as required.

Q. Please comment on Ms. Beale's seventh recommendation for the Gas Price Stabilization Policy to be updated with changes that occurred with the termination of the BP Energy agreement.

A. We concur that the Gas Price Stabilization Policy should be updated as changes resulting from the termination of the BP Energy agreement become evident. While UNS Gas made incremental changes to the Policy at the end of 2008, several operational changes have occurred with the distribution of duties that were still in flux at year-end. The policies are reviewed annually, however, and significant changes, such as the migration away from BP Energy, will produce effects that may require more frequent updates. Moving through the first full 12-month period post BP Energy termination, additional changes may be identified which require policy modifications.

Q. Please comment on Ms. Beale's eighth recommendation for the Gas Price Stabilization Policy to be updated at least annually.

A. We concur with this recommendation. Since adoption of the Gas Price Stabilization Policy, UNS Gas protocol has been to conduct a review of the policy at the end of each calendar year.

Q. Please comment on Ms. Beale's ninth recommendation that all individuals involved in gas procurement sign the Policy acknowledgement form.

A. We agree with the recommendation that all personnel involved in gas procurement sign an Acknowledgement Form. Personnel who will sign the Acknowledgement Form include those employees who perform tasks related to gas scheduling, transportation contracting, risk management and risk control.

Q. Please comment on Ms. Beale's tenth recommendation that there should be a single "owner" of the Gas Price Stabilization Policy.

A. We agree that a single person should be designated to modify the Gas Price Stabilization Policy. This ensures that proper control of updates and modifications is maintained.

IV. EXPLORING ALTERNATIVE PAYMENT METHODS.

Q. Has UNS Gas provided its customers with alternative ways in which to pay their bills, pursuant to Decision No. 70011?

A. Yes. In UNS Gas' last general rate case, concerns were raised about customers paying their gas bills at payday loan centers. As a result, UNS Gas reviewed other options by which its customers would be able to make cash payments. UNS Gas filed information related to "PayScan" with the Commission on February 22, 2008, and indicated that Circle K had been selected as the initial retailer to accept customer payments in Arizona. During the testing phase of the project, however, it was discovered that Circle K lacked the requisite software infrastructure to process payments. As a result, other retailer options were explored, and UNS Gas ultimately came to an agreement with Walmart.

Q. What is the current status of the UNS Gas' / Walmart payment arrangement?

A. This payment option became available to all UNS Gas, as well as Tucson Electric Power Company ("TEP") and UNS Electric, Inc. ("UNS Electric") customers in April of 2009; all Walmart sites in the state of Arizona will accept cash payments. The Company's web site has been updated to reflect this change and bill inserts were used to communicate the new payment option to customers.

UNS Gas has requested that check cashing and/or other outside payment center locations utilize signage, provided by UNS Gas, indicating that these locations will be independently

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rejoinder Testimony of

David G. Hutchens

on Behalf of

UNS Gas, Inc.

August 5, 2009

depending on a variety of factors. Such variability is one reason why growth estimates simply are inappropriate for customer annualization calculations.

III. RESPONSE TO SURREBUTTAL TESTIMONY OF RITA BEALE.

Q. Do you agree with the clarifications Ms. Rita Beale provided in her Surrebuttal Testimony regarding her Direct Testimony Recommendations?

A. Yes. Her clarifications fill in the gaps in my understanding of her recommendations and will be implemented by the Company.

Q. Does this conclude your Rejoinder Testimony?

A. Yes, it does.

45

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rejoinder Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

August 5, 2009

Q. What did Dr. Fish have to say about the credit terms that existed between UNS Gas and BP Energy during the test year?

A. On page 4 of his Surrebuttal Testimony, Dr. Fish expressed an opinion that the credit terms were "not realistic" and "not representative of normal credit terms." He goes on to state that "UNS Gas has the discretion to obtain more favorable terms and conditions from another supplier," and that UNS Gas customers should not have to bear the incremental cost of these credit terms.

Q. What aspect of these credit terms does Dr. Fish criticize?

A. He criticizes the making of payments to BP Energy twice per month instead of on a monthly basis as is customary. His main problem with the acceleration of payments is that the Company's working capital requirements are higher than they would otherwise be.

Q. Did the Company have any alternatives it could have pursued in lieu of making accelerated payments?

A. Yes, but neither of these alternatives would have been cost effective. One of these alternatives would have involved the posting of cash collateral with BP Energy for an extended period of time. The other alternative would have required the issuance of a bank letter of credit in the favor of BP energy. Both of these alternatives would have been more costly than the accelerated payment plan.

Q. Do you agree with Dr. Fish that UNS Gas had the discretion to obtain more favorable terms from another supplier?

A. No. During the test year, BP Energy was a full-requirements supplier to UNS Gas. Only under very limited circumstances would the Company have been permitted to purchase gas from another provider. Since the expiration of that full-requirements contract in mid-

2008, the Company has started purchasing gas from other suppliers. However, it should be noted that other suppliers are not providing generous amounts of credit to UNS Gas. BP Energy still provides more trade credit to UNS Gas than any of the other gas suppliers the Company is now doing business with.

Q. Do you agree with Dr. Fish that the credit terms extended by BP Energy were "not realistic" and "not representative of normal credit terms"?

A. No. As stated above, BP Energy has extended more trade credit to UNS Gas than any other supplier. Credit terms are negotiated between a buyer and seller as part of the contracting process. Since BP Energy was the Company's sole gas supplier during the test year, and since UNS Gas' credit profile is weaker than most gas utilities, it should not be surprising that UNS Gas would bump up against this credit limit during peak periods of gas usage. While the acceleration of payments to third party providers is not a very common practice, in the case of UNS Gas is was a cheaper alternative relative to posting cash collateral or providing a letter of credit.

Q. Do you agree with Dr. Fish that the Company's customers should not be responsible for the incremental cost of providing credit support?

A. No. The Company makes no profit on the sale of natural gas procured in the wholesale market for retail customers. Since the Company is providing a valuable gas procurement service that benefits its retail customers with no mark-up, it is hard to understand why Dr. Fish believes that credit support costs incurred for gas procurement should not be recouped by the Company.

46

BEFORE THE ARIZONA CORPORATION COMMISSION

<u>COMMISSIONERS</u>
KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

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

Rejoinder Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

August 5, 2009

Q. What did Dr. Fish have to say about the credit terms that existed between UNS Gas and BP Energy during the test year?

A. On page 4 of his Surrebuttal Testimony, Dr. Fish expressed an opinion that the credit terms were "not realistic" and "not representative of normal credit terms." He goes on to state that "UNS Gas has the discretion to obtain more favorable terms and conditions from another supplier," and that UNS Gas customers should not have to bear the incremental cost of these credit terms.

Q. What aspect of these credit terms does Dr. Fish criticize?

A. He criticizes the making of payments to BP Energy twice per month instead of on a monthly basis as is customary. His main problem with the acceleration of payments is that the Company's working capital requirements are higher than they would otherwise be.

Q. Did the Company have any alternatives it could have pursued in lieu of making accelerated payments?

A. Yes, but neither of these alternatives would have been cost effective. One of these alternatives would have involved the posting of cash collateral with BP Energy for an extended period of time. The other alternative would have required the issuance of a bank letter of credit in the favor of BP energy. Both of these alternatives would have been more costly than the accelerated payment plan.

Q. Do you agree with Dr. Fish that UNS Gas had the discretion to obtain more favorable terms from another supplier?

A. No. During the test year, BP Energy was a full-requirements supplier to UNS Gas. Only under very limited circumstances would the Company have been permitted to purchase gas from another provider. Since the expiration of that full-requirements contract in mid-

47

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rejoinder Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

August 5, 2009

2008, the Company has started purchasing gas from other suppliers. However, it should be noted that other suppliers are not providing generous amounts of credit to UNS Gas. BP Energy still provides more trade credit to UNS Gas than any of the other gas suppliers the Company is now doing business with.

Q. Do you agree with Dr. Fish that the credit terms extended by BP Energy were "not realistic" and "not representative of normal credit terms"?

A. No. As stated above, BP Energy has extended more trade credit to UNS Gas than any other supplier. Credit terms are negotiated between a buyer and seller as part of the contracting process. Since BP Energy was the Company's sole gas supplier during the test year, and since UNS Gas' credit profile is weaker than most gas utilities, it should not be surprising that UNS Gas would bump up against this credit limit during peak periods of gas usage. While the acceleration of payments to third party providers is not a very common practice, in the case of UNS Gas is was a cheaper alternative relative to posting cash collateral or providing a letter of credit.

Q. Do you agree with Dr. Fish that the Company's customers should not be responsible for the incremental cost of providing credit support?

A. No. The Company makes no profit on the sale of natural gas procured in the wholesale market for retail customers. Since the Company is providing a valuable gas procurement service that benefits its retail customers with no mark-up, it is hard to understand why Dr. Fish believes that credit support costs incurred for gas procurement should not be recouped by the Company.

48

BEFORE THE ARIZONA CORPORATION COMMISSION

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

At: Phoenix, Arizona

Date: August 11, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 239 through 396)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

it? Did you hire a lawyer? Did you go to bat for your company and your ratepayers?

A. Well, this has been a long-dated relationship, and I believe it's been a beneficial relationship for all parties involved, our business relationship with BP Energy. So, you know, it would really be a last resort before we would go hire an attorney to try and resolve this.

The way it's typically done in wholesale energy procurement is that we have someone in our shop who manages credit exposure from our angle. You know, they have someone in their -- probably a credit manager on their side who manages credit risk from their side. Those two parties try to negotiate.

You know, we would obviously try to negotiate a higher credit allowance, you know, but quite frankly, it's not something that we can just do unilaterally. It's their decision as a seller of gas to us as to how much credit they're willing to extend to us. And so, you know, in the context of what they were comfortable with from a credit standpoint, you know, their request was not unreasonable.

Q. Okay. But it made a big difference, though, it looks to me like. I mean, I don't know exactly what it meant on a month-to-month basis for the company, and we

49

BEFORE THE ARIZONA CORPORATION COMMISSION

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

At: Phoenix, Arizona

Date: August 11, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 239 through 396)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

can ask Mr. Dukes about that, but if what happened caused your cash working capital to jump from -- adjustment to jump from $97,000 to $2.1 million, that's significant, it seems to me. And that means this company, BP, was asking you to lay out a lot more cash every month and earlier every month.

And, you know, it just seems to reason that if I'm a company and I'm being asked to lay out all of that cash on the front end, and I have opportunity costs associated with laying out that cash and not collecting interest on it or investing elsewhere, I'm going to be a little upset, aren't I?

A. You are not happy with the collateral call. We never are, but it's part of doing business. And we get collateral calls all the time from counterparties.

Q. So Mr. Dukes would know what you did to fight it?

A. No. I would probably be in a better position, because our credit person reports to me.

Q. So did you fight it?

A. Our credit manager, who is Barbara McCormick, is also our assistant treasurer. Barbara called BP, her counterpart at BP Energy, and tried to work out some additional credit. It just was not forthcoming.

Q. And when did that happen, Mr. Grant? Was that during the credit crisis of September 2008, or is that

50

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rejoinder Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

August 5, 2009

Q. What did Dr. Fish have to say about the credit terms that existed between UNS Gas and BP Energy during the test year?

A. On page 4 of his Surrebuttal Testimony, Dr. Fish expressed an opinion that the credit terms were "not realistic" and "not representative of normal credit terms." He goes on to state that "UNS Gas has the discretion to obtain more favorable terms and conditions from another supplier," and that UNS Gas customers should not have to bear the incremental cost of these credit terms.

Q. What aspect of these credit terms does Dr. Fish criticize?

A. He criticizes the making of payments to BP Energy twice per month instead of on a monthly basis as is customary. His main problem with the acceleration of payments is that the Company's working capital requirements are higher than they would otherwise be.

Q. Did the Company have any alternatives it could have pursued in lieu of making accelerated payments?

A. Yes, but neither of these alternatives would have been cost effective. One of these alternatives would have involved the posting of cash collateral with BP Energy for an extended period of time. The other alternative would have required the issuance of a bank letter of credit in the favor of BP energy. Both of these alternatives would have been more costly than the accelerated payment plan.

Q. Do you agree with Dr. Fish that UNS Gas had the discretion to obtain more favorable terms from another supplier?

A. No. During the test year, BP Energy was a full-requirements supplier to UNS Gas. Only under very limited circumstances would the Company have been permitted to purchase gas from another provider. Since the expiration of that full-requirements contract in mid-

2008, the Company has started purchasing gas from other suppliers. However, it should be noted that other suppliers are not providing generous amounts of credit to UNS Gas. BP Energy still provides more trade credit to UNS Gas than any of the other gas suppliers the Company is now doing business with.

Q. Do you agree with Dr. Fish that the credit terms extended by BP Energy were "not realistic" and "not representative of normal credit terms"?

A. No. As stated above, BP Energy has extended more trade credit to UNS Gas than any other supplier. Credit terms are negotiated between a buyer and seller as part of the contracting process. Since BP Energy was the Company's sole gas supplier during the test year, and since UNS Gas' credit profile is weaker than most gas utilities, it should not be surprising that UNS Gas would bump up against this credit limit during peak periods of gas usage. While the acceleration of payments to third party providers is not a very common practice, in the case of UNS Gas is was a cheaper alternative relative to posting cash collateral or providing a letter of credit.

Q. Do you agree with Dr. Fish that the Company's customers should not be responsible for the incremental cost of providing credit support?

A. No. The Company makes no profit on the sale of natural gas procured in the wholesale market for retail customers. Since the Company is providing a valuable gas procurement service that benefits its retail customers with no mark-up, it is hard to understand why Dr. Fish believes that credit support costs incurred for gas procurement should not be recouped by the Company.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

At: Phoenix, Arizona

Date: August 11, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME II
(Pages 239 through 396)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

objection to RUCO-10?

(No response.)

ACALJ NODES: RUCO-10 is admitted.

(Exhibit RUCO-10 was admitted into evidence.)

MR. POZEFSKY: Thank you.

Q. (BY MR. POZEFSKY) I have just a few questions on this issue of the cash working capital, Mr. Grant.

I'll ask you, Mr. Grant, when the company entered into the agreements which changed or -- which changed the payment schedule, did the company consider what the impact would be on the company's cash working capital? Are you the witness to ask that?

A. Well, by cash working capital from a financial standpoint, that's -- you're basically talking about our liquidity. So yes, we considered that.

Q. Did you consider what the impact would be on the ratepayers?

A. Well, we considered the cost differential between that course of action and the other courses of action, which would have meant either getting another letter of credit from a bank, or just posting additional cash and depositing it in escrow for that period of time. So we did consider the costs, what we felt were the lower cost options, which should translate into benefit to customers.

Q. But ultimately the company was aware that it would have an effect on the company's cash working capital, correct?

A. You mean in terms of what is presented in this rate case?

Q. Yes.

A. No. I think at the time we were more focused on just making sure that we could have access to that gas supply. I don't think we were too concerned -- I mean, if you will, just given the situation we were in, we were more concerned about just making sure that we continued to receive gas under our contract for our customers as opposed to what, you know, impact it might have on cash working capital in a future rate case.

Q. Well, you are aware, Mr. Grant, that the company's cash working capital went up from $1,300, I believe, in its direct case, and then when we considered the payments, the cash working capital request now is 2.1 million, correct?

A. I don't know the specific numbers. That would be from Mr. Dukes.

Q. Okay.

A. I'm responding to Mr. Fish's commentary on our credit arrangement with BP Energy, because I believe he's off the mark.

MR. POZEFSKY: Thank you. That's all I have,

51

NO

REFERENCE

TO

RECORD

52

SEE

APPENDIX

"A"

ATTACHED TO BRIEF

53

BEFORE THE ARIZONA CORPORATION COMMISSION

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.	DOCKET NO. G-04204A-08-0571

Direct Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

November 7, 2008

III. CUSTOMER ANNUALIZATION ADJUSTMENT.

Q. What is the purpose of a customer annualization adjustment in the rate-making process?

A. Customer annualization adjustments should restate the number of test-year bills and volumes to be *consistent with* (but not necessarily *equal to*) the number of customers on the system at the end of the test-year. Customers should expect a positive customer adjustment on a growing system. A positive customer adjustment typically entails additions to both customers and therms.

Q. Is your customer annualization adjustment positive given that the UNS Gas system is growing?

A. No, the adjustment is negative. The customer annualization adjustment, exclusive of an adjustment for a specific industrial customer, is a negative 837,517 therms. This adjustment follows the simple methodology that was supported by both the Staff and RUCO in the Company's last general rate case, and approved in Decision No. 70011. This approved adjustment methodology must now be applied consistently and uniformly to avoid biasing the customer annualization adjustment results.

Q. Why is the customer annualization adjustment negative?

A. Under the methodology approved in Decision No. 70011, the monthly customers during the test year are brought equal to the year-end customer count levels. Assuming that customers grow by a positive amount each and every month, there will be a positive customer annualization adjustment for each month, and therefore a positive overall customer annualization adjustment. Customer counts in early months of the test-year would need to be adjusted upward (a positive adjustment) to bring them to test year-end levels.

However, customer counts on the UNS Gas system often follow a more cyclical, seasonal pattern, with the customer count falling during the summer months. If the test-year ends during the summer (as in this case in June 2008), the test-year-end customer count may be less than some of the monthly customer counts during the previous eleven months of the test year. If months prior to test-year-end have customer counts greater than test year-end levels, the approved annualization methodology will lead to negative annualization adjustments for these months. A negative annualization adjustment means that a month's customer count would need to be adjusted downward to the lower customer count prevailing at test-year end.

In this proceeding, there are enough negative monthly adjustments to tip the net customer annualization adjustment (the sum of all annualization adjustments across months and across classes) negative, even for the growing UNS Gas system. Because the Company's proposal in the last general rate case to adjust for cyclicality in the customer count was rejected by the Commission, I am supporting the proposed negative annualization adjustment on the grounds that it is calculated using the Commission-approved methodology. Had the Company's adjustment for cyclicality been employed in this proceeding's customer annualization, the customer annualization adjustment would have brought monthly adjusted customers to levels adjusted for cyclicality and *consistent* with test-year-end levels – not simply to levels *equal* to year-end levels.

Q. What was the effect of customer annualization adjustments on test-year sales volumes?

A. Adding the negative 837,517 therm adjustment discussed above to a negative customer annualization adjustment of 2,290,881 therms attributable to one of the Company's industrial customers yields a total customer annualization adjustment of a negative 3,128,398 therms.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

July 8, 2009

I. INTRODUCTION.

Q. Please state your name and address.

A. My name is D. Bentley Erdwurm. My business address is One South Church Avenue, Tucson, Arizona 85701.

Q. Did you file Direct Testimony in this proceeding?

A. Yes.

Q. On whose behalf are you filing your Rebuttal Testimony in this proceeding?

A. My Rebuttal Testimony is filed on behalf of UNS Gas, Inc. ("UNS Gas").

Q. What is the purpose of your Rebuttal Testimony in this proceeding?

A. The purpose of my Rebuttal Testimony is to address Arizona Corporation Commission ("Commission") Staff's and the Residential Utility Consumer Office's ("RUCO") Direct Testimony on (i) the customer annualization adjustment, and (ii) UNS Gas' proposal for phased-in residential customer charge increases over a two-year period after rate implementation.

II. CUSTOMER ANNUALIZATION ADJUSTMENT.

Q. Please address the issue of the customer annualization adjustment.

A. UNS Gas proposed a customer annualization adjustment that follows the methodology approved in UNS Gas' last general rate case, Docket No. 04204A-06-0463, Decision No. 70011 (the "2006 Rate Case"). In both the 2006 Rate Case and this current, pending rate case, I refer to the methodology approved in Decision No. 70011 as "traditional."

Decision No. 70011 (at page 18-19) unambiguously expressed a preference for, and adopted, the traditional method of customer annualization adjustments.

In this proceeding, UNS Gas follows the approved "traditional" customer annualization methodology, while Staff and RUCO have deviated from this approved methodology.

Q. Please briefly describe the traditional customer annualization methodology.

A. Under this traditional approach, the monthly customer count for each of the first eleven months of the test-year is brought equal to the customer count in the twelfth and final month of the test-year (i.e., test-year-end). Assuming that the customer count grows by a positive amount each month, there will be a positive customer annualization adjustment for each month, and therefore a positive overall customer annualization adjustment. Customer counts for the first eleven months of the test-year would need to be adjusted upward (a positive adjustment) to bring them to the test-year-end level.

The purpose of the customer annualization adjustment is to recognize growth over the test-year. The customer count in the last (12^{th}) month of the test-year is never adjusted because the last month is test-year-end. The count in the next-to-last (11^{th}) month is adjusted for one month of growth, because the eleventh month is just one month removed from test-year-end. As one steps back in time toward the beginning of the test-year, the monthly counts are adjusted for progressively more months of growth. In this simple example, the monthly adjusted customer count (i.e., the actual customers plus the adjustment for each month) over the test-year is constant and unchanging.

UNS Gas' residential and commercial customer counts exhibit some seasonal variation. Customer counts dip in the summer, when some customers disconnect service with the intention of reconnecting in the late fall and winter. Test-year customer counts in the

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rejoinder Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

August 5, 2009

Q. Do you agree with Mr. Smith's contention?

A. Not at all. This result is an expected consequence of the application of the traditional approach to customer annualization. And it is not just expected; the result is entirely appropriate, in the public interest, and necessary to ensure equitable and consistent treatment of the parties to this proceeding.

Q. Please explain.

A. UNS Gas has in this proceeding proposed the exact methodology approved the Commission and supported by Staff and RUCO in the 2006 Case. This methodology is well-established in Arizona and elsewhere. I have been calculating customer annualization adjustments using this simple method since early 1982 when I was employed by the Public Utility Commission of Texas.

Under the traditional approach to customer annualization, customer counts are adjusted to test-year-end levels. The traditional approach is simple, and does not attempt to remove the effects of seasonality. Mr. Smith states the obvious with his observation that "the decrease in revenue produced by the Company's calculation appears to be related to customer <u>seasonality</u> rather than a permanent decline in customer count during the test year." (Smith Surrebuttal, page 38, lines 8-11.) Since UNS Gas adds seasonal customers in the winter and loses them in the summer, the traditional method of customer annualization yields relatively larger customer annualization adjustments (that tend to lower rates) for winter-ending test years and relatively smaller customer annualization adjustments (that tend to increase rates) for summer ending test-years – as we had in this proceeding (test year ended June 30, 2008) – as compared to approaches that remove the effects of seasonality. The application of the traditional approach to customer count data for the test-year ended June 30, 2008 – data that exhibits both seasonality and an insignificant underlying growth rate - results in a negative customer annualization in this case.

