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BEFORE THE ARIZONA CORPORATIO[N 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 **NOTICE OF FILING APPENDIX IN SUPPORT OF REPLY BRIEF OF UNS GAS, INC.**

UNS Gas, Inc., through undersigned counsel, files its Appendix in Support of UNS Gas, Inc's' Reply Brief filed on October 5, 2009.

RESPECTFULLY SUBMITTED this 5th day of October 2009.

UNS Gas, Inc.

By ____________________
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Attorneys for UNS Gas, Inc.

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Ar[izona Corporation Comm]ission
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Original and 13 copies of the foregoing filed this 5th day of October 2009, with:

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

Copy of the foregoing hand-delivered/mailed this 5th day of October 2009, to:

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Arizona Corporation Commission
1200 West Washington Street
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By Mary Ippolito

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
KRISTIN K. MAYES - CHAIRMAN
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APPENDIX

IN SUPPORT OF

REPLY BRIEF

OF UNS GAS, INC

Volume 1 of 1

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ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE 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

STAFF'S INITIAL POST-HEARING BRIEF

The Utilities Division of the Arizona Corporation Commission ("Staff") hereby files its closing brief in the above-captioned matter. In this brief, Staff will address the major disputed issues. On any issue not specifically addressed in this brief, Staff maintains its position as presented in its testimony.

I. INTRODUCTION.

UNS Gas, Inc. ("UNSG" or the "Company") is a public service corporation that provides natural gas distribution services to approximately 140,000 customers in Mohave, Coconino, Navajo, Yavapai and Santa Cruz counties in Arizona. UNSG was formerly a part of the Arizona local gas distribution operations of Citizens Communications Company, prior to its 2003 acquisition by UniSource Energy. UNSG, at the conclusion of a rate moratorium, filed an application for a rate increase in 2006. The Commission approved new rates for UNSG in November 2007.[1] UNSG filed an application for a rate increase on November 7, 2008.

UNSG is seeking an increase in its base rates of approximately $9.5 million, a 6 percent increase over its test year revenues. The effect on the proposed fixed monthly and delivery charges will be an increase of approximately 19% over test year revenues, exclusive of gas recovery costs. UNSG used a test year ending June 30, 2008.[2]

[1] Decision No. 70011 (November 27, 2007).
[2] Ex UNSG-16 (Dukes Direct) at 3.

According to Mr. Dukes, UNSG proposed to include in rate base vehicles, leak detection equipment, A&G costs for structures, and replacement and relocation of mains. None of these items was in service or associated with the test year.[9] The Company identified these items as "non-revenue producing", stating that its selection of these items were made in an attempt to address concerns raised in Decision No. 70011. The Company's rationale for the inclusion of post test year plant is flawed and should be rejected by the Commission.

The discussion of post-test-year plant in Decision No. 70011 is relatively short. The Commission rejected the UNSG proposal to include post-test-year plant for some of the same reasons it rejected the Company's argument regarding the inclusion of Construction Work In Progress. The Commission found that in several instances where the inclusion of post-test-year plant was approved, there were assurances that there would not be a mismatch in revenue. The Commission, in Decision No. 70011, did not give instructions to UNSG on how to more favorably position post-test-year plant for inclusion in rate base in its next rate case.

UNSG attempts to bolster its position by citing several previous Commission decisions involving water companies that allowed post-test-year plant into rate base. Those decisions are distinguishable from the instant case. For example, UNSG cites Decision No. 68176 as supportive of its position.[10] In *Chaparral City Water Company*, Chaparral City Water Company ("Chaparral") was seeking recovery of an expansion of a water treatment plant used to treat Central Arizona Project water. Construction of the plant in question was commenced in 2003 and completed in March 2004, three months after the end of the test year. During the test year in that matter, Chaparral's peak demand exceeded 10 million gallons per day, but it only had the capacity to treat 8 million gallons per day. The Commission found that Chaparral needed the plant to serve existing customers during the summer, when demand peaks. The Commission was also persuaded by the fact that the plant was placed into service shortly after the end of the test year. In this instance, Chaparral also needed the capacity to aid in its maintenance and provide a safe operating margin.[11] The situation faced by Chaparral is far different than the situation faced by UNSG.

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[9] TR 309:3-10.
[10] UNSG-6 (Hutchens Rebuttal) at 5.
[11] In the Matter of the Application of Chaparral City Water Company, Docket No. W-02113A-04-0616.

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UNSG is seeking an increase in its base rates of approximately $9.5 million, a 6 percent increase over its test year revenues. The effect on the proposed fixed monthly and delivery charges will be an increase of approximately 19% over test year revenues, exclusive of gas recovery costs. UNSG used a test year ending June 30, 2008.[2]

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[2] Ex UNSG-16 (Dukes Direct) at 3.

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[9] TR 309:3-10.
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[11] In the Matter of the Application of Chaparral City Water Company, Docket No. W-02113A-04-0616.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
MIKE GLEASON - CHAIRMAN
WILLIAM A. MUNDELL
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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-____

Direct Testimony of

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

November 7, 2008

v. Post Test Year Non-Revenue Producing Plant.

Q. Please explain the Post Test Year Non-Revenue Producing Plant adjustment.

A. This adjustment is being made to aid the Company in having a more reasonable opportunity to earn its authorized return by accelerating the recovery of investments made prior to the end of the test year into plant that will not produce additional revenues beyond the test year adjusted amount. These investments were not in service by the end of the test year, but will be in service when rates established in this case go into effect. These are investments in items like transportation equipment, general plant, replacements and relocations of existing facilities.

Q. Is the Company advocating that the Commission should allow the recovery of and on plant investment expended by the end of the test year, but not in service?

A. Yes. The Commission should allow UNS Gas to recover such costs. The Company has made investments to serve existing customers and will not see any additional revenue directly related to these investments until the time the investments are reflected in rate base within a rate proceeding. The inclusion of post test year non-revenue producing plant in rate base will help the Company to begin recovering its investment and an opportunity at earning a reasonable return in a more equitable time frame. If this current case follows an expected course, new rates will go into effect in December 2009 at the earliest. Based upon the circumstances of this matter in which Staff required at least six months of actual rates billed within the test year - a new rate case could not be filed until October of 2010, with rates most likely not effective until January 2012. So the recovery of and on investments actually made prior to the end of the test year, but not technically in service, will not produce additional revenues until January 2012, in other words, over 3 ½ years after the investments were made to serve existing customers.

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IN THE MATTER OF THE 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 **STAFF'S INITIAL POST-HEARING BRIEF**

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[1] Decision No. 70011 (November 27, 2007).
[2] Ex UNSG-16 (Dukes Direct) at 3.

In Chaparral, it proposed to include plant that was in service a mere three months after the end of the test year. This is not the case for UNSG. Mr. Dukes admits that the plant UNSG is seeking to include is placed in service more than three months after the test year. [12] In fact, Mr. Dukes testified that its requested post-test-year plant could be more than a year after the test year. He further testifies that UNSG does not have an issue with a safety operating margin, nor does it have a problem making routine repairs. The Chaparral decision is not supportive of the UNSG position.

UNSG also cites Decision No. 65350 as supportive of its position that post-test year plant should be included in rate base.[13] In *Bella Vista Water Co., Inc.*, the Commission held that post-test year plant should be reviewed on a case-by-case basis. Further in that matter, Bella Vista was seeking to include plant that had been placed in service one year and three days after the end of the test year. Again, UNSG admits that its requested plant may be placed into service more than a year after its test year.

Commission rules require the end of the test year, which is the one-year historical period used in determining rate base, operating income and rate of return, to be the most recent practical date available prior to the filing. A.A.C. R14-2-103(A)(3)(p). Compliance with Commission rules and recognition of Commission policy on appropriate test year selection requires a utility to choose a test year that includes all major rate base and operating income items needed to support its rate application, and to include pro forma adjustments to its chosen test year that are consistent with past Commission action under similar circumstances. While the Commission has allowed the inclusion of post-test-year plant in rate base,[14] as Staff witness Dr. Thomas Fish testified, those situations are special and unusual and thus warrant the recognition of post-test-year plant.[15] Staff has traditionally recognized two such scenarios: (1) 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, and (2) when conditions such as the following exist: (a) the cost of the post-test-year plant is significant and substantial, (b) the net impact on revenue and expenses for the

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[12] TR 72:16-19.
[13] Ex S-2 (Decision No. 68176) at 5-6.
[14] Ex S-3 (Bella Vista Water Co., Inc., Docket No. W-02465A-01-0776).
[15] *See* In the Matter of Arizona Water Company, Docket No. W-01445A-02-0169.

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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

EXHIBIT
UNSG-42
ADMITTED

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:

A. Only the portion we've identified as post test year plant, nonrevenue-producing.

Q. And that segues into my next topic, which is post test year plant. Could you please describe the post test year plant that the company seeks recovery of?

A. Yeah. It's primarily equipment such as vehicles, detection equipment for leak surveys. It's replacements of mains and services, relocations of mains and services, administrative, our A&G costs for structures, things of that nature.

Q. And the test year in this case, Mr. Dukes, is the 12 months ending June 30, 2008?

A. Yes, it is.

Q. And I'm looking at Page 5, I believe it's in your direct testimony. These projects that we talk about, they weren't in service at the end of the test year, correct?

A. That is correct.

Q. And you anticipate that they will be in service prior to the rates becoming into effect?

A. It's my understanding that they're in service now.

Q. That was my next question. Are all of these projects in service at this time?

A. That is my understanding, yes.

Q. And are all of these projects used and useful at this time?

A. Yes.

Q. And are all of the costs for these projects known and measurable?

A. The cost of the project, yes.

Q. And as I understand it, you mentioned in answer to my first question, your argument is that this plant in question is nonrevenue-producing plant, correct?

A. Yes, materially we believe it's nonrevenue-producing.

Q. Do you disagree that this plant would reduce expenses?

A. I mean, to the extent there are replacements, there is the possibility of some amount of reduced cost. I don't think it's material, because the material reductions, especially with regards to services and mains that are being reduced or replaced would be the cost of the leaks themselves and the lost natural gas. And obviously, that cost is going to pass through directly to the ratepayers, those savings are going to pass through directly to the ratepayer through the PGA process.

Q. Well, if, in fact, there would be some reduction in expenses, can you relate them back to the test year expenses, caused by the post test year plant?

A. We have not identified anything that we believe

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. 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

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BEFORE THE ARIZONA CORPORATION COMMISSION

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DOCKET NO. G-04204A-08-0571

INITIAL POST-HEARING BRIEF OF UNS GAS, INC.

SEPTEMBER 18, 2009

existing customers could have some impact on revenues or expenses, the evidence did not show a *material impact* on revenues and expenses.[20]

Along similar lines, in Decision No. 68176 (September 30, 2004) the Commission explained that "inclusion of post test year plant always causes some mismatch between revenues and expenses, even if the post test year plant is revenue neutral."[21] The Commission nevertheless included the post test year plant in rate base. The Commission emphasized materiality again in Decision No. 67279 (October 5, 2004) noting that "there would not be a material impact on revenue or expenses."[22]

Staff and RUCO also assert that that post test year plant should only be approved in "compelling" or "very compelling" circumstances.[23] But the Commission has rejected such arguments before. For example, in Decision No. 65350 (November 1, 2002), the Commission stated that "We do not agree with Staff and RUCO that the Commission has always required extraordinary circumstances to allow post test year plant."[24] The Commission has summarized its past cases as follows: "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."[25]

Here, the record confirms that UNS Gas: (i) 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, and (ii) included communication equipment, vehicles, tools, power equipment and natural gas detector equipment, which are all necessary to serve the existing customer base as well as service and main replacements to ensure safe and reliable service to our existing customers.[26] Moreover, the evidence supports UNS Gas'

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[20] Decision No. 65350 (Nov. 1, 2002) at 10.
[21] Decision No. 68176 (Sept. 30, 2004) at 5.
[22] Decision No. 67279 (Oct. 5, 2004) at 7.
[23] Ex. RUCO-20 (Smith Direct) at 14; Ex. S-13 (Fish Surrebuttal) at 2.
[24] Decision No. 65350 (Nov. 1, 2002) at 11.
[25] Decision No. 67279 (Oct. 5, 2004) at 6.
[26] See Ex. UNSG-17 (Dukes Rebuttal) at 5.

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BEFORE THE ARIZONA CORPORATION

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DOCKET CONTROL

IN THE MATTER OF THE 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 **STAFF'S INITIAL POST-HEARING BRIEF**

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I. INTRODUCTION.

UNS Gas, Inc. ("UNSG" or the "Company") is a public service corporation that provides natural gas distribution services to approximately 140,000 customers in Mohave, Coconino, Navajo, Yavapai and Santa Cruz counties in Arizona. UNSG was formerly a part of the Arizona local gas distribution operations of Citizens Communications Company, prior to its 2003 acquisition by UniSource Energy. UNSG, at the conclusion of a rate moratorium, filed an application for a rate increase in 2006. The Commission approved new rates for UNSG in November 2007.[1] UNSG filed an application for a rate increase on November 7, 2008.

UNSG is seeking an increase in its base rates of approximately $9.5 million, a 6 percent increase over its test year revenues. The effect on the proposed fixed monthly and delivery charges will be an increase of approximately 19% over test year revenues, exclusive of gas recovery costs. UNSG used a test year ending June 30, 2008.[2]

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DO... ...ED

[1] Decision No. 70011 (November 27, 2007).
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In Chaparral, it proposed to include plant that was in service a mere three months after the end of the test year. This is not the case for UNSG. Mr. Dukes admits that the plant UNSG is seeking to include is placed in service more than three months after the test year. [12] In fact, Mr. Dukes testified that its requested post-test-year plant could be more than a year after the test year. He further testifies that UNSG does not have an issue with a safety operating margin, nor does it have a problem making routine repairs. The Chaparral decision is not supportive of the UNSG position.

UNSG also cites Decision No. 65350 as supportive of its position that post-test year plant should be included in rate base.[13] In *Bella Vista Water Co., Inc.*, the Commission held that post-test year plant should be reviewed on a case-by-case basis. Further in that matter, Bella Vista was seeking to include plant that had been placed in service one year and three days after the end of the test year. Again, UNSG admits that its requested plant may be placed into service more than a year after its test year.

Commission rules require the end of the test year, which is the one-year historical period used in determining rate base, operating income and rate of return, to be the most recent practical date available prior to the filing. A.A.C. R14-2-103(A)(3)(p). Compliance with Commission rules and recognition of Commission policy on appropriate test year selection requires a utility to choose a test year that includes all major rate base and operating income items needed to support its rate application, and to include pro forma adjustments to its chosen test year that are consistent with past Commission action under similar circumstances. While the Commission has allowed the inclusion of post-test-year plant in rate base,[14] as Staff witness Dr. Thomas Fish testified, those situations are special and unusual and thus warrant the recognition of post-test-year plant.[15] Staff has traditionally recognized two such scenarios: (1) 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, and (2) when conditions such as the following exist: (a) the cost of the post-test-year plant is significant and substantial, (b) the net impact on revenue and expenses for the

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[12] TR 72:16-19.
[13] Ex S-2 (Decision No. 68176) at 5-6.
[14] Ex S-3 (Bella Vista Water Co., Inc., Docket No. W-02465A-01-0776).
[15] *See* In the Matter of Arizona Water Company, Docket No. W-01445A-02-0169.

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ORIGINAL

BEFORE THE ARIZONA CORPORATION

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BOB STUMP

IN THE MATTER OF THE 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

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[15] *See* In the Matter of Arizona Water Company, Docket No. W-01445A-02-0169.

post-test-year plant is known and insignificant or is revenue-neutral, and (c) the post-test-year plant is prudent and necessary for the provision of services and reflects appropriate, efficient, effective, and timely decision-making.[16]

The Company has not demonstrated that the amount it is seeking to include is so large that the failure to include it would be detrimental to the Company's financial health. The Company is seeking to include routine items, such as trucks. The Commission should reject the Company's argument. The Staff's position is reasonable and should be adopted.

B. <u>UNSG's request for the inclusion of Advances in Aid of Construction into Rate Base is contrary to traditional ratemaking practices and should be rejected.</u>

UNSG argues that it should be allowed to include customer advances of approximately $600,000 that was received during the test year into rate base. Mr. Dukes testified that, because the projects associated with the advances were not in service during the test year, but the amount of advances were spent on projects not included in rate base, the associated funds should be included.[17] This position is contrary to traditional ratemaking practices. Customer advances represent non-investor supplied capital and should be reflected as a deduction to rate base.[18] The Commission's rules (A.A.C. R14-2-103, Appendix B, Schedule B-1) require that Customer Advances be reflected as a deduction from rate base.

In support of its position, the Company cites Decision No. 69914.[19] According to UNSG witness Dukes, the Commission, in that decision, authorized the treatment of contributions in a similar manner to that presently being sought by UNSG.[20] The Commission, in that decision, accorded special treatment to hook-up fees, allowing them to be treated as contributions. UNSG however, is asking for special treatment for advances. While the Company argues that it will not be receiving a return on advances, that is precisely what will happen if advances are not deducted from rate base. The Company has offered no compelling reason to deviate from normal ratemaking treatment and its proposal should be rejected.

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[16] TR 565:1-5.
[17] Ex S-13 (Fish Surrebuttal) at 2-3.
[18] Ex UNSG-16 (Dukes Direct) at 12.
[19] Ex. S-13 (Fish Surrebuttal) at 3.
[20] Docket No. W-01303A-05-0718 (Arizona-American Water Co.).

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BEFORE THE ARIZONA CORPORATION COMMISSION

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2009 SEP 18 P 3: 58

AZ CORP COMMISSION
DOCKET CONTROL

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

INITIAL POST-HEARING BRIEF OF UNS GAS, INC.

SEPTEMBER 18, 2009

Using the DCF, CAPM and RP models, the Company determined the following range of ROEs for the sample group of gas companies:[130]

Summary of Comparable Company Analysis

	DCF Model	CAPM	Risk Premium	Conclusion
Low end of range	9.5%	10.2%	10.2%	10.2%
High end of range	11.2%	11.3%	11.5%	11.2%

Thus, the Company ultimately determined that the sample gas companies had a cost of equity in the range of 10.2% to 11.2%. However, the Company witness, Mr. Grant noted that UNS Gas was more risky than the sample group of companies, and he therefore recommends an ROE of 11.0%.[131]

2. UNS Gas is riskier than the sample group.

A key flaw in Staff's and RUCO's analyses is that they do not adjust their ROEs to recognize that UNS Gas is riskier than the sample groups. Staff's expert Mr. Parcell testified that the ROE should reflect the returns earned by companies "having corresponding risks."[132] He also testified that the proxy group should have a similar risk to the utility in question.[133] Mr. Parcell undermines his argument by not adjusting his ROE to reflect the fact that UNS Gas is riskier than the sample group. This is even more puzzling given that Mr. Parcell has recommended such an adjustment before, in his testimony in the most recent TEP rate case.[134] In the TEP case, Mr. Parcell recommended an ROE for TEP above the midpoint of his range, because TEP had a higher risk that the sample group.[135] The higher risk was due to "[l]ower bond ratings… verses the bond

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[130] Ex. UNSG-13 (Grant Direct) at 24.
[131] Ex. UNSG-13 (Grant Direct) at 24-27.
[132] Ex. S-14 (Parcell Direct) at 7, quoting *Federal Power Comm'n v. Hope Natural Gas Co.,* 320 U.S. 591 (1942).
[133] Tr. (Parcell) at 860.
[134] Tr. (Parcell) at 856-857.
[135] Ex. UNSG-39 (Excerpt from Parcell Feb. 29, 2008 testimony).

ratings of the proxy companies" and a "[l]ower equity ratio... versus the proxy companies."[136] Although UNS Gas now has an equity ratio that is consistent with industry norms, the Company's credit rating is certainly well below the average for the sample group of gas companies used by both Mr. Grant and Mr. Parcell.[137]

Indeed, Mr. Parcell acknowledged a myriad of factors indicating UNS Gas is more risky than the sample group. He acknowledged that UNS Gas is smaller than any of the companies in either of his sample groups.[138] Additionally, Mr. Parcell acknowledged that only two of the 17 sample group companies he used have a credit rating as low as UNS Gas.[139] A lower credit rating, of course, indicates higher risk.[140] Further, UNS Gas has not earned its authorized ROE. As Company witness Mr. Grant noted, both *Value Line* and Mr. Parcell's own comparable earnings analysis show that the comparable gas utilities are earning actual returns of 11 to 12%.[141] Lastly, Mr. Parcell stated that the comparable group companies pay dividends, while UNS Gas has never paid a dividend.[142] In all of these ways, UNS Gas is riskier and less attractive to investors than the companies in the sample groups, and it should therefore have a higher ROE.

3. Importance of dividends to equity investors.

UNS Gas' inability to pay a dividend – *ever* – puts it at a great disadvantage compared to other gas utilities seeking capital. Mr. Parcell emphasized the importance of dividends, noting that he would not include a company in his sample group if it did not pay dividends.[143] If anything, RUCO's witness, Mr. Rigsby, was even more adamant about the importance of dividends to equity investors: "Utilities typically attract income-oriented investors, people that are interested in **getting a regular steady dividend** from the utility."[144] Mr. Rigsby emphasized the point:

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[136] Ex. UNSG-39 (Excerpt from Parcell Feb. 29, 2008 testimony).
[137] Ex. UNSG-13 (Grant Direct) at 25.
[138] Tr. (Parcell) at 860; *see* Decision No. 57944 (July 6, 1992) at 16 (agreeing with Staff's recommendation to increase ROE for sewer division over average of sample group due to small size risk).
[139] Tr. (Parcell) at 861.
[140] Ex. UNSG-13 (Grant Direct) at 25.
[141] Tr. (Grant) at 223.
[142] Tr. (Parcell) at 862.
[143] Tr. (Parcell) at 862.
[144] Tr. (Rigsby) at 799 (emphasis added).

VI. FINANCIAL INTEGRITY.

Mr. Parcell testified that the return must "be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[176] Unfortunately, Staff's recommendation (and RUCO's much lower recommendation) fails to meet this standard. Mr. Parcell did not project whether UNS Gas would actually be able to earn the ROE he recommends.[177] In contrast, Mr. Grant explained that UNS Gas has historically not earned its authorized ROE.[178] Mr. Grant also projected UNS Gas' future earnings under UNS Gas', Staff's and RUCO's proposed revenue requirements:[179]

	Allowed ROE	**Projected Earned ROE**
UNS Gas	11.0%	10.1% (2010); 9.0% (2011)
Staff	10.0%	6-7%
RUCO	8.61%	5-6%

The projected earned ROE under Staff's and RUCO's recommendations will not preserve the financial integrity of UNS Gas. Indeed, the earned ROE under Staff's revenue requirement will be in the same range as bond yields for gas utilities with UNS Gas' credit rating.[180] As Mr. Grant noted, "that's not a sustainable situation for UNS Gas."[181]

It is not only UNS Gas that is concerned with the Company's earned ROE. As Standard & Poor's explains, in analyzing the adequacy of rates, "the analysis does not revolve around "authorized" returns, but rather on actual earned returns."[182] And the Arizona Court of Appeals has held that the "rates established by the Commission should meet the overall operating costs of the utility and produce a reasonable rate of return. It is equally clear that rates cannot be considered just and reasonable if they fail to produce a reasonable return, or if they produce

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[175] Ex. UNSG-38 (Parcell APS excerpt) at 32.
[176] Ex. S-14 (Parcell Direct) at 7 (quoting *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1942)).
[177] Ex. UNSG-36 (Staff Response to UNSG 3.78 and 3.98).
[178] Ex. UNSG-14 (Grant Rebuttal) at 23.
[179] Ex. UNSG-14 (Grant Rebuttal) at 24-28; see also Tr. (Grant) at 206.
[180] Tr. (Grant) at 281 (reporting Baa yield of 6.7%)
[181] Tr. (Grant) at 206.
[182] Ex. UNSG-31 (S&P Report) at 4.

revenue which exceeds a reasonable rate of return." *Consolidated Water Utilities, Ltd. v. Arizona Corp. Comm'n*, 178 Ariz. 478, 141, 875 P.2d 137, 482 (App. 1994). Thus, the rate of return actually "produced" or earned is at the core of ratemaking.

A utility is, of course, not guaranteed its authorized return – only an opportunity to earn the authorized return. But the historical and projected information shows that UNS Gas will not have that opportunity. No one has suggested – much less testified – that there are sufficient measures that UNS Gas could take that would allow it to earn its authorized return. And the prospect of earning the authorized return is a reality for most utilities – Mr. Parcell's comparable earnings analysis shows that the comparable gas utilities are earning actual returns of 11 to 12%,[183] which is in line with or higher than the authorized returns reported in Staff Exhibit S-1.

As discussed above, UNS Gas will not earn its authorized return – even if its full rate request is granted. Therefore, it is critical that the Commission not reduce the rate request which will thereby impair UNS Gas' financial integrity. UNS Gas has been able to steadily improve its equity ratio over time and has managed to obtain an investment grade debt rating. That would not have been possible without the Commission's assistance. It would be poor public policy to allow those gains to be wiped out. Ultimately, ratepayers pay the price for a financially challenged utility – in increased debt and equity costs, in reduced trade credit from wholesale energy providers and in services cut to the bone and beyond.

UNS Gas has worked hard to obtain a debt rating of Baa3 from Moody's.[184] That is the lowest possible investment grade rating. Keeping or improving that rating is of critical importance to both UNS Gas and its ratepayers. UNS Gas has $50 million in notes maturing in August 2011.[185] Those notes must be re-financed.[186] A lower credit rating will result in a higher debt cost than would otherwise be the case. In addition, UNS Gas' credit facility ($60 million, shared with UNS Electric) is maturing in August 2011 and will have to be renewed.[187] As Mr. Grant

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[183] Tr. (Grant) at 223.
[184] Ex. UNSG-19 (Moody's Report).
[185] Ex. UNSG-19 (Moody's Report).
[186] Tr. (Grant) at 231.
[187] Tr. (Grant) at 231.

explained, "an investment grade credit rating helps you tremendously when you're talking to a prospective lender."[188]

Mr. Rigsby could offer no assurance that UNS Gas' credit rating would not be downgraded under RUCO's proposal.[189] Mr. Parcell cannot provide any help in this area either. Instead, he states that "assuming UNS Gas earned my cost of capital recommendation", the results would be "consistent" with a BBB rating.[190] Mr. Parcell has, without any support, merely assumed that his cost that his cost of capital will actually be earned. Indeed, Mr. Parcell specifically denied making any prediction that his assumption will actually occur.[191] Likewise, Staff witness Dr. Fish did not estimate the likelihood of UNS Gas "actually recovering all of its prudent costs."[192] As shown above, there is no evidence that the earned ROE will come even close to the authorized ROE. Quite simply, UNS Gas' credit rating will be seriously imperiled under Staff's and RUCO's revenue requirements. Therefore, the Commission should reject their recommendations and approve the Company's requested revenue requirement.

VII. <u>FAIR VALUE</u>.

A. The Arizona Constitution requires use of fair value in setting rates.

The Arizona Constitution requires that the Commission use fair value in setting rates. Arizona Constitution, Article XV § 14. That requirement has been enforced in numerous court cases. *See e.g. Phelps Dodge Corp. v. Arizona Electric Power Co-op,* 207 Ariz. 95 ¶ 38, 83 P.3d 573, 578 (App. 2004); *Litchfield Park Service Co. v. Arizona Corp. Comm'n*, 178 Ariz. 431, 434, 874 P.2d 988, 991 (App. 1994). The Arizona Supreme Court requires that the "reasonableness and justness of the rates must be related to this finding of fair value." *Simms v. Round Valley*, 80 Ariz. 145, 151, 294 P.d 378, 382 (1956). In other words, "the Commission must first determine the "fair value" of a utility's property and use this fair value as the utility's rate base." *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 578 P.2d 612 (App. 1978).

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[188] Tr. (Grant) at 229.
[189] Tr. (Rigsby) at 777.
[190] Ex. S-14 (Parcell Direct) at 40.
[191] Ex. UNSG-36 (Staff Responses to UNSG 3.78 and 3.98).
[192] Ex. UNSG-24 (Staff Response to UNSG 3.6).

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BEFORE THE ARIZONA CORPORATION

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BOB STUMP

IN THE MATTER OF THE 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 **STAFF'S INITIAL POST-HEARING BRIEF**

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[16] TR 565:1-5.
[17] Ex S-13 (Fish Surrebuttal) at 2-3.
[18] Ex UNSG-16 (Dukes Direct) at 12.
[19] Ex. S-13 (Fish Surrebuttal) at 3.
[20] Docket No. W-01303A-05-0718 (Arizona-American Water Co.).

11

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	Docket No. G-04204A-08-0571

RUCO'S

INITIAL CLOSING BRIEF
(REDACTED)

CWIP that UNSG is requesting in its post test year plant adjustment would appear to support growth, and some would appear to be expense reducing; however, UNSG has not reflected any reduction to expenses. RUCO-21 at 15-16. Additionally, several other items of post test year expense reductions have been identified, which have likewise, not been reflected as pro forma reductions to operating expenses. Id. Consequently, it would be one-sided and inappropriate to reach outside the test year for post test year plant for an increase to the Company's revenue requirement when other downward impacts, such as several expense reductions, are not also being reflected as reductions to the Company's revenue requirement.

The Commission has seldom allowed for the inclusion of CWIP in rate base, and does not typically allow post test year plant for energy utilities. The cases cited by UNSG for post test year plant are water utilities. Water utilities have a higher capital intensity than gas distribution utilities, and UNSG has not justified why it is deserving of an exception to the typical Commission policy against inclusion of CWIP or post test year plant in rate base for energy utilities. It is surely not the normal treatment to allow CWIP or post test year plant in rate base and the Company has not met its burden of showing why extraordinary treatment is appropriate in this case. The plant in question was not in service at the end of the test year and corresponds at least in part to plant that's purpose is to support and service growth. Id. at 14. Yet the Company has failed to account for the corresponding revenues associated with the growth claiming that the plant is non-revenue producing. Even giving the Company the benefit of the doubt on the revenue issue, much of this construction can still be used to offset maintenance expense which even the Company admits is a possibility. Id., Transcript at 310. Yet the

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

EXHIBIT
UNSG-17
ADMITTED

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 is the basis for Dr. Fish and Mr. Smith's removal of the Company's Post Test Year Non Revenue Plant in Service adjustment?

A. Both Dr. Fish and Mr. Smith assert that the investment in the Post Test Year Plant must have been made to improve the system, thus reducing operating expenses. Mr. Smith also argues that the plant will be used to serve additional customers. Mr. Smith further asserts that the inclusion of Construction Work in Progress ("CWIP") requires compelling reasons to stray from Commission's normal practice of excluding CWIP. However, UNS Gas has not proposed including CWIP, so Mr. Smith's comments on CWIP are not relevant.

Q. Do you agree with Dr. Fish or Mr. Smith's adjustments that remove the Company's Post Test Year Non Revenue Plant in Service from rate base?

A. No. UNS Gas is requesting the inclusion in rate base of investments made as of the end of the test year in transportation equipment, general plant, replacement of services, and replacement of mains and relocation of facilities as that plant is now in service. Further, the purpose of these investments is to serve existing customers and these investments are made regardless of any additional customers ever being added to the system. And previous Commission decisions have included non-revenue producing post-test year plant in rate base, including Decision Nos. 65350, 66849, 67279, 68176 and 68864.

In the prior UNS Gas rate case, (Decision No. 70011 (November 27, 2007)), the Commission rejected UNS Gas' request for post-test year plant, noting that we made no attempt to segregate revenue-producing plant from non-revenue producing plant. In this case, we directly responded to this concern by limiting our request for post-test year plant to non-revenue producing plant. However, Staff and RUCO now both imply that because any investment in plant would result in reduced expenses, without citing any empirical evidence to support that assertion, any investment in plant simply cannot be considered "non-revenue producing." Under their analysis, non revenue producing Post Test Year

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. <u>Customer Advances.</u>

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.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
KRISTIN K. MAYES - CHAIRMAN
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BOB STUMP

EXHIBIT
UNSG-17
ADMITTED

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

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	Docket No. G-04204A-08-0571

RUCO'S

INITIAL CLOSING BRIEF
(REDACTED)

Company has not made a corresponding adjustment for the expense reduction. The Company has failed to make a compelling case for the inclusion of the post test year plant and the Commission should reject the Company's request.

Post test year plant is not plant that was in service and/or used and useful during the test year. RUCO-21 at 16. Some of the plant identified, for example, the main replacements could easily result in maintenance expenditure reductions which would not be included in the test year. Id. at 17. The result would be a mismatch between the rate base serving the customers and the revenues received from customers taken during the test year. Id. This mismatch if allowed, results in higher rates and is unfair to ratepayers. This explains why the Commission stated the following in the Company's last rate case:

> We agree with Staff that post-test-year plant should not be included in rate base for the same reasons stated above with respect to the Company's request for CWIP. Although the Commission has allowed post-test-year plant in several prior cases involving water companies, it appears that the issue was developed on the record in those proceedings in a manner that afforded assurance that a mismatch of revenues did not occur. For example, in Decision No. 66849 (March 19, 2004), we stated that "we do not believe that adoption of this method would result in a mismatch because the post-test-year plant additions are revenue neutral (i.e., not funded by CIAC or AIAC)" (Id. at 5). In the instant case, however, the Company's request appears to be simply a fallback to its CWIP position, and there is no development of the record to support inclusion of the post-test-year plant. The entirety of UNS's argument consists of two questions in Mr. Grant's direct testimony, which essentially provided that: the Commission has approved post test-year plant in some prior cases, UNS is experiencing a high customer growth rate, and therefore the Company is entitled to inclusion of post-test-year plant if the Commission denies CWIP (Ex. A-27 at 28-29). Even if we were inclined to recognize post-test-year plant in this case, there is not a sufficient basis upon which to evaluate the reasonableness of the request (i.e., whether a mismatch would exist). We therefore deny the Company's proposal on this issue.

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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

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BEFORE THE ARIZONA CORPORATION COMMISSION

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2009 SEP 18 P 3:58

AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.

DOCKET NO. G-04204A-08-0571

INITIAL POST-HEARING BRIEF OF UNS GAS, INC.

SEPTEMBER 18, 2009

existing customers could have some impact on revenues or expenses, the evidence did not show a *material impact* on revenues and expenses.[20]

Along similar lines, in Decision No. 68176 (September 30, 2004) the Commission explained that "inclusion of post test year plant always causes some mismatch between revenues and expenses, even if the post test year plant is revenue neutral."[21] The Commission nevertheless included the post test year plant in rate base. The Commission emphasized materiality again in Decision No. 67279 (October 5, 2004) noting that "there would not be a material impact on revenue or expenses."[22]

Staff and RUCO also assert that that post test year plant should only be approved in "compelling" or "very compelling" circumstances.[23] But the Commission has rejected such arguments before. For example, in Decision No. 65350 (November 1, 2002), the Commission stated that "We do not agree with Staff and RUCO that the Commission has always required extraordinary circumstances to allow post test year plant."[24] The Commission has summarized its past cases as follows: "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."[25]

Here, the record confirms that UNS Gas: (i) 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, and (ii) included communication equipment, vehicles, tools, power equipment and natural gas detector equipment, which are all necessary to serve the existing customer base as well as service and main replacements to ensure safe and reliable service to our existing customers.[26] Moreover, the evidence supports UNS Gas'

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[20] Decision No. 65350 (Nov. 1, 2002) at 10.
[21] Decision No. 68176 (Sept. 30, 2004) at 5.
[22] Decision No. 67279 (Oct. 5, 2004) at 7.
[23] Ex. RUCO-20 (Smith Direct) at 14; Ex. S-13 (Fish Surrebuttal) at 2.
[24] Decision No. 65350 (Nov. 1, 2002) at 11.
[25] Decision No. 67279 (Oct. 5, 2004) at 6.
[26] See Ex. UNSG-17 (Dukes Rebuttal) at 5.

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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

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Prepared for:

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

A. I don't think they are reasonable or I really don't think they should be ongoing. I really don't think there is justification for that level of expense for an ongoing legal expense. I really don't.

Q. Why don't you think they are reasonable?

A. Because I don't think that the company really needs to get involved with that much outside legal expense. That is an awful lot of money in terms of legal expense. I think the company could probably handle that more effectively, more efficiently in-house in conjunction with the sister companies.

Q. Dr. Fish, on the post-test year plant, is post-test year plant nonrevenue producing?

A. The company claims it is. As far as I know -- I have no reason to say that it isn't nonrevenue producing. Now, that is not the same as saying it's not profit producing.

Q. Should that make a difference in the determination of whether it should be included?

A. No.

Q. Why not?

A. Well, again, the same criteria should be used regardless of the type of plant, and that is whether or not it's necessary -- whether or not it's justified with the facts of the case to be included.

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BEFORE THE ARIZONA CORPORATION COMMISSION

EXHIBIT
UNSG-13
ADMITTED

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-____

Direct Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

November 7, 2008

Q. How does UNS Gas' financial condition compare with other gas distribution utilities?

A. In terms of capital structure, the Company's 50% equity ratio at the end of the test year was in line with the industry average of 50.4% reported by Value Line for 2007. However, in terms of earnings and cash flow, UNS Gas is lagging most firms in the industry by a wide margin. The following table highlights some of the key financial results recorded by UNS Gas in 2007, as well as forecasted results for calendar years 2008 and 2009 assuming that new rates are not implemented until December 2009:

($000s)	2007 Actual	2008 Forecast	2009 Forecast
Net Income	$3,994	$8,425	$7,639
Return on Average Equity	4.6%	8.9%	7.3%
Net Operating Cash Flow	$28,368	$5,891	$21,804
Adjusted Operating Cash Flow (1)	$19,448	$16,303	$16,773
Capital Expenditures (CAPEX)	$22,589	$22,636	$23,247
% CAPEX Funded Internally (2)	86%	72%	72%

Notes:
(1) Adjusted Operating Cash Flow = Net Operating Cash Flow – Change in PGA Balance – Charges Paid to Affiliates (recorded as financing cash flow in 2007).
(2) % CAPEX Funded Internally = Adjusted Operating Cash Flow / Capital Expenditures.

The Company's earned ROE, ranging from a low of 4.6% in 2007 to a high of 8.9% projected for 2008, is quite low when compared with industry average returns. On a composite basis, the average ROE reported by Value Line for the natural gas distribution industry ranged from 11.5% to 12.2% over the period 2005-2007. Even though the Company will have realized a full year of rate relief in 2008, and has already benefited from unusually cold weather in the first half of 2008, UNS Gas still expects to earn a return on equity capital that is significantly lower than its peers in the industry and lower than the 10.0% ROE authorized in its most recent rate case.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
KRISTIN K. MAYES - CHAIRMAN
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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

INITIAL POST-HEARING BRIEF OF UNS GAS, INC.

SEPTEMBER 18, 2009

position that there is not a material mismatch between revenues and expenses. The evidence and prior Commission orders rebut the position of Staff and RUCO on this issue.

UNS Gas has met the standard for including post-test year plant in rate base and the Commission should allow UNS Gas to recover its investment in this prudent plant needed to serve existing customers.

B. Customer Advances.

UNS Gas proposes an adjustment to rate base of $589,152 for customer advances. These advances should not be deducted from rate base because they are tied to plant that is not yet in rate base. Staff and RUCO both oppose the adjustment on the basis that customer advances should be deducted from rate base whenever possible – even if it reduces pre-existing rate base of UNS Gas. In fact, the impact of Staff's and RUCO's position is to reduce UNS Gas' pre-existing rate base by $589,152. Staff's and RUCO's position are inconsistent with regulatory theory, as well as governing legal requirements.

1. Staff and RUCO reduce UNS Gas' pre-existing rate base.

Staff and RUCO's approach has the effect of reducing pre-existing rate base. Staff's witness Dr. Fish agreed with the following example: a utility has a rate base of $100, and receives an advance of $10, which is invested in new plant.[27] Under that example, Dr. Fish stated that the utility's rate base is $90, explaining "you would actually have a reduction."[28] Dr. Fish conceded that even though the rate base has been reduced by $10 to $90, the "economic value would still be $100."[29]

UNS Gas' witness, Mr. Dukes, provided a slightly more elaborate example.[30] Under this example, the utility starts with a rate base of $100 million. It then receives an advance of $10 million, which it invests in plant. 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

[27] Tr. (Fish) at 593-594.
[28] Tr. (Fish) at 594.
[29] Tr. (Fish) at 594.
[30] Ex. UNSG-17 (Dukes Rebuttal) at 6-7.

wiped out."[31] The rate base returns to $100 million only when the related plant is placed in service.[32] Regardless of the amount discussed regarding customer advances, Staff's and RUCO's approach is wrong.

2. Staff's and RUCO's approach is contrary to regulatory theory.

Staff and RUCO note that non-investor supplied capital should not be reflected in rate base. This is the reason that advances are deducted from rate base. UNS Gas wholeheartedly agrees. UNS Gas has not included any advances in rate base. Rather, UNS Gas proposes that its pre-existing rate base not be reduced due to the receipt of a customer advances that are invested but not yet in service. UNS Gas' position simply allows it to continue to recover a return on investments it previously made.

As Mr. Dukes explained, "advances should neither increase nor decrease rate base – the net impact should be zero."[33] Staff's and RUCO's approach results in a net decease to pre-existing rate base from the receipt of an advance.

In addition to denying UNS Gas a return on its investment, Staff's and RUCO's approach creates a serious matching issue. Staff and RUCO recognize the advance (the deduction from rate base) much earlier than the related addition to plant in service (the corresponding addition to rate base).[34] This timing difference reduces UNS Gas' pre-existing rate base.

Finally, Staff suggests that this plant should be excluded due to a Commission rule. But there is no rule that expressly requires advances to be deducted from rate base when the related plant is not yet in service. At the hearing, Staff witness Dr. Fish conceded that the Commission could follow UNS Gas' approach.[35] The purpose of deducting advances from rate base is to recognize the effect of customer-supplied capital. That purpose is not served when the plant funded by the advances is not in service. The Commission has the discretion to not deduct

[31] Ex. UNSG-17 (Dukes Rebuttal) at 6.
[32] Ex. UNSG-17 (Dukes Rebuttal) at 6.
[33] Ex. UNSG-17 (Dukes Rebuttal) at 6.
[34] Ex. UNSG-17 (Dukes Rebuttal) at 6.
[35] Tr. (Fish) at 595-596.

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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

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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?

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ORIGINAL

BEFORE THE ARIZONA CORPORATION

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AZ CORP COMMISSION
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BOB STUMP

IN THE MATTER OF THE 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

STAFF'S INITIAL POST-HEARING BRIEF

The Utilities Division of the Arizona Corporation Commission ("Staff") hereby files its closing brief in the above-captioned matter. In this brief, Staff will address the major disputed issues. On any issue not specifically addressed in this brief, Staff maintains its position as presented in its testimony.

I. INTRODUCTION.

UNS Gas, Inc. ("UNSG" or the "Company") is a public service corporation that provides natural gas distribution services to approximately 140,000 customers in Mohave, Coconino, Navajo, Yavapai and Santa Cruz counties in Arizona. UNSG was formerly a part of the Arizona local gas distribution operations of Citizens Communications Company, prior to its 2003 acquisition by UniSource Energy. UNSG, at the conclusion of a rate moratorium, filed an application for a rate increase in 2006. The Commission approved new rates for UNSG in November 2007.[1] UNSG filed an application for a rate increase on November 7, 2008.

UNSG is seeking an increase in its base rates of approximately $9.5 million, a 6 percent increase over its test year revenues. The effect on the proposed fixed monthly and delivery charges will be an increase of approximately 19% over test year revenues, exclusive of gas recovery costs. UNSG used a test year ending June 30, 2008.[2]

ED

[1] Decision No. 70011 (November 27, 2007).
[2] Ex UNSG-16 (Dukes Direct) at 3.

post-test-year plant is known and insignificant or is revenue-neutral, and (c) the post-test-year plant is prudent and necessary for the provision of services and reflects appropriate, efficient, effective, and timely decision-making.[16]

The Company has not demonstrated that the amount it is seeking to include is so large that the failure to include it would be detrimental to the Company's financial health. The Company is seeking to include routine items, such as trucks. The Commission should reject the Company's argument. The Staff's position is reasonable and should be adopted.

B. <u>UNSG's request for the inclusion of Advances in Aid of Construction into Rate Base is contrary to traditional ratemaking practices and should be rejected.</u>

UNSG argues that it should be allowed to include customer advances of approximately $600,000 that was received during the test year into rate base. Mr. Dukes testified that, because the projects associated with the advances were not in service during the test year, but the amount of advances were spent on projects not included in rate base, the associated funds should be included.[17] This position is contrary to traditional ratemaking practices. Customer advances represent non-investor supplied capital and should be reflected as a deduction to rate base.[18] The Commission's rules (A.A.C. R14-2-103, Appendix B, Schedule B-1) require that Customer Advances be reflected as a deduction from rate base.

In support of its position, the Company cites Decision No. 69914.[19] According to UNSG witness Dukes, the Commission, in that decision, authorized the treatment of contributions in a similar manner to that presently being sought by UNSG.[20] The Commission, in that decision, accorded special treatment to hook-up fees, allowing them to be treated as contributions. UNSG however, is asking for special treatment for advances. While the Company argues that it will not be receiving a return on advances, that is precisely what will happen if advances are not deducted from rate base. The Company has offered no compelling reason to deviate from normal ratemaking treatment and its proposal should be rejected.

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[16] TR 565:1-5.
[17] Ex S-13 (Fish Surrebuttal) at 2-3.
[18] Ex UNSG-16 (Dukes Direct) at 12.
[19] Ex. S-13 (Fish Surrebuttal) at 3.
[20] Docket No. W-01303A-05-0718 (Arizona-American Water Co.).

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BEFORE THE ARIZONA CORPORATION COMMISSION

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BOB STUMP

IN THE MATTER OF THE 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.

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UNSG is seeking an increase in its base rates of approximately $9.5 million, a 6 percent increase over its test year revenues. The effect on the proposed fixed monthly and delivery charges will be an increase of approximately 19% over test year revenues, exclusive of gas recovery costs. UNSG used a test year ending June 30, 2008.[2]

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[1] Decision No. 70011 (November 27, 2007).
[2] Ex UNSG-16 (Dukes Direct) at 3.

post-test-year plant is known and insignificant or is revenue-neutral, and (c) the post-test-year plant is prudent and necessary for the provision of services and reflects appropriate, efficient, effective, and timely decision-making.[16]

The Company has not demonstrated that the amount it is seeking to include is so large that the failure to include it would be detrimental to the Company's financial health. The Company is seeking to include routine items, such as trucks. The Commission should reject the Company's argument. The Staff's position is reasonable and should be adopted.

B. <u>UNSG's request for the inclusion of Advances in Aid of Construction into Rate Base is contrary to traditional ratemaking practices and should be rejected.</u>

UNSG argues that it should be allowed to include customer advances of approximately $600,000 that was received during the test year into rate base. Mr. Dukes testified that, because the projects associated with the advances were not in service during the test year, but the amount of advances were spent on projects not included in rate base, the associated funds should be included.[17] This position is contrary to traditional ratemaking practices. Customer advances represent non-investor supplied capital and should be reflected as a deduction to rate base.[18] The Commission's rules (A.A.C. R14-2-103, Appendix B, Schedule B-1) require that Customer Advances be reflected as a deduction from rate base.

In support of its position, the Company cites Decision No. 69914.[19] According to UNSG witness Dukes, the Commission, in that decision, authorized the treatment of contributions in a similar manner to that presently being sought by UNSG.[20] The Commission, in that decision, accorded special treatment to hook-up fees, allowing them to be treated as contributions. UNSG however, is asking for special treatment for advances. While the Company argues that it will not be receiving a return on advances, that is precisely what will happen if advances are not deducted from rate base. The Company has offered no compelling reason to deviate from normal ratemaking treatment and its proposal should be rejected.

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[16] TR 565:1-5.
[17] Ex S-13 (Fish Surrebuttal) at 2-3.
[18] Ex UNSG-16 (Dukes Direct) at 12.
[19] Ex. S-13 (Fish Surrebuttal) at 3.
[20] Docket No. W-01303A-05-0718 (Arizona-American Water Co.).

23

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

Arizona-American believes that its proposal to finance the White Tanks Project with hook-up fees, which will be treated as contributions in aid of construction ("CIAC"), is equitable because customer growth is largely driving the need for the plant (Surrebuttal Testimony of Thomas M. Broderick, Exh. A-7 at 7). The Company asserts that the amount of the hook-up fee increase it is requesting is reasonable because it is in line with fees charged by West Valley municipal water providers (*See* Exh. A-2 at 9-10; *See also* Direct Testimony of Mike Brilz, Exh. P-1 at 5 and attached Exhibit).

2. Accounting Requests

a. Post-in-Service Allowance for Funds Used During Construction ("AFUDC")

Arizona-American requests that the Commission authorize the Company to record post-in-service AFUDC on the excess of the construction cost of the White Tanks Project (including development, site acquisition, design, company labor, overheads, and AFUDC) over the amount of directly related hook-up fees collected through December 31, 2015, or the date that rates become effective subsequent to a rate case that includes 80 percent (based on estimated cost) of the White Tanks Project in rate base, whichever comes first. The Company also requests that, in order to avoid depressing the Company's earnings and increasing its revenue requirement, the Company be allowed to defer post in-service depreciation expense in excess of the associated amortization of contributions. Additionally, the Company requests that it be allowed to propose, in its next rate case filing for the Agua Fria Water District, specific accounting entries to meet this objective.

The application states that when the plant is completed, there will still be a significant shortage between capital expenses and hook-up fees (Exh. A-2 at 11). The Company requests the ability to book post-in-service AFUDC in order to keep it whole on its investment until such time that the accumulated hook-up fees are sufficient to fund the entire plant balance. This treatment will not affect customer rates because the additional post-in-service AFUDC will later be completely offset by hook-up fee funds.

b. Rate Base – Excess Contribution Exclusion

Arizona-American requests 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 a decision in this case over the aggregate of (1) construction expenditures (including development, site acquisition, design, company labor, overheads, and AFUDC) 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.

The Company states that because construction work in progress ("CWIP") is not typically included in rate base, the collected hook-up fees should not be considered to be CIAC until a corresponding amount of plant, funded by hook-up fees, enters service (Exh. A-2 at 11). Otherwise, the CIAC balance would grow faster than rate base, causing rate base to decline rapidly as hook-up fees are collected, only to then bounce back as plant enters service (*Id.*).

3. <u>2008 Rate Filing Requirements</u>

a. <u>Revised Hook-Up Fee Proposal</u>

Arizona-American requests that the Commission require Arizona-American, as part of its 2008 Agua Fria rate case filing, to include a proposal to adjust the Water Facilities Hook-Up Fee Tariff, based on information known to that date, including:

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.