Equity dictates that these customer annualization results be compared to the results of the 2006 Rate Case, which had a winter-ending test-year (December 31, 2005). In the 2006 Rate Case, use of the traditional approach resulted in larger customer annualization adjustment (which resulted in lower rates) than would an adjustment based on an approach removing seasonality. Because of seasonality, actual December customer counts – which are the basis for the customer annualization adjustment – were relatively high because of the presence of seasonal customers. Neither Staff nor RUCO witnesses were concerned about *seasonality in the 2006 Case when seasonality* reduced UNS Gas' rate increase. In fact, Mr. Smith, then a Staff witness, argued in favor of the use of the traditional approach because it is straight-forward and transparent.[1] RUCO's witness in the 2006 Case, Marylee Diaz-Cortez, claimed that the seasonality was not extreme enough to "depart from the 'traditional' or **Commission-accepted** (*emphasis added)* methodology of revenue annualization."[2]

RUCO – and Staff -- seem determined to oppose the use of the traditional approach when it does not reduce rates. It is unfortunate that Staff and RUCO are permitting the final result – whether rates are increased or reduced – to determine their choice of customer annualization methodology. However, sometimes the traditional and accepted customer annualization approach results in smaller customer annualization adjustments and sometimes it results in larger customer annualization adjustments – as compared to alternate methods adjusting for seasonality. So sometimes application of the traditional

---

[1] 2006 Case, Smith Surrebuttal, page 20, lines 15-22.

[2] See Diaz-Cortez Surrebuttal, Docket No. G-04204A-06-0463, page 12, lines 20-23, see also Decision No. 70011 (November 27, 2007) at page 18, lines 18-20.

adjustment increases rates, and sometimes it decreases rates. This is an equitable result. Over time, things balance out if the traditional approach is used consistently.

Q. Why did you not in this case propose an alternate customer annualization?

A. In the 2006 Case, I did propose such an approach. However, the approach was opposed by both Staff and RUCO, and the Commission opted to maintain the traditional approach in Decision No. 70011. I accepted that the Commission preferred the traditional approach over my proposed approach; therefore, I used the traditional approach in this pending case. The use of the traditional approach in this pending case is consistent with Decision No. 70011, as well as numerous previous gas rate cases in Arizona.

Q. Mr. Smith criticizes your "rote" application of the traditional approach in this pending case. (Smith Surrebuttal, page 38, lines 6-8). Please comment.

A. For Mr. Smith, avoidance of "rote application" seems to be code for a "heads I win, tails you lose" approach that is biased against UNS Gas. Moving back and forth between methodologies – looking for an end result of the lowest possible rates – does not result in just and reasonable rates, is inequitable and is not in the public interest.

Q. In the prior UNS Gas rate case, you proposed an annualization approach that made an adjustment to address seasonality. Why are you opposed to Staff witness Dr. Thomas Fish's customer annualization approach, which also attempts to take seasonality into account?

A. Dr. Fish's unorthodox approach does not simply seek to remove the impact of seasonality within the historic test year – which is what I suggested in the last rate case. Instead, he amplifies seasonality by first adjusting customer counts to relatively high December 2007 customer levels and then inflating them further by applying an inappropriate growth factor. This approach is wholly inconsistent with the historic test year requirement.

Indeed, Dr. Fish's approach acts as a "double whammy" against UNS Gas. Adjusting to December levels *even without the growth factor* is inappropriate. December is not test-year end and the choice of December as an adjusting point appears an attempt to maximize the size of the customer annualization adjustment by adjusting to a seasonal peak. Increasing the December count by the growth factor rubs salt in the wound. The flaws in Dr. Fish's approach are many; they have been extensively discussed in my Rebuttal Testimony. In my Rebuttal Testimony, I explain that Dr. Fish is effectively using a future test-year approach to customer annualization but has failed to coordinate the revenue element of the ratemaking formula with expenses, rate base, and other components affecting rates. In short, he has violated the matching principle.

Q. Did Dr. Fish's Surrebuttal Testimony address some of your concerns?

A. No. I became even more concerned because of his continued attempts to salvage his flawed customer annualization adjustment. Dr. Fish is attempting to forecast customer counts. And a customer annualization adjustment is not identical to a forecast. The fact that he claims to have used historical data to reach his result is inconsequential to the question of whether he is forecasting. The most straightforward way to ascertain whether he is forecasting is to look at the adjusted customer counts that are the basis for his customer annualization adjustment. The customer counts to which Dr. Fish is adjusting exceed all historical regular residential and small volume commercial customer counts. Even one year <u>after</u> the end of the test-year, these customer count levels still have not been reached. In light of these results, we can say absolutely and unambiguously that the customer counts to which Dr. Fish are adjusting are not historical values. Either the customer counts to which Dr. Fish are adjusting are *future* customer counts to be realized at some indeterminate time, or they are customer counts that will never be realized, but they are certainly not historical data.

54

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

July 8, 2009

2006 Rate Case exhibited seasonal variation similar to the variation in the current case. In the 2006 Rate Case, the Commission stated that there was a lack of significant seasonality, and no reason to deviate from the traditional method.[1] The Commission's stated position in favor of the traditional method motivated UNS Gas' use of this method.

Q. Are you concerned that Staff and RUCO witnesses have abandoned the use of the traditional customer annualization methodology?

A. Yes. Both Staff and RUCO witnesses strongly supported the traditional approach in the 2006 Rate Case. Staff's witness Mr. Ralph Smith (now RUCO's witness) testified that the "traditional method of customer annualization has been effective in appropriately coordinating the revenue element of the ratemaking formula with the other components, such as rate base."[2] Likewise, RUCO's witness, Ms. Marylee Diaz-Cortez, stated that UNS Gas does not experience "extreme seasonality" and that there is no "reason to depart from the "traditional" or Commission-accepted methodology of revenue annualization."[3]

Q. Please compare the impact of applying the traditional approach in this case, as compared to the 2006 Rate Case.

A. In the 2006 Rate Case, the traditional approach resulted in a less favorable result for UNS Gas (i.e., lower final rate levels), and the traditional approach was wholeheartedly supported by Staff and RUCO. By contrast, in this current case, the traditional approach results in a more favorable outcome for UNS Gas (i.e., higher final rate levels), however, Staff and RUCO now appear to have soured on the traditional approach.

---

[1] Decision No. 70011 at page 19.
[2] Surrebuttal Testimony of Ralph C. Smith, Docket No. G-04204A-06-0463, page 21, lines 16-18.
[3] Surrebuttal Testimony of Marylee Diaz-Cortez, Docket No. G-04204A-06-0463, page 12, lines 20-23.

55

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

July 8, 2009

2006 Rate Case exhibited seasonal variation similar to the variation in the current case. In the 2006 Rate Case, the Commission stated that there was a lack of significant seasonality, and no reason to deviate from the traditional method.[1] The Commission's stated position in favor of the traditional method motivated UNS Gas' use of this method.

Q. Are you concerned that Staff and RUCO witnesses have abandoned the use of the traditional customer annualization methodology?

A. Yes. Both Staff and RUCO witnesses strongly supported the traditional approach in the 2006 Rate Case. Staff's witness Mr. Ralph Smith (now RUCO's witness) testified that the "traditional method of customer annualization has been effective in appropriately coordinating the revenue element of the ratemaking formula with the other components, such as rate base."[2] Likewise, RUCO's witness, Ms. Marylee Diaz-Cortez, stated that UNS Gas does not experience "extreme seasonality" and that there is no "reason to depart from the "traditional" or Commission-accepted methodology of revenue annualization."[3]

Q. Please compare the impact of applying the traditional approach in this case, as compared to the 2006 Rate Case.

A. In the 2006 Rate Case, the traditional approach resulted in a less favorable result for UNS Gas (i.e., lower final rate levels), and the traditional approach was wholeheartedly supported by Staff and RUCO. By contrast, in this current case, the traditional approach results in a more favorable outcome for UNS Gas (i.e., higher final rate levels), however, Staff and RUCO now appear to have soured on the traditional approach.

---

[1] Decision No. 70011 at page 19.
[2] Surrebuttal Testimony of Ralph C. Smith, Docket No. G-04204A-06-0463, page 21, lines 16-18.
[3] Surrebuttal Testimony of Marylee Diaz-Cortez, Docket No. G-04204A-06-0463, page 12, lines 20-23.

56

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 GAS, INC. FOR 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 DECISION NO. **70011** **OPINION AND ORDER**

DATES OF HEARING: April 16, 17, 18, 19, 20, 24, and 25, 2007.

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Dwight D. Nodes

IN ATTENDANCE: Mike Gleason, Chairman
Kristin K. Mayes, Commissioner

APPEARANCES:

Mr. Michael W. Patten and Mr. Timothy Sabo, ROSHKA, DEWULF & PATTEN, P.L.C. and Ms. Michelle Livengood, UNISOURCE ENERGY SERVICES, on behalf of Applicant;

Mr. Scott S. Wakefield, Chief Counsel, on behalf of the Residential Utility Consumer Office;

Ms. Cynthia Zwick, Executive Director, Arizona Community Action Association;

Mr. Marshall Magruder, in propria persona; and

Mr. Keith Layton and Ms. Maureen Scott, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

We agree with Staff and RUCO that UNS has not presented a valid case for departing from the traditional method of calculating customer revenue annualization. Although the Company's arguments may have some validity in a theoretical sense, adoption of the cyclical methodology is not warranted in this proceeding. RUCO and Staff highlighted some of the flaws inherent in the Company's proposal, including the lack of any significant demonstrated seasonality, the complexity of the formula, lack of transparency, and the claim by the Staff witness that the methodology may actually result in an understatement of revenues. We therefore decline to adopt UNS's revenue annualization proposal.

<u>Weather Normalization</u>

Staff witness Ralph Smith stated that Staff's weather normalization adjustment increases retail revenue by $1,962, compared to UNS's proposal, because, in Staff's annualization, the weighted average number of customers exceeded the level reflected in the Company's corresponding annualization. Mr. Smith claims that both the Staff and UNS weather normalization adjustments reflect an increase to revenue due to warmer than normal temperatures during the test year (Ex. S-27 at 25).

In its brief, UNS states that the weather normalization adjustment should reflect the other positions taken herein, including the customer annualization adjustment proposed by the Company.

Although RUCO accepts the Company's proposed weather normalization, it proposes a further adjustment of $900 related to the additional customers/revenue the Company proposes be recognized as a result of its customer annualization proposal (RUCO Ex. 6 at 16).

It is not entirely clear whether the weather normalization issue remains in dispute given our determination above that the Company's customer annualization recommendation should not be adopted. To the extent that there is any remaining disagreement on this issue, we adopt Staff's weather normalization recommendation in accordance with the discussion above regarding customer annualization.

. . .

. . .

. . .

57

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

July 8, 2009

UNS Gas strongly believes that equity dictates that the traditional approach – as the "accepted" approach - should apply in this case since it applied in the 2006 Rate Case which was adjudicated very recently.

Q. Explain why the consistency in customer annualization adjustment methodology is preferable to switching back and forth between various approaches.

A. One of the best arguments for consistency is that it promotes and supports the image of basic fairness in the treatment of various parties to the case. Moving back and forth between methodologies – looking for an end result of the lowest possible rates – does not result in just and reasonable rates, is inequitable and is not in the public interest.

Q. How does Dr. Fish attempt to justify deviating from the traditional approach?

A. Dr. Fish points to seasonal changes in UNS Gas' number of customers. UNS Gas experiences a slight drop in the number of customers in the summer, and Dr. Fish argues that this seasonality renders the traditional approach inappropriate for use in this case. However, UNS Gas' seasonality is essentially unchanged from the 2006 Rate Case, when the Commission noted a "lack of any significant demonstrated seasonality."[8] Moreover, the alleged seasonality problem raised by Dr. Fish typically occurs whenever an Arizona gas utility uses a test-year that ends in the summer.

Q. Are there other issues related to the customer annualization?

A. Yes. Staff's flawed customer annualization adjustment resulted in related flawed adjustments - fruits of the poisonous tree - to weather normalization and to rate case revenue annualization. Moreover, the flaws in Dr. Fish's rate case revenue annualization are compounded; the revenue annualization does not fully adjust test-year revenue for the rate change that occurred within the test-year. It appears that Dr. Fish's adjustment is

[8] Decision No. 70011 at page 19, line 5.

58

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

methodology.

With your customer annualization methodology you took the customer account at the midpoint of the test year; correct?

A. That's right.

Q. Which would be the December 2007 numbers?

A. That's correct.

Q. And is it fair to say that the December 2007 customer count was among the highest monthly customer account for the test year?

A. Yes, just from looking at it it appears that it's winter peaking.

Q. And summer months are somewhat lower than that?

A. Yes.

Q. And then assumed a growth rate of 2.5 percent annually for the remainder of the year, and so therefore you added 1.25 percent to the December customer count numbers?

A. No, I didn't assume at all. What I did was assume that the company knew what its growth rate was and use that growth rate, which on the average is two and a half percent. I didn't forecast a growth rate. I didn't do any type of forecast analysis of the company's growth rate.

But I did use what the company -- the company

59

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rejoinder Testimony of

David G. Hutchens

on Behalf of

UNS Gas, Inc.

August 5, 2009

Q. Are there other flaws to Dr. Fish argument?

A. Yes. Dr. Fish implies that a Company with no, or low, overall net customer growth cannot have growth related expenses. This is factually incorrect. A company could be adding new customers to its system and be losing an equal number of existing customers with the net result of "no growth". One can clearly see that a company in this situation would still have growth related investments. This may be particularly true where a company provides service to a broad, yet diverse, area.

Q. Is this what the Company is experiencing?

A. To some extent. We still have new customers hooking up to our systems but we are also losing a number of customers. The net of which is a lower overall customer growth rate and growth related expenses that are higher than would be expected if you looked at overall (or net) customer growth. Moreover, in this economy, lost customers can be particularly exacerbated in a situation where your service area includes a significant number of second homes or investor-owned homes.

Q. Dr. Fish continues to rely on a 2.5% growth estimate for UNS Gas from last fall. Is that reliance appropriate?

A. No. That estimate is outdated and reflected a 10-year average growth level as estimated last fall. It was not intended to reflect a short-term growth estimate. Even UNS Gas' one-year growth estimate from last fall (1.0%) ended up being significantly overstated to what occurred (-0.1%) Indeed, as set forth in Mr. Erdwurm's Rebuttal Testimony, there has been no short-term growth in our service area. Moreover, recent growth estimates have decreased significantly. For example, UNS Gas does not expect more than a 0.6% average annual growth over the next three years. But that number could change significantly again, depending on a variety of factors. Such variability is one reason why growth estimates simply are inappropriate for customer annualization calculations.

III. <u>RESPONSE TO SURREBUTTAL TESTIMONY OF RITA BEALE.</u>

Q. Do you agree with the clarifications Ms. Rita Beale provided in her Surrebuttal Testimony regarding her Direct Testimony Recommendations?

A. Yes. Her clarifications fill in the gaps in my understanding of her recommendations and will be implemented by the Company.

Q. Does this conclude your Rejoinder Testimony?

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

<u>COMMISSIONERS</u>
KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

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

Rebuttal Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

July 8, 2009

improperly limited to his overstated customer growth estimate. A rate case annualization adjustment should apply to all test-year sales – not just growth – billed prior to the "within-the-test-year" rate change. Therefore, Staff's adjustments to weather normalization and to rate case revenue annualization do not conform to accepted methodologies and should not be adopted.

III. CUSTOMER COUNTS SINCE THE END OF THE TEST YEAR.

Q. Do you have more recent data concerning customer counts?

A. Yes. Exhibit DBE-3 shows customer count data through May 2009. After the test-year (i.e., after June 2008), UNS Gas has experienced minimal to negative growth. Current (May 2009) residential (R-10) and small commercial (C-20) customer counts are below end of the test-year levels. Exhibit DBE-3 demonstrates that the customer counts used by Dr. Fish in his customer annualization adjustment are so significantly overstated that, even eleven months after the end of the test-year, UNS Gas' actual customer counts still fall well short of Dr. Fish's results. Additionally, Exhibit DBE-3 demonstrates that customer growth has slowed substantially in the test-year and in more recent months. As shown on pages 2 and 5 of Exhibit DBE-3, year-over-year customer growth is *negative* for eight out of eleven post test-year months. Thus, even if Dr. Fish's method is used, his growth factor is clearly excessive.

IV. PHASED-IN RESIDENTIAL CUSTOMER CHARGE INCREASES.

Q. Please summarize why UNS Gas is proposing to phase-in the residential customer charge increases over a two-year period.

A. My Direct Testimony focused on the need to recover more fixed costs through the fixed customer charge component. I proposed a phased-in increase for the (non-CARES)

60

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for: By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

rate case within two years. In fact, they filed almost immediately a new case after the last rate case decision.

I'm wondering if that is, in fact, the case, if they come in within a two-year period, isn't it likely that customer growth, given the current state of the economy, is likely to remain somewhat flat during that two-year period, even if there is some smaller recovery, that the growth of customers is not likely to reach the levels that were previously seen, say, in the 2006/2007 time period?

A. You know, to be perfectly honest with you, I think the company is in a situation where its growth is difficult. One of the confidential data requests -- and for the life of me I can't remember right now -- the company showed --

Q. Wait a minute. Wait a minute. If it's a confidential data request, I'm assuming there is --

A. It's relevant. It's really relevant.

Q. Well, I know.

A. I can't remember the numbers, so I can't violate the -- I can recall the general --

Q. Okay. Well, as long -- I don't know what is confidential or what is not, but I don't want you to disclose in a public record something that you have signed an agreement not to disclose. And if that is where you

61

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

A. About 127,000 approximately.
Q. Right, and adding 1.25 percent to that number; correct?
A. That's correct.
Q. And the empirical evidence is that at no point during the historic test year during this rate case did the R-10 number count exceed 127,000 customers; correct?
A. That's correct. Just as Company witness Erdwurm said, that it's not necessary that exceed, that it be equal. It simply should be consistent, and obviously this is consistent.
Q. So at no point did the customer count exceed your 127,000; is that right?
A. Yes. Clearly it didn't.
Q. And it didn't occur before the test year either, did it?
A. No.
Q. And it hasn't occurred up until today, has it?
A. No -- well, I didn't know. It didn't occur up until --
Q. You have seen customer --
A. -- Mr. Bentley's --
Q. -- counts --
MADAM COURT REPORTER: Sir, one at a time.
ACALJ NODES: One at a time. Wait until he is

done with his question and then answer.

THE WITNESS: Okay.

Q. BY MR. PATTEN: You have seen Mr. Bentley's exhibit that provided customer counts for R-10 customers up through May of 2009; correct?

A. It was through May, yes, sir.

Q. And that didn't approach your number of 128,000?

A. It approached it; it didn't exceed it.

ACALJ NODES: And, for the record, you are meaning Mr. Erdwurm not Mr. Bentley?

MR. PATTEN: We call him Mr. Bentley.

ACALJ NODES: Okay.

MR. PATTEN: But it was Mr. Erdwurm?

ACALJ NODES: Because he's the Rolls-Royce of witnesses.

Q. BY MR. PATTEN: Let's turn to bad debt expense.

A. Okay.

ACALJ NODES: If I could, just on this topic, before we move on.

MR. PATTEN: Sure.

FURTHER EXAMINATION

BY ACALJ NODES:

Q. Dr. Fish, your customer annualization

62

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

July 8, 2009

improperly limited to his overstated customer growth estimate. A rate case annualization adjustment should apply to all test-year sales – not just growth – billed prior to the "within-the-test-year" rate change. Therefore, Staff's adjustments to weather normalization and to rate case revenue annualization do not conform to accepted methodologies and should not be adopted.

III. CUSTOMER COUNTS SINCE THE END OF THE TEST YEAR.

Q. Do you have more recent data concerning customer counts?

A. Yes. Exhibit DBE-3 shows customer count data through May 2009. After the test-year (i.e., after June 2008), UNS Gas has experienced minimal to negative growth. Current (May 2009) residential (R-10) and small commercial (C-20) customer counts are below end of the test-year levels. Exhibit DBE-3 demonstrates that the customer counts used by Dr. Fish in his customer annualization adjustment are so significantly overstated that, even eleven months after the end of the test-year, UNS Gas' actual customer counts still fall well short of Dr. Fish's results. Additionally, Exhibit DBE-3 demonstrates that customer growth has slowed substantially in the test-year and in more recent months. As shown on pages 2 and 5 of Exhibit DBE-3, year-over-year customer growth is *negative* for eight out of eleven post test-year months. Thus, even if Dr. Fish's method is used, his growth factor is clearly excessive.

IV. PHASED-IN RESIDENTIAL CUSTOMER CHARGE INCREASES.

Q. Please summarize why UNS Gas is proposing to phase-in the residential customer charge increases over a two-year period.