The Company states that this will allow the Commission to reset the hook-up fees as necessary, based on the best information available at the time.

b. <u>Operation and Maintenance ("O&M") Expense Recovery Mechanism</u>

Arizona-American requests that the Commission require Arizona-American, as part of its 2008 Agua Fria rate case filing, to include a proposed mechanism, similar to the Commission's arsenic cost recovery mechanism ("ACRM") procedure, to defer and subsequently recover O&M expense incurred for the White Tanks Project until such expenses can be placed in base rates.

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.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	Docket No. G-04204A-08-0571

RUCO'S

INITIAL CLOSING BRIEF
(REDACTED)

Decision No. 70011 at 18. Likewise, in this case, the Company has failed to present a record sufficient to support its request to include the post test year plant.

RELIEF REQUESTED: The Commission should remove $1.528 million of Post Test Year Non-Revenue Producing Pant in Service from rate base.

Customer Advances

Similar to the Company's proposed adjustment for post test year plant, the Company is trying to advance an argument that was rejected in the Company's last rate case. In Decision No. 70011, the Commission concluded that customer advances are customer-supplied funds that are properly deducted from rate base. Decision No. 70011 at 9. Nonetheless, the Company is attempting in this case to have a portion of its customer advances excluded from the determination of rate base, using similar arguments it used in its last rate case. RUCO-21 at 21.

The Company agrees that customer advances should be deducted from rate base and that the advances are non-investor supplied capital. UNSG-17 at 6. The Company believes, however, that the recognition of the reduction should not be made earlier than the addition to plant in service. Id.

The Company's arguments are unpersuasive here for the same reason they were rejected in the last case. UNSG has the use of non-investor supplied capital from the moment it gets the money. RUCO-21 at 22. The Company does not have to hold it in an escrow account. Id.

Moreover, if the Company's position were adopted, the Company's shareholders would earn a return on non-investor supplied capital which is seldom, if ever justified. The Company has ignored the fact that UNSG records allowances for funds used during

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	Docket No. G-04204A-08-0571

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26

BEFORE THE ARIZONA CORPORATION COMMISSION

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

EXHIBIT
UNSG-18
ADMITTED

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

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

August 5, 2009

Q. What else does RUCO argue?

A. Mr. Smith argues that UNS Gas is not a water company, and past examples of post test year plant have been for water companies. True, but water company rates are set by the same principles and methods – matching, prudence, rate base, operating expenses, return on equity, etc. And many of the decisions involve large, sophisticated "Class A" water companies like Arizona-American, Arizona Water, and Chaparral City. All three of those companies are part of multi-state utility holding companies. Clearly, allowing post test year plant is not a policy limited to small, financially fragile water companies.

B. <u>Customer Advances.</u>

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

A. No. Their arguments continue to be that 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.

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

A. Yes. That is why I have included all of the customer advances as of the end of the test year as **reduction** of rate base except for the small portion already expended by the end of the test year on projects not included within rate base. I am only asking that the Commission allow that small portion of cash advances not be deducted from rate base. Throughout the testimonies of Dr. Fish and Mr. Smith they speak of matching, but they fail to follow that principle for these advances. As I explained in my Rebuttal Testimony, Dr. Fish's and Mr. Smith's approach creates a mismatch between when plant-in-service is measured, and when the advances are measured. And this mismatch has the result of

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

EXHIBIT
UNSG-18
ADMITTED

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

Dallas J. Dukes

on Behalf of

UNS Gas, Inc.

August 5, 2009

eliminating from rate base pre-existing plant funded by investors. It's simply a mismatch to reduce rate base for these advances relating to plant that, as of the end of the test year, is not in service or in rate base. Staff's and RUCO's method amounts to reducing the return on and of investor-supplied capital.

Q. Do the Commission's rules forbid UNS Gas's request?

A. No. Staff and RUCO suggest that Rule 103 (A.A.C. R14-2-103) compels a ruling in their favor. In the past, Staff and RUCO have made similar arguments about post test year plant – that it is forbidden by Rule 103. The Commission has repeatedly rejected such arguments, finding that the Commission can approve adjustments to rate base notwithstanding Rule 103.[11]

Q. What about Mr. Smith's concern that UNS Gas does not reduce CWIP by Customers Advances prior to calculating AFUDC?

A. UNS Gas is not arguing for advances to be excluded as a reduction in rate base – UNS Gas is arguing for recovery of and on rate base properly invested in by the Company to serve customers. The projects funded by the advances UNS Gas is asking to exclude are not in rate base, not accruing AFUDC and historically over 80% of all advances are returned to the developers and never become contributions at all. The very minor amount of AFUDC that was accrued on the advance portion of these projects during their short construction period is only a fraction of the lost return on and of rate base being denied to UNS Gas.

[11] Decision No. 66849 (March 19, 2004) at 4:18-20; Decision No. 65350 (Nov. 1, 2002) at 10:10-12.

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

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:

treating these advances really as if they didn't even exist?

A. Could you repeat that question?

Q. Sure. For that period of time that we're talking about, prior to the time it's reduced -- it's treated as a reduction from rate base, if the company isn't reducing it from rate base, nor is the company deducting it from AFUDC, isn't the company essentially treating these advances as if they didn't even exist?

A. Well, I mean, I think that might be a fair description, but also you have to take into account we also are acting like the rate base that's been invested in during that time doesn't exist as well.

Q. Do you believe, Mr. Dukes, that it's inappropriate for the company to earn a return on noninvestor-supplied capital?

A. Yeah. That's essentially why I'm not trying to exclude the portions that we've received that are properly matched in rate base, or the amounts that we had not expended as of the end of the test year.

With regards to AFUDC, I pointed out in my rebuttal or rejoinder testimony, one of them, I pointed out that when you calculate the AFUDC, I mean, these projects have very short construction periods, you know, less than three months, primarily. So, you know, the allowance for funds used during construction on that 589,000 is maybe less than $15,000. Whereas, the return on that would be disallowed on the portion of rate base that's being excluded by a mismatch, in my opinion, could amount to, probably over the life of the rates, let's just assume the rates are in effect for three years, that could be close to 350- to $400,000. So it's just a minor portion.

Q. I'm looking at your response to the data request to number -- to letter "i" there. And I gather from what you said just in your response to that data request that you don't believe that the company would be earning a return on noninvestor-supplied capital for that portion; is that correct?

A. Well, I think that's consistent with what I have just said.

Q. I just want to make sure that the record is clear on that.

Now, Mr. Dukes, in support of your recommendation, didn't you rely or didn't you cite the Commission's decision in the Arizona-American case where they were asking for approvals associated with the transaction with the Maricopa County Municipal Water Conservation District?

A. Can you cite the decision number?

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BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

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

2009 SEP 18 P 3: 58

AZ CORP COMMISSION
DOCKET CONTROL

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

INITIAL POST-HEARING BRIEF OF UNS GAS, INC.

SEPTEMBER 18, 2009

advances or contributions from rate base and has done so in the past.[36] In this case, the evidence supports the Company's approach as a matter of equity, fairness and matching.

C. Working Capital.

Natural gas is the primary expense for UNS Gas. Staff's witness, Dr. Fish, agreed that gas is "by far the single biggest expenditure" of UNS Gas, representing two-thirds of total costs.[37] It has an enormous impact on UNS Gas' cash flow, and thus its working capital requirements.

UNS Gas' largest supplier is British Petroleum (BP). Despite UNS Gas' financial weakness (compared to other gas utilities), BP still provides more credit to UNS Gas than any other supplier.[38]

BP's request for credit support took the form of a requirement to pay for gas twice a month, rather than the previous once-a-month schedule. The change occurred during the test year, and continued after the test year. Staff's witness, Dr. Fish, did not dispute these facts.[39] Dr. Fish also recognized that "management determined to pay it that way in order to meet its obligation to serve."[40]

Nevertheless, Dr. Fish testified that the working capital adjustment associated with this change in payment terms should be rejected. Dr. Fish opined that these credit terms were "not realistic and... not representative of normal credit terms."[41] Dr. Fish also speculated that UNS Gas "has the discretion to obtain more favorable terms and conditions from another supplier."[42] Dr. Fish's testimony on this issue is contrary to fact and he should not speculate on this matter. Dr. Fish testified that he was not a gas procurement expert, and he did not conduct a survey of the credit terms available to gas utilities.[43] Nor has he identified a single supplier willing to extend

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[36] In Decision No. 69914 (Sept. 27, 2008) at page 29, the Commission did not require Arizona-American Water Company to deduct from rate base contributions associated with hook-up fees pertaining to a specific surface water treatment plant that was not yet in service.
[37] Tr. (Fish) at 601-602.
[38] Ex. UNSG-15 (Grant Rejoinder) at 5.
[39] Tr. (Fish) at 597-598.
[40] Tr. (Fish) at 598.
[41] Ex. S-13 (Fish Surrebuttal) at 4.
[42] Ex. S-13 (Fish Surrebuttal) at 4.
[43] Tr. (Fish) at 601.

better terms to UNS Gas than those offered by BP. Staff's gas procurement expert in this case – Ms. Rita Beale – reviewed how UNS Gas procured its natural gas supply. She noted that UNS Gas procurement practices were generally consistent with industry standards. However, she did make several suggestions intended to improve UNS Gas' natural gas procurement process. UNS Gas has agreed to implement Ms. Beale's suggestions.[44] It is important to note, however, that Ms. Beale did not mention or question the credit terms required by BP and accepted by UNS Gas. Therefore, Staff's own natural gas procurement expert, through her silence, undermines Dr. Fish's position.

UNS Gas' witness, Mr. Grant, testified that UNS Gas explored all available options for obtaining supply.[45] He testified that all of these alternatives would have been more costly.[46] Mr. Grant also noted that UNS Gas' credit options are limited because "UNS Gas' credit profile is weaker than most gas utilities."[47] Mr. Grant explained that obtaining a higher credit allowance "quite frankly, it's not something that we can just do unilaterally."[48] Mr. Grant testified that UNS Gas' credit manager "tried to work out some additional credit. It was just not forthcoming."[49]

Dr. Fish's speculation that UNS Gas could obtain more favorable credit terms elsewhere is simply unsupported by any evidence. The evidence is that BP is still the most generous supplier of trade credit, and options other than twice-a-month payments would have been more expensive. Additionally, the record supports that UNS Gas' management acted prudently in evaluating all other credit options and in its choice to accept BP's credit terms as they produced the lowest cost.[50] UNS Gas' working capital adjustment reflects the unfortunate reality of its situation, and should be adopted. Further, the situation with BP highlights UNS Gas' need for rate relief in order to improve its credit profile.

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[44] See Ex. UNSG-6 (Hutchens Rebuttal) at 8-12; Ex. UNSG-7 (Hutchens Rejoinder) at 4.
[45] Ex. UNSG-15 (Grant Rejoinder) at 4-5.
[46] Ex. UNSG-15 (Grant Rejoinder) at 4.
[47] Ex. UNSG-15 (Grant Rejoinder) at 5.
[48] Tr. (Grant) at 288.
[49] Tr. (Grant) at 289.
[50] See Ex. UNSG-15 (Grant Rejoinder) at 4-5; Tr. (Grant) at 282-283.

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ORIGINAL

BEFORE THE ARIZONA CORPORATION

COMMISSIONERS
KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE 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

STAFF'S INITIAL POST-HEARING BRIEF

The Utilities Division of the Arizona Corporation Commission ("Staff") hereby files its closing brief in the above-captioned matter. In this brief, Staff will address the major disputed issues. On any issue not specifically addressed in this brief, Staff maintains its position as presented in its testimony.

I. INTRODUCTION.

UNS Gas, Inc. ("UNSG" or the "Company") is a public service corporation that provides natural gas distribution services to approximately 140,000 customers in Mohave, Coconino, Navajo, Yavapai and Santa Cruz counties in Arizona. UNSG was formerly a part of the Arizona local gas distribution operations of Citizens Communications Company, prior to its 2003 acquisition by UniSource Energy. UNSG, at the conclusion of a rate moratorium, filed an application for a rate increase in 2006. The Commission approved new rates for UNSG in November 2007.[1] UNSG filed an application for a rate increase on November 7, 2008.

UNSG is seeking an increase in its base rates of approximately $9.5 million, a 6 percent increase over its test year revenues. The effect on the proposed fixed monthly and delivery charges will be an increase of approximately 19% over test year revenues, exclusive of gas recovery costs. UNSG used a test year ending June 30, 2008.[2]

[1] Decision No. 70011 (November 27, 2007).
[2] Ex UNSG-16 (Dukes Direct) at 3.

ratepayers because the Company is purchasing gas on their behalf.[27] While the Company feels that this is a risk that should be borne by the ratepayers, Staff disagrees and would contend that ratepayers should not be saddled with additional costs associated with the unusual payment terms.[28]

IV. INCOME STATEMENT.

Staff and the Company disagree on various adjustments made to the Company's Operating Income. Staff's adjustments are reasonable and should be adopted.

A. Customer Annualization.

Staff's customer annualization adjustment creates a level of test year customers that reflects a level of operating revenues and expenses and net plant investment that is representative of normal conditions be expected to exist during the time that the resulting rates will be in effect. [29] Staff witness Dr. Fish used the end of the calendar year values as suggested by Company witness Edwurm instead of the end of the test year values. Staff based its calculations on December 2007 values. Since December 2007 is the midpoint of the test year, Staff used the growth factor of 2.5% presented by Company witness Hutchens, and adjusted the mid-year customer count by 1.25 percent. Staff's adjustment results in an adjustment of $869,221. Contrary to the assertions made by Company witness Bentley Edwurm, Staff did not use a "future test year approach", but based its calculations on the growth rate provided by UNSG, which it estimated to be 2.5%.[30]

B. Weather Normalization Adjustment.

Staff's customer annualization adjustment resulted in an increase in the number of customers for the test year. Because the test year was cooler than normal, these additional customers could be expected to consume more gas than in a normal year. Staff made a corresponding weather normalization adjustment.[31]

C. Postage.

Staff agreed with the Company's postage adjustment to reflect the May 2009 postage increase. Staff calculated an increase in test year postage expenses of $49,247, and also added

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[27] TR 324:3-14.
[28] TR 285:12-18.
[29] Ex S-13 (Fish Surrebuttal) at 4.
[30] TR 561:23-25, TR 562:1-2.
[31] Ex S-13 (Fish Surrebuttal) at 10.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

EXHIBIT
UNSG-15
ADMITTED

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.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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RUCO'S

INITIAL CLOSING BRIEF
(REDACTED)

Cash Working Capital

The issue here comes down to the Company's change from its direct position to a much higher cash working capital request caused by the Company's revised purchase gas lag payment calculation. In its direct case, the Company proposed a purchased gas payment lag of 27.89 days which is close to the lag used by the Company in its last rate case-30.97 days. UNSG 21 at 24. The Company's revised rebuttal position for its purchased gas lag days is 19.17 days. RUCO-21, Schedule RCS-8 at page 1. In terms of dollars, the Company's original proposed cash working capital allowance was approximately $1,568. Its revised working capital allowance is over $2.18 million - over a 1300 percent increase! RUCO-21 at 23.

The gist of the Company's basis for the revision was a change made subsequent to the test year, i.e., the payment terms for purchased gas. UNSG-17 at 8. The change was to a twice-monthly payment necessitated by credit limitations. Id. The Company's decision to change its payment schedule was voluntary and any negative repercussions in its working capital needs should not be borne by the ratepayers.

The Company had alternatives to changing its payment schedule as the Company explained in response to a RUCO data request. RUCO-21 at 29-30, Schedule RCS-8 at page 21. Among them, the Company admits that it could have made more frequent payments of amounts owed, the Company could have provided a standby letter of credit from a financial institution, it could have curtailed doing new business with the supplier, or any combination of the above. Id. Any one or combination of these alternatives to making more frequent payments could have negated the impact on test year costs. Moreover, the Company failed to provide any

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BEFORE THE ARIZONA CORPORATION COMMISSION

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EXHIBIT
UNSG-17
ADMITTED

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

C. Cash Working Capital.

Q. Did any of the parties propose changes to the Company's cash working capital calculation?

A. Yes. Dr. Fish reduced cash working capital based on his review of certain payment lags. He identified certain purchased gas payment lags for an individual vendor that were approximately half the payment cycle time of the other payments made by that vendor. Dr. Fish assumed these shorter payment lags were an anomaly and he adjusted the payment lags associated with those particular certain purchased gas payments to reflect a payment period of 35 days. Staff believed — incorrectly — that the 35 day pay period is more reflective of expected pay cycles based on historical payment patterns.

Q. Was Dr. Fish correct in his assumption?

A. No. The payment lag is actually much shorter then 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. Therefore, Dr. Fish's adjustment to payment lags is factually incorrect and should not be adopted.

Q. Have you revised your Cash Working Capital adjustment?

A. Yes. 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.

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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.

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RUCO'S

INITIAL CLOSING BRIEF
(REDACTED)

cost-benefit analysis, from the perspective of ratepayers, that the management decision to make more frequent payments was the least cost option. Indeed, it appears that this may have been the greatest cost option from the perspective of ratepayers, as evidenced by the huge increase in UNSG's request for a cash working capital allowance.

There is also no proof that the change in payment terms is anything other than temporary. The Company made a temporary adjustment to a bi-monthly payment schedule in the previous winter (December 2007-January 2008) which then reverted back to the monthly schedule. RUCO-21 at 29. This change was not unusual given that the Company is a winter-peaking gas distribution company, so that its exposure to suppliers is greatest during the winter months. Id. The Commission should reject the Company's revised cash working capital recommendation as it is unreasonable under the circumstances.

RELIEF REQUESTED: The Commission should use the cash working capital allowance of approximately $1,600 in UNSG's original filing, and reject UNSG's request for a revised working capital allowance of over $2.18 million - over a 1300 percent increase! RUCO-21 at 23.

Customer Deposits

Customer Deposits, an offset to rate base, also have fluctuated from month to month, as shown in UNSG's response to a Staff data request. The test year average for Customer Deposits would be approximately $3.034 million, versus the June 30, 2008 balance of only $2.609 million used by UNSG. RUCO-20 at 22-23. If Customer

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RUCO'S

INITIAL CLOSING BRIEF
(REDACTED)

Deposits were also to be calculated using a test year average, rather than using the year-end balance, an adjustment for this would decrease rate base by approximately $425,000. Id.

RELIEF REQUESTED: RUCO recommends that a year-end balance be used for Customer Deposits. However, if other rate base components, such as Prepayments, are going to be adjusted using a 13-month average, then, for consistency with such an adjustment, Customer Deposits, which have also fluctuated during the test year, should also be reflected in rate base on a 13-month average basis.

Accumulated Deferred Income Taxes

The Company proposes to increase rate base by including some Accumulated Deferred Income Tax ("ADIT") balances related to stock-based compensation and for accrued liabilities. In general, if an item is disallowed for ratemaking purposes, the related ADIT should also be disallowed. RUCO-21 at 33. Rate base should not be increased for the ADIT on stock-based compensation because the underlying liability, stock-based compensation is a stockholder expense, not a ratepayer responsibility. For the ADIT on accrued liability items, rate base should not be increased for the ADIT because the related accrued liability items are not deducted from rate base. Id. 31-36.

If these items are to be reflected in rate base, it should result in a net reduction because the accrued liability items for vacation pay and pensions are larger than the related ADIT. In fact the related ADIT is computed by multiplying the accrued liability amounts by the combined state and federal tax rate. Id. at 34-35. There is a direct relationship between the accrued liabilities and the related ADIT and it would be

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Supreme Court of Arizona.
ARIZONA CORPORATION COMMISSION; William T. Brooks, John H. Barry and Mit Sims, as members of said Commission, Appellants,
v.
ARIZONA WATER COMPANY, a corporation, Appellee.
No. 6649.

Feb. 11, 1959.

Actions, consolidated for trial, to determine fair value of water utility's properties for purpose of fixing rate bases and rates of return. The Superior Court, Maricopa County, Jesse A. Udall, J., entered judgment vacating and remanding four separate orders of Corporation Commission fixing the rate bases and rates of return, and commission and commission members appealed. The Supreme Court, Johnson, J., held that, where vendor and water utility properties took a price less than book value to achieve a tax saving of one and one half million dollars, a power contract worth a million dollars, as well as hundreds of thousands of dollars in interest, commission's finding that fair value was purchase price, plus additions subsequent to purchase, and finding that the earnings requirement was 5% of such amount were arbitrary and, therefore, improper.

Judgment affirmed.

West Headnotes

[1] Waters and Water Courses 405 ⚿203(10)

405 Waters and Water Courses
405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
405k203(10) k. Reasonableness of Charges. Most Cited Cases
In determining fair value of water utility properties for purpose of fixing utility's rate bases and rates of return, a reasonable judgment concerning all relevant factors is required on part of Corporation Commission, and fair value cannot be said to have been determined if commission abuses its discretion in considering such factors or refuses to consider all relevant factors. A.R.S.Const. art. 15, § 14.

[2] Waters and Water Courses 405 ⚿203(10)

405 Waters and Water Courses
405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
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In determining fair value of water utility properties for purpose of fixing rate bases and rates of return, weight to be given each relevant factor is matter within Corporation Commission's discretion so long as such discretion is not abused. A.R.S.Const. art. 15, § 14.

[3] Waters and Water Courses 405 ⚿203(10)

405 Waters and Water Courses
405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
405k203(10) k. Reasonableness of Charges. Most Cited Cases
No special formula exists for determining fair value of water utility properties for purpose of fixing utility's rate bases and rates of return, but the Corporation Commission must establish the rate based on basis of fair value alone. A.R.S.Const. art. 15, § 14.

[4] Waters and Water Courses 405 ⚿203(10)

405 Waters and Water Courses
405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
405k203(10) k. Reasonableness of Charges. Most Cited Cases

Where considerable time had elapsed since original construction of water utility, both original cost less depreciation and reproduction cost new less depreciation were relevant factors regarding determination of fair value of utility property for purpose of fixing rate bases and rates of return, and, therefore, Corporation Commission could be properly required, in determining such value, to consider evidence submitted as to both factors. A.R.S. § 40-254; A.R.S.Const. art. 15, § 14.

[5] Waters and Water Courses 405 203(10)

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In fixing water utility's rate bases and rates of return on basis of fair value of utility property, fair value was to be determined as of time of inquiry before the Corporation Commission, and, therefore, commission would have to consider the original and reproduction costs of such property as of end of test period used in determining such value, rather than as of some earlier date, or of some average date. A.R.S. § 40-254; A.R.S.Const. art. 15, § 14.

[6] Waters and Water Courses 405 203(10)

405 Waters and Water Courses
405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
405k203(10) k. Reasonableness of Charges. Most Cited Cases

A water utility is entitled to a fair return on fair value of its properties devoted to public use, no more and no less. A.R.S.Const. art. 15, § 14.

[7] Waters and Water Courses 405 203(10)

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405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
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In determining fair value of water utility's properties for purpose of fixing utility's rate bases and rates of return, purchase price as capital investment could not be considered, and considerations in arriving at purchase price were not necessarily those elements which comprised fair value, and, therefore, purchase price of the property would not constitute, as matter of law, its fair value, however, commission could, in its discretion, inquire into recent purchase transactions as evidence related to the fair value. A.R.S.Const. art. 15, § 14.

[8] Waters and Water Courses 405 203(12)

405 Waters and Water Courses
405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
405k203(12) k. Review by Courts and Injunction Against Enforcement. Most Cited Cases

Where vendor and water utility properties took a price less than book value to achieve a tax saving of 1 1/2 million dollars, a power contract worth a million dollars, as well as hundreds of thousands of dollars in interest, Corporation Commission's finding that, for purpose of fixing utility's rate bases and rates of return, fair value of the properties was purchase price plus additions subsequent to purchase and finding that the earnings requirement was 5% of such amount were arbitrary and, therefore, improper. A.R.S. § 40-254; A.R.S.Const. art. 15, § 14.

***200 **413** Robert Morrison, Atty. Gen., W. T. Willey, Sp. Asst. Atty. Gen., Walter Roche, Phoenix, Tom Fulbright, Florence, Charles W. Stokes, Coolidge, Eugene K. Mangum, Casa Grande, of counsel, for appellants.

Fennemore, Craig, Allen & McClennen, Phoenix, for appellee.

JOHNSON, Justice.

This is an appeal from a judgment of the Maricopa County Superior Court vacating and remanding, under A.R.S. § 40-254, four separate orders of the appellant Arizona Corporation Commission fixing the rate bases and rates of return of the appellee Arizona Water Company for its water utility properties located in and serving the towns of Florence, Coolidge, Casa Grande and Ajo Heights, respectively. Four separate actions were filed and were consolidated for trial, as the issues involved were identical. The trial court found that the Commission failed to determine the fair value of the Company's properties devoted to the public use at the time of the inquiry and that it failed to give the Company a fair return on such properties, thus in effect taking its property without due process of law.

The Arizona Water Company, on April 1, 1955, purchased water utilities properties located in ten Arizona towns for a lump sum price on the entire system. Shortly thereafter the Company petitioned the Commissiom for a determination, for rate-making purposes, of the fair value of the Company's properties serving the four communities above mentioned as well as for a determination of the needed earnings requirements of the Company based upon such fair values. Hearings were then held before the Commission in each of the four localities.

A test period of the most conveniently recent one-year period was agreed upon, as is the custom in the utilities field. At each hearing the Commission's own staff and ***201** the Company each presented testimony as to the percentage of the entire system which it felt should be allocated to each of the four towns. The Company presented evidence pertaining to the cost of reproduction new, less observed depreciation, for that portion of the utility properties serving each town, as well as evidence of year-end original cost less depreciation, which was the original cost as it stood on the books at the end of the test period, including all additions.

The staff presented evidence of the average original cost less depreciation of the Company's properties, taking the average between the original costs less depreciation at the beginning and at the end of the test period, there having been additions in the meantime. The Commission had in its files its records of its authorization of the Company's purchase of the entire system for $3,600,000 in April, 1955. The price was mentioned during the hearings but no testimony was taken concerning the entire transaction or the seller's reasons for accepting that amount, which was about 55% of the net book value. Mention was made of a prior determination by the Commission in 1951 of the fair value of the then much smaller system; this fair value ****414** amount was a good deal in excess of the purchase price later paid by the Company.

The Commission's orders, all dated October 25, 1956, in each instance stated the purchase price of the entire system, the percentage of the system allocated to that particular town and the resulting amount, and found that there had been supplies purchased and improvements made since that time and that a pro rata portion of operating expenses and other factors should be allowed. In each of its four orders the Commission found this total of purchase price plus additions and expenses to be the rate base, and allowed the sum of 5% of the rate base to be earned by the Company. The Company's applications for rehearings were denied.

The appellant Commission assigns as error a conclusion of law of the trial court that

'In the determination of the fair value of the Company's properties devoted to the public use at the time of the inquity, the Commission must, in each instance, consider the original cost less depreciation of the Company's property devoted to the public use at the end of the test period, together with reproduction cost new less depreciation of the Company's properties at the end of the test period, where such evidence is submitted.'

[1][2][3] We have stated that a reasonable judgment concerning all relevant factors is required in determining the fair value of the properties at the time of the inquiry. Simms v. Round Valley Light & Power Company, 80 Ariz. 145, 294 P.2d 378. If ***202** the Commission abuses its discretion in considering these factors or if it refuses to consider all the relevant factors, the fair value of the properties cannot have been determined under our Constitution. The weight given to each particular factor is entirely within the discretion of the Commission, so long as that discretion is not abused. The Constitution of Arizona, Article 15, Section 14, A.R.S., states that the Commission 'shall, to aid it in the proper discharge of its duties, ascertain the fair value of the property within the State of every public service corporation doing business therein; * * *.' No formula is given for determining fair value, and we do not attempt to prescribe one, but the Commission must establish the rate base on the basis of fair value and that alone. Round Valley case, supra.

[4] We do not believe that the trial court was in error in requiring the Commission to consider in this case both the original cost less depreciation and the reproduction cost new less depreciation where evidence on these factors is submitted. These factors are both relevant, particularly where there has been considerable time since the original construction of the utility.

[5] Since fair value is to be determined as of the time of the inquiry, Round Valley case, supra, the trial court was correct in requiring that the original and reproduction costs at the end of the test period, rather than those of some earlier date, or of some average date, be used. There may have been additions to or deletions from the properties of the utility after the beginning of the test period. Average costs, average earnings, average customers, et cetera, over the test period may be necessary in order for the Commission to get a fair earnings picture, as such a test period method avoids seasonal peaks and valleys in a utility's operations. But in finding the fair value rate base the only relevant original cost figure is that computed at the time of the inquiry, or as near as possible thereto. An 'average original cost' figure found by averaging the original costs less depreciation as computed at the beginning and at the end of the test period, thus roughly halving any additions or deletions, is simply not the original cost at the time of the inquiry and should not be used as regarding the physical property. The estimates of reproduction cost new less observed depreciation should also be as close to the time of the inquiry as possible.

The appellant Commission assigns as error the trial court's conclusion of law that

****415** 'Evidence of 'purchase price' is not a proper factor for consideration by the Commission in its determination of the fair value of the Company's properties devoted to the public use at the time of inquiry.'

The Commission contends that a recent purchase price is market value and that ***203** market value would be fair value as a matter of law. We think not. It would be almost impossible for a public utility to have a market value, as the term of commonly used, since such things are not routinely and commonly sold on the public market. But even so, there would be many elements and considerations involved in arriving at the price to be paid for a public utility which could be of no concern in arriving at the fair value. For instance, any price, 'market' or otherwise, would necessarily include the sale value of the utility's assurance of a fair rate of return and the fact that it operates as a monopoly. And consider the instant case, wherein testimony at the trial court revealed that the seller of the properties under consideration was willing to take a price less than the book value, because the transaction would give it a tax saving of one and one-half million dollars, a power contract worth a million dollars, as well as hundreds of thousands of dollars in interest.

[6] Here, the purchase price happened to be less than the book value of the properties; it could as easily have been a great deal more than the book value. This court has held that under our constitu-

tion the Corporation Commission must find the fair value of the properties devoted to the public use, and that in determining the fair value of Commission cannot be guided by the prudent investment theory nor can it use common equity as the rate base standard. Round Valley case, supra. The amount of capital invested is immaterial. Under the law of fair value a utility is not entitled to a fair return on its investment; it is entitled to a fair return on the fair value of its properties devoted to the public use, no more and no less. It has been stated that under this test it makes no difference whether the utility 'bought it, received it as a gift, or won it in a lottery.' Peoples Natural Gas Co. v. Pennsylvania Public Utility Comm., 153 Pa.Super. 475 34 A.2d 375, 381.

[7] Therefore, since the purchase price as capital investment cannot be considered, and since the considerations in arriving at a purchase price are not necessarily those elements comprising fair value, we hold that the purchase price of a public utility does not constitute, as a matter of law, its fair value.

However, the Commission must consider all available evidence related to the fair value, and an inquiry into a recent purchase transaction might be of assistance, in the discretion of the Commission. But the *reasons* for that purchase price and not the amount itself would be of first importance in shedding light on the fair value of the property. Certain facts concerning the physical condition of the properties, or what is actually used and useful, or the practical effects of particular business practices might thus be revealed more clearly. A purchase price which was a product of ***204** many considerations not relevant to fair value is, as a dollar figure, obviously not in itself necessarily indicative of the fair value of the properties sold. It is of course possible that the fair value might by coincidence be the same amount as that which had been paid in a purchase transaction. But this would be highly unlikely in a situation such as that in the instant case, where there is a great disparity between the purchase price on the one hand and the apparently undisputed and uninflated original cost and reproduction cost figures on the other.

[8] Thus, if the Commission had taken into consideration the entire recent purchase transaction it would not have been an abuse of discretion. But here the Commission considered only that part of the transaction concerning the amount paid to the seller, and in that respect it acted arbitrarily, as all relevant factors were thus not considered in finding the fair value of ****416** the properties. The trial court was correct in setting aside and remanding the orders finding the fair values of the properties to be the purchase price plus additions subsequent to purchase and finding the earnings requirements to be the sum of 5% of that amount.

The judgment of the trial court remanding the cause to the Commission for the determination of the fair value of the properties, a fair rate of return to be allowed thereon, and the affixing of just and reasonable rates is hereby affirmed.

PHELPS, C. J., and STRUCKMEYER, UDALL, and BERNSTEIN, JJ., concurring.
Ariz. 1959
Arizona Corp. Commission v. Arizona Water Co.
27 P.U.R.3d 412, 85 Ariz. 198, 335 P.2d 412

END OF DOCUMENT

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BEFORE THE ARIZONA CORPORATION COMMISSION

EXHIBIT
UNSG-7
ADMITTED

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,

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

EXHIBIT
UNSG-7
ADMITTED

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

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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.

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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

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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

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Suite 502
2200 North Central Avenue
Phoenix, Arizona 85004-1481

Prepared for:

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

Q. When have you done that before?

A. I think it was in the dinosaur age. It was a long time ago. It was a TEP case. I believe it was in '85 or '86, and it was through RUCO. And it wasn't under Airedair, so I'm not familiar with the exact issues.

Q. All right.

A. It was a long time ago.

Q. Since --

A. And, as a matter of fact, the hearing was in Tucson.

Q. And since that time you have not appeared in a rate case before the Corporation Commission?

A. No, I have been in other courts.

Q. Yes. I will ask you about the monthly charge proposal.

Do you believe that the company's fixed cost to provide service to a residential customer varies from location to location?

A. I would expect there is some variations. That wouldn't surprise me at all because of their geographic variations and requirements for the system, sure.

Q. There may be different soil types?

A. Sure.

Q. Any variation would not be the result of whether the customer lives in a cold-weather climate or a

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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

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BEFORE THE ARIZONA CORPORATION COMMISSION

EXHIBIT
UNSG - 20
ADMITTED

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-____

Direct Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

November 7, 2008

I. INTRODUCTION.

Q. Please state your name and business address.

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

Q. By whom are you employed and what are your duties and responsibilities?

A. I am employed by Tucson Electric Power Company ("TEP") as a Lead Analyst in the Pricing and Economic Forecasting department. In this role I prepare cost-of-service studies and rate design proposals. I also perform these functions for UNS Gas, Inc. ("UNS Gas").

Q. Please describe your background and work experience.

A. I earned my Master of Science in Economics from Texas A&M University, and my Bachelor of Arts in Economics from the University of Dallas. I have over 25 years of utility experience in the areas of cost allocation and rate design, forecasting, valuation and fair market value determination, and utility mergers and acquisitions. I have testified before state regulators in Arizona, Texas and Alabama on these issues. I testified on behalf of Tucson Electric Power Company ("TEP") in general rates cases during the 1990's on cost allocation, rate design and unbundling to facilitate direct access. I have also provided testimony in the most recent general rates for UNS Gas (2006), UNS Electric, Inc. (2006), and TEP (2007).

Q. What is the purpose of your Direct Testimony?

A. I am sponsoring Schedules G and H, which summarize the class cost-of-service study, rate design and proof of revenue for this filing. I also will sponsor, and my testimony will explain: (i) the weather normalization pro-forma adjustment; (ii) the year-end

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

EXHIBIT
UNSG-22
ADMITTED

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

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D. Bentley Erdwurm

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August 5, 2009

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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:

A. No. Cyclicality is a feature of this particular service territory. There are part-year residents, and then there's also people who disconnect in the summer. Because of the cool winters and -- cold winters in some parts of our service territory and very mild, moderate summers where you don't absolutely need natural gas, so cyclicality is a fact of our service territory.

And I tried to removed that from the customer annualization adjustment in the last case, but the feeling was that the traditional approach was the best. And I understand the simplicity and ease of calculation, which the other parties have raised. It is an important concept, and I didn't -- I went ahead and used the traditional approach, and now it seems that what people once liked, they have turned against. They no longer like the traditional approach.

Q. Mr. Erdwurm, have you ever seen this type of customer annualization method as proposed in this case by Staff in your experience?

A. I have never seen an annualization adjustment performed this way. Typically, customer annualization is a very cut-and-dry, noncontroversial area. It's very surprising to see it's a big issue in any case, but I've never seen -- like I said, one of the big problems I see in Dr. Fish's approach is that he jumps so far outside the

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	Docket No. G-04204A-08-0571

RUCO'S

INITIAL CLOSING BRIEF
(REDACTED)

The traditional method may have made sense in that case, but it is counterintuitive in this case.

RUCO is recommending that no adjustment should be made to test year revenues for customer annualization. RUCO-21 at 39. During the test year, it is undisputed that the Company experienced growth. UNSG-20 at 7. It does not make sense to reduce test year revenues when UNSG has continued to grow throughout the test year. RUCO-21 at 17. According to the Company, and RUCO agrees, "Customers should expect a positive customer adjustment on a growing system." UNSG-20 at 7. The Company's negative customer adjustment proposal is contrary to what the Company admits its customers should expect.

When pressed why the Commission should adopt a recommendation that is simply "counterintuitive" to the facts in this case, the Company's witness, Bentley Erdwurm responded "Well, we have to maintain consistency even when it's counterintuitive. That's what makes things fair." Transcript at 435. With all due respect to Mr. Erdwurm, for whom RUCO has nothing but respect, RUCO disagrees. First, for the reasons explained above, RUCO does not believe the adoption of its recommendation would be inconsistent with the Commission's prior decision. Finally, the Commission, as a matter of policy, should always be open to reconsidering a methodology where a blanket application would be counterintuitive under the facts and circumstances. RUCO urges the Commission to reject the Company's proposal to adjust test year revenues for customer annualization.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	Docket No. G-04204A-08-0571

RUCO'S

INITIAL CLOSING BRIEF
(REDACTED)

growth through the test year would be unreasonable, and would result in an unnecessary addition to the amount of revenue increase being inflicted upon the utility's customers.

All things being equal, it would be hypocritical for RUCO to argue that the Commission should rely on its previous decisions to reject the Company's contradictory recommendations on other issues, and not rely on its previous decision to accept the Company's recommendation here. But all things are not equal.

In the Company's last rate case, the Company had proposed to calculate customer revenue annualization based on a cyclical growth pattern. Decision No. 70011 at 17. The Company argued that its proposal in that case was appropriate because "in cases of cyclical growth, the mathematics break down and ... [the traditional method] will often give you totally counterintuitive result, where you would actually have a negative customer adjustment on a growing system" Id. at 18.

RUCO was not persuaded by the Company's argument in that case noting that even though the Company's customer levels are somewhat seasonal, they do not exhibit a degree of seasonality or produce an aberrational result which makes the traditional approach inappropriate. Id. The Commission ultimately agreed with RUCO and Staff concluding: "... that UNS has not presented a valid case for departing from the traditional method of calculating customer service annualization. Although the Company's arguments have some validity in a theoretical sense, adoption of the cyclical methodology is not warranted in this proceeding." Id at 19.

RUCO believes that it would be a leap to conclude from the Commission's last decision that the Commission made a policy decision favoring the "traditional method."

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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

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 3.41 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

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

EXHIBIT
UNSG-17
ADMITTED

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

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
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BEFORE THE ARIZONA CORPORATION COMMISSION

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UNSG-17
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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.

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.

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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

$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.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

EXHIBIT
UNSG-17
ADMITTED

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. **Outside Legal Expense.**

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.

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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

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EXHIBIT
S-12
ADMITTED

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

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BEFORE THE ARIZONA CORPORATION COMMISSION

EXHIBIT
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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).

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
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EXHIBIT
UNSG-8
ADMITTED

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-____

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;

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BEFORE THE ARIZONA CORPORATION COMMISSION

<u>COMMISSIONERS</u>
MIKE GLEASON - CHAIRMAN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

EXHIBIT UNSG-11 ADMITTED

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-____

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.

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News

Brewer restores school cuts, axes tax repeal

by **Mary Jo Pitzl** - Sept. 5, 2009 12:00 AM
The Arizona Republic

Gov. Jan Brewer served up a mixed verdict on the state's budget Friday, restoring spending for education and social services, vetoing a tax repeal and abandoning hopes of putting a sales-tax hike before voters this year.

The Republican governor said her actions leave the state able to operate until early next year without the need to borrow money. But with the budget still out of balance, lawmakers will need to keep working on spending cuts and tax increases, she said.

"I will not give up on the future of our state," Brewer said at a news conference. "I will not give up on education. I will not give up on the fight for our most vulnerable citizens. And I will not let our beloved Arizona fall off the cliff of bankruptcy."

She blamed "a handful of Republican and Democratic extremists" for the inability to move forward immediately with her call for a temporary sales-tax increase, the contentious issue that dragged Arizona's budget debate into a record ninth month.

Brewer said she has not given up. Although she was hoping for a Dec. 8 election on a 1-cent-per-dollar sales-tax increase, she suggested the matter could be put on the March ballot.

Lawmakers were disappointed with her actions, which closes work - at least for the short term - on a budget saga that began in January.

Business groups lamented the return of the property tax, while the state's teacher's union applauded it since its $250 million in proceeds are directed to schools. In addition, Brewer spared education $220 million in cuts, as well as about $100 million in reductions to services to the state's children, elderly and poor.

"In the big picture, we are better off this afternoon than we were this morning," said John Wright, president of the Arizona Education Association.

Business groups said the return of the property tax, which was suspended for three years, will throttle economic recovery.

"Arizonans now face a reinforced recession injected with the steroid of more taxes and increased government spending," Tim Lawless, president of the Arizona chapter of the National Association of Industrial and Office Properties.

Glenn Hamer, CEO of the Arizona Chamber of Commerce & Industry, said the tax increase will hurt homeowners and businesses alike.

"Governor Brewer, by her actions, ensured that their taxes will go up next year at a time when Arizonans are least able to afford it," he said in a statement.

Brewer said she did not veto the property-tax repeal to force Republicans back to the bargaining table on the sales-tax referral. The repeal was a Republican priority this year.

She supports a phaseout of the property tax, she said, but in better economic times.

"I think it's unconscionable at this time, when we have a deficit of $4 billion, that we would allow that (tax) to continue to be suspended," she said.

County governments, which send out the property-tax bills, had held off on their late-August mailing until Brewer acted. Maricopa County begins printing bills today; taxes are due Oct. 1. The tax amounts to about $60 on a median-priced home in the Valley; utilities, with sprawling land holdings, face five- and six-digit increases.

GOP legislative leaders said Brewer took the wrong approach in reversing more than $300 million in spending cuts to education and the Department of Economic Security, while also cautioning the state cannot sustain those spending levels. It was an implicit pitch for her sales-tax hike, which she estimates would raise $1 billion a year.

Senate President Bob Burns said the governor appeared to be making assumptions.

"We basically have an increase in spending without the revenue first," said Burns, R-Peoria. "It's almost like we're betting on having this (sales-tax) referral."

He and House Speaker Kirk Adams said the governor's actions deepen the state's structural deficit, which will continue year after year, by $350 million.

They estimate the state faces a $3.1 billion deficit in the current year. Brewer pegs the number closer to $4 billion, noting that lawmakers still have to erase a $400 million deficit from the budget that ended June 30. The governor did not release an accounting of the impact of her budget actions.

Democrats, for their part, bristled at being labeled "extremists" and released pages of documents they say show they were willing to make huge concessions to balance the budget.

However, they acknowledged that the governor's moves line up well with Democratic goals: Restoring education and welfare spending and blocking the property-tax repeal, which they portray as tax breaks for corporations at a time the state cannot afford to give up revenue.

The budget picture at the state Capitol is expected to remain quiet for the next few weeks. However, Brewer said a "clean up" special session is needed by Sept. 30 to restore policy moves that, left untouched, could harm a dozen state agencies, including the Arizona Corporation Commission and the state Lottery.

Phoenix Business Journal - September 4, 2009
/phoenix/stories/2009/08/31/daily90.html

Phoenix Business Journal

Friday, September 4, 2009

Gov. Brewer nixes equalization tax repeal

Phoenix Business Journal - by Mike Sunnucks

Arizona Gov. Jan Brewer OK'd portions of state budget bills Friday, but she nixed a permanent repeal of a $250 million property tax on businesses and residents.

Brewer's move upset business and real estate advocates who want the state equalization rate gone. The property tax was temporarily repealed in 2005, but will come back without action.

Brewer had until Saturday to take action on budget bills, which did not include a sales tax increase referendum she and the business community want to help solve what is likely a $4 billion budget hole.

The Legislature has blocked the sales tax increase vote, and Brewer could call another special session to try again on that front. The state budget should have been done July 1.

Business and conservative backers of dropping the equalization rate were upset by the veto.

"It is unfortunate that after months of finagling, negotiations and arm-twisting, property taxes are going up," said Steve Voeller, president of the antitax Arizona Free Enterprise Club. "The economy is battered enough; it doesn't need a new layer of taxes to make matters worse."

Voeller expects Brewer to call a special session to make another bid for a statewide referendum on sales taxes. The governor also nixed some education cuts in the budget bill she signed off on Friday.

Tim Lawless, Arizona president of NAIOP, a real estate industry group, criticized Brewer for raising property taxes via the veto and calling for sales tax hikes while not cutting spending.

"The whole concept of taxing our way into prosperity, as Winston Churchill once said, is like a man standing in a bucket and trying to lift himself up by the handle. Let's face it, everyone knows that increased spending and taxes are the worst possible option in this economy," said Lawless, whose group has been a major proponent of getting rid of the equalization tax.

Brewer generally had voiced support for getting rid of the property tax item, and it could be brought back as part of trade-off package that includes the sales tax increase referendum and other tax cuts.

Democrats had opposed the $250 million tax repeal.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

EXHIBIT
UNSG-17
ADMITTED

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. Bad Debt Expense.

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.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
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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

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
KRISTIN K. MAYES - CHAIRMAN
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G. **Outside Legal Expense.**

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

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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-____

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,

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EXHIBIT UNSG-17 ADMITTED

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. Are Staff and RUCO's adjustments consistent with prior Commission orders?

A. Yes and no. The Commission's position on the recovery of incentive compensation program cost has varied, somewhat inconsistently, based on the nature of the incentive compensation. UNS Gas' incentive compensation is a cash-based incentive program available to all non-union employees. The Commission allowed full recovery of a similar program for Arizona Public Service Company ("APS") in Decision No. 69663 (June 28, 2007). However, I acknowledge that the Commission previously allowed only 50% recovery of the PEP in the last UNS Gas and UNS Electric rate cases, relying primarily on how it treated the Southwest Gas Management Incentive Program in the Southwest Gas rate cases. UNS Gas continues to believe that given the nature of its PEP, it should be allowed full recovery of the PEP expense.

Q. Does the Commission's position in the recent APS rate case support your position?

A. Yes. The Commission provided for full recovery of APS' Cash-based Incentive Compensation plan expenses in Decision No. 69663 (page 37) stating:

> APS' variable incentive program is an "at risk" pay program where a part of an employee's annual cash compensation is put at risk and expectations are established for the employee at the start of the year. If certain performance results are achieved, a predictable award will be earned based upon objective criteria. 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. (APS Exhibit No. 51, Gordon Rebuttal, p. 8) Staff did not oppose inclusion of the TY variable incentive expense in cost of service, noting that although corporate earnings serve as a threshold or precondition to the payout, the TY level of expense is tied primarily to performance measures that directly benefit APS customers. (Staff Exhibit No. 43, Dittmer Direct, p. 110)

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BEFORE THE ARIZONA CORPORATION COMMISSION

EXHIBIT
UNSG-17
ADMITTED

COMMISSIONERS
KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
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IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	DOCKET NO. G-04204A-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

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DATA REQUEST PACKET

Staff's Responses to UNS Gas' Data Requests:

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

EXHIBIT
UNSG 24
ADMITTED

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**

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

EXHIBIT
UNSG 41
ADMITTED

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

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BEFORE THE ARIZONA CORPORATION COMMISSION

EXHIBIT
UNSG-13
ADMITTED

<u>COMMISSIONERS</u>
MIKE GLEASON - CHAIRMAN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
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Direct Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

November 7, 2008

company group. The low end of this range represents the minimum value obtained from both the CAPM and the bond yield plus risk premium approach, while the high end of this range represents the high value obtained from the DCF analysis.

Summary of Comparable Company Analysis

	DCF Model	CAPM	Risk Premium	Conclusion
Low end of range	9.5%	10.2%	10.2%	10.2%
High end of range	11.2%	11.3%	11.5%	11.2%

F. Cost of Equity for UNS Gas.

Q. How did you determine the cost of equity for UNS Gas?

A. This is best accomplished by comparing the risk profile of UNS Gas to that of the comparable company group and selecting an appropriate point estimate based on the well established relationship between risk and expected return.

Q. How does the risk profile of UNS Gas differ from that of the comparable company group?

A. Relative to an investment in the group of comparable companies, an equity investment in UNS Gas is decidedly riskier. First, UNS Gas is much smaller than any of the comparable companies, thereby limiting the Company's ability to withstand financial shocks arising from unforeseen events. As indicated in Exhibit KCG-2, the smallest company in the comparable company group had a market capitalization of nearly $1 billion as of August 2008. Second, all of the companies in the comparable company group provide a current return to their shareholders in the form of a dividend, something that UNS Gas has not been able to do since the Company's inception in 2003. Third, while the Company's senior unsecured debt obligations were recently assigned an investment-grade credit rating of Baa3, this rating is at the low end of the credit ratings enjoyed by companies in the comparable company group. As may be seen in Exhibit KCG-2, the median issuer rating for the comparable company group is "A" from Standard & Poor's, "A3/Baa1" from Moody's and A- from Fitch. Consequently, it is reasonable to conclude that the cost of capital (both debt and equity) would be higher for UNS Gas relative to the comparable company group. As may be seen Exhibit KCG-12, investors require a higher rate of return (or YTM) on Baa-rated public utility bonds relative to A-rated public utility bonds. As of August 2008, this credit spread risk premium was approximately 60 basis points (or 0.6%). Since common stock investments are inherently riskier than investment-grade bond investments, this observed risk premium from the bond market can be used as an estimate of the *minimum* equity risk premium required by equity investors in a Baa-rated public utility relative to an A-rated public utility.

Q. What is your estimate of the cost of equity capital for UNS Gas?

A. In light of the risk factors cited above, as well as the credit spread and equity risk premiums applicable to lower-rated utilities, it is reasonable to conclude that the cost of equity for UNS Gas is near the high end of the range established for the comparable company group. As such, a reasonable point estimate for UNS Gas is 11.0%.

Q. Are you recommending an allowed ROE equal to the cost of equity for UNS Gas?

A. Yes I am, assuming that UNS Gas is provided with an opportunity to actually earn something close to its 11.0% cost of equity capital. An allowed ROE of 11.0% is fair to both the Company and its customers based on the analysis presented above. This level of return should also be sufficient to support the financial integrity of UNS Gas, so long as other key aspects of the Company's rate request are granted.