A. My Direct Testimony focused on the need to recover more fixed costs through the fixed customer charge component. I proposed a phased-in increase for the (non-CARES)

EXHIBIT

DBE-3

UNS Gas, Inc.
Test-Year Ending June 30, 2008

Rate R-10 Customer Count
Customer Count Growth Measures (August 2003-May 2009)

Month	Monthly Customer Count	12 Month Moving Average	% Monthly Change in Moving Average	Monthly Change On Annualized Basis	Year-Over-Year Change
August-03	112,280	-----	-----	-----	-----
September-03	112,347	-----	-----	-----	-----
October-03	113,807	-----	-----	-----	-----
November-03	114,975	-----	-----	-----	-----
December-03	114,402	-----	-----	-----	-----
January-04	115,000	-----	-----	-----	-----
February-04	114,331	-----	-----	-----	-----
March-04	115,254	-----	-----	-----	-----
April-04	115,491	-----	-----	-----	-----
May-04	115,241	-----	-----	-----	-----
June-04	115,969	-----	-----	-----	-----
July-04	115,533	114,553	-----	-----	-----
August-04	116,003	114,863	0.3%	3.3%	3.3%
September-04	115,949	115,163	0.3%	3.2%	3.2%
October-04	115,763	115,326	0.1%	1.7%	1.7%
November-04	116,776	115,476	0.1%	1.6%	1.6%
December-04	117,256	115,714	0.2%	2.5%	2.5%
January-05	117,850	115,951	0.2%	2.5%	2.5%
February-05	117,950	116,253	0.3%	3.2%	3.2%
March-05	118,857	116,553	0.3%	3.1%	3.1%
April-05	118,520	116,806	0.2%	2.6%	2.6%
May-05	118,414	117,070	0.2%	2.8%	2.8%
June-05	118,917	117,316	0.2%	2.5%	2.5%
July-05	118,669	117,577	0.2%	2.7%	2.7%
August-05	119,326	117,854	0.2%	2.9%	2.9%
September-05	119,352	118,138	0.2%	2.9%	2.9%
October-05	120,088	118,498	0.3%	3.7%	3.7%
November-05	120,644	118,820	0.3%	3.3%	3.3%
December-05	121,483	119,173	0.3%	3.6%	3.6%
January-06	122,261	119,540	0.3%	3.8%	3.7%
February-06	122,562	119,924	0.3%	3.9%	3.9%
March-06	122,791	120,252	0.3%	3.3%	3.3%
April-06	122,689	120,600	0.3%	3.5%	3.5%
May-06	122,317	120,925	0.3%	3.3%	3.3%
June-06	122,404	121,216	0.2%	2.9%	2.9%
July-06	122,520	121,536	0.3%	3.2%	3.2%
August-06	123,022	121,844	0.3%	3.1%	3.1%
September-06	123,526	122,192	0.3%	3.5%	3.5%
October-06	124,204	122,535	0.3%	3.4%	3.4%
November-06	124,828	122,884	0.3%	3.5%	3.5%
December-06	125,383	123,209	0.3%	3.2%	3.2%
January-07	125,429	123,473	0.2%	2.6%	2.6%
February-07	125,495	123,717	0.2%	2.4%	2.4%
March-07	125,310	123,927	0.2%	2.1%	2.1%
April-07	125,010	124,121	0.2%	1.9%	1.9%
May-07	125,035	124,347	0.2%	2.2%	2.2%
June-07	124,841	124,550	0.2%	2.0%	2.0%

Rate R-10 Customer Count
Customer Count Growth Measures (August 2003-May 2009)

Month	Monthly Customer Count	12 Month Moving Average	% Monthly Change in Moving Average	Monthly Change On Annualized Basis	Year-Over-Year Change
July-07	**124,445**	**124,711**	**0.1%**	**1.6%**	**1.6% Test Year Month 1**
August-07	**124,320**	**124,819**	**0.1%**	**1.0%**	**1.1% Test Year Month 2**
September-07	**124,871**	**124,931**	**0.1%**	**1.1%**	**1.1% Test Year Month 3**
October-07	**125,497**	**125,039**	**0.1%**	**1.0%**	**1.0% Test Year Month 4**
November-07	**125,973**	**125,134**	**0.1%**	**0.9%**	**0.9% Test Year Month 5**
December-07	**126,530**	**125,230**	**0.1%**	**0.9%**	**0.9% Test Year Month 6**
January-08	**126,782**	**125,342**	**0.1%**	**1.1%**	**1.1% Test Year Month 7**
February-08	**126,799**	**125,451**	**0.1%**	**1.0%**	**1.0% Test Year Month 8**
March-08	**126,239**	**125,529**	**0.1%**	**0.7%**	**0.7% Test Year Month 9**
April-08	**125,566**	**125,575**	**0.0%**	**0.4%**	**0.4% Test Year Month 10**
May-08	**125,216**	**125,590**	**0.0%**	**0.1%**	**0.1% Test Year Month 11**
June-08	**124,957**	**125,600**	**0.0%**	**0.1%**	**0.1% Test Year Month 12**
July-08	124,790	125,628	0.0%	0.3%	0.3%
August-08	124,856	125,673	0.0%	0.4%	0.4%
September-08	124,712	125,660	0.0%	-0.1%	-0.1% Year-over-year contraction.
October-08	123,985	125,534	-0.1%	-1.2%	-1.2% Year-over-year contraction.
November-08	126,380	125,568	0.0%	0.3%	0.3%
December-08	125,522	125,484	-0.1%	-0.8%	-0.8% Year-over-year contraction.
January-09	125,136	125,347	-0.1%	-1.3%	-1.3% Year-over-year contraction.
February-09	126,134	125,291	0.0%	-0.5%	-0.5% Year-over-year contraction.
March-09	125,128	125,199	-0.1%	-0.9%	-0.9% Year-over-year contraction.
April-09	124,681	125,125	-0.1%	-0.7%	-0.7% Year-over-year contraction.
May-09	124,293	125,048	-0.1%	-0.7%	-0.7% Year-over-year contraction.

In months following the test year, there were year-over-year contractions in 8 out of 11 months --
NOT SIGNS OF A RAPIDLY GROWING SYSTEM.

Rate R-10 Customer Count
Customer Count Growth Measures

Month	Aug-03 through Jun-04	Jul-04 through Jun-05	Jul-05 through Jun-06	Jul-06 through Jun-07	**Test Year** Jul-07 through Jun-08	Jul-08 through May-09	Month
Jul		115,533	118,669	122,520	**124,445**	124,790	Jul
Aug	112,280	116,003	119,326	123,022	124,320	124,856	Aug
Sep	112,347	115,949	119,352	123,526	124,871	124,712	Sep
Oct	113,807	115,763	120,088	124,204	125,497	123,985	Oct
Nov	114,975	116,776	120,644	124,828	125,973	126,380	Nov
Dec	114,402	117,256	121,483	125,383	126,530	125,522	Dec
Jan	115,000	117,850	122,261	125,429	126,782	125,136	Jan
Feb	114,331	117,950	122,562	125,495	126,799	126,134	Feb
Mar	115,254	118,857	122,791	125,310	126,239	125,128	Mar
Apr	115,491	118,520	122,689	125,010	125,566	124,681	Apr
May	115,241	118,414	122,317	125,035	125,216	124,293	May
Jun	115,969	118,917	122,404	**124,841**	**124,957**		Jun

Dr. Fish adjusts to:	**128,112**	**R-10 Customers - A level never reached.**
Annualized Test-Year Growth (1st measure)	0.45%	(Based on Jul07 (beginning) and Jun08 (end)) (124957/124445)^(12/11)-1
Annualized Test-Year Growth (2nd measure)	0.09%	(Based on Jun07 (beginning) and Jun08 (end)) (124957/124841)-1

Rate R-20 Customer Count
Customer Count Growth Measures (August 2003-May 2009)

Month	Monthly Customer Count	12 Month Moving Average	% Monthly Change in Moving Average	Monthly Change On Annualized Basis	Year-Over-Year Change
August-03	10,219	-----	-----	-----	-----
September-03	10,198	-----	-----	-----	-----
October-03	10,208	-----	-----	-----	-----
November-03	10,404	-----	-----	-----	-----
December-03	10,511	-----	-----	-----	-----
January-04	10,699	-----	-----	-----	-----
February-04	10,687	-----	-----	-----	-----
March-04	10,747	-----	-----	-----	-----
April-04	10,788	-----	-----	-----	-----
May-04	10,680	-----	-----	-----	-----
June-04	10,647	-----	-----	-----	-----
July-04	10,532	10,527	-----	-----	-----
August-04	10,471	10,548	0.2%	2.4%	2.5%
September-04	10,449	10,569	0.2%	2.4%	2.5%
October-04	10,464	10,590	0.2%	2.4%	2.5%
November-04	10,711	10,616	0.2%	2.9%	3.0%
December-04	10,866	10,645	0.3%	3.4%	3.4%
January-05	10,901	10,662	0.2%	1.9%	1.9%
February-05	10,915	10,681	0.2%	2.2%	2.1%
March-05	10,998	10,702	0.2%	2.4%	2.3%
April-05	10,984	10,718	0.2%	1.8%	1.8%
May-05	10,926	10,739	0.2%	2.3%	2.3%
June-05	10,840	10,755	0.1%	1.8%	1.8%
July-05	10,796	10,777	0.2%	2.5%	2.5%
August-05	10,754	10,800	0.2%	2.7%	2.7%
September-05	10,724	10,823	0.2%	2.6%	2.6%
October-05	10,752	10,847	0.2%	2.7%	2.8%
November-05	10,845	10,858	0.1%	1.2%	1.3%
December-05	11,041	10,873	0.1%	1.6%	1.6%
January-06	11,159	10,895	0.2%	2.4%	2.4%
February-06	11,193	10,918	0.2%	2.6%	2.5%
March-06	11,201	10,935	0.2%	1.9%	1.8%
April-06	11,163	10,950	0.1%	1.6%	1.6%
May-06	11,068	10,961	0.1%	1.3%	1.3%
June-06	11,015	10,976	0.1%	1.6%	1.6%
July-06	11,000	10,993	0.2%	1.9%	1.9%
August-06	10,987	11,012	0.2%	2.1%	2.2%
September-06	11,035	11,038	0.2%	2.9%	2.9%
October-06	11,159	11,072	0.3%	3.8%	3.8%
November-06	11,288	11,109	0.3%	4.1%	4.1%
December-06	11,435	11,142	0.3%	3.6%	3.6%
January-07	11,477	11,168	0.2%	2.9%	2.8%
February-07	11,479	11,192	0.2%	2.6%	2.6%
March-07	11,444	11,213	0.2%	2.2%	2.2%
April-07	11,385	11,231	0.2%	2.0%	2.0%
May-07	11,337	11,253	0.2%	2.4%	2.4%
June-07	11,302	11,277	0.2%	2.6%	2.6%

Rate R-20 Customer Count
Customer Count Growth Measures (August 2003-May 2009)

Month	Monthly Customer Count	12 Month Moving Average	% Monthly Change in Moving Average	Monthly Change On Annualized Basis	Year-Over-Year Change
July-07	11,267	**11,300**	**0.2%**	**2.4%**	**2.4% Test Year Month 1**
August-07	11,227	**11,320**	**0.2%**	**2.1%**	**2.2% Test Year Month 2**
September-07	11,232	**11,336**	**0.1%**	**1.8%**	**1.8% Test Year Month 3**
October-07	11,306	**11,348**	**0.1%**	**1.3%**	**1.3% Test Year Month 4**
November-07	11,404	**11,358**	**0.1%**	**1.0%**	**1.0% Test Year Month 5**
December-07	11,558	**11,368**	**0.1%**	**1.1%**	**1.1% Test Year Month 6**
January-08	11,606	**11,379**	**0.1%**	**1.1%**	**1.1% Test Year Month 7**
February-08	11,614	**11,390**	**0.1%**	**1.2%**	**1.2% Test Year Month 8**
March-08	11,570	**11,401**	**0.1%**	**1.1%**	**1.1% Test Year Month 9**
April-08	11,482	**11,409**	**0.1%**	**0.9%**	**0.9% Test Year Month 10**
May-08	11,420	**11,416**	**0.1%**	**0.7%**	**0.7% Test Year Month 11**
June-08	11,384	**11,423**	**0.1%**	**0.7%**	**0.7% Test Year Month 12**
July-08	11,327	11,428	0.0%	0.5%	0.5%
August-08	11,284	11,432	0.0%	0.5%	0.5%
September-08	11,211	11,431	0.0%	-0.2%	-0.2% Year-over-year contraction.
October-08	11,299	11,430	0.0%	-0.1%	-0.1% Year-over-year contraction.
November-08	11,422	11,431	0.0%	0.2%	0.2%
December-08	11,505	11,427	0.0%	-0.5%	-0.5% Year-over-year contraction.
January-09	11,501	11,418	-0.1%	-0.9%	-0.9% Year-over-year contraction.
February-09	11,536	11,412	-0.1%	-0.7%	-0.7% Year-over-year contraction.
March-09	11,477	11,404	-0.1%	-0.8%	-0.8% Year-over-year contraction.
April-09	11,416	11,399	0.0%	-0.6%	-0.6% Year-over-year contraction.
May-09	11,354	11,393	0.0%	-0.6%	-0.6% Year-over-year contraction.

In months following the test year, there were year-over-year contractions in 8 out of 11 months --
NOT SIGNS OF A RAPIDLY GROWING SYSTEM.

UNS Gas, Inc.
Test-Year Ending June 30, 2008

Rate R-20 Customer Count
Customer Count Growth Measures

Month	Aug-03 through Jun-04	Jul-04 through Jun-05	Jul-05 through Jun-06	Jul-06 through Jun-07	Test Year Jul-07 through Jun-08	Jul-08 through May-09	Month
Jul		10,532	10,796	11,000	**11,267**	11,327	Jul
Aug	10,219	10,471	10,754	10,987	11,227	11,284	Aug
Sep	10,198	10,449	10,724	11,035	11,232	11,211	Sep
Oct	10,208	10,464	10,752	11,159	11,306	11,299	Oct
Nov	10,404	10,711	10,845	11,288	11,404	11,422	Nov
Dec	10,511	10,866	11,041	11,435	11,558	11,505	Dec
Jan	10,699	10,901	11,159	11,477	11,606	11,501	Jan
Feb	10,687	10,915	11,193	11,479	11,614	11,536	Feb
Mar	10,747	10,998	11,201	11,444	11,570	11,477	Mar
Apr	10,788	10,984	11,163	11,385	11,482	11,416	Apr
May	10,680	10,926	11,068	11,337	11,420	11,354	May
Jun	10,647	10,840	11,015	**11,302**	**11,384**		Jun

Dr. Fish adjusts to:	**11,702**	**R-20 Customers - A level never reached.**
Annualized Test-Year Growth (1st measure)	1.13%	(Based on Jul07 (beginning) and Jun08 (end)) (11384/11267)^(12/11)-1
Annualized Test-Year Growth (2nd measure)	0.73%	(Based on Jun07 (beginning) and Jun08 (end)) (11384/11302)-1

63

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Has Staff expressed a specific view about considering new customers added after the test-year in the customer annualization adjustment?

A. Yes. In the 2006 Rate Case, Mr. Smith testified for Staff that "customers added after the test-year are not considered in the annualization adjustment."[6] Mr. Smith elaborated that "Customers that are added after the end of the test-year are typically not considered in an annualization adjustment, unless it is a major customer addition and the other elements of the ratemaking formula (rate base, depreciation, etc) have been appropriately synchronized."[7] There has been no "major customer addition" and Dr. Fish did not adjust the other elements of the ratemaking formula. Dr. Fish's use of customer counts far outside of the test-year – counts that still have not been actually reached – is impossible to square with Staff's customer annualization testimony in the 2006 Rate Case.

Q. Please illustrate how Dr. Fish has adjusted customer counts to overstated levels.

A. First, with respect to his adjustment to the regular residential rate, R-10, shown on Schedule THF-C-4 (page 1 of 8) of Dr. Fish's Direct Testimony, the R-10 customer count over the test-year (July 2007-June 2008) shows a minimum monthly count of 124,320 customers in August 2007, a maximum count of 126,799 customers in February 2008, and a test-year-end count of 124,957 in June 2008. Dr. Fish adjusts to a residential R-10 customer count of 128,112. This exceeds the maximum test-year residential R-10 monthly count by over 1%. As discussed below, more than a year after the close of the test-year, UNS Gas has not reached this inflated customer count and may not reach it for some significant time to come. Dr. Fish's residential customer count exceeds all pre-test-year counts as well as all counts occurring through July 8, 2009. While the 128,112 customer count may occur at some unknown future date, the Commission sets rates based on historic, not future, test-years and has repeatedly used the methodology followed by

---

[6] Surrebuttal Testimony of Ralph C. Smith, Docket No. G-04204A-06-0463, page 21, lines 25-26.
[7] Id. page 22, lines 2-5.

64

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Has Staff expressed a specific view about considering new customers added after the test-year in the customer annualization adjustment?

A. Yes. In the 2006 Rate Case, Mr. Smith testified for Staff that "customers added after the test-year are not considered in the annualization adjustment."[6] Mr. Smith elaborated that "Customers that are added after the end of the test-year are typically not considered in an annualization adjustment, unless it is a major customer addition and the other elements of the ratemaking formula (rate base, depreciation, etc) have been appropriately synchronized."[7] There has been no "major customer addition" and Dr. Fish did not adjust the other elements of the ratemaking formula. Dr. Fish's use of customer counts far outside of the test-year – counts that *still have not been actually reached* – is impossible to square with Staff's customer annualization testimony in the 2006 Rate Case.

Q. Please illustrate how Dr. Fish has adjusted customer counts to overstated levels.

A. First, with respect to his adjustment to the regular residential rate, R-10, shown on Schedule THF-C-4 (page 1 of 8) of Dr. Fish's Direct Testimony, the R-10 customer count over the test-year (July 2007-June 2008) shows a minimum monthly count of 124,320 customers in August 2007, a maximum count of 126,799 customers in February 2008, and a test-year-end count of 124,957 in June 2008. Dr. Fish adjusts to a residential R-10 customer count of 128,112. This exceeds the maximum test-year residential R-10 monthly count by over 1%. As discussed below, more than a year after the close of the test-year, UNS Gas has not reached this inflated customer count and may not reach it for some significant time to come. Dr. Fish's residential customer count exceeds all pre-test-year counts as well as all counts occurring through July 8, 2009. While the 128,112 customer count may occur at some unknown future date, the Commission sets rates based on historic, not future, test-years and has repeatedly used the methodology followed by

[6] Surrebuttal Testimony of Ralph C. Smith, Docket No. G-04204A-06-0463, page 21, lines 25-26.
[7] Id. page 22, lines 2-5.

65

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

Q. And do you have any idea of the size of gas costs relative to any other particular cost of the company?

A. The PGA -- if I recall correctly, the purchase gas costs was about two-thirds -- if I recall correctly it was around two-thirds of the total cost, gross cost.

Q. All right.

A. If I recall approximately. So it was by far the largest.

Q. Okay. Let's turn to customer annualization.

A. Okay.

Q. Let's turn to page 20 of your direct testimony.

A. Okay.

Q. And you disagreed with the company's customer annualization methodology; correct?

A. In this case, absolutely.

Q. And this is the first regulatory proceeding in which you have provided testimony on residential customer annualization; correct?

A. Residential customer annualization, yes, it is.

Q. Let me just ask: Do you agree with the statement that "The purpose of annualization is to recognize changes that occurred during the test year as if those events had been reflected in the entire year"?

A. Read that again, would you please.

Q. "The purpose of annualization is to recognize

66

SEE

APPENDIX

"A"

ATTACHED TO BRIEF

67

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Gas' fuel expense, especially when compared to statewide internet cost projections or National or even Regional statistics regarding fuel prices as presented by Staff and RUCO. By applying the three year average cost to the three year average consumption the Company is suggesting a $51,258 reduction in test year fuel cost. If this three year average is not used, then the actual test year expenses should be used as reflected in UNS Gas' original Application. In no event should Staff's and RUCO's internet cost projections be used, as they are simply not known and measurable.

I. Postage expense.

Q. Do you agree with the postage expense adjustment proposed by Staff?

A. Yes. Staff proposes an adjustment based on the known and measurable increase in postage rates that has occurred. However, this adjustment would then need to be corrected to reflect the correct annualized number of customers, as discussed in Mr. Erdwurm's testimony.

Q. Does this conclude your Rebuttal Testimony?

A. Yes, it does.

68

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

misleading data regarding fuel expense, especially when compared to UNS Gas' proposal, which averages fuel costs actually incurred in its service territory over a period of years.

Q. **Are there other issues with Staff and RUCO's adjustments?**

A. Yes. RUCO inadvertently had an additional amount in their schedules and actually reduced fuel cost by $471,000 in its revenue requirements. The amount they intended to reduce it by was $241,000. Also both Staff and RUCO relied upon data provided by the Company and labeled as fuel expense, but it was actually fuel cost. Fuel cost exceeds fuel expense because a portion of fuel cost is capitalized. The fuel cost data used by Staff and RUCO does not provide an accurate measure of fuel expense. The amounts spent to obtain fuel for UNS Gas, and the a per gallon data is correct, but the actual expense is only 73.4% of that cost, the other 26.6% of that cost went to capital projects. Fuel cost as identified goes into a transportation clearing account and then is charged out as vehicles are used along with other cost like insurance, and maintenance. 26.6% of those costs actually go to capital projects and thus the fuel expense is only 73.4%.

Q. **What does the 73.4% mean to Staff and RUCO's adjustments?**

A. It means that only 73.4% of Staff's and RUCO's reductions should actually be applied to revenue requirements if either were to be accepted.

Q. **What is the Company's suggestion for adjusting test year fuel expense?**

A. Fuel prices are highly volatile. The Company recommends using the three year average to normalize the cost based on recent actual cost incurred by UNS Gas. UNS Gas' primary service territories are not located in Arizona's major urban communities and as such UNS Gas' actual fuel cost tends to be higher than Tucson and Phoenix. The average price per gallon of fuel incurred by UNS Gas over the past three years in its service territory is $3.05 per gallon. This amount is known, measurable and provides compelling evidence of UNS

Gas' fuel expense, especially when compared to statewide internet cost projections or National or even Regional statistics regarding fuel prices as presented by Staff and RUCO. By applying the three year average cost to the three year average consumption the Company is suggesting a $51,258 reduction in test year fuel cost. If this three year average is not used, then the actual test year expenses should be used as reflected in UNS Gas' original Application. In no event should Staff's and RUCO's internet cost projections be used, as they are simply not known and measurable.

I. <u>Postage expense.</u>

Q. Do you agree with the postage expense adjustment proposed by Staff?

A. Yes. Staff proposes an adjustment based on the known and measurable increase in postage rates that has occurred. However, this adjustment would then need to be corrected to reflect the correct annualized number of customers, as discussed in Mr. Erdwurm's testimony.

Q. Does this conclude your Rebuttal Testimony?

A. Yes, it does.

69

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
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 ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	DOCKET NO. G-04204A-08-0571

NON-CONFIDENTIAL SURREBUTTAL

TESTIMONY

[**CONFIDENTIAL INFORMATION HAS BEEN REDACTED**]

OF

RALPH C. SMITH

ON BEHALF OF THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JULY 29, 2009

expenditure levels because circumstances have changed and UNSG's budget for outside legal has decreased. The amount allowed in this case should in no event be higher than UNSG's 2009 budget, which was provided in the CONFIDENTIAL response to RUCO 11.35. In my direct testimony I had recommended an allowance of $171,865. Because it appears that some level of EPNG FERC costs will be ongoing, I had provided for an annual amount for EPNG FERC proceedings of approximately $100,000 based on actual test year costs. As shown on Schedule C-7, this adjustment had reduced UNSG's requested outside legal expense by $217,674. The annual amount of $171,865 of normalized outside legal expense that I had recommended in my direct testimony should be adequate in view of the fact that future FERC costs will be allocated between UNSG and TEP. Moreover, UNSG has not presented a cost-benefit analysis, or an evaluation of the impact of its legal expenditures.

Fleet Fuel Expense

Q. What is the dispute concerning Fleet Fuel Expense?

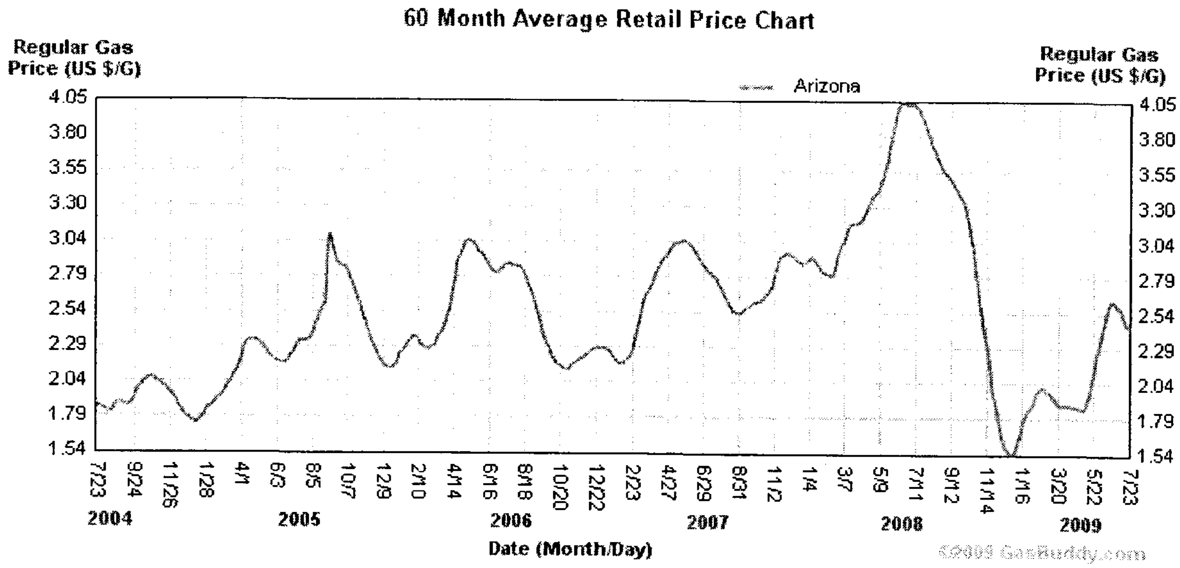
A. UNSG witness Dukes addresses this at pages 29-31 of his Rebuttal Testimony. All parties – UNSG, Staff and RUCO – appear to agree that the test year level of expense needs to be adjusted to a "normal" level given the extreme volatility of fuel expense; however, the parties do not agree upon the amount of adjustment. My reasons for recommending a normalizing adjustment include that the test year fleet fuel expense was based on unusually high fuel prices in effect during the test year, in some months over $4.00 a gallon, the country's record high point. The amount of gallons purchased in the test year is also the highest among historical yearly gallons purchased.

Mr. Dukes appears to agree with the use of a three-year average of fuel usage to normalize the expense. However, he wants to apply a backward-looking cost of fuel that includes the extreme peak costs during 2008 in order to normalize the cost.

At page 30, Mr. Dukes also identifies two technical corrections to the adjustment calculation I had presented with my direct testimony: (1) remove an additional amount inadvertently included and (2) reflect an O&M expense allocation of 73.4 percent. I agree with Mr. Dukes about these two points and will reflect appropriate corrections.

Q. Do you agree with the concept of using an average for fuel prices?

A. Yes. Because the cost has been so volatile, using an average is appropriate to derive a normalized amount. However, I do not agree with Mr. Dukes that a backward-looking average of 2006-2008 prices is necessarily representative of current and expected prices. Based on the following chart, gasoline prices in Arizona reached extreme levels in 2008, over $4 per gallon, and have been significantly lower before and since.



Q. In response to RUCO discovery, did UNSG provide more current information on Fleet Fuel Expense?

A. Yes. In response to RUCO 11.36(f), UNSG provided average fuel prices for the 36-months through June 2009.

Q. Have you updated RUCO's adjustment for Fleet Fuel Expense?

A. Yes. Attachment RCS-7, Schedule C-8 Revised shows the updated adjustment. This adjustment uses an average fuel cost of $2.95 per gallon based on January 2006 through June 2009 information. The incorporation of more current information and a longer period helps mitigate the impact of the extreme peak gasoline prices of mid-2008. This average cost of fuel also is reasonable in view of the graph of historic Arizona gasoline prices from ArizonaGasPrices.com depicted on the above chart. As shown on Schedule C-8 Revised, page 1 of 3, I have reduced fleet fuel expense by $71,963. This exceeds the $51,258 reduction proposed by UNSG in its Rebuttal Testimony by $20,705.

70

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
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

SURREBUTTAL

TESTIMONY

OF

THOMAS H. FISH, PH.D.

ON BEHALF OF

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 29, 2009

Q. Is the correct pro forma fuel expense adjustment $308,381?

A. No. In providing the fleet fuel expense, the Company actually provided fleet fuel *cost*. Fleet cost, according to the Company, exceeds fuel expense because a portion of it is capitalized to capital projects. Because 26.6 percent of fuel cost is capitalized and assigned to capital projects associated with the fuel usage and the remainder is fuel expense, the fleet fuel expense adjustment should be reduced by 26.6 percent to $226,352.

Call Center

Q. Did the Company question Staff's pro forma adjustment for call center expense?

A. Yes. At pages 22 to 25, Mr. Dukes criticizes this adjustment. He suggests that call center usage was poorly measured and that if the Company had its own call center rather than sharing one with its sister companies that the cost would be higher.

Q. Do you agree with Mr. Dukes' argument?

A. No. Staff is not suggesting that the Company create its own call center. The issue really is not the allocation method, but that call center costs seem to be increasing at an alarming rate. The sizable increase in costs associated with the Call Center, and the apparent lack of justification for these cost increases, suggest that the Company may not be controlling costs as it should. Absent support for the increase in call center expenses, the Company should not be granted permission to recover those expenses. According to Mr. Erdwurm's Schedules with his Rebuttal Testimony, the Company's customer count has declined since the end of the previous test year.

71

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

between the test year average price per gallon of $3.33 and a forecasted $1.96 per gallon?

A. That's right.

Q. Okay. If you could turn to page -- and your surrebuttal did not change the estimated or forecasted $1.96 per gallon from your direct testimony to your surrebuttal; correct?

A. That's correct.

Q. Okay. If you could turn to page 24 of your direct testimony.

A. Okay.

Q. You indicate that the $1.96 number per gallon came from the Energy Information Administration; is that correct?

A. That's correct.

Q. And you did not attach anything from the Energy Administration to your testimony that indicated the date of that projection?

A. No, not in my testimony. My recollection is that I think -- I believe we provided that in a data request. I'm not sure if we did; I think we did.

Q. Do you know if that fuel estimate was for gasoline or diesel?

A. I believe it was for gasoline.

Q. So it's not for diesel?

A. That is my understanding.
Q. And do you understand that the company does use diesel fuel as well?
A. That's correct.
Q. All right. Do you know whether the Energy Information Administration projection changes over time?
A. Yes, it does.
Q. And have you looked to see what the current Energy Information Administration estimate is for Arizona?
A. No, I haven't.
Q. Would it surprise you to know that for 2010 the estimate is $2.66 per gallon?
A. No. As a matter of fact, almost anything in terms of energy forecasts would not surprise me. It's hard to forecast.
Q. And let me ask you another question about the $1.96.
Was that price specific to the UNS Gas service area?
A. I believe it was specific to Arizona total, not to the certificated territory.
Q. Do you know if the prices in rural Arizona tend to be higher than the prices in the Phoenix metropolitan area?
A. Prices in rural areas in general tend to be

higher than prices in concentrated areas where there is competition.

Q. But you are sticking by the $1.96 for your adjustment at this point?

A. It could happen again.

MR. PATTEN: That is all I have, Your Honor. I told you it would be an hour and a half.

ACALJ NODES: You did. You said it right.

Mr. Pozefsky, do you have any additional questions at this point in time?

MR. POZEFSKY: Of course, Your Honor, but not many.

RECROSS-EXAMINATION

BY MR. POZEFSKY:

Q. Dr. Fish, on the outside legal question, I would like to clarify this.

You said you didn't agree with the expense. You are talking about what the company reported as expense for those three years.

Do you not agree with it? Is that because you don't agree that they are consistent with what the actual expenses are or is it that you just don't agree that those expenses are reasonable?

72

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

A. That is my understanding.

Q. And do you understand that the company does use diesel fuel as well?

A. That's correct.

Q. All right. Do you know whether the Energy Information Administration projection changes over time?

A. Yes, it does.

Q. And have you looked to see what the current Energy Information Administration estimate is for Arizona?

A. No, I haven't.

Q. Would it surprise you to know that for 2010 the estimate is $2.66 per gallon?

A. No. As a matter of fact, almost anything in terms of energy forecasts would not surprise me. It's hard to forecast.

Q. And let me ask you another question about the $1.96.

Was that price specific to the UNS Gas service area?

A. I believe it was specific to Arizona total, not to the certificated territory.

Q. Do you know if the prices in rural Arizona tend to be higher than the prices in the Phoenix metropolitan area?

A. Prices in rural areas in general tend to be

73

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

A. That is my understanding.
Q. And do you understand that the company does use diesel fuel as well?
A. That's correct.
Q. All right. Do you know whether the Energy Information Administration projection changes over time?
A. Yes, it does.
Q. And have you looked to see what the current Energy Information Administration estimate is for Arizona?
A. No, I haven't.
Q. Would it surprise you to know that for 2010 the estimate is $2.66 per gallon?
A. No. As a matter of fact, almost anything in terms of energy forecasts would not surprise me. It's hard to forecast.
Q. And let me ask you another question about the $1.96.
Was that price specific to the UNS Gas service area?
A. I believe it was specific to Arizona total, not to the certificated territory.
Q. Do you know if the prices in rural Arizona tend to be higher than the prices in the Phoenix metropolitan area?
A. Prices in rural areas in general tend to be

74

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

A. That is my understanding.

Q. And do you understand that the company does use diesel fuel as well?

A. That's correct.

Q. All right. Do you know whether the Energy Information Administration projection changes over time?

A. Yes, it does.

Q. And have you looked to see what the current Energy Information Administration estimate is for Arizona?

A. No, I haven't.

Q. Would it surprise you to know that for 2010 the estimate is $2.66 per gallon?

A. No. As a matter of fact, almost anything in terms of energy forecasts would not surprise me. It's hard to forecast.

Q. And let me ask you another question about the $1.96.

Was that price specific to the UNS Gas service area?

A. I believe it was specific to Arizona total, not to the certificated territory.

Q. Do you know if the prices in rural Arizona tend to be higher than the prices in the Phoenix metropolitan area?

A. Prices in rural areas in general tend to be

75

DATA REQUEST PACKET

Staff's Responses to UNS Gas' Data Requests:

UNSG 2.1	UNSG 3.10	UNSG 3.22
UNSG 2.2	UNSG 3.11	UNSG 3.39
UNSG 2.4	UNSG 3.12	UNSG 3.40
UNSG 3.4	UNSG 3.13	UNSG 3.41
UNSG 3.5	UNSG 3.14	UNSG 3.57
UNSG 3.6	UNSG 3.15	UNSG 3.58
UNSG 3.7	UNSG 3.20	UNSG 3.60
UNSG 3.9	UNSG 3.21	UNSG 3.65

UNSG-24

ARIZONA CORPORATION COMMISSION
DOCKET NO. G-04204A-08-0571
STAFF'S RESPONSE TO UNS GAS, INC.'S
THIRD SET OF DATA REQUESTS
July 7, 2009

UNSG 3.40 Does Staff believe that the future fuel costs are "known and measurable?" If so, please provide all support for that belief?

RESPONSE: No. The Commission expects that the Company will utilize its procurement policy and hedging practices to stabilize such costs.

RESPONDENT: DR. THOMAS FISH

WITNESS: DR. THOMAS FISH

76

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 14, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME IV

(Pages 534 through 732, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

2005 test year level.
Is that a fair reading of what you are recommending?
A. Yes, sir.
Q. And you have not disputed the actual test year call center expense allocated to UNS Gas, have you?
A. No. We are not quarrelling with the allocation factors. That is not an issue.
Q. And you justify the reductions by the reduced number of service orders; correct?
A. That is an indication.
In my determination the growth and expenses in that area are completely out of control. That is \$400,000 -- 400 and plus -- and that is 20 percent of the total call center expenses. But approximately 20 percent is what is allocated. You are talking about \$2 million. This is a huge amount of increasing.
That is what we are saying. Fine, if this is used and useful and it's a necessary cost of providing service, great, include it. But I don't see any justification for that amount at that magnitude of costs being included in this rate case. I just don't see any explanation for it.
Q. Even give the flat growth we have experienced recently, the company has, in fact, experienced

UNSG 3.41 Does Staff dispute that the Call Center expense during the test year was $116,627 per month on average for UNS Gas?

RESPONSE: No. Staff relied on the information provided by the Company.

RESPONDENT: DR. THOMAS FISH

WITNESS: DR. THOMAS FISH

77

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. What was the basis for Dr. Fish's assertion?

A. Dr. Fish argues that while the costs increased, the number of "service orders" did not substantially increase from 2005 to the test year.

Q. Do you agree with Dr. Fish's adjustment to reduce the test year expense for the Call Center?

A. No. Service orders are a poor measurement of Call Center use; in fact UNS Gas customers have substantially increased use of the Call Center. Moreover, assuming expense levels established using a 2005 test year are appropriate for rates going in to effect in 2010 without any adjustment for inflation, wage increases or equipment additions is unreasonable. The Call Center has seen the magnitude of call volume and call duration for UNS Gas grow by approximately 150% over the 2005 levels. Service orders are only a minor portion of the services provided by the Call Center to UNS Gas. UNS Gas is using more of the Call Center's capacity (as one of the three affiliates) then it was in 2005. In addition, the overall annual operating cost of the Call Center has increased 22% from 2005 to 2008. The overall capital investment in the facility, computers, and phones will continue to increase as the company ensures that customers have a mechanism to access the Company.

Q. You state that UNS Gas customer usage of the Call Center has increased. What data do you have to support this assertion?

A. From the last test year (2005) through 2008, call volume has increased steadily. In 2005, the Call Center received 352,330 calls for UNS Gas; in 2006, the Call Center received 483,026 calls; in 2007, the Call Center received 514,689 calls; and in 2008, the Call Center received 526,156 calls. This amounts to an increase of 150% from 2005 to 2008. In 2006, the Call Center spent approximately 16.5% of its time handling UNS Gas calls, while in the first half of 2009 that number had increased to almost 22%.

Q. How are Call Center costs allocated today?

A. Call Center costs are allocated based on the talk time that the Call Center experiences by customers of TEP, UNS Electric, and UNS Gas. However, in three districts (Kingman, Havasu, and Nogales) there is combined talk time for both UNSE and UNSG, and, as a result, the system cannot distinguish between talk time for a particular company, so in these three districts talk time is split by customer count.

Q. Why is Dr. Fish's adjustment incorrect?

A. Dr. Fish bases his adjustment on the declining service orders per month. As I noted above, service orders are only one small contributor to talk time. If customers only called for a hook up for new service, we would have a significantly smaller Call Center. Furthermore, in spite of declining service orders per month, inbound call volume, and the costs associated with that call volume, has continued to increase. Often, we have to explain the bills, make billing arrangements, discuss credit terms, discuss a disconnect or reconnect due to a past due bill, etc. Answering our customers' questions and providing them the information they desire takes time, and time on the telephone is an appropriate and more rationally related way to allocate costs than an allocation based solely on one aspect of customer service, the service order.

The specific talk time for UNS Gas customers has increased over time: in 2006, the average talk time was 16.6% of the total for the three affiliates; in 2007, 23.6%; in 2008, 20.4%.

Q. What other factors contributed to the increase?

A. The other contributing factor is that costs have increased in the Call Center over time. On average in 2005, total monthly Call Center costs before allocations were roughly $415,000. In the test year, July 2007 to June 2008, the monthly costs averaged about

78

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. What was the basis for Dr. Fish's assertion?

A. Dr. Fish argues that while the costs increased, the number of "service orders" did not substantially increase from 2005 to the test year.

Q. Do you agree with Dr. Fish's adjustment to reduce the test year expense for the Call Center?

A. No. Service orders are a poor measurement of Call Center use; in fact UNS Gas customers have substantially increased use of the Call Center. Moreover, assuming expense levels established using a 2005 test year are appropriate for rates going in to effect in 2010 without any adjustment for inflation, wage increases or equipment additions is unreasonable. The Call Center has seen the magnitude of call volume and call duration for UNS Gas grow by approximately 150% over the 2005 levels. Service orders are only a minor portion of the services provided by the Call Center to UNS Gas. UNS Gas is using more of the Call Center's capacity (as one of the three affiliates) then it was in 2005. In addition, the overall annual operating cost of the Call Center has increased 22% from 2005 to 2008. The overall capital investment in the facility, computers, and phones will continue to increase as the company ensures that customers have a mechanism to access the Company.

Q. You state that UNS Gas customer usage of the Call Center has increased. What data do you have to support this assertion?

A. From the last test year (2005) through 2008, call volume has increased steadily. In 2005, the Call Center received 352,330 calls for UNS Gas; in 2006, the Call Center received 483,026 calls; in 2007, the Call Center received 514,689 calls; and in 2008, the Call Center received 526,156 calls. This amounts to an increase of 150% from 2005 to 2008. In 2006, the Call Center spent approximately 16.5% of its time handling UNS Gas calls, while in the first half of 2009 that number had increased to almost 22%.

79

BEFORE THE ARIZONA CORPORATION COMMISSION

<u>COMMISSIONERS</u>
KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. If present service levels were handled independently by UNS Gas, would the cost be higher?

A. Absolutely. UNS Gas as an independent company would need a facility, phone lines, computer systems, phone systems, Call Center employees, supervisors, a manager and so forth. By joining with its affiliates TEP and UNS Electric, UNS Gas realizes economies of scale that it could not achieve as a stand-alone customer. It is more cost effective to share the significant fixed cost with two other utilities. UNS Gas should not be denied full recovery of the reasonable cost to serve the demands of its customers. Adoption of Staff's recommendation would encourage the Company to reevaluate this cost effective system against implementing a standalone Call Center for UNS Gas.

Q. Why invest in the Call Center?

A. The Call Center is the primary vehicle in which customers have human contact with the Company. The Company values our customers, and wants to ensure that customers have a way to get answers to questions they may have regarding their service. As a result, we continue to invest in the Call Center. In 2007, a new billing system was implemented. In 2009, we are making other technology improvements to ensure that customers obtain the information they desire. While the 2009 expenses are not included in this rate case, these investments can fortunately be shared by three affiliates serving over 600,000 customers as opposed to UNS Gas having to make these investments on its own. Furthermore, upon acquiring the gas assets from Citizen's in 2003, the access customers had in calling the Call Center was inadequate, as evidenced by many customers not even able to get into the system, let alone talk to a customer service representative. We will continue to invest in a reasonable level of technology in our Call Center to give our customers a reasonable customer service experience.

80

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

$507,000, a 22% increase over more than three years. In that time, wages and on-going costs continue to increase, and we continue to offer new services to our customers that are included in these costs. For example, UNS Gas customers now have credit card processing and on-line bill presentment. These new services cost money that increase our costs but ultimately provide the customer with better options and a better service level experience. However, increasing talk time at UNS Gas, was the largest contributor to the allocated Call Center costs, not increased Call Center costs.

F. <u>Bad Debt Expense.</u>

Q. Did Staff or RUCO reduce the Company's pro forma bad debt expense?

A. Yes. Staff reduced the pro forma expense level based on Dr. Fish's assertion that the Company has recorded too much expense for bad debt the last three years based on his assertion that the Company is over reserved for bad debt.

Q. Do you agree with Dr. Fish's assertion that the Company is over reserved and his corresponding assertion that bad debt expense has been overstated?

A. No. Dr. Fish has performed some analysis of the change in the Allowance for Bad Debt ("allowance") account that has taken place from the years 2005 and 2006 in comparison to the current levels and asserts that it is over stated by approximately 100%. The allowance account is a contra asset account that reduces the Accounts Receivable ("A/R") account on the Company's balance sheet so that the net of the two reflects the reality that not all of those accounts will be fully collected. This account is reconciled on a quarterly basis by the accounting department of TEP and is audited annually by an independent accounting firm to insure that it is materially accurate. To say that it is overstated by that magnitude is to assert error on the part of the accounting professionals. This is something to which I take considerable exception and that is blatantly incorrect.

81

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. What are Mr. Smith's reasons for excluding the January 2010 increase from the adjustment?

A. Mr. Smith believes that the increase is too far from the end of the test year and not known at this time. He essentially is making the same argument that RUCO witnesses made in each of the last three Southwest Gas filings that were ultimately rejected by the Commission.

Q. Do you agree with Mr. Smith's rationale?

A. No. The rates in this case are not likely to go into effect until January of 2010 at the earliest and will be in effect for the 2010 calendar year. The increase is being applied to employee levels as of the end of test year and therefore is not creating any mismatch of revenue and expenses. At this time we know the increases attributable to the portion of the workforce that are classified and have contracts in place. As for the unclassified employees, the increase will be known prior to rates going into effect and support of the approved increase can be provided prior to the close of the record.

Q. Has such requested treatment been approved by this Commission?

A. Yes. For example, this treatment is consistent with the last UNS Electric rate case, Decision No. 70360 (May 27, 2008), and the most recent Southwest Gas Rate Case, Decision No. 70665 (December 24, 2008).

82

Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A1. Frank Grijalva. My business address is 750 South Tucson Boulevard, Tucson, Arizona 85716-5689.

Q2. PLEASE DESCRIBE YOUR RECENT EMPLOYMENT.

A2. I am the Business Manager/Financial Secretary for Intervenor Local Union 1116, International Brotherhood of Electrical Workers, AFL-CIO, CLC ("IBEW Local 1116"). The position of Business Manager/Financial Secretary is an elected union position and, due to the retirement of my predecessor, I was appointed by our Executive Board to my present position in October 2007. Because all IBEW local unions also have a person holding the position of "President," it is common for persons outside of our organization to believe that the "President" is the principal officer of the Local. That is not the case. Article 17, §§ 4 and 8 of the Constitution of the International Brotherhood of Electrical Workers, AFL-CIO, clearly states that the Business Manager/Financial Secretary is the "principal officer" of any IBEW local union.

Prior to my becoming Business Manager/Financial Secretary for IBEW Local 1116, I was employed by the Tucson Electric Power Company ("TEP") for twenty-two (22) years in a variety of bargaining unit positions, the last of which was as a Designer for Transmission and Distribution Construction. While employed at TEP, I was a very active member of IBEW Local 1116, including previously serving as the Local's President

EXPENSE ADJUSTMENT AND PAYROLL TAX EXPENSE ADJUSTMENT?

A9. On page 19, lines 20-25, of Dallas Dukes' Direct Testimony, a reference is made to an "estimated pay rate increase that will go into effect January 1, 2010" and that "[t]he pay rate increase as of January 1, 2010, will be known prior to the close of the record in this proceeding and prior to rates going into effect based on a decision in this proceeding." Because UNS Gas and IBEW Local 1116 just recently concluded their contract negotiations regarding, *inter alia*, the year 2010, this should assist the Company in making any adjustments that may need to be made to the Payroll Expense and Payrolls Tax Expense adjustments. In particular, if the contractually agreed-upon pay increase is greater than the estimate set forth in the Application, then Gas ought to seek, and IBEW Local 1116 would fully support, a corresponding increase to the Payroll Expense and Payroll Tax Expense adjustments.