V. COST OF DEBT CAPITAL.

Q. What was UNS Gas' embedded cost of debt for the test-year?

A. As shown on Schedule D-2 of the Company's Application, the weighted average cost of debt for UNS Gas was 6.49% as of the end of the test-year.

Q. What cost of debt do you recommend in this case?

A. I recommend use of the 6.49% cost at the end of the test-year. This cost reflects the interest rate of 6.23% on the two long-term notes issued by UNS Gas in 2003, the amortization of related debt issuance costs, and 50% of the issuance cost amortization and commitment fees on the joint revolving credit facility shared with UNS Electric. Although UNS Gas had no borrowings outstanding on the revolving credit facility at the end of the test-year, maintenance of this facility is critical for purposes of funding seasonal working capital needs and future PGA bank balances, as well as funding a portion of capital expenditures. As such, it is appropriate to reflect the annual fixed cost of this facility in the cost of debt for UNS Gas.

VI. WEIGHTED AVERAGE COST OF CAPITAL.

Q. Please summarize your findings regarding the weighted average cost of capital for UNS Gas.

A. Based on the recommended capital structure, the proposed cost of debt, and UNS Gas' cost of equity capital, I recommend the Commission adopt a WACC of 8.75%, calculated as follows:

	% 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%

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BEFORE THE ARIZONA CORPORATION COMMISSION

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BOB STUMP

2009 SEP 18 P 3:58

AZ CORP COMMISSION
DOCKET CONTROL

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

INITIAL POST-HEARING BRIEF OF UNS GAS, INC.

SEPTEMBER 18, 2009

Using the DCF, CAPM and RP models, the Company determined the following range of ROEs for the sample group of gas companies:[130]

Summary of Comparable Company Analysis

	DCF Model	CAPM	Risk Premium	Conclusion
Low end of range	9.5%	10.2%	10.2%	10.2%
High end of range	11.2%	11.3%	11.5%	11.2%

Thus, the Company ultimately determined that the sample gas companies had a cost of equity in the range of 10.2% to 11.2%. However, the Company witness, Mr. Grant noted that UNS Gas was more risky than the sample group of companies, and he therefore recommends an ROE of 11.0%.[131]

2. UNS Gas is riskier than the sample group.

A key flaw in Staff's and RUCO's analyses is that they do not adjust their ROEs to recognize that UNS Gas is riskier than the sample groups. Staff's expert Mr. Parcell testified that the ROE should reflect the returns earned by companies "having corresponding risks."[132] He also testified that the proxy group should have a similar risk to the utility in question.[133] Mr. Parcell undermines his argument by not adjusting his ROE to reflect the fact that UNS Gas is riskier than the sample group. This is even more puzzling given that Mr. Parcell has recommended such an adjustment before, in his testimony in the most recent TEP rate case.[134] In the TEP case, Mr. Parcell recommended an ROE for TEP above the midpoint of his range, because TEP had a higher risk that the sample group.[135] The higher risk was due to "[l]ower bond ratings… verses the bond

[130] Ex. UNSG-13 (Grant Direct) at 24.
[131] Ex. UNSG-13 (Grant Direct) at 24-27.
[132] Ex. S-14 (Parcell Direct) at 7, quoting *Federal Power Comm'n v. Hope Natural Gas Co.,* 320 U.S. 591 (1942).
[133] Tr. (Parcell) at 860.
[134] Tr. (Parcell) at 856-857.
[135] Ex. UNSG-39 (Excerpt from Parcell Feb. 29, 2008 testimony).

ratings of the proxy companies" and a "[l]ower equity ratio… versus the proxy companies."[136] Although UNS Gas now has an equity ratio that is consistent with industry norms, the Company's credit rating is certainly well below the average for the sample group of gas companies used by both Mr. Grant and Mr. Parcell.[137]

Indeed, Mr. Parcell acknowledged a myriad of factors indicating UNS Gas is more risky than the sample group. He acknowledged that UNS Gas is smaller than any of the companies in either of his sample groups.[138] Additionally, Mr. Parcell acknowledged that only two of the 17 sample group companies he used have a credit rating as low as UNS Gas.[139] A lower credit rating, of course, indicates higher risk.[140] Further, UNS Gas has not earned its authorized ROE. As Company witness Mr. Grant noted, both *Value Line* and Mr. Parcell's own comparable earnings analysis show that the comparable gas utilities are earning actual returns of 11 to 12%.[141] Lastly, Mr. Parcell stated that the comparable group companies pay dividends, while UNS Gas has never paid a dividend.[142] In all of these ways, UNS Gas is riskier and less attractive to investors than the companies in the sample groups, and it should therefore have a higher ROE.

3. Importance of dividends to equity investors.

UNS Gas' inability to pay a dividend – *ever* – puts it at a great disadvantage compared to other gas utilities seeking capital. Mr. Parcell emphasized the importance of dividends, noting that he would not include a company in his sample group if it did not pay dividends.[143] If anything, RUCO's witness, Mr. Rigsby, was even more adamant about the importance of dividends to equity investors: "Utilities typically attract income-oriented investors, people that are interested in **getting a regular steady dividend** from the utility."[144] Mr. Rigsby emphasized the point:

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[136] Ex. UNSG-39 (Excerpt from Parcell Feb. 29, 2008 testimony).
[137] Ex. UNSG-13 (Grant Direct) at 25.
[138] Tr. (Parcell) at 860; *see* Decision No. 57944 (July 6, 1992) at 16 (agreeing with Staff's recommendation to increase ROE for sewer division over average of sample group due to small size risk).
[139] Tr. (Parcell) at 861.
[140] Ex. UNSG-13 (Grant Direct) at 25.
[141] Tr. (Grant) at 223.
[142] Tr. (Parcell) at 862.
[143] Tr. (Parcell) at 862.
[144] Tr. (Rigsby) at 799 (emphasis added).

"dividend yield… again, if you are an income-oriented investor, then that is what you want to look at."[145] He repeated the point again: "investors can rely on them [utilities] to pay out fairly stable dividends over a period of time."[146] Mr. Rigsby's remarks on the importance of dividends are profoundly ironic given UNS Gas' inability to pay a dividend and Mr. Rigsby's ultimate recommendation of an ROE for UNS Gas of only 8.61%. Staff's and RUCO's recommendations would ensure that UNS Gas would remain unable to pay dividends; as such UNS Gas would remain highly unattractive to the income investors extolled by Mr. Rigsby. Without the ability to pay steady dividends, UNS Gas is at a competitive disadvantage relative to other gas utilities, and would have to offer a higher return compared to such utilities in order to entice investors to invest in UNS Gas. Consequently, the Commission should adopt the Company's ROE recommendation.

4. Impact of Economy.

UNS Gas is aware of the current economic situation and its effect on its ratepayers and employees. In response, the Company has proposed: (i) exempting CARES customers from proposed changes in non-commodity rates (i.e., excluding gas commodity costs),[147] (ii) auto-enrolling LIHEAP-qualified customers into CARES,[148] and (iii) a lower rate request than could otherwise be justified.[149]

RUCO erroneously implied that the Presiding Administrative Law Judge had determined to adjust the ROE to reflect the economy.[150] However, the Presiding Administrative Law Judge quickly corrected that misstatement.[151] To the extent that RUCO, or any party, suggests that the Commission should put its "thumb on the scale" and alter the ROE due to the economy, any such suggestion can and should be firmly rejected. Instead, the ROE should be based on the evidence in the record.

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145 Tr. (Rigsby) at 800.
146 Tr. (Rigsby) at 801.
147 Ex. UNSG-5 (Hutchens Direct) at 11.
148 Tr. (Hutchens) at 80-81.
149 See Ex. UNSG-13 (Grant Direct) at 30-32; Tr. (Grant) at 170.
150 Tr. (Rigsby) at 797-798.
151 Tr. (Rigsby) at 797-798

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Regulatory Research Associates
REGULATORY FOCUS

January 12, 2009

MAJOR RATE CASE DECISIONS--JANUARY 2007-DECEMBER 2008
SUPPLEMENTAL STUDY

This Supplemental Study was prepared in conjunction with the Special Report entitled *Major Rate Case Decisions--January 1990-December 2007* that was uploaded to our website on Jan. 8. This study contains chronological listings of all major electric and gas cases decided during the years 2007 and 2008. These listings, with key data concerning each case, appear on pages 5 through 11 of this report. Tables summarizing industry-wide concerning cases decided in past years appear on pages 2 and 3. The average return on equity (ROE) authorized electric utilities in 2008 approximated 10.5%, compared to 10.4% in 2007. There were 37 electric ROE determinations in 2007, and 39 in 2007. The average ROE authorized gas utilities approximated 10.4% in 2008, compared to 10.2% in 2007. There were 30 gas cases that included an ROE determination in 2008, and 37 in 2007. We note that these ROEs are simple, non-weighted averages. Not included in these averages is a Sept. 17, 2008 steam rate case decision for Consolidated Edison of New York, in which the New York Public Service Commission adopted a settlement that incorporated a 9.3% return on common equity (48% of capital) and a 7.5% return on rate base.

After reaching a low in the late-1990's and early-2000's, the number of equity return determinations for energy companies has generally increased over the last several years. The total number of electric and gas equity return determinations in 2008 (67) was 180% greater than the number in 2000 (24). Increased costs, including environmental compliance expenditures, and the need for generation and delivery system infrastructure upgrades and expansion at many companies argue for a continuation of the increased level of rate case activity over the next several years. However, cost efficiencies from technological improvements, the use of multi-year settlements that do not specify return parameters, and a reduced number of companies due to mergers may prevent the number of rate cases and equity return determinations from significantly increasing further. We note that electric industry restructuring in many states has led to the unbundling of rates, with state commissions authorizing revenue requirement and return parameters for delivery operations only (which we footnote in our chronology), thus complicating historical data comparability. We also note that the financial crisis that began in September 2008 and the resulting significant increase in non-U.S. Treasury debt yields may indicate that utility equity costs have increased and lead to higher authorized ROEs by commissions.

The individual electric and gas cases listed on pages 5 through 11 are presented with the decision date shown first, followed by the company name, the abbreviation of the state issuing the decision, the authorized rate of return (ROR) and ROE, and the common equity component of the adopted capital structure. If the capital structure included cost-free capital or investment tax credit balances at the overall rate of return, an asterisk (*) follows the number in this column. Next we show the month and year in which the adopted test year ended, whether the commission utilized an average or a year-end rate base valuation, and the amount of the permanent rate change authorized. Fuel adjustment clause and other rider-related rate changes are not reflected in this study.

The table on page 2 shows the average ROE authorized annually since 1990, and by quarter since 2002, in major electric and gas rate decisions, followed by the number of observations in each period. The tables on page 3 show the composite electric and gas industry data for all the cases included in the chronology of this and earlier reports, summarized annually since 1995 and by quarter for the past eight quarters.

EXHIBIT
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(Text continued on page 4.)

Electric Utilities--Summary Table*

	Period	ROR %	(# Cases)	ROE %	(# Cases)	Eq. as % Cap. Struc.	(# Cases)	Amt. $ Mil.	(# Cases)
1995	Full Year	9.44	(30)	11.55	(33)	45.90	(30)	455.7	(43)
1996	Full Year	9.21	(20)	11.39	(22)	44.34	(20)	-5.6	(38)
1997	Full Year	9.16	(12)	11.40	(11)	48.79	(11)	-553.3	(33)
1998	Full Year	9.44	(9)	11.66	(10)	46.14	(8)	-429.3	(31)
1999	Full Year	8.81	(18)	10.77	(20)	45.08	(17)	-1683.8	(30)
2000	Full Year	9.20	(12)	11.43	(12)	48.85	(12)	-291.4	(34)
2001	Full Year	8.93	(15)	11.09	(18)	47.20	(13)	14.2	(21)
2002	Full Year	8.72	(20)	11.16	(22)	46.27	(19)	-475.4	(24)
2003	Full Year	8.86	(20)	10.97	(22)	49.41	(19)	313.8	(12)
2004	Full Year	8.44	(18)	10.75	(19)	46.84	(17)	1091.5	(30)
2005	Full Year	8.30	(26)	10.54	(29)	46.73	(27)	1373.7	(36)
2006	Full Year	8.24	(24)	10.36	(26)	48.67	(23)	1465.0	(42)
	1st Quarter	8.44	(8)	10.27	(8)	47.80	(8)	403.5	(9)
	2nd Quarter	7.94	(11)	10.27	(11)	46.02	(11)	718.6	(12)
	3rd Quarter	7.90	(4)	10.02	(4)	48.34	(4)	119.1	(6)
	4th Quarter	8.38	(15)	10.56	(16)	49.59	(14)	160.7	(19)
2007	Full Year	8.22	(38)	10.36	(39)	48.01	(37)	1401.9	(46)
	1st Quarter	8.36	(9)	10.45	(10)	49.25	(8)	802.9	(9)
	2nd Quarter	8.21	(7)	10.57	(8)	47.64	(7)	510.5	(8)
	3rd Quarter	8.32	(10)	10.47	(11)	48.96	(10)	737.5	(13)
	4th Quarter	8.09	(9)	10.33	(8)	47.58	(8)	848.5	(12)
2008	**Full Year**	**8.25**	**(35)**	**10.46**	**(37)**	**48.41**	**(33)**	**2899.4**	**(42)**

Gas Utilities--Summary Table*

	Period	ROR %	(# Cases)	ROE %	(# Cases)	Eq. as % Cap. Struc.	(# Cases)	Amt. $ Mil.	(# Cases)
1995	Full Year	9.64	(16)	11.43	(16)	49.98	(15)	-61.5	(31)
1996	Full Year	9.25	(23)	11.19	(20)	47.69	(19)	193.4	(34)
1997	Full Year	9.13	(13)	11.29	(13)	47.78	(11)	-82.5	(21)
1998	Full Year	9.46	(10)	11.51	10)	49.50	(10)	93.9	(20)
1999	Full Year	8.86	(9)	10.66	(9)	49.06	(9)	51.0	(14)
2000	Full Year	9.33	(13)	11.39	(12)	48.59	(12)	135.9	(20)
2001	Full Year	8.51	(6)	10.95	(7)	43.96	(5)	114.0	(11)
2002	Full Year	8.80	(20)	11.03	(21)	48.29	(18)	303.6	(26)
2003	Full Year	8.75	(22)	10.99	(25)	49.93	(22)	260.1	(30)
2004	Full Year	8.34	(21)	10.59	(20)	45.90	(20)	303.5	(31)
2005	Full Year	8.25	(29)	10.46	(26)	48.66	(24)	458.4	(34)
2006	Full Year	8.51	(16)	10.43	(16)	47.43	(16)	444.0	(25)
	1st Quarter	8.40	(10)	10.44	(10)	48.33	(9)	158.4	(13)
	2nd Quarter	8.32	(3)	10.12	(4)	49.67	(4)	37.3	(5)
	3rd Quarter	7.88	(7)	10.03	(8)	48.70	(6)	402.0	(12)
	4th Quarter	7.97	(12)	10.27	(15)	47.74	(11)	215.7	(18)
2007	Full Year	8.12	(32)	10.24	(37)	48.37	(30)	813.4	(48)
	1st Quarter	8.78	(7)	10.38	(7)	52.07	(7)	129.6	(7)
	2nd Quarter	8.28	(3)	10.17	(3)	51.80	(3)	52.0	(4)
	3rd Quarter	8.33	(7)	10.49	(7)	50.58	(7)	312.8	(10)
	4th Quarter	8.45	(13)	10.34	(13)	49.25	(13)	390.4	(20)
2008	**Full Year**	**8.48**	**(30)**	**10.37**	**(30)**	**50.47**	**(30)**	**884.8**	**(41)**

* Number of observations in each period indicated in parentheses.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
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JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

EXHIBIT
UNSG-13
ADMITTED

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-____

Direct Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

November 7, 2008

approved in 2007 by the Commission. However, even with this rate increase, it is unlikely the Company will be able to earn the 10.0% ROE authorized by the Commission in that rate proceeding (Decision No. 70011). This is due largely to the wide gap between the embedded cost of utility plant reflected in the Company's current rates and the higher cost of utility plant added since December 31, 2005, the test year in UNS Gas' last rate case. Internal cash flow at UNS Gas is also quite weak relative to the Company's annual capital spending requirements for new plant and equipment. Continued weakness in the Company's earnings and cash flow, coupled with the lack of any dividend on shareholder capital, places UNS Gas at a competitive disadvantage in terms of attracting the capital needed for utility plant investment.

Q. What steps has the Company taken to improve its financial condition over time?

A. Since the acquisition of gas distribution properties from Citizens Communications Company ("Citizens") in 2003, UNS Gas' balance of common equity capital has nearly doubled from $50 million to $99 million as of June 30, 2008. This has been achieved through the retention of 100% of annual earnings at UNS Gas and an additional equity infusion of $16 million made by UniSource Energy. As a result, the Company's ratio of common equity to total capital has improved from 33% in August of 2003 to approximately 50% as of the test year ending June 30, 2008. Over time UNS Gas has also taken steps to reduce its operating costs wherever feasible and to realize additional economies of scale through the sharing of administrative support services with TEP and UNS Electric. The Company's revolving credit facility, which is shared with UNS Electric, was also refinanced in 2006 with a resulting decrease to the interest rate applicable to borrowings under that facility.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
DOCKET CONTROL

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

INITIAL POST-HEARING BRIEF OF UNS GAS, INC.

SEPTEMBER 18, 2009

CAPM. Mr. Rigsby obtained a DCF result of 11.40% (within the range of the other experts), but his CAPM produced an ROE range of 5.25 to 6.39%.[161] Mr. Rigsby's CAPM results are **below** UNS Gas' cost of debt, as well as below the cost of new debt.[162] Mr. Rigsby's CAPM result is wholly implausible. Accordingly, RUCO's ROE recommendation should be rejected.

6. Staff's ROE should also be rejected.

Staff's ROE is also flawed. Most significantly, as already noted, Staff fails to recognize that UNS Gas is riskier than the sample group it references. Simply stated, UNS Gas, a smaller company with a lower credit rating, no dividends, and lower earned returns has more risk than the sample group.

Mr. Grant noted the large sell-off in utility stocks in recent months. In response, Mr. Parcell suggested that a drop in stock price results in a lower cost of capital. But in discovery, Mr. Parcell admitted that "stock price declines can be produced by changing perceptions of risk or changes in risk aversion, even if future expectations of dividends and earnings have not changed."[163]

Mr. Parcell also speculated that UNS Gas is insulated from the impact of the economy, because sales will not drop.[164] But Mr. Parcell admitted that he had not actually reviewed UNS Gas' sales data.[165] In fact, UNS Gas' sales have dropped significantly from the end of the test year due, in part, to the economy.[166]

Further, Mr. Parcell uses only the single-stage version of the DCF. However, the Commission uses the multi-stage version of the DCF.[167] Investors do not expect a single, uniform growth rate. The multi-stage DCF recognizes this and is therefore superior. As the Commission explained, the multi-stage DCF "properly recognizes that investors expect both non-constant

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[161] Ex. RUCO-13 (Rigsby Direct) at 32.
[162] See e.g. Ex. RUCO-19, showing updated utility bond yields of 6.62% for Baa bonds.
[163] Ex. UNSG-36 (Staff Response to UNSG 3.92).
[164] Ex. S-14 (Parcell Direct) at 39.
[165] Ex. UNSG-36 (Staff Response to UNSG 3.95.b).
[166] Tr. (Grant) at 207.
[167] Ex. UNSG-14 (Grant Rebuttal) at 12.

short-term growth as well as constant long term growth."[168] The Commission has considered both types of DCF, and often averages the results of the two to produce an overall DCF estimate. Staff has proposed, and the Commission has approved, that approach to the DCF in many orders.[169] Mr. Parcell does not explain why he rejected Staff's traditional approach, and his exclusive reliance on the single-stage DCF should be rejected in favor of the more accurate and realistic multi-stage DCF proposed by the Company.

In addition, Mr. Parcell is inconsistent regarding which company he is evaluating. At times, he states he is determining the cost of equity "for UNS Gas".[170] Yet at other times he implies he is really determining the cost of equity for Unisource Energy: "but the subject company for the raising of equity dollars is UNS West Energy [sic]"[171] And sometimes he implies that he is somehow looking to both UNS Gas and Unisource.[172] The proper analysis should focus on UNS Gas, not the holding company UniSource Energy Corporation.

Finally, Mr. Parcell's recommendation is detrimentally low when compared with Staff's own Exhibit 1. Staff presented an exhibit showing historical ROE's of 10% to 11%.[173] In fact, the most recent year suggested an average ROE of 10.37%. Mr. Parcell's recommendation is at the very bottom of the range when compared to other authorized ROEs – even though UNS Gas has never paid a dividend and the record is clear that it is decidedly riskier than the average utility. In spite of the evidence in the record, including Staff's own exhibit, Mr. Parcell recommends that UNS Gas' ROE should be 10%, which is below the average ROE authorized to other utilities. Further, Mr. Parcell's recommendation is inconsistent with his recommendation of an 11.0% ROE for APS. Mr. Parcell sought to avoid that comparison, claiming the 11% figure was Staff's decision.[174] But his APS testimony actually states "I recommend an 11.0 percent level".[175]

[168] Decision No. 66849 at 22.
[169] See, e.g., Decision No. 68176 at 21 (stating Staff's approach) and 26 (agreeing with Staff); Decision No. 68858 at 25, 28; Decision No. 69164 at 23, 26; Decision No. 69440 at 18, 20; Decision No. 70209 at 27, 30.
[170] Ex. S-14 (Parcell Direct) at 38.
[171] Tr. (Parcell) at 860.
[172] Ex. S-14 (Parcell Direct) at 24.
[173] Ex. S-1 (Regulatory Focus Report).
[174] Tr. (Parcell) at 855.

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EXHIBIT S-14 ADMITTED

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

DAVID C. PARCELL

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

JUNE 08, 2009

COMPARISON COMPANIES
RATES OF RETURN ON AVERAGE COMMON EQUITY

COMPANY	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	1992-2001 Average	2002-2008 Average	2009	2010	2012-14
Parcell Proxy Group																						
Avista Corp.	11.7%	12.2%	10.5%	11.2%	10.6%	15.0%	10.2%	1.1%	13.4%	7.9%	4.5%	6.7%	4.6%	5.8%	8.8%	4.1%	8.2%	10.4%	6.1%	8.0%	8.0%	8.0%
Hawaiian Electric Industries, In	10.9%	10.5%	11.1%	11.0%	10.5%	10.9%	11.5%	11.1%	9.8%	12.4%	11.9%	11.1%	9.3%	9.7%	9.3%	7.7%	8.1%	11.0%	9.6%	8.5%	10.0%	10.5%
Northeast Utilities	12.6%	9.4%	12.6%	11.9%	0.1%	-6.2%	-2.3%	-7.3%	-1.3%	8.6%	6.4%	7.1%	5.1%	5.4%	4.5%	8.6%	9.8%	3.8%	6.7%	8.5%	9.5%	8.5%
Pinnacle West Capital Corp.	10.7%	10.9%	10.2%	10.6%	11.2%	11.9%	11.5%	12.3%	12.4%	12.8%	8.6%	8.3%	8.2%	6.7%	9.2%	8.5%	7.9%	11.5%	8.2%	7.5%	8.0%	9.0%
Pepco Holdings, Inc.	10.6%	12.0%	10.8%	10.5%	11.7%	10.5%	11.3%	11.7%	8.9%	11.9%	9.8%	7.6%	8.3%	8.1%	7.1%	7.9%	9.0%	11.0%	8.2%	7.5%	8.5%	8.5%
TECO Energy, Inc.	16.1%	15.1%	14.5%	16.6%	16.5%	14.8%	13.5%	13.8%	17.4%	17.2%	13.5%	-0.7%	9.2%	14.2%	14.7%	14.3%	8.9%	15.6%	10.6%	11.0%	12.0%	12.0%
Westar Energy, Inc.	11.0%	12.4%	10.7%	11.1%	10.4%	-1.6%	7.1%	5.2%	3.2%	-2.2%	5.0%	10.6%	7.7%	9.6%	11.1%	10.0%	6.6%	6.7%	8.7%	8.0%	8.0%	8.0%
Average	11.9%	11.8%	11.5%	11.8%	10.1%	7.9%	9.0%	6.9%	9.1%	9.8%	8.5%	7.2%	7.5%	8.5%	9.2%	8.7%	8.4%	10.0%	8.3%	8.4%	9.1%	9.2%
Median	11.0%	12.0%	10.8%	11.1%	10.6%	10.9%	11.3%	11.1%	9.8%	11.9%	8.6%	7.6%	8.2%	8.1%	9.2%	8.5%	8.2%	11.1%	8.3%	8.0%	8.5%	8.5%
Grant Comparable Company Group																						
AGL Resources	11.6%	11.0%	11.6%	13.1%	13.2%	12.7%	12.6%	7.9%	11.2%	12.7%	14.7%	15.3%	13.9%	13.3%	13.6%	12.8%	12.5%	11.8%	13.7%	12.5%	13.0%	14.5%
Atmos Energy Corp	10.7%	12.7%	10.0%	12.2%	14.4%	12.3%	15.8%	6.7%	8.5%	11.1%	10.3%	11.2%	9.1%	9.1%	10.0%	9.2%	9.0%	11.4%	9.7%	9.0%	8.5%	9.5%
Laclede Group	9.9%	13.4%	11.5%	10.0%	14.0%	13.2%	11.0%	10.0%	9.1%	10.6%	7.8%	11.8%	11.2%	11.1%	13.1%	12.0%	12.6%	11.3%	11.4%	12.5%	10.5%	11.0%
New Jersey Resources Corp	12.2%	11.8%	13.0%	13.3%	13.9%	14.5%	14.7%	15.0%	15.1%	15.2%	15.9%	16.8%	15.8%	16.2%	14.6%	10.2%	16.5%	13.9%	15.1%	13.5%	13.0%	11.0%
NICOR Inc	15.3%	15.3%	15.7%	14.6%	17.0%	16.9%	14.7%	15.7%	18.2%	18.8%	17.3%	12.4%	13.0%	12.8%	15.2%	14.9%	12.5%	16.2%	14.0%	11.0%	12.5%	12.0%
Northwest Natural Gas Co	6.0%	13.7%	12.2%	11.4%	13.2%	11.2%	8.3%	10.1%	10.2%	10.3%	8.7%	9.2%	9.3%	10.1%	10.9%	12.4%	11.2%	10.5%	10.2%	11.0%	11.0%	11.0%
Piedmont Natural Gas Co	14.1%	13.8%	12.2%	12.3%	13.2%	13.8%	13.6%	12.1%	12.5%	12.0%	10.8%	12.2%	12.4%	11.6%	11.0%	11.8%	12.4%	13.0%	11.7%	12.5%	13.5%	13.5%
South Jersey Industries	11.6%	11.0%	8.5%	11.4%	11.1%	11.9%	10.1%	15.6%	15.4%	15.3%	14.0%	13.1%	13.4%	13.2%	17.2%	13.3%	13.5%	12.2%	13.9%	13.5%	13.5%	14.5%
Southwest Gas Corp	5.1%	3.9%	7.5%	0.6%	1.7%	5.4%	10.4%	7.5%	7.3%	6.7%	6.8%	6.2%	8.8%	6.5%	9.7%	8.8%	6.1%	5.6%	7.5%	6.0%	7.5%	9.0%
WGL Holdings	12.5%	12.1%	12.6%	12.4%	15.0%	14.1%	11.3%	10.3%	11.9%	11.9%	7.1%	14.4%	11.9%	12.1%	10.8%	11.0%	12.0%	12.4%	11.3%	12.0%	11.5%	11.0%
Average	10.9%	11.9%	11.5%	11.1%	12.7%	12.6%	12.0%	11.1%	11.9%	12.5%	11.3%	12.3%	11.9%	11.6%	12.6%	11.6%	11.8%	11.8%	11.9%	11.4%	11.5%	11.7%
Median	11.6%	12.4%	11.9%	12.3%	13.6%	12.9%	11.9%	10.2%	11.5%	11.9%	10.6%	12.3%	12.2%	11.9%	12.0%	11.9%	12.4%	12.1%	11.9%	12.3%	12.0%	11.0%

Source: Calculations made from data contained in Value Line Investment Survey.