I know that Dallas Dukes believes that "the rate can be updated if its varies ***significantly*** from the estimate" but, in my opinion, it ought to be updated irrespective of the size of the discrepancy. Otherwise, public service corporations, like UNS Gas, would not be allowed to recuperate their actual increases in the cost of doing business.

Q10. DO YOU BELIEVE THAT UNS GAS OUGHT TO RECOVER A GREATER SHARE OF ITS FIXED COSTS THROUGH A HIGHER FIXED MONTHLY SERVICE CHARGE?

83

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. What are Mr. Smith's reasons for excluding the January 2010 increase from the adjustment?

A. Mr. Smith believes that the increase is too far from the end of the test year and not known at this time. He essentially is making the same argument that RUCO witnesses made in each of the last three Southwest Gas filings that were ultimately rejected by the Commission.

Q. Do you agree with Mr. Smith's rationale?

A. No. The rates in this case are not likely to go into effect until January of 2010 at the earliest and will be in effect for the 2010 calendar year. The increase is being applied to employee levels as of the end of test year and therefore is not creating any mismatch of revenue and expenses. At this time we know the increases attributable to the portion of the workforce that are classified and have contracts in place. As for the unclassified employees, the increase will be known prior to rates going into effect and support of the approved increase can be provided prior to the close of the record.

Q. Has such requested treatment been approved by this Commission?

A. Yes. For example, this treatment is consistent with the last UNS Electric rate case, Decision No. 70360 (May 27, 2008), and the most recent Southwest Gas Rate Case, Decision No. 70665 (December 24, 2008).

84

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. What are Mr. Smith's reasons for excluding the January 2010 increase from the adjustment?

A. Mr. Smith believes that the increase is too far from the end of the test year and not known at this time. He essentially is making the same argument that RUCO witnesses made in each of the last three Southwest Gas filings that were ultimately rejected by the Commission.

Q. Do you agree with Mr. Smith's rationale?

A. No. The rates in this case are not likely to go into effect until January of 2010 at the earliest and will be in effect for the 2010 calendar year. The increase is being applied to employee levels as of the end of test year and therefore is not creating any mismatch of revenue and expenses. At this time we know the increases attributable to the portion of the workforce that are classified and have contracts in place. As for the unclassified employees, the increase will be known prior to rates going into effect and support of the approved increase can be provided prior to the close of the record.

Q. Has such requested treatment been approved by this Commission?

A. Yes. For example, this treatment is consistent with the last UNS Electric rate case, Decision No. 70360 (May 27, 2008), and the most recent Southwest Gas Rate Case, Decision No. 70665 (December 24, 2008).

85

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Do you have any additional comments on Staff's SERP adjustment?

A. Yes. Staff incorrectly pulled an amount from the lead lag study as the SERP expense and the amount they used is actually the test year PEP expense for UNS Gas.

C. Rate Case Expense.

Q. Did Staff or RUCO dispute the Company's pro forma rate case expense?

A. Dr. Fish (at page 29) proposes an adjustment to Rate Case Expense based on the Company's response to Staff Data Request 6.88. UNS Gas agrees with that adjustment and Exhibit DJD-1 reflects that change in the Company's Rate Case Expense pro forma adjustment.

RUCO reduced the Company's proposed rate case expense. Mr. Smith (at page 50-51) proposes an allowance of a normalized level of $100,000 on an annual basis in expense for rate case expense based on the $300,000 rate case expense recovery over three years provided in the last UNS Gas rate case.

Q Do you agree with RUCO's recommendation of a normalized annual allowance of $100,000?

A. No. To the date of this testimony UNS Gas has already incurred over $400,000 in external rate case cost through the use of substantial TEP employee time (which is allocated to UNS Gas) and outside counsel. The final cost will be in excess of UNS Gas' initial $500,000 estimate. These costs are the incremental real cost associated with filing a rate case by a utility that does not have its own regulatory counsel or rates group on hand and built into base rates.

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
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

DIRECT

TESTIMONY

OF

THOMAS FISH

ON BEHALF OF

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JUNE 08, 2009

Rate Case Expense Adjustment

Q. Please explain your Rate Case Expense pro forma Adjustment.

A. This is an adjustment provided by the Company in its response to Data Request 6.88 and is reproduced as THF – C17. It removes the test year amortization of rate case expense of $300,000 allowed in Decision No. 70011 for the 2006 rate case that will be recovered prior to new rates becoming effective. The adjustment results in a reduction of test year expense of $58,333.

Income Tax Adjustment

Q. Please explain your income tax adjustment.

A. This adjustment is shown on page 4 of Schedule THF – C2. It reflects the income tax effect of the pro forma changes in income and expense items.

COST OF SERVICE - RATE DESIGN

Q. Are you proposing a rate design for the Company to use to recover its revenue deficiency?

A. Yes.

Q. What is the underlying rationale for the structure and magnitude of the tariffs you are proposing?

A. The underlying rationale for the structure and magnitude of the tariffs that I am proposing is that they should be efficient, equitable, and result in providing the Company the opportunity to recover its cost of providing service. Rates should be simple and easy to understand, and minimize revenue fluctuations, they should be efficient in the sense that wasteful production and consumption practices are discouraged, and they should not be

86

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Do you have any other comments on this issue?

A. Yes. RUCO is recommending an annual allowance of $100,000 for rate case expense. Putting that amount in some context, it would not even cover the cost of UNS Gas (with almost 150,000 customers) employing one attorney on staff full time as regulatory counsel considering salary, benefits and overhead. It is just not a reasonable level of recovery. Also, if RUCO wants to establish a normalized level of rate case expense, it should be based on actual cost and the expected level to be incurred. RUCO's position, if adopted, would penalize UNS Gas for efficiently outsourcing its regulatory needs by disallowing prudently incurred costs. UNS Gas contends that its use of TEP employees and outside counsel is more cost effective than hiring more employees to staff an entirely separate regulatory division at UNS Gas. RUCO's position would have the effect of encouraging the Company to reevaluate this cost effective system in favor of more costly, but necessary, options, including the hiring of regulatory counsel and staffing a regulatory division.

Q. Are there other problems with RUCO's reduction?

A. Yes. If Staff's and RUCO's recommendations and the returns they will generate are adopted by the Commission, it is very likely that UNS Gas will need to quickly file another rate case. There is no basis for RUCO to assume a three year amortization period under such a scenario. Based upon the most recent evidence in which UNS Gas has filed serial rate cases, RUCO should be recommending an 18 month amortization period. If their $300,000 artificial limit is approved, then the annualized or normalized annual expense would be $200,000 to reflect the short period the rates in this case are likely to be in effect, and to give the Company a reasonable opportunity to recover some portion of its allowed rate case expense.

87

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Do you have any other comments on this issue?

A. Yes. RUCO is recommending an annual allowance of $100,000 for rate case expense. Putting that amount in some context, it would not even cover the cost of UNS Gas (with almost 150,000 customers) employing one attorney on staff full time as regulatory counsel considering salary, benefits and overhead. It is just not a reasonable level of recovery. Also, if RUCO wants to establish a normalized level of rate case expense, it should be based on actual cost and the expected level to be incurred. RUCO's position, if adopted, would penalize UNS Gas for efficiently outsourcing its regulatory needs by disallowing prudently incurred costs. UNS Gas contends that its use of TEP employees and outside counsel is more cost effective than hiring more employees to staff an entirely separate regulatory division at UNS Gas. RUCO's position would have the effect of encouraging the Company to reevaluate this cost effective system in favor of more costly, but necessary, options, including the hiring of regulatory counsel and staffing a regulatory division.

Q. Are there other problems with RUCO's reduction?

A. Yes. If Staff's and RUCO's recommendations and the returns they will generate are adopted by the Commission, it is very likely that UNS Gas will need to quickly file another rate case. There is no basis for RUCO to assume a three year amortization period under such a scenario. Based upon the most recent evidence in which UNS Gas has filed serial rate cases, RUCO should be recommending an 18 month amortization period. If their $300,000 artificial limit is approved, then the annualized or normalized annual expense would be $200,000 to reflect the short period the rates in this case are likely to be in effect, and to give the Company a reasonable opportunity to recover some portion of its allowed rate case expense.

88

DATA REQUEST PACKET

RUCO's Responses to UNS Gas' Data Requests:

UNSG 2.25
UNSG 2.48
UNSG 2.55
UNSG 3.2
UNSG 3.13
UNSG 3.16
UNSG 3.18
UNSG 3.20
UNSG 3.21
UNSG 3.22
UNSG 3.31
UNSG 3.34
UNSG 3.35
UNSG 3.36

THIRD SET OF DATA REQUESTS
FROM UNS GAS, INC.
TO RESIDENTIAL UTILITY CONSUMER OFFICE
(DOCKET NO. G-04204A-08-0571)

UNSG 3.31 Please provide a detailed budget from Mr. Smith showing how UNS Gas could prepare and prosecute this case using his $300,000 recommended allowance for rate case expense.

RESPONSE:

Mr. Smith has not prepared such a budget and notes that the recommended allowance for UNSG in the current case is consistent with the allowances for rate case cost that was allowed by the Commission in the last UNSG rate case, as well as in the last UNS Electric rate case.

RESPONDENT: Ralph C. Smith

WITNESS: Ralph C. Smith

89

BEFORE THE ARIZONA CORPORATION COMMISSION

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.	DOCKET NO. G-04204A-08-0571

Direct Testimony of

Gary A. Smith

on Behalf of

UNS Gas, Inc.

November 7, 2008

those customers' monthly imbalances. Reducing the monthly threshold to 1,500 therms is a more reasonable volume. This change in the language also makes UNS Gas' monthly operating window consistent with the monthly operating window allowed by other gas distribution utilities in the state.

Q. Is the Company proposing any changes to monthly residential customer charges?

A. Yes, the Company is proposing a phased-in increase in residential customer charges to levels more reflective of the true customer-related costs. During Phase 1 of the implementation, residential customer charges will increase from the current $8.50 per month to $10.00, when new rates become effective. One year after new rates become effective, Phase 2 will increase the residential customer charge to $12.00 per month, and one year after Phase 2 implementation, Phase 3 will increase the residential customer charge to $14.00 per month. Mr. Erdwurm's Direct Testimony provides more detail on this proposal.

IV. AMERICAN GAS ASSOCIATION ("AGA") BENEFITS.

Q. Does the Company use a cost/benefit analysis in determining the value of AGA's services?

A. Yes. In 2006, the AGA's programs, services and advocacy efforts provided its members with $479 million in outright savings or avoided costs. The AGA collected under $18 million in membership dues which resulted in more than a $27 return on every $1 in paid AGA dues.

Q. Is UNS Gas requesting recovery for the AGA's marketing and lobbying activities?

A. No. In accordance with previous Commission decisions, UNS Gas is not requesting recovery of the dues associated with marketing and lobbying activities.

Q. What amount of AGA dues is the Company requesting recovery of?

A. UNS Gas is requesting the recovery of $45,964 related to AGA dues. As detailed below, the information and services UNS Gas received from the AGA far exceeds this cost.

Q. Would you please describe some of AGA's activities and how these activities benefit, either directly or indirectly, a member company's customers?

A. Yes. AGA conducts hundreds of operating and engineering activities to improve the safety, efficiency and productivity of member companies' engineering and operating functions. Some recent examples of AGA's operating and engineering activities include:

(1) Over all, the safety records of natural gas utilities are outstanding and they continue to improve. To encourage greater improvement in the safety of the natural gas delivery system, AGA hosted a Safety Leadership Summit in late 2007 for its members to come together and discuss the state of the natural gas industry in four critical areas of safety:

- Employee Safety;
- Utility Contractor Safety;
- Pipeline Safety; and
- Public Safety.

(2) AGA publishes the Gas Piping Technology Committee ("GPTC") Guide periodically. This GPTC Guide is prepared by safety experts from gas distribution and transmission companies, federal and state regulatory agencies, manufacturers and industry consultants and is updated when new materials and procedures are approved for use. UNS Gas uses the GPTC Guide to design and select piping material types. This Guide has saved UNS Gas time and some of the expense of designing and developing its systems, and insures standardization.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

D. Membership Dues Expense - American Gas Association ("AGA").

Q. Did Staff or RUCO reduce the Company's pro forma membership dues expense?

A. Yes. Both Staff and RUCO proposed adjustments to AGA dues expense.

Q. Does the Company agree with their proposals?

A. No. First, Staff is recommending the same reduction (3.5%) of the AGA dues as the last rate case. However, UNS Gas already agreed to follow the approach from the last rate case, and therefore UNS reduced the AGA dues expense by 4.0% in its Application. Staff's adjustment is unnecessary and essentially double-counts the reduction.

Second, RUCO is recommending the normal and recurring core dues associated with the AGA be reduced well beyond the portion identified as lobbying expense by the AGA. This reduction is based on a 2001 NARUC study that is based on 1999 data. Not only is this analysis stale, but it is not relevant. The Company has provided substantial and compelling support of and for the many benefits provided by the membership and the expense sought for recovery is reasonable and should be recoverable.

E. Call Center Expense.

Q. Did either Staff or RUCO reduce the Company's Call Center expense?

A. Yes. Staff reduced the Call Center expense being allocated to UNS Gas from TEP. TEP's Call Center serves UNS Gas, UNS Electric and TEP. Dr. Fish asserts that the increase in the expense level being allocated to UNS Gas is not commensurate with an increased service level and therefore is inappropriate. Dr. Fish adjusted test year expense back to the level approved in the last rate case, which is based on a 2005 test year.

90

BEFORE THE ARIZONA CORPORATION COMMISSION

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.	DOCKET NO. G-04204A-08-0571

Direct Testimony of

Gary A. Smith

on Behalf of

UNS Gas, Inc.

November 7, 2008

Q. What amount of AGA dues is the Company requesting recovery of?

A. UNS Gas is requesting the recovery of $45,964 related to AGA dues. As detailed below, the information and services UNS Gas received from the AGA far exceeds this cost.

Q. Would you please describe some of AGA's activities and how these activities benefit, either directly or indirectly, a member company's customers?

A. Yes. AGA conducts hundreds of operating and engineering activities to improve the safety, efficiency and productivity of member companies' engineering and operating functions. Some recent examples of AGA's operating and engineering activities include:

(1) Over all, the safety records of natural gas utilities are outstanding and they continue to improve. To encourage greater improvement in the safety of the natural gas delivery system, AGA hosted a Safety Leadership Summit in late 2007 for its members to come together and discuss the state of the natural gas industry in four critical areas of safety:

- Employee Safety;
- Utility Contractor Safety;
- Pipeline Safety; and
- Public Safety.

(2) AGA publishes the Gas Piping Technology Committee ("GPTC") Guide periodically. This GPTC Guide is prepared by safety experts from gas distribution and transmission companies, federal and state regulatory agencies, manufacturers and industry consultants and is updated when new materials and procedures are approved for use. UNS Gas uses the GPTC Guide to design and select piping material types. This Guide has saved UNS Gas time and some of the expense of designing and developing its systems, and insures standardization.

(3) The Operating and Engineering Committee helped initiate a campaign to increase awareness among contractors and excavators about the damage that can be done to buried pipeline mains as a result of their activities. AGA is a supporting sponsor of this National Program known as the "Common Ground Alliance." Two out of three reportable incidents on these mains are a result of third-party excavators. Most incidents occurred because the utility was not notified that work was about to be done or given the opportunity to mark the gas line. As a result of this effort, AGA has helped to raise public awareness of the importance of damage prevention programs and has provided a forum for states to better address this issue. UNSG continues to work to improve communication with excavators and reduce these incidents which are costly in terms of injuries and repair expenses, and which, for the most part, are avoidable.

(4) The AGA has taken the lead in developing easy-to-use personal computer software to deal with a variety of operating and/or engineering issues faced by gas companies. The cost of these programs to member companies is minimal in relation to costs saved, specifically development and labor costs. So far, software programs have been developed in the following areas:

- Gas Measurement - performs orifice flow and super compressibility calculations; and
- Gas Properties – Calculates natural gas speed of sound, critical flow coefficient and other thermodynamic properties.

(5) The AGA updates "Report No. 3, Orifice Metering of Natural Gas." This Report is a standard reference in gas contracts. Improved measurement accuracy increases UNS Gas' efficiency and UNS Gas' ability to pass any savings on to its customers.

(6) The AGA's Plastic Materials Committee evaluates the use of plastic materials and new fabrication techniques for gas piping systems. This Committee publishes the AGA Plastic Pipe Manual for Gas Services, which includes the latest information on plastic materials, piping components and design, as well as installation procedures covered under Federal and State regulatory codes and standards for natural gas distribution piping systems. Through the use of this information, member companies can more quickly, confidently and safely increase the use of more cost-effective plastic materials.

(7) The AGA Best Practices Program for Gas Distribution is an effort to identify procedures of superior performing gas industry companies and innovative work practices that can be used to improve participants' operations. The program focuses on improving the safety and efficiency of gas distribution system construction, maintenance, operation and inspection. Information is made available regarding a number of operational improvements in areas such as street repairs, safer trenchless technology and automated dispatching. Members have documented millions of dollars in savings from participation in this program, which in turn translates to lower costs for the customer.

(8) The Operating and Engineering Committee has developed a large number of manuals and textbooks that are essential in the day-to-day operation of gas utilities. An excellent example is the Gas Engineering and Operating Practices Services. This 11-book series has become the authoritative work on gas utility engineering. AGA manuals are incorporated by reference in the Commission's Pipeline Safety Regulations (at A.A.C. R14-5-202.R., for example).

(9) The AGA's Operating Section continues to provide support to its members who seek industry information on a variety of operations and engineering issues. The SOS Program is a resource for AGA members who have the need to query others on a particular subject. The SOS program is a simple and effective way for members to better understand how others are addressing a particular issue/challenge. Recent SOS requests include member-initiated surveys on the following topics:

- Oversight of, and quality checks on, contractors that perform locating services;
- Security metrics;
- Excavation and backfill practices around transmission lines;
- Third party damage claims;
- Gas odorization practices;
- Budget practices used for forecasting operations & maintenance workload;
- Elevated delivery pressure; and
- Right of Way acquisition.

These are just a few of the many operating and engineering-related projects that benefit a member company and its customers. While all of these benefits cannot necessarily be quantified in specific dollar amounts, it is clear that AGA activities provide significant benefits to customers in terms of improving the reliability and safety of UNS Gas' distribution system.

Q. Do you represent UNS Gas on any of the many AGA Committees?

A. Yes. I am a member of the AGA Operations and Engineering Committee. This group focuses on five areas:

- Safety, Security & Environment;
- Distribution and Transmission Engineering, Construction & Maintenance;

91

BEFORE THE ARIZONA CORPORATION COMMISSION

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 REASONABL E 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

Direct Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

November 7, 2008

which is not reflective of normal and recurring levels. In 2005, 2006 and 2007 the Company spent $488,000, $439,000 and $242,000 respectively, on outside legal costs, excluding UNS Gas rate case activity. That results in a three-year average of $390,000 which is reflective of normal and recurring levels and is consistent with expected spending levels.

Q. Is the Normalization of Outside Legal Expenses adjustment consistent with the last UNS Gas rate case, Docket No. G-04204A-06-0463?

A. Yes. The adjustment was prepared and calculated in the same manner as was approved by the Commission in the last UNS Gas Rate Order.

xx. CARES Expense.

Q. Please explain the CARES Expense adjustment.

A. The CARES Expense adjustment is necessary to remove the activity in the test-year based on the prior deferred accounting treatment. As I discussed earlier, the deferred accounting treatment ceased as of December 1, 2007, along with the implementation of the rates, pursuant to Commission Decision No. 70011. The proper revenue levels for CARES activity are adjusted through the Rate Case Revenue Annualization adjustment, sponsored by Company witness, D. Bentley Erdwurm. To reflect the impact of that event in this rate filing, it is also necessary to remove the test-year CARES amortization expense. By doing these things, the test-year is adjusted to reflect the currently approved CARES accounting treatment to insure that revenue requirements do not include the recovery of discounts to CARES customers as an expense and test-year revenues properly reflect the actual billings to customers net of the CARES discounts.

92

BEFORE THE ARIZONA CORPORATION COMMISSION

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

At: Phoenix, Arizona

Date: August 12, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME III
(Pages 397 through 533)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

Q. Mr. Gray, I'm going to actually ask you a couple of questions based on your curriculum vitae attached.

It indicates there that one of your responsibilities is to represent the ACC in natural gas proceedings at FERC; is that true?

A. Yes.

Q. Does that continue to be true?

A. Yes.

Q. And what has been your involvement in the FERC gas proceedings over the years, just generally.

A. Primarily, the FERC proceedings have been pipeline rate cases. El Paso and Transwestern are the two main pipelines, and we've been involved in both cases, although we've spent a lot more time in El Paso than Transwestern over the years.

Q. Do you coordinate with the Arizona utilities that also participate in those proceedings?

A. We do actively have discussions with the utilities about issues and talk through the case, yes.

Q. And is there a level of cooperation between the Commission and the Arizona utilities in those rate cases?

A. Certainly. There's often a lot of common interest between the Commission and Arizona utilities to represent Arizona issues, and we do coordinate, yes.

Q. Is it fair to say that the Commission feels it benefits from the resources that the Arizona utilities provide in those rate cases?

A. Certainly the ongoing discussions that we have with the utilities are helpful to us as we participate in the cases.

Q. Do you believe that it's appropriate for UNS Gas to participate in FERC proceedings that would ultimately impact their customers, such as the El Paso Natural Gas rate case?

A. Certainly. I mean, obviously, every case that's filed at FERC is different. But certainly in the case of an El Paso general rate case where rates are set that UNS Gas pays, they would have -- I think they would have an interest in being involved, yes.

Q. Particularly if those rates are passed directly on to their customers?

A. Certainly.

Q. And would it be your preference for UNS Gas to continue to participate in those rate cases?

A. I think as a general principle, yes. Obviously, you know, if a case came along that there wasn't anything proposed that would impact UNS, then that would be, you know, something to consider. But generally speaking, when these cases come along, there are impacts to -- that are passed along to the customers. So as a general concept, yes.

Q. And would that continue to be true, particularly given the budget pressures facing the Commission and its ability to dedicate resources to FERC proceedings?

A. I'm not quite sure what you're saying with that question.

MR. PATTEN: I'll withdraw that. It was a commentary on our legislature.

That's all I have, Your Honor.

ACALJ NODES: Chairman Mayes.

CHMN. MAYES: I understood the question.

EXAMINATION

Q. (BY CHMN. MAYES) But Mr. Gray, let me ask you just a couple of questions first about the this interest rate issue.

You note in your testimony, your direct testimony on Page 4, that the Commission adopted the PGA mechanism in 1998. But at that time there actually wasn't any interest rate at all; is that correct?

A. That's my understanding, yes.

Q. So how long did we go -- how long did it go without an interest rate applied to it?

A. I mean, I don't know the history dating back

93

BEFORE THE ARIZONA CORPORATION COMMISSION

<u>COMMISSIONERS</u>
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 REASONABL E 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

Direct Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

November 7, 2008

percentage of actual account write-offs experienced during the past three years. This method of calculating bad debt expense is consistent with past Commission accepted practice.

Q. Is the Bad Debt Expense adjustment consistent with the last UNS Gas rate case, Docket No. G-04204A-06-0463?

A. Yes. The adjustment was prepared and calculated in the same manner as was approved by the Commission in the last UNS Gas Rate Order.

xviii. Miscellaneous Expenses.

Q. Please explain the Miscellaneous Expense adjustment.

A. This adjustment removes test-year expenses that should not be included in revenue requirements because they are for out-of-period activity, not reflective of test-year activity and/or should not be recovered from customers. Also included in this adjustment is an increase to test year postage expense to reflect the postage rate increase that went into effect May 12th, 2008.

xix. Normalize Outside Legal Expense.

Q. Please explain the adjustment to Normalize Outside Legal Expense.

A. This adjustment is being made to reflect a three-year average of outside legal costs. Legal costs by their nature are for primarily "individual" non-recurring activities. In this case, the test year activity is actually fairly reflective of a normal and recurring level, prior to adjustment, but the test year contained $310,000 in outside legal costs related to the last UNS Gas rate case filing that were disallowed recovery of and thus written off within the test year. Once that adjustment is made the test year level is only $84,000,

which is not reflective of normal and recurring levels. In 2005, 2006 and 2007 the Company spent $488,000, $439,000 and $242,000 respectively, on outside legal costs, excluding UNS Gas rate case activity. That results in a three-year average of $390,000 which is reflective of normal and recurring levels and is consistent with expected spending levels.

Q. Is the Normalization of Outside Legal Expenses adjustment consistent with the last UNS Gas rate case, Docket No. G-04204A-06-0463?

A. Yes. The adjustment was prepared and calculated in the same manner as was approved by the Commission in the last UNS Gas Rate Order.

xx. <u>CARES Expense.</u>

Q. Please explain the CARES Expense adjustment.

A. The CARES Expense adjustment is necessary to remove the activity in the test-year based on the prior deferred accounting treatment. As I discussed earlier, the deferred accounting treatment ceased as of December 1, 2007, along with the implementation of the rates, pursuant to Commission Decision No. 70011. The proper revenue levels for CARES activity are adjusted through the Rate Case Revenue Annualization adjustment, sponsored by Company witness, D. Bentley Erdwurm. To reflect the impact of that event in this rate filing, it is also necessary to remove the test-year CARES amortization expense. By doing these things, the test-year is adjusted to reflect the currently approved CARES accounting treatment to insure that revenue requirements do not include the recovery of discounts to CARES customers as an expense and test-year revenues properly reflect the actual billings to customers net of the CARES discounts.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

At: Phoenix, Arizona

Date: August 12, 2009

Filed: August 21, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME III
(Pages 397 through 533)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

By: MICHELE E. BALMER
Certified Reporter
Certificate No. 50489

Prepared for:

Q. Mr. Gray, I'm going to actually ask you a couple of questions based on your curriculum vitae attached.
It indicates there that one of your responsibilities is to represent the ACC in natural gas proceedings at FERC; is that true?
A. Yes.
Q. Does that continue to be true?
A. Yes.
Q. And what has been your involvement in the FERC gas proceedings over the years, just generally.
A. Primarily, the FERC proceedings have been pipeline rate cases. El Paso and Transwestern are the two main pipelines, and we've been involved in both cases, although we've spent a lot more time in El Paso than Transwestern over the years.
Q. Do you coordinate with the Arizona utilities that also participate in those proceedings?
A. We do actively have discussions with the utilities about issues and talk through the case, yes.
Q. And is there a level of cooperation between the Commission and the Arizona utilities in those rate cases?
A. Certainly. There's often a lot of common interest between the Commission and Arizona utilities to represent Arizona issues, and we do coordinate, yes.
Q. Is it fair to say that the Commission feels it

benefits from the resources that the Arizona utilities provide in those rate cases?

A. Certainly the ongoing discussions that we have with the utilities are helpful to us as we participate in the cases.

Q. Do you believe that it's appropriate for UNS Gas to participate in FERC proceedings that would ultimately impact their customers, such as the El Paso Natural Gas rate case?

A. Certainly. I mean, obviously, every case that's filed at FERC is different. But certainly in the case of an El Paso general rate case where rates are set that UNS Gas pays, they would have -- I think they would have an interest in being involved, yes.

Q. Particularly if those rates are passed directly on to their customers?

A. Certainly.

Q. And would it be your preference for UNS Gas to continue to participate in those rate cases?

A. I think as a general principle, yes. Obviously, you know, if a case came along that there wasn't anything proposed that would impact UNS, then that would be, you know, something to consider. But generally speaking, when these cases come along, there are impacts to -- that are passed along to the customers. So as a general concept, yes.

Q. And would that continue to be true, particularly given the budget pressures facing the Commission and its ability to dedicate resources to FERC proceedings?

A. I'm not quite sure what you're saying with that question.

MR. PATTEN: I'll withdraw that. It was a commentary on our legislature.

That's all I have, Your Honor.

ACALJ NODES: Chairman Mayes.

CHMN. MAYES: I understood the question.

EXAMINATION

Q. (BY CHMN. MAYES) But Mr. Gray, let me ask you just a couple of questions first about the this interest rate issue.

You note in your testimony, your direct testimony on Page 4, that the Commission adopted the PGA mechanism in 1998. But at that time there actually wasn't any interest rate at all; is that correct?

A. That's my understanding, yes.

Q. So how long did we go -- how long did it go without an interest rate applied to it?

A. I mean, I don't know the history dating back

94

BEFORE THE ARIZONA CORPORATION COMMISSION

<u>COMMISSIONERS</u>
KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

and use that normalized relationship to apply to pro forma retail revenue to calculate pro forma bad debt expense. That is why the Company's calculation of 4.87% of pro forma retail revenues is a proper reflection of expected bad debt levels based on the historical levels of bad debt expense and net write-off levels. The allowance account is at an appropriate level balance given the accounts in A/R and the company as expensed the proper level for the three year period in question. As such, the Company's adjustment should be accepted.

G. <u>Outside Legal Expense.</u>

Q. Did either Staff or RUCO reduce the Company's pro forma outside legal expense?

A. Yes. Both Staff and RUCO reduced UNS Gas's pro forma outside legal expense. Staff chose to eliminate the Company's adjustment entirely and did not give any substantive reason for the elimination. RUCO reduced the adjustment by about two-thirds with the primary reason being that the Company's normalization included cost associated with the Company's intervention, in support of its customers, in El Paso Natural Gas Company ("EPNG") rate case before FERC. Both Staff and RUCO fail to provide an allowance for normalized, on-going costs of legal services, based on either historical or projected costs.

Q. Do you agree with RUCO's significant reduction of the Company's normalized outside legal cost?

A. No. The basis for Mr. Smith's adjustment is to exclude the cost to monitor and participate in the EPNG rate case that was incurred in the years 2005-2007 in calculating his normalized outside legal cost. UNS Gas has been involved in monitoring all, and participating in many, of the interstate pipeline filings made by EPNG and Transwestern Pipeline ("TW") at FERC each and every year since UES has owned the Company. Since July 2007, there have been approximately thirty filings, in addition to general system-wide rate case filings, made by EPNG and TW at FERC. UNS Gas has intervened in and monitored these filings, and has participated in and litigated some of these cases because the filings could result in changes to the EPNG and TW pipeline tariffs, which in turn could affect the rates and terms and conditions under which UNS Gas receives services from those pipelines and ultimately affect the services and rates of UNS Gas' core customers. UNS Gas has no indication that this level of intervention on behalf of the customers of UNS Gas will be reduced. EPNG filed a Natural Gas System Wide Rate Case on June 27, 2008 (Docket No. RP08-426-000). This rate case is currently progressing toward litigation and is not likely to be resolved until first quarter 2010. If EPNG is not satisfied with the rate case order handed down by FERC, they could appeal it to the Court of Appeals. Additionally, TW will most likely file for a system-wide rate case in 2011. Both EPNG and TW file rate cases regularly and frequently; there is no basis to assume that UNS Gas will not incur legal costs in these cases, unless RUCO and Staff are suggesting that UNS Gas simply stop participating in FERC cases thereby ensuring that UNS Gas customers' interests will not be represented in those matters.

In the last UNS Gas rate case, , the Commission allowed the Company to recover outside legal expenses related to FERC rate cases (Decision No. 70011 at page 20). It should do so here, as well. If the Commission now eliminates the historical level of cost recovery of intervention in these cases from base rates – the unequivocal message to UNS Gas is that UNS Gas customers' interests should not be represented in FERC cases in the future.

H. <u>Fleet Fuel Expense.</u>

Q. Did Staff or RUCO reduce the Company's pro forma fleet fuel expense?

A. Yes. Both Staff and RUCO proposed to reduce the Company's pro forma expense to reflect the reduced cost of fuel currently being incurred by the Company.

95

BEFORE THE ARIZONA CORPORATION COMMISSION

<u>COMMISSIONERS</u>
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 REASONABL E 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

Direct Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

November 7, 2008

ruled that the program benefited shareholders and customers equally and therefore the expense should be shared equally.

Q. Do you agree with the Commission's prior decision to reduce the cash based incentive plan of UNS Gas by 50%?

A. No, I do not. The Commission did *not* rule that the costs themselves or the program were imprudent or that they did not benefit the customers of UNS Gas. If the Commission finds that the costs are prudent and that the program benefits customers, it should allow *full* recovery of the cost based on the adjustment proposed by the Company.

xvi. <u>Rate Case Expense.</u>

Q. Please explain the Rate Case Expense adjustment.

A. The Rate Case Expense adjustment addresses the outside costs already incurred, and expected to be incurred, in connection with this rate case. This amount is an estimate of the anticipated final cost and will be updated before this proceeding concludes. The adjustment amortizes the balance to expense over three years. This is the approximate time period between when UNS Gas filed this rate case and when the next rate case will likely occur. The adjustment also reflects the collection of the anticipated remaining balance of rate case expense allowed to be recovered in Decision No. 70011. That remaining balance will also be amortized over the anticipated life of rates in this case.

xvii. <u>Bad Debt Expense.</u>

Q. Please explain the Bad Debt Expense adjustment.

A. Bad Debt Expense is adjusted to a level reflective of final, pro forma weather-normalized, customer-annualized test-year operating revenues, and the average

percentage of actual account write-offs experienced during the past three years. This method of calculating bad debt expense is consistent with past Commission accepted practice.

Q. Is the Bad Debt Expense adjustment consistent with the last UNS Gas rate case, Docket No. G-04204A-06-0463?

A. Yes. The adjustment was prepared and calculated in the same manner as was approved by the Commission in the last UNS Gas Rate Order.

xviii. <u>Miscellaneous Expenses.</u>

Q. Please explain the Miscellaneous Expense adjustment.

A. This adjustment removes test-year expenses that should not be included in revenue requirements because they are for out-of-period activity, not reflective of test-year activity and/or should not be recovered from customers. Also included in this adjustment is an increase to test year postage expense to reflect the postage rate increase that went into effect May 12th, 2008.

xix. <u>Normalize Outside Legal Expense.</u>

Q. Please explain the adjustment to Normalize Outside Legal Expense.

A. This adjustment is being made to reflect a three-year average of outside legal costs. Legal costs by their nature are for primarily "individual" non-recurring activities. In this case, the test year activity is actually fairly reflective of a normal and recurring level, prior to adjustment, but the test year contained $310,000 in outside legal costs related to the last UNS Gas rate case filing that were disallowed recovery of and thus written off within the test year. Once that adjustment is made the test year level is only $84,000,

96

BEFORE THE ARIZONA CORPORATION COMMISSION

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 REASONABL E 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

Direct Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

November 7, 2008

percentage of actual account write-offs experienced during the past three years. This method of calculating bad debt expense is consistent with past Commission accepted practice.

Q. Is the Bad Debt Expense adjustment consistent with the last UNS Gas rate case, Docket No. G-04204A-06-0463?

A. Yes. The adjustment was prepared and calculated in the same manner as was approved by the Commission in the last UNS Gas Rate Order.

xviii. Miscellaneous Expenses.

Q. Please explain the Miscellaneous Expense adjustment.

A. This adjustment removes test-year expenses that should not be included in revenue requirements because they are for out-of-period activity, not reflective of test-year activity and/or should not be recovered from customers. Also included in this adjustment is an increase to test year postage expense to reflect the postage rate increase that went into effect May 12th, 2008.

xix. Normalize Outside Legal Expense.

Q. Please explain the adjustment to Normalize Outside Legal Expense.

A. This adjustment is being made to reflect a three-year average of outside legal costs. Legal costs by their nature are for primarily "individual" non-recurring activities. In this case, the test year activity is actually fairly reflective of a normal and recurring level, prior to adjustment, but the test year contained $310,000 in outside legal costs related to the last UNS Gas rate case filing that were disallowed recovery of and thus written off within the test year. Once that adjustment is made the test year level is only $84,000,

97

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

$507,000, a 22% increase over more than three years. In that time, wages and on-going costs continue to increase, and we continue to offer new services to our customers that are included in these costs. For example, UNS Gas customers now have credit card processing and on-line bill presentment. These new services cost money that increase our costs but ultimately provide the customer with better options and a better service level experience. However, increasing talk time at UNS Gas, was the largest contributor to the allocated Call Center costs, not increased Call Center costs.

F. <u>Bad Debt Expense.</u>

Q. Did Staff or RUCO reduce the Company's pro forma bad debt expense?

A. Yes. Staff reduced the pro forma expense level based on Dr. Fish's assertion that the Company has recorded too much expense for bad debt the last three years based on his assertion that the Company is over reserved for bad debt.

Q. Do you agree with Dr. Fish's assertion that the Company is over reserved and his corresponding assertion that bad debt expense has been overstated?

A. No. Dr. Fish has performed some analysis of the change in the Allowance for Bad Debt ("allowance") account that has taken place from the years 2005 and 2006 in comparison to the current levels and asserts that it is over stated by approximately 100%. The allowance account is a contra asset account that reduces the Accounts Receivable ("A/R") account on the Company's balance sheet so that the net of the two reflects the reality that not all of those accounts will be fully collected. This account is reconciled on a quarterly basis by the accounting department of TEP and is audited annually by an independent accounting firm to insure that it is materially accurate. To say that it is overstated by that magnitude is to assert error on the part of the accounting professionals. This is something to which I take considerable exception and that is blatantly incorrect.

98

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Can you tell us how the Company evaluates the allowance account?

A. Yes. Primarily this is achieved by looking at the aged accounts receivable reports and the historical recovery levels of these aged assets. A hypothetical example would be that you have $10 million of A/R and $1 million of that is over 120 days unpaid – historically the Company only collects 10% of accounts that delinquent. In that example, you would have an allowance account balance of $900,000 until you actually wrote the accounts off and removed them from A/R. What Dr. Fish did not discover in his analysis was that the allowance account grew substantially in 2007 because of the conversion of the Customer Billing System. Upon this conversion the normal process and timing of A/R write offs was essentially put on hold.

Q. What was the impact of putting the normal A/R write off process on hold?

A. When you do that the A/R balance becomes overstated, you have not cleared accounts out that are just not collectible any more. Correspondingly, the allowance account grows so as to reflect the proper "net" A/R balance. This holding on write-off processing also impacted the historical net write-off information. So if you look at net write-offs historically there was also a significant decrease in 2007 and that information would skew any normalization if you used an average of net write-offs including that period.

Q. So what does this mean in relation to Dr. Fish's adjustment to bad debt expense?

A. It means that Dr. Fish was looking at only one side of the equation and came to an incorrect conclusion. Bad debt expense is the accrual based expense to match expected net write-offs with revenue as it is recorded. Now this is not a perfect process, it is done by continually looking at your historical levels of recovery and looking at the allowance account versus the aging of your A/R and monitoring other items like large customer bankruptcies. That is why for ratemaking purposes the preferred method is to take net write offs (or bad debt expense) as a percentage of retail revenue over a long period of time

99

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Q. Can you tell us how the Company evaluates the allowance account?

A. Yes. Primarily this is achieved by looking at the aged accounts receivable reports and the historical recovery levels of these aged assets. A hypothetical example would be that you have $10 million of A/R and $1 million of that is over 120 days unpaid – historically the Company only collects 10% of accounts that delinquent. In that example, you would have an allowance account balance of $900,000 until you actually wrote the accounts off and removed them from A/R. What Dr. Fish did not discover in his analysis was that the allowance account grew substantially in 2007 because of the conversion of the Customer Billing System. Upon this conversion the normal process and timing of A/R write offs was essentially put on hold.

Q. What was the impact of putting the normal A/R write off process on hold?

A. When you do that the A/R balance becomes overstated, you have not cleared accounts out that are just not collectible any more. Correspondingly, the allowance account grows so as to reflect the proper "net" A/R balance. This holding on write-off processing also impacted the historical net write-off information. So if you look at net write-offs historically there was also a significant decrease in 2007 and that information would skew any normalization if you used an average of net write-offs including that period.

Q. So what does this mean in relation to Dr. Fish's adjustment to bad debt expense?

A. It means that Dr. Fish was looking at only one side of the equation and came to an incorrect conclusion. Bad debt expense is the accrual based expense to match expected net write-offs with revenue as it is recorded. Now this is not a perfect process, it is done by continually looking at your historical levels of recovery and looking at the allowance account versus the aging of your A/R and monitoring other items like large customer bankruptcies. That is why for ratemaking purposes the preferred method is to take net write offs (or bad debt expense) as a percentage of retail revenue over a long period of time and use that normalized relationship to apply to pro forma retail revenue to calculate pro forma bad debt expense. That is why the Company's calculation of 4.87% of pro forma retail revenues is a proper reflection of expected bad debt levels based on the historical levels of bad debt expense and net write-off levels. The allowance account is at an appropriate level balance given the accounts in A/R and the company as expensed the proper level for the three year period in question. As such, the Company's adjustment should be accepted.

G. <u>Outside Legal Expense.</u>

Q. Did either Staff or RUCO reduce the Company's pro forma outside legal expense?

A. Yes. Both Staff and RUCO reduced UNS Gas's pro forma outside legal expense. Staff chose to eliminate the Company's adjustment entirely and did not give any substantive reason for the elimination. RUCO reduced the adjustment by about two-thirds with the primary reason being that the Company's normalization included cost associated with the Company's intervention, in support of its customers, in El Paso Natural Gas Company ("EPNG") rate case before FERC. Both Staff and RUCO fail to provide an allowance for normalized, on-going costs of legal services, based on either historical or projected costs.

Q. Do you agree with RUCO's significant reduction of the Company's normalized outside legal cost?

A. No. The basis for Mr. Smith's adjustment is to exclude the cost to monitor and participate in the EPNG rate case that was incurred in the years 2005-2007 in calculating his normalized outside legal cost. UNS Gas has been involved in monitoring all, and participating in many, of the interstate pipeline filings made by EPNG and Transwestern Pipeline ("TW") at FERC each and every year since UES has owned the Company. Since July 2007, there have been approximately thirty filings, in addition to general system-wide

100

DATA REQUEST PACKET

Staff's Responses to UNS Gas' Data Requests:

UNSG 2.1	UNSG 3.10	UNSG 3.22
UNSG 2.2	UNSG 3.11	UNSG 3.39
UNSG 2.4	UNSG 3.12	UNSG 3.40
UNSG 3.4	UNSG 3.13	UNSG 3.41
UNSG 3.5	UNSG 3.14	UNSG 3.57
UNSG 3.6	UNSG 3.15	UNSG 3.58
UNSG 3.7	UNSG 3.20	UNSG 3.60
UNSG 3.9	UNSG 3.21	UNSG 3.65

UNSG-24

UNSG 3.4 Is Thomas H. Fish, Ph.D. a Certified Public Accountant?

RESPONSE: No.

RESPONDENT: DR. THOMAS FISH

WITNESS: DR. THOMAS FISH

UNSG 3.5 Please list all accounting classes taken by Thomas H. Fish, Ph.D. (including title, number of credit hours, and name of institution).

RESPONSE: **Dr. Fish obtained a Ph.D. and a masters and undergraduate degrees in economics. Masters and Doctoral level programs in economics and finance consist of a series of classes whose content include financial accounting as supporting concepts taught in the classes. The financial accounting concepts were primarily covered in the Ph.D. level finance classes.**

RESPONDENT: **DR. THOMAS FISH**

WITNESS: **DR. THOMAS FISH**

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

APPENDIX

IN SUPPORT OF

INITIAL POST-HEARING

BRIEF OF UNS GAS, INC

Volume 2 of 3

101

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 18, 2009

Filed: August 25, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI

(Pages 809 through 929, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

ACC

until 12:10 p.m.)

ACALJ NODES: Okay. Let's go back on the record.

Mr. Patten.

MR. PATTEN: Thank you, Your Honor.

Q. BY MR. PATTEN: Mr. Smith, I want to talk to you about the bad debt expense proposed by the company.

You are a CPA, aren't you?

A. Yes.

Q. And you have not proposed any adjustment to the company's bad debt expense in this case, have you?

A. No, I didn't.

MR. PATTEN: All right. That is all I have, Your Honor.

ACALJ NODES: Oh, it was brief.

MR. PATTEN: Well, you gave me a chance, and I weeded a few things out.

EXAMINATION

BY ACALJ NODES:

Q. Let me ask a couple questions if I might, Mr. Smith.

A. Sure.

Q. In talking about the fair value rate of return issue, are you aware of any other states that continue to

102

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
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 ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	)	DOCKET NO. G-04204A-08-0571

REDACTED DIRECT

TESTIMONY

OF

RALPH C. SMITH

ON BEHALF OF THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JUNE 8, 2009

Period	Average Number of Commercial Customers	Change
12 Months Ended:		
6/30/2005	10,764	
6/30/2006	10,989	225
6/30/2007	11,293	304
TYE 6/2008	11,442	149

Looking at comparable periods ending in June 30, through the current test year ended June 30, 2008, UNS Gas has gained commercial customers in each year.