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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 10, 2009

Filed: August 14, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME I
(Pages 1 through 238)

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:

testimony at the time we filed the case, we believed that would allow us to earn the 11 percent cost of equity that we've indicated.

Since that time, our sales have decreased fairly significantly, and now we're looking at, at best, turning to 10 percent return on equity with that $9.5 million rate increase.

CHMN. MAYES: Okay.

ACALJ NODES: One other question before I give it back to Mr. Pozefsky.

FURTHER EXAMINATION

Q. (BY ACALJ NODES) He referenced the rating agencies and their view of the Arizona Commission's, I guess, support for utility companies in general. Do you recall that?

A. Yes.

Q. Would you agree that rating agencies are looking at public utility regulatory commissions solely from the perspective of investor interests, and not in any way from the perspective of customer interests?

A. I would say generally you're correct. I mean, they're interested in looking at the probability of a bondholder recovering his principal and earning his or her

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ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE 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

STAFF'S INITIAL POST-HEARING BRIEF

The Utilities Division of the Arizona Corporation Commission ("Staff") hereby files its closing brief in the above-captioned matter. In this brief, Staff will address the major disputed issues. On any issue not specifically addressed in this brief, Staff maintains its position as presented in its testimony.

I. INTRODUCTION.

UNS Gas, Inc. ("UNSG" or the "Company") is a public service corporation that provides natural gas distribution services to approximately 140,000 customers in Mohave, Coconino, Navajo, Yavapai and Santa Cruz counties in Arizona. UNSG was formerly a part of the Arizona local gas distribution operations of Citizens Communications Company, prior to its 2003 acquisition by UniSource Energy. UNSG, at the conclusion of a rate moratorium, filed an application for a rate increase in 2006. The Commission approved new rates for UNSG in November 2007.[1] UNSG filed an application for a rate increase on November 7, 2008.

UNSG is seeking an increase in its base rates of approximately \$9.5 million, a 6 percent increase over its test year revenues. The effect on the proposed fixed monthly and delivery charges will be an increase of approximately 19% over test year revenues, exclusive of gas recovery costs. UNSG used a test year ending June 30, 2008.[2]

[1] Decision No. 70011 (November 27, 2007).
[2] Ex UNSG-16 (Dukes Direct) at 3.

a market price of a utility's common stock that is 150 percent or more above the stock's book value is indicative of earnings that exceed the utility's reasonable cost of capital.[97]

Staff's 9.5 percent to 10.5 percent CE recommendation is based on current market conditions and the proposition that ratepayers should not be required to pay rates based on earnings levels that result in excessive market-to-book ratios.[98]

4. General Economic Conditions.

The costs of capital are determined in part by current and prospective economic and financial conditions."[99] It is well chronicled that, over the past two years and especially over the past several months, the United States and global financial markets have been in turmoil with global credit markets virtually coming to a standstill.[100] However, this does not imply that the cost of equity for gas utilities such as UNSG has increased.[101] This is true for several reasons.

First, UNSG is a regulated utility that sells a product that has no real substitute and is a product for which that consumers can do little to control the amount they use.[102] Therefore, UNSG is partially, if not largely, insulated from the impacts of depressed economic conditions.[103] Second, since the major impact of a recession will be to depress the profits of most enterprises, it is to be expected that capital costs will decrease in tandem with a significant recession.[104] "The United States and global markets have and are taking extraordinary measures designed to put liquidity into the credit markets and make credit more accessible again,"[105] steps which are "clearly designed to lower the cost of capital."[106]

Further, despite this financial turmoil, there is no indication that UNSG's risks have increased since its last rate proceeding,[107] and absent such an indication, there is no justification for increasing

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[97] *Id* at 9.
[98] Ex S-14 (Parcell Direct) at 38.
[99] *Id.*
[100] *Id* at 39.
[101] *Id.*
[102] *Id.*
[103] *Id.*
[104] *Id.*
[105] *Id.*
[106] *Id.*
[107] Ex S-14 (Parcell Direct) at 39.

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BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
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IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	Docket No. G-04204A-08-0571

RUCO'S

INITIAL CLOSING BRIEF
(REDACTED)

model cannot be applied to companies having expected short-term growth rates that are significantly higher or lower than their long-term growth potential. RUCO-13 at 54.

RUCO's witness William Rigsby used a single-stage constant growth that relied on 5-year growth projections that are specific to the local distribution companies ("LDC") used in Mr. Rigsby's proxy. Id. at 55. The long-term growth rate used by Mr. Grant, which was used in his multi-stage DCF model, assumes a long-term growth rate for LDCs that will be very close to an inflation-adjusted growth rate of all goods and services produced by labor and property in the US into perpetuity. RUCO-13 at 55. This assumption that utility long-term growth rates will closely mirror national Gross Domestic Product growth into perpetuity is suspect. Id.

Furthermore, as pointed out in the surrebuttal testimony of Mr. Rigsby, FERC requires that the growth components of the multi-stage model be weighted in such a way that more emphasis is placed on the short-term (i.e. 5-year estimates) as opposed to long-term estimates (inflation adjusted GDP) that are calculated into perpetuity. RUCO-14 at 8. The rationale for the FERC's weighting requirement is "that short-term growth rates are more predictable, and thus deserve a higher weighting than long term growth rate projections." Id. Thus the FERC places more weight on the growth estimates used by Mr. Rigsby in his constant growth DCF model.

Using Mr. Grant's inputs and estimates, a single-stage model would produce a mean average estimate of 9.17 percent, which is 223 basis points below Mr. Rigsby's 11.40 percent estimate. RUCO-13 at 56. Further, there were changes to stock prices of proxy companies between the filing of the Company's direct testimony and RUCO's direct testimony. Id. at 57. In general, the stock prices for the LDC's used in Mr.

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Grant's and Mr. Rigsby's proxies have fallen since the Company filed its direct case. Id. Thus, a single stage model using updated stock prices, while holding Mr. Grant's other DCF component estimates constant would produce a lower single-stage DCF estimate than the one Mr. Rigsby calculated. Id. at 58. It is clear that Mr. Rigsby's growth rate inputs are suitable estimates of long term growth.

Second, the witnesses used a different proxy for the market rate of return in their CAPM analyses. Mr. Rigsby used both geometric and arithmetic means of historical returns. Id. at 60. Mr. Grant relied solely on the arithmetic mean of historical returns as the proxy for the market rate of return. Id. Information on both the geometric and arithmetic means is widely available to the investment community, and it is therefore appropriate to use both means in CAPM analysis. Id., RUCO-14 at 9. Further, the geometric mean provides a truer picture of the effects of compounding on the value of an investment when return variability exists, and therefore it is an important metric to include. Id.

Finally, Mr. Rigsby used updated betas for the proxy companies in his CAPM analysis. RUCO-13 at 60. The mean average of Value Line betas used by Mr. Grant was .87, as opposed to Mr. Rigsby's average beta of .67. Id.

It is not uncommon for RUCO and the Staff to also differ in their approach to cost of equity. However, RUCO's approach, as will be more fully explained, is more sensitive to the current economic environment. Staff's witness, David Parcell utilized three methodologies in calculating Staff's return on equity recommendation. S-14 at 38. Parcell's methodologies produced the following results:

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BEFORE THE ARIZONA CORPORATION COMMISSION

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RUCO'S

INITIAL CLOSING BRIEF
(REDACTED)

Discounted Cash Flow	9.5-10.5%
Capital Asset Pricing Model	7.3-7.8%
Comparable Earnings	9.5-10.5%

Id. Mr. Parcell recommended a cost of equity of 9.5% to 10.5% for the Company. Id. This reflected the DCF and Comparable Earnings Models. Within the range, Mr. Parcell recommended 10.0 percent level, which is the same level of equity approved by the Commission in the Company's last rate case. Mr. Parcell's CAPM analysis **was not** reflected in his range of recommendations for Staff's return on equity. Transcript at 832.

Mr. Parcell's admitted that CAPM is frequently used as a check for the DCF analysis. Transcript at 833. In this case, Mr. Parcell's CAPM analysis would clearly indicate that the DCF range of 9.5-10.5% would be too high. Nonetheless, Mr. Parcell's gave less weight to his CAPM results calling it an "outlier". Transcript at 825. Mr. Parcell attributes the low CAPM results in large part to the decline in the economy and investor's "flight of quality" to more secure Treasury securities. Transcript at 824-825. The result is higher priced Treasury securities and lower yields which in turn, lowered the risk-free rate in the CAPM which produced lower than normal CAPM results. Id.

Not surprisingly, RUCO's CAPM results were also low – 5.26-6.39%. RUCO-13 at 32. RUCO, however, did not disregard its CAPM results. Mr. Parcell apparently began disregarding the results of his CAPM calculations in other cases before this Commission when the financial markets went into turmoil. Transcript at 833. While there is a certain sense of logic to Mr. Parcell's dismissal of the CAPM now, it begs the question what is a normal economy? Mr. Parcell did not disregard the CAPM in other

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Moody's Investors Service

Global Credit Research
Credit Opinion
23 JUL 2009

EXHIBIT
UNSG-19
ADMITTED

Credit Opinion: UNS Gas, Inc.

UNS Gas, Inc.

Tucson, Arizona, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Bkd Senior Unsecured	Baa3
Ult Parent: UniSource Energy Corporation	
Outlook	Stable
Sr Sec Bank Credit Facility	Ba1

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Opinion

Rating Drivers

Stable regulated operations with in historically challenging regulatory environment

Limited non-regulated exposure and ring-fencing

Strong credit metrics

Cross-support within UES family

Corporate Profile

UNS Gas, Inc. (UNSE: Baa3 senior unsecured (guaranteed), stable) is local distribution utility serving approximately 146,000 retail customers in Arizona. UNSG and UNS Electric, Inc. (UNSE: Baa3 senior unsecured (guaranteed), stable), a regulated electric utility in Arizona, are both subsidiaries of UniSource Energy Services (UES) which is the guarantor. UES is a wholly owned subsidiary of UniSource Energy Corporation (UNS: Ba1 senior secured bank credit facility (security limited to stock of certain subsidiaries), stable), whose largest subsidiary is Tucson Electric Power (TEP: Baa3 senior unsecured, stable), a regulated electric utility in Arizona.

SUMMARY RATING RATIONALE

The Baa3 rating assigned to UNSG's senior unsecured notes reflects the interdependence that currently exists between the company and its affiliate UNSE as a result of their shared credit facility and parental guarantee from UES. The rating reflects our view of the consolidated credit quality of UES, which guarantees the debt of both UNSG and UNSE. On a stand-alone basis, UNSG has a credit profile moderately better than its rating as evidenced by metrics that map to rating levels within the LDC gas utility methodology that are somewhat stronger than its rating category.

DETAILED RATING CONSIDERATIONS

Regulated operations in historically challenging environment

Virtually all of UNSG's operations are regulated. Moody's generally views a significant percentage of regulated operations as positive for credit quality as regulated cash flows tend to be more stable and predictable than those of unregulated companies. This key factor is tempered somewhat by the regulatory environment of Arizona, which Moody's generally ranks below average for U.S. regulatory jurisdictions in terms of expectation of timely recovery of costs and predictability of rate decisions. Moody's also notes that three new commissioners began their term in January 2009 and it is not clear how or whether this might impact Moody's perception of the regulatory environment in Arizona over time.

Regulatory lag continues although moderating capital expenditures are a mitigant

UNSG's last fully litigated rate case was resolved in approximately 16 months with new rates in place reflecting a historic test year that ended two years before the decision. This level of regulatory lag makes adequate and timely recovery difficult to achieve. UNS Gas filed a general rate case in November 2008 requesting a $10 million rate increase (6%) premised on an 11% ROE and 50% equity ratio using a June 2008 test year end. A decision is expected by late 2009 or early 2010. Moody's expects further need for rate cases over the medium-term due to regulatory lag and on-going capital expenditures. The utility is not expected to earn its 10% allowed ROE during this time unless it receives adequate rate relief.

Capital expenditures were above $22 million annually from 2005-2007 but are expected to generally remain below $20 million over the near-term. Moderating capital expenditures reduces the need for regulatory relief though lag is expected to continue.

Effective recovery of purchased gas costs

UNSG has a gas cost recovery mechanism that appears to be functioning adequately. The Purchased Gas Adjustor mechanism may be changed monthly based on a comparison of rolling twelve-month average actual gas cost and gas costs in base rates, though there are limits to the levels of adjustments over a twelve month period. UNSG may also request a surcharge to recover deferred balances. As of March 31, 2009, UNSG had a $6 million over recovered purchased gas costs balance included as a current liability.

Due to the traditionally challenging regulatory environment in Arizona, as well as the uncertainty surrounding the impact of new commissioners, the regulatory supportiveness factor has been scored in the Ba range in the LDC methodology framework.

Non-regulated exposure and ring-fencing within UES is limited

Although UNSG's risk of exposure to non-regulated activities is considered quite modest as both UNSG and UNSE are fully regulated, there is significant interdependence between the UES subsidiaries in the form of a shared credit agreement and parental guarantee. Services are also shared with UniSource's primary regulated utility TEP. UNSG contributed approximately 63% of consolidated UES' EBIT and 14% of consolidated UNS' EBIT.

The Arizona Corporation Commission (ACC) has not restricted UNSG's ability to pay dividends to its parent; however, the utility has not paid a dividend over the last several years. There are dividend restrictions under the company's notes and credit agreement, but UNSG is well within the limits imposed by these documents. Overall, ring-fencing at UNSG maps within the Baa criteria outlined in the LDC Methodology.

Cross support of debt within UES constrains rating

The rating also recognizes the position of UNSE and UNSG as indirect subsidiaries of UNS through UES. UES is an intermediate holding company with no operations or debt. Debt at UNSE and UNSG is guaranteed by UES, which creates cross-support. UES has not historically received any dividend payments from its utility subsidiaries, and none are anticipated for the foreseeable future. UNS has periodically contributed equity to UNSG in support of its capital program and to strengthen its balance sheet.

Improved metrics provide credit support for weaker regulatory environment

Credit metrics overall reflect on-going regulatory lag issues as well as the benefits of cost controls, and a modest debt profile.

ROE, EBIT/Customer and EBIT/Interest

UNSG's average ROE, EBIT/Customer and EBIT/Interest have historically mapped to the lower Baa/high Ba level. In 2008, metrics improved moderately due to the impact of the base rate increase in late 2007 and slowing customer growth; however, they continue to map to the high Ba/low Baa level. UNSG's metrics could improve moderately within the Baa rating range if regulatory lag is reduced or the company receives better than anticipated rate relief.

RCF/Debt, Debt to Capitalization and FCF/FFO

UNSG's cash flow and debt-related credit metrics have historically mapped to the upper Baa/low A level. Retained and free cash flow have improved as UNSG has not paid dividends to its parent recently and capital expenditures have begun to decline. This has allowed retained earnings to increase equity capitalization and also reduce the need for new debt financing. Continued moderating levels of capital expenditures are expected to increase free cash flow and debt financing is expected to be minimal over the near-term. Beyond 2010, free cash flow is expected to once again become negative unless rate relief is better than anticipated. Over time, these metrics could improve to the low A range.

Liquidity Profile

UNSG's cash flow profile has generally been stable with operating cash flow approximately covering capital expenditures; however, in 2008, cash from operations of $2.8 million were significantly below capital expenditures of approximately $16 million. Cash on hand was used to meet the shortfall as cash flow was significantly impacted by collateral postings and refunds from over-recovered purchased gas costs. Over the near-term, capital expenditures of $19-21 million annually are expected to continue to be funded roughly by cash flow from operations.

UNSG has two $50 million issues of senior unsecured notes outstanding, one maturing in August 2011 and one maturing in 2015. UNSG's short term liquidity needs are supported by a joint UNSG/UNSE $60 million credit facility which matures August 2011. Either borrower may borrow up to a maximum of $45 million, so long as the combined amount does not exceed $60 million. As of March 31, 2009, there were no amounts drawn on the facility but UNSE had $17 million of letters of credit outstanding and UNSG had $5 million of letters of credit outstanding which reduced availability under the facility.

The UNSG/UNSE credit facility contains two financial covenants applicable to each borrower: for UNSE a maximum debt to capital ratio of 65% and a minimum interest coverage ratio of 2.25 times, for UNSG a maximum debt to capital ratio of 67%, and a minimum interest coverage of 2.25 times. As of March 31, 2009, the ratios were 54% and 4.01 times at UNSE and 50% and 4.02 times at UNSG. The credit facility requires a material adverse change (MAC) representation at each new borrowing. In Moody's opinion, the requirement of a MAC representation significantly increases the risk that the credit facility may not be available when liquidity needs are greatest.

Moody's assumes that UNSG will manage the amount of its near term obligations within the limits of its available sources of cash, including its committed bank credit facilities.

Rating Outlook

The stable outlook for UNSG reflects our expectations of continued stable or modestly improved cash flows resulting from expected rate case decisions, an assumption that any increases in the cost of gas will continue to be recovered on a relatively timely basis, and our understanding that future capital expenditures will be financed in a manner intended to maintain UNSG's current level of financial strength and flexibility.

What Could Change the Rating - Up

UNSG's rating is currently constrained by its interdependence with UNSE and our view of the consolidated credit quality of UES. In the event this interdependence was reduced while UNSG retained its similar credit profile, the rating or outlook could be revised upward. Alternatively, if there were to be an improvement in the consolidated credit quality of UES, this could result in positive rating action for UNSG.

What Could Change the Rating - Down

A downward revision could occur if there is deterioration in the credit quality or ratings of UES or UNSE or UNSG credit metrics decline to the low Baa/high Ba range, for example, RCF/Debt below 10% or EBIT / Interest coverage of less than 2x, or if regulatory support significantly worsens, then there could be a downward revision in the rating or outlook.

Rating Factors

UNS Gas, Inc.

Local Gas Distribution	Aaa	Aa	A	Baa	Ba	B	Caa
Factor 1: Sustainable Profitability (20%)							

a) Return on Equity (15%)				X			
b) EBIT to Customer Base (5%)				X			
Factor 2: Regulatory Support (10%)							
a) Regulatory Support and Relationship					X		
Factor 3: Ring Fencing (10%)							
a) Ring Fencing				X			
Factor 4: Financial Strength and Flexibility (60%)							
a) EBIT/Interest (15%)				X			
b) Retained Cash Flow/Debt (15%)			X				
c) Debt to Book Capitalization (excluding goodwill) (15%)				X			
d) Free Cash Flow/Funds from Operations (15%)			X				
Rating:							
a) Methodology Model Implied Senior Unsecured Rating				**Baa2**			
b) Actual Senior Unsecured Equivalent Rating				**Baa3**			

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF)
UNS GAS, INC. FOR THE ESTABLISHMENT)
OF JUST AND REASONABLE RATES AND) DOCKET NO.
CHARGES DESIGNED TO REALIZE A) G-04204A-08-0571
REASONABLE RATE OF RETURN ON THE)
FAIR VALUE OF THE PROPERTIES OF UNS)
GAS, INC. DEVOTED TO ITS OPERATIONS)
THROUGHOUT THE STATE OF ARIZONA.)

At: Phoenix, Arizona

Date: August 10, 2009

Filed: August 14, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME I
(Pages 1 through 238)

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:

itself to capital attraction on reasonable terms.

I mean, sustained low returns on equity does not incentivize any equity investor to put money into a company like UNS Gas when they can earn 11 to 12 percent in other gas utilities. It puts us at a competitive disadvantage.

So while I agree with you that relatively speaking we have made some progress, there are still many challenges that remain. And we do have the lowest investment grade credit rating, and we're concerned that, you know, if it went the other way, it went down, that would really complicate our effort to refinance the credit facility which matures in 2011. We have $50 million in notes that mature also in 2011. And we also have ongoing relationships with gas suppliers who can curtail the amount of credit they give us.

Q. Well, and that's -- if I may continue, Mr. Torrey -- that's sort of another question on that front. I mean, would it be easier to refinance that credit facility if you had no bond rating to begin with? I mean, you did start out with having no bond rating to begin with. So I'm wondering, why did you go after the bond rating? Was it a rate case strategy?

A. Just one second. Could I get some water?

Q. Okay. No, seriously. I'm wondering why you

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BEFORE THE ARIZONA CORPORATI[ON COMMISSION]

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AZ CORP COMMISSION
DOCKET CONTROL

COMMISSIONERS
KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
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BOB STUMP

IN THE MATTER OF THE 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 **STAFF'S INITIAL POST-HEARING BRIEF**

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UNSG is seeking an increase in its base rates of approximately $9.5 million, a 6 percent increase over its test year revenues. The effect on the proposed fixed monthly and delivery charges will be an increase of approximately 19% over test year revenues, exclusive of gas recovery costs. UNSG used a test year ending June 30, 2008.[2]

A[rizona Corporation] Commission
DOC[KET]ED

[1] Decision No. 70011 (November 27, 2007).
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In Decision No. 70441, the Commission revised the method of calculating operating income.[119] The Commission calculated operating income by multiplying the FVROR times the FVRB. The Commission used a FVRB that reflects a 50/50 weighting of OCRB, and the reconstruction cost new rate base ("RCND"). This Decision left the door open for adjustments to the adopted formula. Specifically, the Remand Decision states: "Although we believe that the cost of debt may reflect the effects of inflation, we are not convinced that the evidence presented in this proceeding is developed sufficiently enough to make that determination with certainty."[120]

Cost of capital is designed to apply to OCRB. When the concept of FVRB is introduced, the link between rate base and capital structure is broken. The amount of FVRB that exceeds OCRB is not financed with investor-supplied funds. Since the increment ("Fair Value Increment") between fair value rate base and original cost rate base is not financed with investor-supplied funds, it is logical and appropriate, from a financial standpoint, to assume that this increment has no financing cost. As a result, the cost of capital, through the capital structure, can be modified to account for a level of cost-free capital in an equal dollar amount to the increment of FVRB over the OCRB. Such a procedure would still provide for a return being earned on all investor-supplied funds and would thus be consistent with financial standards. Thus applying a 6.03% rate to the UNSG FVRB provides for a return on all investor-supplied capital.[121]

However, should the Commission determine that there should be a specific return (greater than zero) applied to the Fair Value Increment, Staff has offered an alternative calculation. It should not be necessary to provide for <u>any</u> return on the Fair Value Increment since this is not investor-supplied capital. However, the Commission may choose to evaluate this issue from both a financial and a public policy perspective.

The weighted cost of capital ("WCOC") authorized by the Commission has already provided for a full cost of equity return and cost of debt return on the portions of equity and debt capital that

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[120] Ex S-6 (Beale Direct) at 2-5.
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are supporting the OCRB portion of the FVRB. As a result, there is no need to provide any additional return on the portions of FVRB supported by common equity and debt.[122]

Stated differently, both the cost of debt and the return on common equity (i.e., capital stock, paid-in capital, and retained earnings - the investment of common shareholders) are already provided for in a traditional WCOC. Only the portion of the FVRB that exceeds OCRB ("Fair Value Increment") needs to have a specific return identified in order to reflect a return component on that Fair Value Increment.