Q. What do you conclude from this information?

A. I conclude that UNS Gas has added, on average, both residential and commercial customers in each and every year, including the test year. Consequently, an adjustment to decrease test year revenue would understate test year and going-forward revenues and be inappropriate and should be rejected. Test year revenue of $516,000 should not be removed as proposed by UNSG. RUCO adjustment C-1 restores this amount of actual test year revenue to the test year.

C-2 Depreciation & Property Taxes for CWIP/Post Test Year Plant

A. This adjustment is related to RUCO Adjustment B-1, which removed UNSG's request for inclusion in rate base of CWIP/Post Test Year Plant. It removes $58,107 of Depreciation Expense, $11,351 of O&M Expense related to depreciation on transportation equipment, and $25,584 of Property Tax Expense related to the adjustment to remove UNSG's request for CWIP/Post Test Year Plant in Service. In total, UNSG's expenses are reduced by $95,042.

Q. How did you determine the recommended assessment rate for property taxes?

A. This adjustment reflects the known statutory assessment ratio of 22 percent applicable for 2009, when rates in this case are expected to be effective. Section 42-15001 of the Arizona State Legislature provides the current percentages for property tax assessments. The assessment rate schedule provides for decreasing the 25 percent rate applicable in 2005 by 0.5 for the year 2006 and 1.0 percent each year thereafter until a 20 percent rate is attained in 2011. The Company's calculation also used a 22 percent assessment rate.

C-3 Incentive Compensation Expense

Q. Please explain Staff Adjustment C-3.

A. This adjustment provides for the allocation of 50 percent of the test year expense for the incentive compensation to shareholders. Test year expense for incentive compensation expense proposed by UNSG is reduced by $140,484. Related payroll tax expense is decreased by $12,027.

Q. Please explain why a 50 percent allocation to shareholders is appropriate for an incentive compensation program.

A. In general, incentive compensation programs can provide benefits to both shareholders and ratepayers. The removal of 50% of the incentive compensation expense, in essence, provides an equal sharing of such cost, and therefore provides an appropriate balance between the benefits attained by both shareholders and ratepayers. Both shareholders and ratepayers stand to benefit from the achievement of performance goals; however, there is no assurance that the award levels included in the Company's proposed expense for the test year will be repeated in future years.

Q. Please briefly discuss the key provisions of the incentive compensation program.

103

BEFORE THE ARIZONA CORPORATION COMMISSION

<u>COMMISSIONERS</u>
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 REASONABL E 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

Direct Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

November 7, 2008

These Company wide goals are pushed down to the individual non-bargaining employee level and put into individual performance plans that provide measurable incentives for employees and put a portion of their individual pay at-risk. The amount of dollars available is determined based on Company wide results, but individual payments are determined based on individual accomplishments, thus those that perform at the highest levels can be rewarded accordingly. Payments are made to employees either late in the first quarter or early in the second quarter of the following year.

The adjustment is calculated by taking the average of the incentive compensation expense for the past three years and adjusting the amount reflected in test-year operating expenses to that level. Since the incentive compensation payments are subject to payroll taxes, a portion of the adjustment reflects the incremental effect of payroll taxes thereon.

Q. Does this cash based incentive compensation program result in employee salaries and wages in excessive of market?

A. No. When combined with the employees' base salaries, the total cash compensation is actually below the median of market, based on the most recent benchmark studies.

Q. Is the Incentive Compensation adjustment consistent with the last UNS Gas rate case, Docket No. G-04204A-06-0463?

A. Yes. The adjustment was prepared and calculated in a similar manner as was "partially" approved by the Commission in the last UNS Gas Rate Order.

Q. What do you mean by "partially" approved in the last Rate Order?

A. The cash-based short-term incentive plan expense that was approved in the last rate case was 50% of the pro forma expense amount proposed by the Company. The Commission

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

EXHIBIT

DJD-1

UNS GAS, INC.
COMPARISON OF ADJUSTMENTS TO REVENUE REQUIREMENT
TEST YEAR ENDED JUNE 30, 2008

	UNSG As Filed 11/7/08	ACC As Filed 6/8/09	RUCO As Filed 6/8/09	UNSG Revised 7/8/09	Summary	UNSG Witness
Original Cost Rate Base - Unadjusted	$176,153,570	$176,153,570	$176,153,570	$176,153,570		Dukes
Rate Base Adjustments						
Acquisition Adjustment	32,852,425	32,852,425	32,852,425	32,852,425	No change	Dukes
Southern Union Acquisition Adjustment	(16,145,381)	(16,145,381)	(16,145,381)	(16,145,381)	No change	Dukes
Griffith Plant	(4,942,600)	(4,942,600)	(4,942,600)	(4,942,600)	No change	Dukes
Build-Out Plant	(7,896,628)	(7,896,628)	(7,896,628)	(7,896,628)	No change	Dukes
Golden Valley Plant	(4,393,096)	(4,393,096)	(4,393,096)	(4,393,096)	No change	Dukes
Post-Test Year Non-Revenue Plant in Service	1,527,588	-	-	1,527,588	Staff disallowed CWIP-Post Test Year Plant (THF-B-5, pg 14-16). RUCO disallowed CWIP-Post Test Year Plant (B-1, pg 13-18).	Dukes
Customer Advances Adjustment	589,152	-	-	589,152	Staff disallowed Customer Advances (THF-B6, pg 16-17). RUCO disallowed Customer Advances (B-2, pg 18-20).	Dukes
Accumulated Deferred Income Taxes	4,450,108	4,411,114	4,253,852	4,450,108	Changes are recalculations based on proposed pro forma adjustments. Staff disallowed SERP expense (THF-B9, pg 18-19). RUCO disallowed specific items (Div Equivalents, Restricted Stock, Stock Options, Vacation & Pension) from the ADIT Calculation (B-6, pg 23-24).	Kissinger
Working Capital	97,967	(1,530,037)	2,296	2,183,948	Staff adjusted cash working capital for a change in the purchased gas payment lag and for the impact of the other proposed adjustments to operating revenue and expense (THF-B7, B8 & B10, pg 17-18). RUCO disallowed the 13-month average adjustment of $92,671 for Prepaids (B-3, pg 20-21). UNSG adjusted cash working capital as a result of other pro forma adjustments/changes and to reflect the corrected purchased gas payment lag.	Dukes
Total Adjustments	6,139,535	2,355,797	3,730,868	8,225,516		
Pro Forma OCRB	182,293,105	178,509,367	179,884,439	184,379,086		
Proposed Rate of Return	8.75%	8.24%	7.55%	8.75%	Staff ROE 10%; RUCO ROE 8.61%, Company ROE 11%	Grant
Required Operating Income	$15,950,647	$14,709,172	$13,581,275	$16,133,170		

UNS GAS, INC.

COMPARISON OF ADJUSTMENTS TO REVENUE REQUIREMENT

TEST YEAR ENDED JUNE 30, 2008

	UNSG As Filed 11/7/08	ACC As Filed 6/8/09	RUCO As Filed 6/8/09	UNSG Revised 7/8/09	Summary	UNSG Witness
Original Operating Income - Unadjusted	$13,447,491	$13,447,491	$13,447,491	$13,447,491		Dukes
<u>Operating Income Adjustments</u>						
<u>Operating Revenue Adjustments</u>						
Griffith Plant Operations	(865,152)	(865,152)	(865,152)	(865,152)	No change	Dukes
Golden Valley Rev & Exp	(2,148,778)	(2,148,778)	(2,148,778)	(2,148,778)	No change	Dukes
Gas Cost Rev & Purchased Gas Cost	(90,472,202)	(90,472,202)	(90,472,202)	(90,472,202)	No change	Dukes
NSP Revenue & Gas Cost	(17,165,706)	(17,165,706)	(17,165,706)	(17,165,706)	No change	Dukes
Rate Case Revenue Annualization	1,448,476	1,797,514	1,448,476	1,448,476	Staff's adjustment differs because they assumed additional customers for the entire year based on 12/31/2007 customer levels increased by 1.25%.	Erdwurm
Customer Annualization	(516,003)	655,768	-	(516,003)	Staff adjusted revenue reflect additional customers based on 12/31/2007 customer levels increased by 1.25%. RUCO argues we are a growing system and that a negative annualization made no sense so they reversed our adjustment.	Erdwurm
Weather Normalization	(882,453)	(903,889)	(882,453)	(882,453)	Staff's adjustment reflects the additional assumed customers.	Erdwurm
DSM Revenue & Expense	(130,917)	(130,917)	(130,917)	(130,917)	No change	Dukes
Service Fees & Late Fees	239,235	239,235	239,235	239,235	No change	Dukes
Total Adjustments to Operating Revenues	(110,493,500)	(108,994,127)	(109,977,497)	(110,493,500)		
<u>Operating Expense Adjustments</u>						
Griffith Plant Operations	(160,390)	(160,390)	(160,390)	(160,390)	No change	Dukes
Golden Valley Rev & Exp	(1,763,947)	(1,763,947)	(1,763,947)	(1,763,947)	No change	Dukes
Gas Cost Rev & Purchased Gas Cost	(90,472,202)	(90,472,202)	(90,472,202)	(90,472,202)	No change	Dukes
NSP Revenue & Gas Cost	(16,696,668)	(16,696,668)	(16,696,668)	(16,696,668)	No change	Dukes
DSM Revenue & Expense	(130,917)	(130,917)	(130,917)	(130,917)	No change	Dukes
Payroll Expense	362,018	362,018	136,278	362,018	RUCO removed the 2010 pay increase, stating it is not known & measurable, but allows the 2009 increase (C-12, pg 55-56)	Dukes
Payroll Tax Expense	2,557	(9,182)	(22,325)	2,557	Staff adjusted payroll tax expense to reflect the proposed reduction for incentive compensation expense but used an overall rate of 10%, which is incorrect (THF-C16, pg 28). RUCO is removing the Payroll Tax associated with the 2010 pay increase disallowed. RUCO did not excluded the Capital portion in their Payroll Tax calculation. Should have been incrementally adjusted by $17,354 instead of $24,882. (C-12, pg 55-56)	Dukes
Pension and Benefits	77,544	77,544	77,544	77,544	No change	Dukes
Incentive Compensation (Staff & RUCO Adj)	30,930	(86,463)	(121,581)	30,930	Staff adjusted based on allowance of 50%, but appears to have incorrect expense amounts (THF-C14, pg 27-28). RUCO disallowed 50% of the Incentive Comp in the TY (TY total is $280,968/2 = $140,484 disallowed & $24,054/2 = 12,027 disallowed for taxes), RUCO's adjustment was not done incremental and is including the as filed adjustment as well (C-3, pg 29-35).	Dukes

UNS GAS, INC.

COMPARISON OF ADJUSTMENTS TO REVENUE REQUIREMENT

TEST YEAR ENDED JUNE 30, 2008

	UNSG As Filed 11/7/08	ACC As Filed 6/8/09	RUCO As Filed 6/8/09	UNSG Revised 7/8/09	Summary	UNSG Witness
Rate Case Expense (Staff & RUCO Adj; UNSG Adj.)	200,000	141,667	41,667	141,667	Staff adjusted test year rate case expense to reflect the correction of the error in the original pro forma as provided in response to Staff Data Request TF 6.68 (THF-C17, pg 29). RUCO allows only $300,000/3 for $100,000 per year and is removing the $58,333 prior year rate case expense still included in the TY. ($100,000 allowable - $58,333 included in test year = $41,667 adjustment) (C-9, pg 50-53). UNSG is adjusting expense in accordance with the corrected pro forma as presented in response to Staff Data Request TF 6.68.	Dukes
CARES Expense	(25,983)	(25,983)	(25,983)	(25,983)	No change	Dukes
CARES Regulatory Asset Amort.	164,197	164,197	164,197	164,197	No change	Dukes
Y2K Amortization	(76,753)	(76,753)	(76,753)	(76,753)	No change	Dukes
Miscellaneous Expenses (Staff Adj for AGA dues & postage expense; RUCO Adj for AGA dues)	(827,301)	(779,380)	(844,063)	(827,301)	Staff adjusted postage expense for the postage increase of $.02 effective in 5/11/09 using Staff's annualized customers in THF-C4 and the incremental postage cost based on the $.02 increase and UNSG actual customers per Schedule H2 (THF-C8, pg 25), but the final adjustment was incorrect do to an addition error. Staff adjusted AGA dues expense to reflect the same disallowance in the prior rate case (THF-C10, pg 25), but the AGA dues and the percentage disallowed are incorrect and UNSG already removed 4% of AGA dues in the original pro forma. RUCO disallowed 40% of the AGA dues in TY (C-6, pg 43-48).	Dukes
Normalize Outside Legal Expense	305,984	-	88,310	305,984	Staff disallowed the UNSG adjustment to normalize test year legal expense (THF-C11, pg 26) arguing that the adjustment was related to prior rate case expense, when the pro forma was to normalize the test year ignorring the large write-off related to prior rate case expense. RUCO disallowed a majority of El Paso legal costs in the normalization calculation (C-7, pg 48-49).	Dukes
Bad Debt Expense	63,211	(123,416)	63,211	63,211	Staff adjusted Bad Debt Expense (THF-C7, pg 23-24) to reflect the uncollectible rate used in the prior rate case, arguing that UNSG over-accrued the Allowance for Doubtful Accounts in the last three years and thus our three-year average overstates test year expense.	Dukes
Depr & Property Tax - CWIP-Post Test Year (RUCO Adj)	-	-	(95,042)	-	Staff did not adjust depreciation expense for the CWIP removed from rate base. RUCO adjuted Depr. & Property taxes for remove of the CWIP-Post TY for rate base above (C-2, pg 28-29).	Dukes
Stock-Based Compensation Exp (RUCO Adj)	-	-	(266,399)	-	RUCO disallowed 100% of the Stock Base Comp Expense in TY (C-4, pg 35-39).	Dukes
SERP (Staff & RUCO Adj)	-	(310,412)	(101,021)	-	Staff disallowed 100% of SERP expense (THF-C15, pg 28) but used the incorrect amount of SERP expense. RUCO disallowed 100% of SERP expense (C-5, pg 40-43).	Dukes
Fleet Fuel Expense (Staff & RUCO Adj; UNSG Adj.)	-	(294,599)	(471,826)	(51,258)	Staff adjusts Fleet Fuel Expense (THF-C8, pg 24) to reflect an average price per gallon of $1.96 for 2009. Staff's adjustment has an error in the result of the fuel cost of $1.96 per gallon multiplied by the total gallons used; the total Staff cost of $450,747 should be $437,027. In addition, Staff does not reflect the transportation allocation capitalization rate of 26.6% to Capital and 73.4% to O&M. RUCO normalizes Fleet Fuel Expense (C-8, pg 49-50). There is an error is RUCO's number: 1) the $471,826 includes $230,913 too much because the property tax adjustment is picked up twice; and 2) an adjustment needs to be made for the amount of fleet fuel that would be capitalized through the transportation allocation - 26.6% goes to Capital and 73.4% stays in O&M. UNSG is adjusting operating expense to reflect a 3-yr average fuel expense.	Dukes
Call Center (Staff Adj)	-	(484,798)	-	-	Staff is allowing allocation of call center cost based on our prior rate filing amount because request for service agreements have not increased substantially (THF-C12, pg 26-27).	Smith, Dukes

UNS GAS, INC.						
COMPARISON OF ADJUSTMENTS TO REVENUE REQUIREMENT						
TEST YEAR ENDED JUNE 30, 2008						
	UNSG	ACC	RUCO	UNSG		
	As Filed	As Filed	As Filed	Revised		UNSG
	11/7/08	6/8/09	6/8/09	7/8/09	Summary	Witness
Synchronized Interest (Staff Adj)	-	54,906	-	-	Staff adjusted synchronized interest related to interest on debt as a separate expense instead of including it in the income tax adjustment.	Dukes
Depr. & Amort. Exp. Annualization	(227,976)	(227,976)	(227,976)	(227,976)	No change	Kissinger
Property Tax	1,354,074	1,354,074	1,123,161	1,354,074	RUCO adjusted the Property tax rate from 8.1359 to 7.6127 to reflect a different assesment rate period (C-11, pg 54-55).	Kissinger
Income Taxes	(824,391)	397,788	161,937	(808,257)	Changes are recalculations based on other pro forma adjustments.	Kissinger
Total Adjustments to Operating Expense	(108,646,013)	(109,090,892)	(109,620,788)	(108,739,470)		
Total Net Adjustments	(1,847,487)	96,765	(356,709)	(1,754,030)		
Adjusted Operating Income	$11,600,004	$13,544,256	$13,090,781	$11,693,460		
Operating Income Deficiency	$4,350,643	$1,164,915	$490,494	$4,439,710		
Fair Value Addition (Pre-Tax)	$1,442,389	$912,685	$23,382	$1,353,322		Grant
Fair Value Operating Income Deficiency	$5,793,032	$2,077,600	$513,876	$5,793,032		
Gross Revenue Conversion Factor	1.6366	1.6343	1.6366	1.6366		Kissinger
Increase in Gross Revenue Requirement	$9,480,876	$3,395,423	$841,000	$9,480,876		

104

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Similar to the APS Plan, the PEP rewards certain performance if the desired results, which are based on objective criteria, are achieved. The actual amount of the award depends upon the achieved results. The intent of the plan is to: link pay with business performance and personal contributions to results; motivate participants to achieve higher levels of performance; communicate and focus on critical success measures; reinforce desired business behaviors, as well as results; and to reinforce an employee ownership culture.

Q. Please further explain the PEP and some of the benefits to customers, the Company and to employees.

A. A more accurate description of that program would be "a portion of an individual's fair and reasonable compensation put "at risk" to encourage and enhance group and individual performance". The at-risk compensation portion is used on an individual basis to reward specific performance and provides management with an additional tool to encourage further cost savings, motivate individuals and to encourage employees to impact goals.

If the PEP program is eliminated, there would be considerable increased pressure on base compensation. Employee base compensation would eventually have to be increased toward market to allow the Company to compete in attracting and retaining a skilled workforce. It is not reasonable to assume that the Company would be able to continue to attract employees at compensation rates well below the market median, without the PEP. So, Staff's recommendation will drive base compensation upward so that little to no compensation is variable or at risk. If that result came to fruition, then UNS Gas employees would not be as incentivized to meet performance based criteria that directly benefit UNS Gas customers.

Q. Are there advantages to the PEP versus just paying base compensation?

A. From the Company's and the customers' perspectives, there are many advantages to using a program like PEP, rather than just paying median market wages as non-variable base

105

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Similar to the APS Plan, the PEP rewards certain performance if the desired results, which are based on objective criteria, are achieved. The actual amount of the award depends upon the achieved results. The intent of the plan is to: link pay with business performance and personal contributions to results; motivate participants to achieve higher levels of performance; communicate and focus on critical success measures; reinforce desired business behaviors, as well as results; and to reinforce an employee ownership culture.

Q. Please further explain the PEP and some of the benefits to customers, the Company and to employees.

A. A more accurate description of that program would be "a portion of an individual's fair and reasonable compensation put "at risk" to encourage and enhance group and individual performance". The at-risk compensation portion is used on an individual basis to reward specific performance and provides management with an additional tool to encourage further cost savings, motivate individuals and to encourage employees to impact goals.

If the PEP program is eliminated, there would be considerable increased pressure on base compensation. Employee base compensation would eventually have to be increased toward market to allow the Company to compete in attracting and retaining a skilled workforce. It is not reasonable to assume that the Company would be able to continue to attract employees at compensation rates well below the market median, without the PEP. So, Staff's recommendation will drive base compensation upward so that little to no compensation is variable or at risk. If that result came to fruition, then UNS Gas employees would not be as incentivized to meet performance based criteria that directly benefit UNS Gas customers.

Q. Are there advantages to the PEP versus just paying base compensation?

A. From the Company's and the customers' perspectives, there are many advantages to using a program like PEP, rather than just paying median market wages as non-variable base

106

BEFORE THE ARIZONA CORPORATION COMMISSION

<u>COMMISSIONERS</u>
KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

Similar to the APS Plan, the PEP rewards certain performance if the desired results, which are based on objective criteria, are achieved. The actual amount of the award depends upon the achieved results. The intent of the plan is to: link pay with business performance and personal contributions to results; motivate participants to achieve higher levels of performance; communicate and focus on critical success measures; reinforce desired business behaviors, as well as results; and to reinforce an employee ownership culture.

Q. Please further explain the PEP and some of the benefits to customers, the Company and to employees.

A. A more accurate description of that program would be "a portion of an individual's fair and reasonable compensation put "at risk" to encourage and enhance group and individual performance". The at-risk compensation portion is used on an individual basis to reward specific performance and provides management with an additional tool to encourage further cost savings, motivate individuals and to encourage employees to impact goals.

If the PEP program is eliminated, there would be considerable increased pressure on base compensation. Employee base compensation would eventually have to be increased toward market to allow the Company to compete in attracting and retaining a skilled workforce. It is not reasonable to assume that the Company would be able to continue to attract employees at compensation rates well below the market median, without the PEP. So, Staff's recommendation will drive base compensation upward so that little to no compensation is variable or at risk. If that result came to fruition, then UNS Gas employees would not be as incentivized to meet performance based criteria that directly benefit UNS Gas customers.

Q. Are there advantages to the PEP versus just paying base compensation?

A. From the Company's and the customers' perspectives, there are many advantages to using a program like PEP, rather than just paying median market wages as non-variable base

compensation. The most direct savings result because PEP is not part of base compensation; therefore employee costs such as vacation pay, sick pay, long term disability, 401K matching, pension expense and other post-retirement benefits that are based on base pay are all reduced. The impact of reduced compounding wage increases that would be based on a higher base pay total is another benefit. Additionally, the benefits produced from the specific goals are tied to a portion of the employees' compensation, which allows management to have greater flexibility to distinguish and reward high-performers, to attract and retain more talented employees, and to mitigate the costs of training new employees by retaining key ones. Neither Staff nor RUCO dispute these facts and that the PEP brings added flexibility at reasonable cost.

From the employee perspective, the proper mix of base wages and incentive pay has benefits. Individual employees are rewarded for contributing to the overall success of the organization and are allowed to directly participate in corporate success with a clear line of sight to goals. Employees can be acknowledged and rewarded for making a difference by exhibiting extra effort, working more hours on the job (for professionals not eligible for overtime pay), or supporting the program goals. Also, payment to individual non-union employees is discretionary, so talented and high-contributing employees can earn more through the program, which can be a motivating factor and can also lead to higher retention rates for more talented employees. Rather than being an over-inflated program, the PEP provides direct benefit to UNS Gas customers economically. Neither Staff, nor RUCO for that matter, have presented any evidence to demonstrate that the compensation and benefit packages of the UNS Gas employees (including incentive compensation) are not prudent or reasonable.

107

DATA REQUEST PACKET

Staff's Responses to UNS Gas' Data Requests:

UNSG 2.1	**UNSG 3.10**	**UNSG 3.22**
UNSG 2.2	**UNSG 3.11**	**UNSG 3.39**
UNSG 2.4	**UNSG 3.12**	**UNSG 3.40**
UNSG 3.4	**UNSG 3.13**	**UNSG 3.41**
UNSG 3.5	**UNSG 3.14**	**UNSG 3.57**
UNSG 3.6	**UNSG 3.15**	**UNSG 3.58**
UNSG 3.7	**UNSG 3.20**	**UNSG 3.60**
UNSG 3.9	**UNSG 3.21**	**UNSG 3.65**

UNSG-24

UNSG 3.60 Does Dr. Fish believe that an organization is more likely to achieve specified goals when 1) achieving those goals are part of an incentive compensation plan; or when 2) compensation is entirely disconnected from achievement of goals?

RESPONSE: **Dr. Fish can respond more fully to this request when provided with a list of specified goals. Dr. Fish believes that, everything else equal, an organization might be more likely to achieve specified goals when achieving specific goals is part of a comprehensive compensation plan that may include incentives.**

RESPONDENT: **DR. THOMAS FISH**

WITNESS: **DR. THOMAS FISH**

108

DATA REQUEST PACKET

RUCO's Responses to UNS Gas' Data Requests:

UNSG 2.25
UNSG 2.48
UNSG 2.55
UNSG 3.2
UNSG 3.13
UNSG 3.16
UNSG 3.18
UNSG 3.20
UNSG 3.21
UNSG 3.22
UNSG 3.31
UNSG 3.34
UNSG 3.35
UNSG 3.36

THIRD SET OF DATA REQUESTS
FROM UNS GAS, INC.
TO RESIDENTIAL UTILITY CONSUMER OFFICE
(DOCKET NO. G-04204A-08-0571)

UNSG 3.16 Assume that the prudent total compensation for utility employee X is $50,000, exclusive of health insurance.

a. What incentives are created by paying the full $50,000 as straight salary?

b. What incentives are created by paying $10,000 as a potential bonus for meeting customer service goals, and $40,000 as straight salary?

c. What incentives are created by paying $10,000 as a potential bonus for meeting customer service goals, $5,000 as a stock-based compensation and $35,000 as straight salary?

d. Which compensation structure (a, b or c) is most beneficial to ratepayers? Why?

e. Under Mr. Smith's proposals in this case, under compensation structure a, what amount of expense would be reflected in revenue requirement?

f. Under Mr. Smith's proposals in this case, under compensation structure b, what amount of expense would be reflected in revenue requirement?

g. Under Mr. Smith's proposals in this case, under compensation structure c, what amount of expense would be reflected in revenue requirement?

h. Which compensation structure allowed the utility the greatest amount of expense reflected in revenue requirement? Is that compensation structure the same as the structure identified in response to sub-part d? If not, why is that an optimal result as a matter of regulatory policy?

i. Does RUCO believe that the total compensation to UNS Gas employees in the test year was unreasonable? If so, please provide the basis for that belief and all supporting materials.

UNSG 3.16 (Continued)

RESPONSE: a. This would depend on the way an individual employee viewed his/her job. Presumably the incentives of any pay structure include showing up for work on time and performing competently and diligently in fulfilling the job requirements.

b. The request is phrased in a manner to presume that the bonus might incent the affected employee to work harder to meet the customer service goal.

c. The request is phrased in a manner to presume that the bonus might incent the affected employee to work harder to meet the customer service goal, and to make management decisions to try to keep the earnings up and the stock price high, to the extent that such actions would produce more value for the employee in the form of the stock based compensation component.

d. If Mr. Smith's recommendations were adopted, the "c" hypothetical.

e. Assuming the entire amount was charged to expense and none was capitalized or charged to non-expense accounts or to non-utility activities or other affiliates, $50,000, unless any was for SERP, in which case the SERP expense would be removed.

f. Assuming the entire amount was charged to expense and none was capitalized or charged to non-expense accounts or to non-utility activities or other affiliates, $45,000, unless any was for SERP, in which case the SERP expense would be removed. The $45,000 is based on removing one-half of the

UNSG 3.16 (Continued)

incentive compensation expense to reflect the 50/50 sharing that the Commission has adopted in several recent rate case decisions.

g. Assuming the entire amount was charged to expense and none was capitalized or charged to non-expense accounts or to non-utility activities or other affiliates, $40,000, unless any was for SERP, in which case the SERP expense would be removed. The $40,000 is based on removing one-half of the incentive compensation expense to reflect the 50/50 sharing that the Commission has adopted in several recent rate case decisions, and removing the expense for the stock based compensation.

h. The "a" hypothetical. No. The "c" hypothetical appears to represent an optimal result as a matter of regulatory policy as such policy has been articulated by the Commission in a series of its rate case decisions concerning various elements of utility compensation. As articulated in such decisions, the Commission has rejected attempts by utilities to focus only on the amounts of total compensation and whether the total was reasonable or not, and the Commission has in a series of decisions evaluated the specific components of utility compensation, including utility management and executive compensation, specifically for ratemaking purposes. As an illustrative example, the Commission noted in a prior APS case, stock-based performance incentive goals have the potential to negatively affect customer service, and ratepayers should not be required to pay executive compensation that is based on the performance of the Company's stock price. (Decision No. 69663 at 36.) Several other illustrative examples of how

the Commission has evaluated and decided similar issues were cited in Mr. Smith's direct testimony.

i. Confidential UniSource executive compensation studies that Mr. Smith reviewed in a previous rate case raised questions about the reasonableness of some of the UniSource compensation and information presented by Southwest Gas in its last rate case suggested that UNS was less efficient on a per-customer cost basis. Establishing executive compensation at a 75th percentile level, for example, could be one indication of above-average compensation that could be viewed as unreasonable for ratemaking purposes. Public information suggests that there may be UNS executives who are earning above-average compensation which might be considered unreasonable for ratemaking purposes. Additionally, a series of prior Commission decisions have found that it is inappropriate for jurisdictional ratemaking purposes to charge ratepayers for certain specific elements of utility compensation, and Mr. Smith has attempted to make his recommendations consistent with the analysis and reasoning of those decisions. Thus, based on the series of prior Commission decisions cited in Mr. Smith's direct testimony, portions of the UNS compensation are disallowable, in the sense that the same or similar compensation components have been disallowed by the Commission in prior decisions.

RESPONDENT: Ralph C. Smith

WITNESS: Ralph C. Smith

109

DATA REQUEST PACKET

RUCO's Responses to UNS Gas' Data Requests:

UNSG 2.25
UNSG 2.48
UNSG 2.55
UNSG 3.2
UNSG 3.13
UNSG 3.16
UNSG 3.18
UNSG 3.20
UNSG 3.21
UNSG 3.22
UNSG 3.31
UNSG 3.34
UNSG 3.35
UNSG 3.36

UNSG 3.16 Assume that the prudent total compensation for utility employee X is $50,000, exclusive of health insurance.

a. What incentives are created by paying the full $50,000 as straight salary?

b. What incentives are created by paying $10,000 as a potential bonus for meeting customer service goals, and $40,000 as straight salary?

c. What incentives are created by paying $10,000 as a potential bonus for meeting customer service goals, $5,000 as a stock-based compensation and $35,000 as straight salary?

d. Which compensation structure (a, b or c) is most beneficial to ratepayers? Why?

e. Under Mr. Smith's proposals in this case, under compensation structure a, what amount of expense would be reflected in revenue requirement?

f. Under Mr. Smith's proposals in this case, under compensation structure b, what amount of expense would be reflected in revenue requirement?

g. Under Mr. Smith's proposals in this case, under compensation structure c, what amount of expense would be reflected in revenue requirement?

h. Which compensation structure allowed the utility the greatest amount of expense reflected in revenue requirement? Is that compensation structure the same as the structure identified in response to sub-part d? If not, why is that an optimal result as a matter of regulatory policy?

i. Does RUCO believe that the total compensation to UNS Gas employees in the test year was unreasonable? If so, please provide the basis for that belief and all supporting materials.

UNSG 3.16 (Continued)

RESPONSE: a. This would depend on the way an individual employee viewed his/her job. Presumably the incentives of any pay structure include showing up for work on time and performing competently and diligently in fulfilling the job requirements.

b. The request is phrased in a manner to presume that the bonus might incent the affected employee to work harder to meet the customer service goal.

c. The request is phrased in a manner to presume that the bonus might incent the affected employee to work harder to meet the customer service goal, and to make management decisions to try to keep the earnings up and the stock price high, to the extent that such actions would produce more value for the employee in the form of the stock based compensation component.

d. If Mr. Smith's recommendations were adopted, the "c" hypothetical.

e. Assuming the entire amount was charged to expense and none was capitalized or charged to non-expense accounts or to non-utility activities or other affiliates, $50,000, unless any was for SERP, in which case the SERP expense would be removed.

f. Assuming the entire amount was charged to expense and none was capitalized or charged to non-expense accounts or to non-utility activities or other affiliates, $45,000, unless any was for SERP, in which case the SERP expense would be removed. The $45,000 is based on removing one-half of the

UNSG 3.16 (Continued)

incentive compensation expense to reflect the 50/50 sharing that the Commission has adopted in several recent rate case decisions.

g. Assuming the entire amount was charged to expense and none was capitalized or charged to non-expense accounts or to non-utility activities or other affiliates, $40,000, unless any was for SERP, in which case the SERP expense would be removed. The $40,000 is based on removing one-half of the incentive compensation expense to reflect the 50/50 sharing that the Commission has adopted in several recent rate case decisions, and removing the expense for the stock based compensation.

h. The "a" hypothetical. No. The "c" hypothetical appears to represent an optimal result as a matter of regulatory policy as such policy has been articulated by the Commission in a series of its rate case decisions concerning various elements of utility compensation. As articulated in such decisions, the Commission has rejected attempts by utilities to focus only on the amounts of total compensation and whether the total was reasonable or not, and the Commission has in a series of decisions evaluated the specific components of utility compensation, including utility management and executive compensation, specifically for ratemaking purposes. As an illustrative example, the Commission noted in a prior APS case, stock-based performance incentive goals have the potential to negatively affect customer service, and ratepayers should not be required to pay executive compensation that is based on the performance of the Company's stock price. (Decision No. 69663 at 36.) Several other illustrative examples of how

the Commission has evaluated and decided similar issues were cited in Mr. Smith's direct testimony.

i. Confidential UniSource executive compensation studies that Mr. Smith reviewed in a previous rate case raised questions about the reasonableness of some of the UniSource compensation and information presented by Southwest Gas in its last rate case suggested that UNS was less efficient on a per-customer cost basis. Establishing executive compensation at a 75th percentile level, for example, could be one indication of above-average compensation that could be viewed as unreasonable for ratemaking purposes. Public information suggests that there may be UNS executives who are earning above-average compensation which might be considered unreasonable for ratemaking purposes. Additionally, a series of prior Commission decisions have found that it is inappropriate for jurisdictional ratemaking purposes to charge ratepayers for certain specific elements of utility compensation, and Mr. Smith has attempted to make his recommendations consistent with the analysis and reasoning of those decisions. Thus, based on the series of prior Commission decisions cited in Mr. Smith's direct testimony, portions of the UNS compensation are disallowable, in the sense that the same or similar compensation components have been disallowed by the Commission in prior decisions.

RESPONDENT: Ralph C. Smith

WITNESS: Ralph C. Smith

110

DATA REQUEST PACKET

RUCO's Responses to UNS Gas' Data Requests:

UNSG 2.25
UNSG 2.48
UNSG 2.55
UNSG 3.2
UNSG 3.13
UNSG 3.16
UNSG 3.18
UNSG 3.20
UNSG 3.21
UNSG 3.22
UNSG 3.31
UNSG 3.34
UNSG 3.35
UNSG 3.36

THIRD SET OF DATA REQUESTS
FROM UNS GAS, INC.
TO RESIDENTIAL UTILITY CONSUMER OFFICE
(DOCKET NO. G-04204A-08-0571)

UNSG 3.18 Does Mr. Smith contend that UNS Gas' incentive compensation costs are imprudent? If yes, please explain, including comparisons to incentive compensation costs of other regulated gas utilities.

RESPONSE:

Mr. Smith contends that portions of UNS Gas' compensation are disallowable for ratemaking purposes. A prudence evaluation was not necessary in order to implement the ratemaking policies and evaluation articulated by the Commission in a series of recent decisions on utility incentive compensation costs, consequently, one was not undertaken on behalf of RUCO in the current UNSG rate case. Mr. Smith's testimony explains how incentive compensation costs were treated for ratemaking purposes in the last UNSG rate case as well as for Southwest Gas Corporation, another regulated gas utility with significant operations in Arizona. A series of prior Commission decisions have found that it is inappropriate for jurisdictional ratemaking purposes to charge ratepayers for certain specific elements of utility compensation, and Mr. Smith has attempted to make his recommendations consistent with the analysis and reasoning of those decisions. Thus, based on the series of prior Commission decisions cited in Mr. Smith's direct testimony, portions of the UNS compensation are disallowable, in the sense that the same or similar compensation components have been disallowed by the Commission in prior decisions.

RESPONDENT: Ralph C. Smith

WITNESS: Ralph C. Smith

THIRD SET OF DATA REQUESTS
FROM UNS GAS, INC.
TO RESIDENTIAL UTILITY CONSUMER OFFICE
(DOCKET NO. G-04204A-08-0571)

UNSG 3.20 Does Mr. Smith believe that it is common for an investor-owned gas utility to have an incentive compensation program? If no, please explain and provide examples of comparable gas utilities without such programs.

RESPONSE:

Mr. Smith has not undertaken to determine which do and do not specifically have such programs, since that type of research that did not appear to be necessary to apply the analytical framework suggested in the series of recent Commission orders on this issue cited in Mr. Smith's testimony in the context of the current UNSG rate case; however, he is generally aware that some investor owned gas utilities, including UNSG and Southwest Gas, have such programs and generally believes it is not uncommon among larger investor owned gas utilities.

RESPONDENT: Ralph C. Smith

WITNESS: Ralph C. Smith

111

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

management decision making. However, I believe the exact opposite is true. Stock-based compensation or equity compensation is primarily awarded in the form of stock options, which vest over a period of years and whose ultimate value is based on the *future* strength and performance of the Company. As such, the stock based compensation strongly promotes long-term employee and director retention and long-term sustainable performance activities.

Q. Why do you believe full recovery of the stock based compensation is appropriate in this case?

A. Neither Staff nor RUCO has questioned that the program provides benefits to customers, its prudency, the reasonableness of the cost or that it was incurred to provide service to customers. This program, like PEP, is designed to put individual employee's compensation at risk. However, this program focuses on creating incentives for long term planning and the long term success of the Company. Clearly customers benefit from the long term planning and success of the Company. Indeed, the Commission itself recognizes the benefits of long term planning through its Integrated Resource Planning, Energy Efficiency Standards, Renewable Energy Standards and Renewable Transmission planning dockets – all are focused on the long term service provided to customers.

3. <u>Supplemental Executive Retirement Plan ("SERP").</u>

Q. Did Staff or RUCO take exception to the SERP expense contained within the test year?

A. Yes. Both parties removed 100% of the SERP expense allocated to UNS Gas, asserting that SERP expense is simply an excess benefit provided to select executives. The Company strongly opposes this representation as misleading and incorrect. This expense

112

DATA REQUEST PACKET

RUCO's Responses to UNS Gas' Data Requests:

UNSG 2.25
UNSG 2.48
UNSG 2.55
UNSG 3.2
UNSG 3.13
UNSG 3.16
UNSG 3.18
UNSG 3.20
UNSG 3.21
UNSG 3.22
UNSG 3.31
UNSG 3.34
UNSG 3.35
UNSG 3.36

UNSG 3.21 Does Mr. Smith believe that it is common for an investor-owned gas utility to have some stock-based compensation expenses? If no, please explain and provide examples of comparable gas utilities without such programs.

RESPONSE:

Mr. Smith has not undertaken to determine which do and do not specifically have such programs, since that type of research that did not appear to be necessary to apply the analytical framework suggested in the series of recent Commission orders on this issue cited in Mr. Smith's testimony in the context of the current UNSG rate case; however, he is generally aware that some investor owned gas utilities, including UNSG and Southwest Gas, have such programs and generally believes it is not uncommon among larger investor owned gas utilities.

RESPONDENT: Ralph C. Smith

WITNESS: Ralph C. Smith

113

BEFORE THE ARIZONA CORPORATION COMMISSION

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

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

Rebuttal Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

July 8, 2009

and program is not an "excess" benefit or cost. It is the cost required to keep retirement benefits equal as a percentage of compensation for eligible employees.

Q. Do you agree with their adjustments to remove 100% of the SERP expenses allocated to UNSG?

A. No, I do not. They both have relied upon recent Commission decisions that disallowed the recovery of SERP expenses. The SERP program is a portion of the compensation and benefits package made available to UniSource officers. The level of compensation, incentives and benefits are all determined by the Compensation Committee of the Board that is comprised of independent Board members.

The reason a program like SERP is necessary is because of funding deductibility limits defined within the Internal Revenue Code. And those funding limits are set based on tax revenue collection needs, not on the point at which it is no longer fair to provide retirement benefits. They are not a guideline for how much is fair and reasonable as part of an employee benefit program. The evaluation of that should be the reasonableness of the compensation and the executive benefit package itself. All UNS Gas is asking for here is to allow executives to have the same proportion or level of retirement benefits as for other Company employees

Q. Is SERP an excess benefit?

A. No. It simply keeps those individuals whose compensation level exceeds deductibility levels equal to those individuals whose compensation does not. The intention of the plan is to keep them equal.

114

DATA REQUEST PACKET

Staff's Responses to UNS Gas' Data Requests:

UNSG 2.1	UNSG 3.10	UNSG 3.22
UNSG 2.2	UNSG 3.11	UNSG 3.39
UNSG 2.4	UNSG 3.12	UNSG 3.40
UNSG 3.4	UNSG 3.13	UNSG 3.41
UNSG 3.5	UNSG 3.14	UNSG 3.57
UNSG 3.6	UNSG 3.15	UNSG 3.58
UNSG 3.7	UNSG 3.20	UNSG 3.60
UNSG 3.9	UNSG 3.21	UNSG 3.65

UNSG-24

UNSG 3.57 Provide any evidence that SERP is an atypical cost for a gas utility.

RESPONSE: **Dr. Fish does not know that SERP is an atypical cost for a gas utility. To the extent that this request suggests that this is Dr. Fish's testimony, please provide a reference.**

RESPONDENT: **DR. THOMAS FISH**

WITNESS: **DR. THOMAS FISH**

115

DATA REQUEST PACKET

RUCO's Responses to UNS Gas' Data Requests:

UNSG 2.25
UNSG 2.48
UNSG 2.55
UNSG 3.2
UNSG 3.13
UNSG 3.16
UNSG 3.18
UNSG 3.20
UNSG 3.21
UNSG 3.22
UNSG 3.31
UNSG 3.34
UNSG 3.35
UNSG 3.36

BEFORE THE ARIZONA CORPORATION COMMISSION

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

EVIDENTIARY HEARING

At: Phoenix, Arizona

Date: August 18, 2009

Filed: August 25, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME VI

(Pages 809 through 929, inclusive)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

ACC

By: Kate E. Baumgarth, RPR
Certified Reporter
Certificate No. 50582

Q. And, Mr. Parcell, could you review lines 18 through 25 of that?
A. I would be glad to, yes.
Q. And on those lines you agree that the proxy group should have similar risk and therefore a similar expected cost of capital to the subject company; correct?
A. Yes.
Q. And you still agree with that today, don't you?
A. Yes, subject, of course, to the fact that the subject company for the rate case is UNS Gas, but the subject company for the raising of equity dollars is UNS West Energy. As long as you reflect that, I agree, yes.
Q. Could you turn to Schedule 6 of your direct testimony?
A. Sure.
Q. And Schedule 6 indicates proxy groups that you used; is that correct?
A. That is correct.
Q. And is it fair to say that each of the utilities shown in Parcell proxy group are much larger than UNS Gas; is that correct?
A. Well, those aren't -- those aren't utilities; those are holding companies, which in some cases have multiple utility subsidiaries, just like UNS Energy does.

THIRD SET OF DATA REQUESTS
FROM UNS GAS, INC.
TO RESIDENTIAL UTILITY CONSUMER OFFICE
(DOCKET NO. G-04204A-08-0571)

UNSG 3.22 Does Mr. Smith believe that it is common for an investor-owned gas utility to have a SERP program? If no, please explain and provide examples of comparable gas utilities without such programs.

RESPONSE:

Mr. Smith has not undertaken to determine which do and do not specifically have such programs, since that type of research that did not appear to be necessary to apply the analytical framework suggested in the series of recent Commission orders on this issue cited in Mr. Smith's testimony in the context of the current UNSG rate case; however, he is generally aware that some investor owned gas utilities, including UNSG and Southwest Gas, have such programs and generally believes it is not uncommon among larger investor owned gas utilities.

RESPONDENT: Ralph C. Smith

WITNESS: Ralph C. Smith

116

BEFORE THE ARIZONA CORPORATION COMMISSION

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.	DOCKET NO. G-04204A-08-0571

Direct Testimony of

Karen G. Kissinger

on Behalf of

UNS Gas, Inc.

November 7, 2008

Q. Please explain the Property Tax adjustment.

A. The Property Tax adjustment is intended to reflect in pro forma test-year operating expenses an amount based on final, adjusted plant in service at the end of the test-year, using the 2009 statutory assessment ratio of 22.0%, and the most currently known average property tax rates. To the extent that more current average tax rate information becomes available during the conduct of this rate case, the Company will update that part of the tax adjustment.

Q. Please explain the Income Tax Expense adjustment.

A. The Income Tax Expense adjustment is computed with the intent to reflect in pro forma test-year operating expenses an amount of income taxes based on final adjusted operating revenues, operating expense, and rate base. It is computed in two parts. The first part is pro forma current income tax expense, the tax liability computed as though an actual income tax return was being prepared on final adjusted test-year taxable operating income. For this purpose, it was necessary to identify all operating book-tax differences ("Schedule M items"), both timing and permanent, and then recompute based on adjusted test-year operating revenues and expenses, if necessary. The tax deduction for interest was computed using a synchronization methodology reflecting final adjusted rate base and the weighted cost of debt in the capital structure.

The second part of the income tax calculation is deferred income tax expense. Deferred income taxes are computed on the Schedule M items representing timing differences for which the Company has obtained normalization ratemaking authority from the Commission as previously described in my Direct Testimony.

NOTICE OF FILING APPENDIX IN SUPPORT OF INITIAL POST-HEARING BRIEF OF UNS GAS, INC.

PART 1 OF 2
BARCODE # 0000102827

TO REVIEW PART 2 PLEASE SEE:

BARCODE # 0000102852