If it is determined that it is desirable to provide an additional (non-zero) return on the Fair Value Increment, the proper return should be no larger than the real (i.e., after inflation is removed) risk-free rate of return.

The Staff alternative FVROR proposal incorporates a return on the Fair Value Increment with a maximum value of 2.5 percent. Staff proposes the mid-point of this range, or 1.25 percent. As a result, in the alternative Staff proposes a 6.36 FVROR for UNSG.

The Company is critical of Staff's methodology used to calculate the FVROR. Company witness Grant maintains that the Staff FVROR recommendation to apply a zero percent return to the Fair Value Increment amounts to a "backing in" method of assigning a FVROR.[123] This is incorrect. The Staff recommendation specifically recognizes the value of the FVRB increment and applies the actual cost of this capital (which is zero) to it. As such, Staff specifically recognizes and utilizes the FVRB in establishing rates.

Staff's recommendations are consistent with the Commission's directive on calculating FVROR and should be adopted.

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[122] The *UNSG Inc. Price Stabilization Policy* essentially sets a non-discretionary portion of forecasted gas load (minimum 45 percent) to be hedged with fixed price instruments at ratable quantities of 1/27th over 27 different months leading up to the physical flow month, excluding August, September and October.

[123] A.R.S. 40-252 is the statutory vehicle to amend or modify a Commission decision after notice and an opportunity to be heard is provided to the affected public service corporation.

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[121] TR 48:9-14.

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Supreme Court of Arizona.
ARIZONA CORPORATION COMMISSION; William T. Brooks, John H. Barry and Mit Sims, as members of said Commission, Appellants,
v.
ARIZONA WATER COMPANY, a corporation, Appellee.
No. 6649.

Feb. 11, 1959.

Actions, consolidated for trial, to determine fair value of water utility's properties for purpose of fixing rate bases and rates of return. The Superior Court, Maricopa County, Jesse A. Udall, J., entered judgment vacating and remanding four separate orders of Corporation Commission fixing the rate bases and rates of return, and commission and commission members appealed. The Supreme Court, Johnson, J., held that, where vendor and water utility properties took a price less than book value to achieve a tax saving of one and one half million dollars, a power contract worth a million dollars, as well as hundreds of thousands of dollars in interest, commission's finding that fair value was purchase price, plus additions subsequent to purchase, and finding that the earnings requirement was 5% of such amount were arbitrary and, therefore, improper.

Judgment affirmed.

West Headnotes

[1] Waters and Water Courses 405 ⚷203(10)

405 Waters and Water Courses
405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
405k203(10) k. Reasonableness of Charges. Most Cited Cases

In determining fair value of water utility properties for purpose of fixing utility's rate bases and rates of return, a reasonable judgment concerning all relevant factors is required on part of Corporation Commission, and fair value cannot be said to have been determined if commission abuses its discretion in considering such factors or refuses to consider all relevant factors. A.R.S.Const. art. 15, § 14.

[2] Waters and Water Courses 405 ⚷203(10)

405 Waters and Water Courses
405IX Public Water Supply
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In determining fair value of water utility properties for purpose of fixing rate bases and rates of return, weight to be given each relevant factor is matter within Corporation Commission's discretion so long as such discretion is not abused. A.R.S.Const. art. 15, § 14.

[3] Waters and Water Courses 405 ⚷203(10)

405 Waters and Water Courses
405IX Public Water Supply
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405k203(10) k. Reasonableness of Charges. Most Cited Cases

No special formula exists for determining fair value of water utility properties for purpose of fixing utility's rate bases and rates of return, but the Corporation Commission must establish the rate based on basis of fair value alone. A.R.S.Const. art. 15, § 14.

[4] Waters and Water Courses 405 ⚷203(10)

405 Waters and Water Courses
405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
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Where considerable time had elapsed since original construction of water utility, both original cost less depreciation and reproduction cost new less depreciation were relevant factors regarding determination of fair value of utility property for purpose of fixing rate bases and rates of return, and, therefore, Corporation Commission could be properly required, in determining such value, to consider evidence submitted as to both factors. A.R.S. § 40-254; A.R.S.Const. art. 15, § 14.

[5] Waters and Water Courses 405 203(10)

405 Waters and Water Courses
405IX Public Water Supply
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In fixing water utility's rate bases and rates of return on basis of fair value of utility property, fair value was to be determined as of time of inquiry before the Corporation Commission, and, therefore, commission would have to consider the original and reproduction costs of such property as of end of test period used in determining such value, rather than as of some earlier date, or of some average date. A.R.S. § 40-254; A.R.S.Const. art. 15, § 14.

[6] Waters and Water Courses 405 203(10)

405 Waters and Water Courses
405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
405k203(10) k. Reasonableness of Charges. Most Cited Cases

A water utility is entitled to a fair return on fair value of its properties devoted to public use, no more and no less. A.R.S.Const. art. 15, § 14.

[7] Waters and Water Courses 405 203(10)

405 Waters and Water Courses
405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
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In determining fair value of water utility's properties for purpose of fixing utility's rate bases and rates of return, purchase price as capital investment could not be considered, and considerations in arriving at purchase price were not necessarily those elements which comprised fair value, and, therefore, purchase price of the property would not constitute, as matter of law, its fair value, however, commission could, in its discretion, inquire into recent purchase transactions as evidence related to the fair value. A.R.S.Const. art. 15, § 14.

[8] Waters and Water Courses 405 203(12)

405 Waters and Water Courses
405IX Public Water Supply
405IX(A) Domestic and Municipal Purposes
405k203 Water Rents and Other Charges
405k203(12) k. Review by Courts and Injunction Against Enforcement. Most Cited Cases

Where vendor and water utility properties took a price less than book value to achieve a tax saving of 1 1/2 million dollars, a power contract worth a million dollars, as well as hundreds of thousands of dollars in interest, Corporation Commission's finding that, for purpose of fixing utility's rate bases and rates of return, fair value of the properties was purchase price plus additions subsequent to purchase and finding that the earnings requirement was 5% of such amount were arbitrary and, therefore, improper. A.R.S. § 40-254; A.R.S.Const. art. 15, § 14.

***200 **413** Robert Morrison, Atty. Gen., W. T. Willey, Sp. Asst. Atty. Gen., Walter Roche, Phoenix, Tom Fulbright, Florence, Charles W. Stokes, Coolidge, Eugene K. Mangum, Casa Grande, of counsel, for appellants.

Fennemore, Craig, Allen & McClennen, Phoenix, for appellee.

JOHNSON, Justice.

This is an appeal from a judgment of the Maricopa County Superior Court vacating and remanding, under A.R.S. § 40-254, four separate orders of the appellant Arizona Corporation Commission fixing the rate bases and rates of return of the appellee Arizona Water Company for its water utility properties located in and serving the towns of Florence, Coolidge, Casa Grande and Ajo Heights, respectively. Four separate actions were filed and were consolidated for trial, as the issues involved were identical. The trial court found that the Commission failed to determine the fair value of the Company's properties devoted to the public use at the time of the inquiry and that it failed to give the Company a fair return on such properties, thus in effect taking its property without due process of law.

The Arizona Water Company, on April 1, 1955, purchased water utilities properties located in ten Arizona towns for a lump sum price on the entire system. Shortly thereafter the Company petitioned the Commissiom for a determination, for rate-making purposes, of the fair value of the Company's properties serving the four communities above mentioned as well as for a determination of the needed earnings requirements of the Company based upon such fair values. Hearings were then held before the Commission in each of the four localities.

A test period of the most conveniently recent one-year period was agreed upon, as is the custom in the utilities field. At each hearing the Commission's own staff and ***201** the Company each presented testimony as to the percentage of the entire system which it felt should be allocated to each of the four towns. The Company presented evidence pertaining to the cost of reproduction new, less observed depreciation, for that portion of the utility properties serving each town, as well as evidence of year-end original cost less depreciation, which was the original cost as it stood on the books at the end of the test period, including all additions.

The staff presented evidence of the average original cost less depreciation of the Company's properties, taking the average between the original costs less depreciation at the beginning and at the end of the test period, there having been additions in the meantime. The Commission had in its files its records of its authorization of the Company's purchase of the entire system for $3,600,000 in April, 1955. The price was mentioned during the hearings but no testimony was taken concerning the entire transaction or the seller's reasons for accepting that amount, which was about 55% of the net book value. Mention was made of a prior determination by the Commission in 1951 of the fair value of the then much smaller system; this fair value ****414** amount was a good deal in excess of the purchase price later paid by the Company.

The Commission's orders, all dated October 25, 1956, in each instance stated the purchase price of the entire system, the percentage of the system allocated to that particular town and the resulting amount, and found that there had been supplies purchased and improvements made since that time and that a pro rata portion of operating expenses and other factors should be allowed. In each of its four orders the Commission found this total of purchase price plus additions and expenses to be the rate base, and allowed the sum of 5% of the rate base to be earned by the Company. The Company's applications for rehearings were denied.

The appellant Commission assigns as error a conclusion of law of the trial court that

'In the determination of the fair value of the Company's properties devoted to the public use at the time of the inquity, the Commission must, in each instance, consider the original cost less depreciation of the Company's property devoted to the public use at the end of the test period, together with reproduction cost new less depreciation of the Company's properties at the end of the test period, where such evidence is submitted.'

[1][2][3] We have stated that a reasonable judgment concerning all relevant factors is required in determining the fair value of the properties at the time of the inquiry. Simms v. Round Valley Light & Power Company, 80 Ariz. 145, 294 P.2d 378. If ***202** the Commission abuses its discretion in considering these factors or if it refuses to consider all the relevant factors, the fair value of the properties cannot have been determined under our Constitution. The weight given to each particular factor is entirely within the discretion of the Commission, so long as that discretion is not abused. The Constitution of Arizona, Article 15, Section 14, A.R.S., states that the Commission 'shall, to aid it in the proper discharge of its duties, ascertain the fair value of the property within the State of every public service corporation doing business therein; * * *.' No formula is given for determining fair value, and we do not attempt to prescribe one, but the Commission must establish the rate base on the basis of fair value and that alone. Round Valley case, supra.

[4] We do not believe that the trial court was in error in requiring the Commission to consider in this case both the original cost less depreciation and the reproduction cost new less depreciation where evidence on these factors is submitted. These factors are both relevant, particularly where there has been considerable time since the original construction of the utility.

[5] Since fair value is to be determined as of the time of the inquiry, Round Valley case, supra, the trial court was correct in requiring that the original and reproduction costs at the end of the test period, rather than those of some earlier date, or of some average date, be used. There may have been additions to or deletions from the properties of the utility after the beginning of the test period. Average costs, average earnings, average customers, et cetera, over the test period may be necessary in order for the Commission to get a fair earnings picture, as such a test period method avoids seasonal peaks and valleys in a utility's operations. But in finding the fair value rate base the only relevant original cost figure is that computed at the time of the inquiry, or as near as possible thereto. An 'average original cost' figure found by averaging the original costs less depreciation as computed at the beginning and at the end of the test period, thus roughly halving any additions or deletions, is simply not the original cost at the time of the inquiry and should not be used as regarding the physical property. The estimates of reproduction cost new less observed depreciation should also be as close to the time of the inquiry as possible.

The appellant Commission assigns as error the trial court's conclusion of law that

****415** 'Evidence of 'purchase price' is not a proper factor for consideration by the Commission in its determination of the fair value of the Company's properties devoted to the public use at the time of inquiry.'

The Commission contends that a recent purchase price is market value and that ***203** market value would be fair value as a matter of law. We think not. It would be almost impossible for a public utility to have a market value, as the term of commonly used, since such things are not routinely and commonly sold on the public market. But even so, there would be many elements and considerations involved in arriving at the price to be paid for a public utility which could be of no concern in arriving at the fair value. For instance, any price, 'market' or otherwise, would necessarily include the sale value of the utility's assurance of a fair rate of return and the fact that it operates as a monopoly. And consider the instant case, wherein testimony at the trial court revealed that the seller of the properties under consideration was willing to take a price less than the book value, because the transaction would give it a tax saving of one and one-half million dollars, a power contract worth a million dollars, as well as hundreds of thousands of dollars in interest.

[6] Here, the purchase price happened to be less than the book value of the properties; it could as easily have been a great deal more than the book value. This court has held that under our constitution the Corporation Commission must find the fair value of the properties devoted to the public use, and that in determining the fair value of Commission cannot be guided by the prudent investment theory nor can it use common equity as the rate base standard. Round Valley case, supra. The amount of capital invested is immaterial. Under the law of fair value a utility is not entitled to a fair return on its investment; it is entitled to a fair return on the fair value of its properties devoted to the public use, no more and no less. It has been stated that under this test it makes no difference whether the utility 'bought it, received it as a gift, or won it in a lottery.' Peoples Natural Gas Co. v. Pennsylvania Public Utility Comm., 153 Pa.Super. 475 34 A.2d 375, 381.

[7] Therefore, since the purchase price as capital investment cannot be considered, and since the considerations in arriving at a purchase price are not necessarily those elements comprising fair value, we hold that the purchase price of a public utility does not constitute, as a matter of law, its fair value.

However, the Commission must consider all available evidence related to the fair value, and an inquiry into a recent purchase transaction might be of assistance, in the discretion of the Commission. But the *reasons* for that purchase price and not the amount itself would be of first importance in shedding light on the fair value of the property. Certain facts concerning the physical condition of the properties, or what is actually used and useful, or the practical effects of particular business practices might thus be revealed more clearly. A purchase price which was a product of ***204** many considerations not relevant to fair value is, as a dollar figure, obviously not in itself necessarily indicative of the fair value of the properties sold. It is of course possible that the fair value might by coincidence be the same amount as that which had been paid in a purchase transaction. But this would be highly unlikely in a situation such as that in the instant case, where there is a great disparity between the purchase price on the one hand and the apparently undisputed and uninflated original cost and reproduction cost figures on the other.

[8] Thus, if the Commission had taken into consideration the entire recent purchase transaction it would not have been an abuse of discretion. But here the Commission considered only that part of the transaction concerning the amount paid to the seller, and in that respect it acted arbitrarily, as all relevant factors were thus not considered in finding the fair value of ****416** the properties. The trial court was correct in setting aside and remanding the orders finding the fair values of the properties to be the purchase price plus additions subsequent to purchase and finding the earnings requirements to be the sum of 5% of that amount.

The judgment of the trial court remanding the cause to the Commission for the determination of the fair value of the properties, a fair rate of return to be allowed thereon, and the affixing of just and reasonable rates is hereby affirmed.

PHELPS, C. J., and STRUCKMEYER, UDALL, and BERNSTEIN, JJ., concurring.
Ariz. 1959
Arizona Corp. Commission v. Arizona Water Co.
27 P.U.R.3d 412, 85 Ariz. 198, 335 P.2d 412

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Supreme Court of Arizona.
Mit SIMMS, William T. Brooks and Timothy D. Parkman, constiuting The Corporation Commission of the State of Arizona, Appellants,
v.
ROUND VALLEY LIGHT & POWER COMPANY, Appellee.
No. 5960.

Feb. 21, 1956.
Rehearing Denied June 12, 1956.

Action by power company against Corporation Commission to challenge rate reduction fixed by the commission. The Superior Court, Maricopa County, Ralph Barry, J., entered judgment setting aside commission's final order, and commission appealed. The Supreme Court, Windes, J., held that evidence was sufficient to sustain commission's finding of fair value.

Judgment reversed.

West Headnotes

[1] Public Utilities 317A 123

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak123 k. Reasonableness of Charges in General. Most Cited Cases
(Formerly 317Ak7.4)
Public utility, which is subject to regulation and fixing of rates, is entitled to realize a fair and reasonable profit from its operation in the service of the public. (A.R.S.) Const. art. 15, § 3.

[2] Public Utilities 317A 124

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak124 k. Value of Property; Rate Base. Most Cited Cases
(Formerly 317Ak75)

Electricity 145 11.3(3)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(3) k. Valuation of Property and Depreciation. Most Cited Cases
In determining rates to be charged by power company, Corporation Commission must find fair value of company's property and use such finding as a rate base for purpose of calculating what are just and reasonable rates, and reasonableness and justness of the rates must be related to the finding of fair value. A.R.S.Const. art. 15, §§ 3, 14.

[3] Public Utilities 317A 124

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak124 k. Value of Property; Rate Base. Most Cited Cases
(Formerly 317Ak75, 317Ak7.5)
Under constitutional provision that Corporation Commission shall prescribe just and reasonable rates for Public Service Corporations and that, to aid it in discharge of its duties, commission shall ascertain the "fair value" of property within state of every Public Service Corporation, quoted phrase is not to be considered as synonymous with "prudent investment", but quoted phrase means the value of property at time of inquiry, whereas "prudent investment" relates to value at time of investment and does not allow increase or decrease in cost of construction to influence the rates, as does phrase "fair value". (A.R.S.) Const. art. 15, §§ 3, 14.

[4] Electricity 145 11.3(3)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(3) k. Valuation of Property and De-

preciation. Most Cited Cases

Public Utilities 317A ⚷127

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak127 k. Depreciation. Most Cited Cases
(Formerly 317Ak7.8)

Where power company revised its average rate of depreciation from 4.37 to 3.28 percent and on basis of such change, adjusted this depreciation reserve back to the inception of the company at the lower depreciation rate, thereby reducing depreciation reserve theretofore accumulated to extent of $15,773, such sum was properly excluded in determining rate base, since company had accumulated such sum as part of depreciation reserve and had charged such sum to operating expense. A.R.S.Const. art. 15, §§ 3, 14.

[5] Public Utilities 317A ⚷124

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak124 k. Value of Property; Rate Base. Most Cited Cases
(Formerly 317Ak75, 317Ak7.5)

In absence of admitted change in material and labor costs since construction, original cost less depreciation of physical plant plus working capital and other items of value necessary to render service is a fair guide in determining rate to be charged by public utility corporation.

[6] Public Utilities 317A ⚷124

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak124 k. Value of Property; Rate Base. Most Cited Cases
(Formerly 317Ak75, 317Ak7.5)

Public utility companies are entitled to reasonable return upon fair value of their properties at time rate is fixed, and, with admitted or proved substantial change in cost of materials and labor, original cost can not be accepted as exclusive measure in determining value of utility properties to establish base to which fixed rate of return may be applied, but appropriate consideration must be given to factor of increased costs. (A.R.S.) Const. art. 15, §§ 3, 14.

[7] Public Lands 317 ⚷15

317 Public Lands
317I Government Ownership
317k9 Cutting and Removing Timber
317k15 k. Criminal Prosecutions. Most Cited Cases
(Formerly 317Ak15)

Evidence of present reconstruction costs of existing plant is at best opinion evidence and carries weakness of some inaccuracy, but Corporation Commission is entitled to reasonably determine the probative value of such estimates and is not compelled to find its value upon mere speculation and would not have right to close its mind to legitimate evidence related to current values, but only a reasonable judgment, which considers all relevant factors, is required in matter of evaluating utility properties for rate-fixing purposes. (A.R.S.) Const. art. 15, §§ 3, 14.

[8] Public Utilities 317A ⚷194

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(C) Judicial Review or Intervention
317Ak188 Appeal from Orders of Commission
317Ak194 k. Review and Determination in General. Most Cited Cases
(Formerly 317Ak32)

Corporation Commission, in exercising its rate-making power, has of necessity a range of legislative discretion, and, so long as such discretion is not abused, the court can not substitute its judgment for that of Corporation Commission as to what is fair value or just and reasonable rate. (A.R.S.) Const. art. 15, §§ 3, 14.

[9] Electricity 145 ⚷ 11.3(7)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(7) k. Judicial Review and Enforcement. Most Cited Cases

Public Utilities 317A ⚷ 194

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(C) Judicial Review or Intervention
317Ak188 Appeal from Orders of Commission
317Ak194 k. Review and Determination in General. Most Cited Cases
(Formerly 317Ak32)

In action by power company against Corporation Commission to challenge rate of reduction ordered by commission, trial court could not weigh evidence and make finding of fair value of company's property but could consider evidence only for purpose of determining whether the commission, in its finding of fair value, acted unreasonably in that their finding did not have substantial support in the evidence, was arbitrary, or was otherwise unlawful. A.C.A.1939, § 69-249 (A.R.S. § 40-254); A.R.S.Const. art. 15, §§ 3, 14.

[10] Public Utilities 317A ⚷ 194

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(C) Judicial Review or Intervention
317Ak188 Appeal from Orders of Commission
317Ak194 k. Review and Determination in General. Most Cited Cases
(Formerly 317Ak32)

Function of determining fair value of power company's property for purpose of rate-fixing was function delegated exclusively to the Corporation Commission and not the court (A.R.S.) Const. art. 15, §§ 3, 14.

[11] Electricity 145 ⚷ 11.3(3)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(3) k. Valuation of Property and Depreciation. Most Cited Cases

Public Utilities 317A ⚷ 127

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak127 k. Depreciation. Most Cited Cases
(Formerly 317Ak7.8)

In determining fair value of power company's property for rate-fixing purposes, Corporation Commission would have right to consider fact that, because of mechanical advances, existing plant of company carried a possible element of obsolescence. A.R.S.Const. art. 15, §§ 3, 14.

[12] Electricity 145 ⚷ 11.3(3)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(3) k. Valuation of Property and Depreciation. Most Cited Cases

Public Utilities 317A ⚷ 124

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak124 k. Value of Property; Rate Base. Most Cited Cases

Standard for establishing rate base for power company must be fair value of power company's property, not what Corporation Commission might believe is fair rate of return on common equity. A.R.S.Const. art. 15, §§ 3, 14.

[13] Electricity 145 ⚷ 11.3(7)

145 Electricity

145k11.3 Regulation of Charges
145k11.3(7) k. Judicial Review and Enforcement. Most Cited Cases
In action by power company against Corporation Commission to challenge reduced rate fixed by commission, evidence was sufficient to sustain commission's finding of fair value. A.R.S.Const. art. 15, §§ 3, 14; A.C.A.1939, § 69-249 (A.R.S. § 40-254).

***147 **379** Robert Morrison, Atty. Gen., Donald O. Corbitt and William T. Willey, Assts. to the Atty. Gen., for appellants. On the brief are James E. Hunter, Phoenix, and Robert C. Stubbs, Tucson.

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WINDES, Justice.

Appellant, the Corporation Commission of Arizona, entered upon an inquiry concerning the rates being charged by the appellee, Round Valley Light and Power Company, a public utility corporation. The appellant will be designated hereinafter as the commission, and the appellee as the company. A hearing was had and the commission entered an order requiring the company to reduce its rates. Thereafter, upon petition of the company, this order was suspended and another hearing held, after which the commission entered its second order requiring reduction in rates but changed the original order in some respects as will hereinafter appear. The company brought an action against the commission under the provisions of section 69-249, A.C.A.1939. The trial court entered judgment setting aside the commission's final order and the commission appeals.

***148** The problems presented are, first, whether the commission in its decision fixing the reduced rates is required to find the fair value of the company's properties being used to serve the public as a basis for the calculation of reasonable rates; and second, ****380** if the law requires the commission to find such value, whether and to what extent the commission must, in finding the same, consider the present reproduction cost less depreciation.

The accounting and engineering staff of the commission made an investigation, including an analysis of the books of the company. As a result of such investigation, the members of the staff at the first hearing presented evidence showing the original book costs of the property less accrued depreciation and customer advances to be $114,158. To this figure was added certain items not disputed herein such as materials and supplies, operating expense reserve, deposits, etc., which produced a total value of $128,884. It is clear that the original order did not take into consideration the reproduction cost of the property but essentially adopted the book cost less depreciation in finding the rate base.

On the second hearing the staff presented evidence showing original book cost of the property less accrued depreciation and customer advances to be $110,526, thereafter making certain additions not herein contested producing a total value of $127,017. This latter figure was recommended by the staff as the proper rate base.

On the rehearing the company submitted evidence concerning the value of the plant and started with the figure of $114,158 presented by the staff on the first hearing as the book cost of the property less depreciation and customer advances. To that figure it added $15,773 as a correction of the depreciation reserve allowed by the staff and added the items not herein contested, and thereby produced an historical cost of $147,238. To this the company added $28,136, which latter item according to the order of the commission was derived from 'Handy's Manual' used to trend historical costs upward to compensate for the difference between the historical and present costs of construction. The company by this calculation recommended a rate base in the sum of these latter items, or $175,374. Thus, it appears that the company presented to the commission evidence, which it asked the commission to accept, of a value for rate-making purposes of $175,374 based upon reconstruction costs less depreciation.

All of the foregoing evidence submitted to the commission on both the first and second hearings was introduced in evidence in the trial court. In addition to this evidence, the company in court presented further evidence consisting principally of an engineer's testimony of an actual detailed appraisement of the property. He testified that in his opinion the reproduction cost less observed depreciation was $193,947. After a slight adjustment the court's judgment recites this latter figure should be ***149** $192,678. After adding items not contested, the court found that the total value was $205,070; that the commission found 7.28 percent as a fair rate of return in the first order; but that it did not apply such rate to the fair value of the company's property. The court concluded as a matter of law that had the commission found the fair value, the rate of return of 7.28 percent in the first order would not have been unreasonable. In fact, the commission in its second order allowed a rate of return of 7.01 percent.

[1] It is elementary that a public utility subject to regulation and fixing of rates is entitled to realize a fair and reasonable profit from its operation in the service of the public. In establishing the rates that will produce the requisite return, a base figure must be found-the rate base. The troublesome questions arise when we approach the method used by the rate-making body in establishing this rate base. In the early case of Smyth v. Ames, 1898, 169 U.S. 466, 18 S.Ct. 418, 434, 42 L.Ed. 819, the Supreme Court of the United States in testing a legislative act fixing railroad rates ruled in effect that a rate-making body could not, without violating the due process and equal protection clauses of the Fourteenth Amendment to the United States constitution, require the company to commit its property to public service without allowing a fair and reasonable reward and the compensation to be allowed the company should likewise be reasonable from the standpoint of the public interest. The Court recognized that how fair compensation was to be determined would always be ****381** an embarrassing question, and then proceeded to state:

'We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And, in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there way not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth.'

***150** In State Of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission, 1923, 262 U.S. 276, 43 S.Ct. 544, 546, 67 L.Ed. 981, 31 A.L.R. 807, the Supreme Court struck down a rate base established by the public service commission of Missouri for the reason that it was founded principally upon original book costs and no consideration was given to reproduction costs. The Court said:
'It is impossible to ascertain what will amount to a fair return upon properties devoted to public service, without giving consideration to the cost of

labor, supplies, etc., at the time the investigation is made.'

In that case Justices Brandeis and Holmes concurred in the result but contended the rate base should be established by a finding of what amount was prudently invested in the enterprise.

Subsequent to announcing the test for arriving at a rate base in Smyth v. Ames, supra, the Supreme Court of the United States struggled with the difficult problem of determining the validity of rates that would be reasonable from the standpoint of both the company and public to be served but not until its decision in Federal Power Commission v. Hope Natural Gas Co., 1944, 320 U.S. 591, 64 S.Ct. 281, 288, 88 L.Ed. 333, did the Court in principle repudiate Smyth v. Ames, supra. In the Hope case the Court, in testing the reasonableness of rates fixed by the Federal Power Commission under the Natural Gas Act, 15 U.S.C.A. s 717 et seq., after holding that Congress had provided no formula by which just and reasonable rates were to be determined, ruled that it was the final result reached and not the method used in reaching the result that was controlling and that it was unimportant to 'determine the various permissible ways in which any rate base on which the return is computed might be arrived at.'

[2] The commission contends that its decision in fixing the company's rates can be said to be just and reasonable under the law as announced in the Hope case and, thus tested, the rates are lawful and should not be disturbed. Our constitution provides that the commission shall prescribe just and reasonable rates, Arizona Constitution, Article 15, section 3, and says that to aid it in the proper discharge of its duties the commission shall 'ascertain the fair value of the property within the state of every public service corporation * * *.' Arizona Constitution, Article 15, section 14. This court in construing these provisions of our constitution in the case of State v. Tucson Gas, Electric Light & Power Co., 1914, 15 Ariz. 294, 138 P. 781, 784, said:

'In order that the Corporation Commission might act intelligently, justly, and fairly between the public service corporations doing business in the state and the general public, section 14 was written into the Constitution * * *. ****382** The 'fair value of the property' of ***151** public service corporations is the recognized basis upon which rates and charges for services rendered should be made, and it is made the duty of the Commission to ascertain such value, not for legislative use, but for its own use, in arriving at just and reasonable rates and charges, and to that end the public service corporations are required to furnish the Commission all the assistance in their power.'

The foregoing pronouncement was subsequently approved in Ethington v. Wright, 1948, 66 Ariz. 382, 189 P.2d 209. While the interpretation concerning rate base was dicta in these cases, we approve the same. It is clear, therefore, that under our constitution as interpreted by this court, the commission is required to find the fair value of the company's property and use such finding as a rate base for the purpose of calculating what are just and reasonable rates. The Hope case cannot be used by the commission. To do so would violate our constitution. The statute under consideration in that case prescribed no formula for establishing a rate base. While our constitution does not establish a formula for arriving af fair value, it does require such value to be found and used as the base in fixing rates. The reasonableness and justness of the rates must be related to this finding of fair value.

[3] The commission argues that fair value as used in the constitution may be considered as synonymous with prudent investment. This theory we cannot approve. Fair value means the value of properties at the time of inquiry, State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission, supra, whereas prudent investiment relates to a value at the time of investment. Justice Brandeis' concurring opinion in State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission, supra. The former allows the increase

or decrease in cost of construction to influence the rates, whereas the latter makes no such allowance. Irrespective of the merits, if any, of the prudent investment theory, because of our constitution the commission cannot use it as a guide in establishing a rate base.

[4] The final order of the commission recites that the average rate of depreciation which the company had been taking was 4.37 percent; that in accordance with the recommendation of the staff this should be revised to allow an average of 3.28 percent; that the company, in calculating its recommended rate base of $175,374, adjusted its depreciation reserve back to the inception of the company at the lower rate of depreciation, thereby reducing the depreciation reserve theretofore accumulated and resulting in an enlarged rate base to the extent of $15,773. For this reason the commission deducted this latter item as not properly in the rate base. Its action in this respect was justified. The company having accumulated this reserve at the higher rate and having charged it to operating expense, this item of $15,773 could be legitimately deducted.

***152** There was evidence that the company is operating a mercantile business independent of its activities as a public utility. In operating this mercantile business, it used land, building, and fixtures, the total value of which was included in arriving at the plant value. Considering that some adjustment should be made by allocating some value to the portion of the property not used in rendering public service but used in connection with the mercantile business, the staff recommended a deduction of $2,621 from the rate base. The commission in its order stated that the company in its recommended base made no deduction for this item but held that some deduction should be made. How much the commission deducted for this latter item the commission did not say. Some subtraction was properly made for the portion of the property being used for purposes other than service to the public as a utility. After making these deductions the commission's order recites:

'In the instant proceedings, we think neither the Staff's original cost rate base $127,017.08 nor the Respondent's 'Trended Value' rate base or $175,374.27 to reflect present day inflated prices, are just and equitable for the ****383** determination of fair value for rate making purposes; and a fair figure lies somewhere between these limitations.

Conclusions and Order

'After full consideration and review of the evidence and testimony submitted upon the record, the Commission finds the fair value of the Company for rate making purposes in the sum of $136,667.00. The Commission further finds that after adjustments herein directed, including related taxes, the net operating income of the Utility Department pro-forma was $16,279.99 as set forth in detail on Table I appended hereto and made a part of this Order. A net operating income in the amount of $16,279.99 indicates a return of 11.91% on a rate base of $136,667.00 which the Commission finds to be excessive and otherwise beyond the reasonable limits of a fair return. The Company, therefore, is hereby ordered to reduce its rates in the amount of $10,350.00 per year which the Commission finds will produce a net operating income of $9,577.42 per year after adjustments for related taxes, and constitutes a return of 7.01% on a fair value of $136,667.00 which we deem to be within the limits of a fair return.'

It will be observed that the Commission after making the foregoing adjustments of the company's recommended rate base decided that neither the staff's recommendation based principally upon the historical costs nor the company's based principally upon the reproduction costs as established by trending upward the historical costs was a fair value for rate-making purposes. Assuming the commission deducted $2,621 recommended by the staff for allocation of ***153** value for the proportionate part used for the mercantile business, it made a further deduction of approximately $20,000 from the company's recommended reproduction cost which was the equivalent of adding approximately $9,600 to the staff's historical cost. and allowed a rate of return on this figure of 7.01 percent. The problem thus presented is whether the trial court was justified in setting this order aside.

[5][6] One of the most difficult tasks for a rate-making body is to properly value utility properties to establish a base that when related to the fixed rate of return will be just and reasonable to both the company and the consuming public. The methods used to reach this result have been productive of much litigation and debate. In the absence of an admitted change in material and labor costs since construction, the original costs less depreciation of the physical plant plus working capital and other items of value necessary to render the service is recognized as a fair guide. McCardle v. Indianapolis Water Co., 1926, 272 U.S. 400, 47 S.Ct. 144, 71 LEd. 316; Los Angeles Gas & Electric Corp. v. Railroad Commission, 1933, 289 U.S. 287, 53 S.Ct. 637, 77 LEd. 1180. With admitted or proven substantial change in the cost of materials and labor, the original cost cannot be accepted as the exclusive measure but appropriate consideration must be given this factor of increased costs. State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission, supra; Los Angeles Gas & Electric Corp. v. Railroad Commission, supra. This is necessary for the reason that the company is entitled to a reasonable return upon the fair value of its properties at the time the rate is fixed. State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission, supra; Willcox v. Consolidated Gas Co., 1909, 212 U.S. 19, 29 S.Ct. 192, 53 L.Ed. 382.

[7] The difficult question with which the courts have struggled is to determine how much consideration must be given this factor in order to bring the finding of value within the sphere of legality. It is well recognized that any evidence of what is the present reconstruction cost of an existing plant is at best opinion evidence and carries the weakness of some inaccuracy. It is based upon estimates. The commission is entitled to reasonably determine the probative force of these estimates and is not compelled to find its value upon mere speculation. Railroad Commission of California v. Pacific Gas & Electric Company, 1937, 302 U.S. 388, 58 S.Ct. 334, 82 LEd. 319. The commission would have no right ****384** to close its mind to legitimate evidence related to current values. Central Maine Power Co. v. Public Utilities Commission, 1954, 150 Me. 257, 109 A.2d 512. Consequently, the courts which hold that this factor or reproduction cost, if supported by legitimate evidence, must be allowed to influence the rate base in some degree generally rule that the rate-making body does ***154** not have to accept these estimates at full value. Georgia Railway & Power Co. v. Railroad Commission, 1923, 262 U.S. 625, 43 S.Ct. 680, 67 LEd. 1144; Chesapeake & Potomac Telephone Co. of Baltimore City v. Public Service Commission, 1952, 201 Md. 170, 93 A.2d 249. No set, rigid formula is required to be used. Only a reasonable judgment considering all relevant factors is required. Los Angeles Gas & Electric Corp. v. Railroad Commission, supra.

[8] The commission in exercising its rate-making power of necessity has a range of legislative discretion and so long as that discretion is not abused, the court cannot substitute its judgment as to what is fair value or a just and reasonable rate. Louisville & N. R. Co. v. Garrett, 1913, 231 U.S. 298, 34 S.Ct. 48, 58 L.Ed. 229. The legislative duty and power to fix just and reasonable rates having been by the constitution delegated exclusively to the corporation commission, the courts cannot disturb the commission's ultimate conclusion or findings of facts in arriving at such conclusion when the same is supported by substantial evidence, is not arbitrary or is not otherwise unlawful. Illinois Central Railroad Co. v. Illinois Commerce Commission, 1944, 387 Ill. 256, 56 N.E.2d 432; Central Maine Power Co. v. Public Utilities Commission, supra.

This rule is not in conflict with decisions of this court to the effect that on appeal from an order of the corporation commission the court may render an independent judgment on the question of public convenience. Corporation Commission of Arizona v. People's Freight Line, Inc., 1932, 41 Ariz. 158, 16 P.2d 420; Corporation Commission v. Southern Pacific Co., 1940, 55 Ariz. 173, 99 P.2d 702; Metropolitan Lines, Inc., v. Brooks, 1950, 70 Ariz. 344, 220 P.2d 480. These cases do not involve an express and specific constitutional grant of power to the administrative body.

[9][10] The company when before the commission submitted a reproduction cost less accrued depreciation plus working capital etc., resulting in a present fair value of $175,374. Included in this figure were two improper items as heretofore related. Likewise, the items added by the company to its estimated value exceeded the staff's additions by $815. In court the company submitted additional evidence presented in the form of an appraisement less observed depreciation plus working capital, etc., resulting in a current fair value of $206,338. The court weighed all this evidence and decided the fair value of the property was $205,070. The court may not weigh the evidence and make a finding of fair value. By the constitution this function is delegated exclusively to the commission. The legislature has the right to grant judicial review in the form of trial de nove as provided in section 69-249, A.C.A.1939, but when the court is testing the validity of rate-making power given to the commission under the constitution, the scope of that review cannot operate to permit the court to usurp, directly ***155** or indirectly, the commission's power thus given. The court may consider the evidence only for the purpose of determining whether the commission in its finding of fair value acted unreasonably in that its finding has no substantial support in the evidence, is arbitrary or otherwise unlawful. Had the appraisement been before the commission, it would not have been compelled to adopt its figures considering that there was other evidence warranting a lower figure.

[11] The company is no longer generating its own electricity but purchases the same from the Rural Electrification Administration, an agency of the Federal government, at a cost much less than when generating its own. The diesel plant theretofore used for generation is used merely as a standby plant. The engineer who made the appraisement, in calculating a reproduction cost less depreciation of this plant of $50,828, assumed the necessity of ****385** reconstructing an identical plant to the one now existing but testified that if one were reconstructing a standby plant today, it would not be of the same character. In other words, because of mechanical advances the existing plant carries a possible element of obsolescence. This certainly is a matter the commission would have the right to consider in arriving at present fair value. Chesapeake & Potomac Telephone Co. of Baltimore City v. Public Service Commission, supra.

If the commission had adopted as a base the company's recommended value of $175,374 and deducted the two items not legitimately contained therein, the allowable recommended rate base of the company could have been approximately $156,980, and the annual earnings of $9,577 would have given the company slightly in excess of six percent return on its own figures, reduced by legitimate deductions.

[12] The company contends the commission in arriving at just and reasonable rates first determined what the company should be allowed to earn in order to maintain a sound financial position, attract necessary additions to capital and pay a fair return on common equity; and second, having thus established the amount the company should be allowed to earn for such purposes, it proceeded to adjust the rate of return to any rate base. If this be true, it would be an illegal method of establishing a rate base. The standard for establishing a rate base must be the fair value of the property and not what the commission might believe was a fair rate of return on common equity. It is true that the amount the company is allowed to earn at 7.01 percent on the established rate base is approximately the amount required to pay 7.5 percent on common equity. This fact and the fact the commission contends that it

was not required to give weight to the factor of reproduction cost would warrant the inference that, possibly, this contention of the company is correct. We do not feel warranted,***156** however, in condemning the commission's order on inference when the face of the order indicates otherwise.

Counsel for the company in their brief say that it is not known by what formula the commission reached the rate base. In the trial court counsel said this figure was reached by taking the historical cost less depreciation plus six or seven thousand dollars as an adjustment for reproduction costs. This adjustment was actually approximately $9,600.

[13] We are unable to say and the trial court cannot be allowed to say that the commission's finding of fair value is without substantial support in the evidence or arbitrary. The judgment must be reversed, and it is so ordered.

LA PRADE, C. J., and UDALL, PHELPS and STRUCKMEYER, JJ., concur.
Ariz. 1956
Simms v. Round Valley Light & Power Co.
13 P.U.R.3d 456, 80 Ariz. 145, 294 P.2d 378

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BEFORE THE ARIZONA CORPORATION

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AZ CORP COMMISSION
DOCKET CONTROL

COMMISSIONERS
KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE 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

STAFF'S INITIAL POST-HEARING BRIEF

The Utilities Division of the Arizona Corporation Commission ("Staff") hereby files its closing brief in the above-captioned matter. In this brief, Staff will address the major disputed issues. On any issue not specifically addressed in this brief, Staff maintains its position as presented in its testimony.

I. INTRODUCTION.

UNS Gas, Inc. ("UNSG" or the "Company") is a public service corporation that provides natural gas distribution services to approximately 140,000 customers in Mohave, Coconino, Navajo, Yavapai and Santa Cruz counties in Arizona. UNSG was formerly a part of the Arizona local gas distribution operations of Citizens Communications Company, prior to its 2003 acquisition by UniSource Energy. UNSG, at the conclusion of a rate moratorium, filed an application for a rate increase in 2006. The Commission approved new rates for UNSG in November 2007.[1] UNSG filed an application for a rate increase on November 7, 2008.

UNSG is seeking an increase in its base rates of approximately $9.5 million, a 6 percent increase over its test year revenues. The effect on the proposed fixed monthly and delivery charges will be an increase of approximately 19% over test year revenues, exclusive of gas recovery costs. UNSG used a test year ending June 30, 2008.[2]

[1] Decision No. 70011 (November 27, 2007).
[2] Ex UNSG-16 (Dukes Direct) at 3.

In Decision No. 70441, the Commission revised the method of calculating operating income.[119] The Commission calculated operating income by multiplying the FVROR times the FVRB. The Commission used a FVRB that reflects a 50/50 weighting of OCRB, and the reconstruction cost new rate base ("RCND"). This Decision left the door open for adjustments to the adopted formula. Specifically, the Remand Decision states: "Although we believe that the cost of debt may reflect the effects of inflation, we are not convinced that the evidence presented in this proceeding is developed sufficiently enough to make that determination with certainty."[120]

Cost of capital is designed to apply to OCRB. When the concept of FVRB is introduced, the link between rate base and capital structure is broken. The amount of FVRB that exceeds OCRB is not financed with investor-supplied funds. Since the increment ("Fair Value Increment") between fair value rate base and original cost rate base is not financed with investor-supplied funds, it is logical and appropriate, from a financial standpoint, to assume that this increment has no financing cost. As a result, the cost of capital, through the capital structure, can be modified to account for a level of cost-free capital in an equal dollar amount to the increment of FVRB over the OCRB. Such a procedure would still provide for a return being earned on all investor-supplied funds and would thus be consistent with financial standards. Thus applying a 6.03% rate to the UNSG FVRB provides for a return on all investor-supplied capital.[121]

However, should the Commission determine that there should be a specific return (greater than zero) applied to the Fair Value Increment, Staff has offered an alternative calculation. It should not be necessary to provide for <u>any</u> return on the Fair Value Increment since this is not investor-supplied capital. However, the Commission may choose to evaluate this issue from both a financial and a public policy perspective.

The weighted cost of capital ("WCOC") authorized by the Commission has already provided for a full cost of equity return and cost of debt return on the portions of equity and debt capital that

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[119] Ex S-9 (Gray Direct) at 6-7.
[120] Ex S-6 (Beale Direct) at 2-5.
[121] TR 48:9-14.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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2009 SEP 18 P 4: 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 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

STAFF'S INITIAL POST-HEARING BRIEF

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[1] Decision No. 70011 (November 27, 2007).
[2] Ex UNSG-16 (Dukes Direct) at 3.

are supporting the OCRB portion of the FVRB. As a result, there is no need to provide any additional return on the portions of FVRB supported by common equity and debt.[122]

Stated differently, both the cost of debt and the return on common equity (i.e., capital stock, paid-in capital, and retained earnings - the investment of common shareholders) are already provided for in a traditional WCOC. Only the portion of the FVRB that exceeds OCRB ("Fair Value Increment") needs to have a specific return identified in order to reflect a return component on that Fair Value Increment.

If it is determined that it is desirable to provide an additional (non-zero) return on the Fair Value Increment, the proper return should be no larger than the real (i.e., after inflation is removed) risk-free rate of return.

The Staff alternative FVROR proposal incorporates a return on the Fair Value Increment with a maximum value of 2.5 percent. Staff proposes the mid-point of this range, or 1.25 percent. As a result, in the alternative Staff proposes a 6.36 FVROR for UNSG.

The Company is critical of Staff's methodology used to calculate the FVROR. Company witness Grant maintains that the Staff FVROR recommendation to apply a zero percent return to the Fair Value Increment amounts to a "backing in" method of assigning a FVROR.[123] This is incorrect. The Staff recommendation specifically recognizes the value of the FVRB increment and applies the actual cost of this capital (which is zero) to it. As such, Staff specifically recognizes and utilizes the FVRB in establishing rates.

Staff's recommendations are consistent with the Commission's directive on calculating FVROR and should be adopted.

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[122]The *UNSG Inc. Price Stabilization Policy* essentially sets a non-discretionary portion of forecasted gas load (minimum 45 percent) to be hedged with fixed price instruments at ratable quantities of 1/27th over 27 different months leading up to the physical flow month, excluding August, September and October.

[123] A.R.S. 40-252 is the statutory vehicle to amend or modify a Commission decision after notice and an opportunity to be heard is provided to the affected public service corporation.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	Docket No. G-04204A-08-0571

RUCO'S

INITIAL CLOSING BRIEF
(REDACTED)

estimated inflation, reducing the recommended OCRB overall rate of return ("OCROR") for estimated inflation, the calculation with the fair value rate base increment at zero cost and the calculation with the fair value rate base increment at 1.25%. Id. Reducing the OCROE for inflation resulted in an overall revenue increase of $4,649,000. RUCO-20, Schedule A, page 2. This result is way too high. Id. Reducing the OCROR for inflation resulted in a revenue decrease of ($524,000") which RUCO felt was much too low. Id. The third proposal considered – the calculation with the FVRB increment as zero cost resulted in an $800,000 increase which RUCO felt is also too low. Id. The last calculation – with a FVRB increment at 1.25% resulted in a revenue increase of $2,290,000 which RUCO felt was still far too high.

Similar to its practice in determining cost of equity, RUCO considered the range that resulted from the four calculations. RUCO recognized that the determination of the FVROR is not an exact science and at best an estimation. RUCO-21 at 10. The estimation, however, must have reasonable basis in order to derive a result that is both fair to the Company and fair to the ratepayer. Of course, the current state of the economy, as bad as it is, must also be factored into the equation. RUCO based its recommendation on how the FVROR has been developed since the Court of Appeals decision, the current economy and what makes sense and is fair and reasonable under the circumstances of this case. Id. RUCO used its discretion in recommending what it believes would be in the Commission's discretion a fair and reasonable rate of return in this matter.

RELIEF REQUESTED: The Commission should adopt RUCO's 5.38% FVROR.

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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 17, 2009

Filed: August 25, 2009

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME V

(Pages 733 through 808, 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. Right.

A. Okay. So 0.80 at $45 would add roughly $3 to the bill that I show on schedule H-4 of my testimony. There is no $45 per usage per therm, so I was extrapolating. The current bill for 35 therms per customer is $19 -- or $20. You would have to add to that the commodity cost of $3, so that is $23.

A customer using 50 therms is currently paying about $25. So you would have to add another $3 to that. So it's somewhere between $25 and $28 currently, and that includes the customer charge.

Q. I'm confused a little bit. If I multiply 45 therms times 80 cents, I get approximately $36, not $3.

A. Oh, I'm sorry. I --

Yes, you are right. I'm sorry. That's correct. So then the average bill would be $54 to $59.

Q. So the $5.50 is approximately 10 percent of the average bill; is that right?

A. That's correct.

Q. Okay. Do you also understand that the company is proposing a reduction in the non-gas volumetric charge with respect to the second and third phased in increases?

A. Yes, that would follow.

Q. And those were intended to create a revenue neutral situation for the average customer; correct?

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BEFORE THE ARIZONA CORPORATION COMMISSION

EXHIBIT
UNSG - 20
ADMITTED

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-____

Direct Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

November 7, 2008

V. RATE DESIGN.

Q. What are the Company's objectives in rate design?

A. The Company has two primary objectives in rate design: i) to more equitably collect the Company's fixed costs; and ii) to expand programs for our low-income customers in collaboration with interested stakeholders.

Q. Please summarize your rate design recommendations.

A. First, UNS Gas proposes an increase in monthly customer charges to levels that better match the true customer-related costs, as indicated by the class cost-of-service study. Under the class cost-of-service study, the "bare bones" monthly customer charges are calculated to be $18.15 for residential service, approximately $19.00 for small commercial/industrial customers and approximately $220.00 for large commercial/industrial customers. "Bare-bones" customer charges restrict the customer classification to metering, meter-reading, service (service drop) to the specific customer, customer service and billing. No demand-related distribution mains or distribution regulators are included, as they may be under a minimum system or zero intercept approach. The "bare-bones" approach leads to relatively low customer charges. However, we do not propose increasing monthly customer charges all the way to the charges suggested by the class cost-of-service study.

For residential service, the increases will be phased-in over two years. Phase 1 will go into effect upon approval of the rate increase. The Phase 2 and Phase 3 rate designs (implemented one year and two years, respectively, after rates go into effect in Phase 1) are based on approved test-year billing determinants, and are revenue neutral with respect to Phase 1 rates, in that test-year proposed revenue remains unchanged. UNS Gas proposes to increase residential customer charges from the current $8.50 per month to

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BEFORE THE ARIZONA CORPORATION C...

Arizona Corporation Commission
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COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR 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.

Conclusion

Although we understand that UNS would like to recover as much of its margin as possible through monthly customer charges, we do not believe it is reasonable to adopt a rate design that would impose a significant increase on customers based on where they live within the Company's service area. Under the Company's recommendation, residential customers with lower usage (*i.e.*, customers typically located in warmer climates) would bear the brunt of the revenue increase due primarily to the dramatic front-loading increase to the fixed monthly customer charge. As set forth in the UNS Final Schedules (based on UNS's proposed revenue requirement), in the "summer" months (April through November), a residential customer (R10) would experience an increase of 146 percent with 5 therms of usage, 118 percent with 10 therms of usage, and 82 percent with 20 therms of usage. During the "winter" months (December through March), the same customer would incur increases of 40 percent with 5 therms of usage, 28 percent with 10 therms of usage, and 13 percent with 20 therms of usage (UNS Final Schedules, Sched. H-4). While higher usage customers may realize lower increases, or even decreases (depending on usage), we do not believe that a dramatic increase imposed on lower usage customers is appropriate in this case. As we stated in the Southwest Gas Decision in rejecting a similar type of rate design proposal, "[such a] rate design would have the effect of encouraging greater usage of natural gas at a time when, by all accounts, an increase in demand for natural gas is coupled with shortages in supply. We do not believe that it is appropriate to send a signal to customers of 'the more you use, the more you save,'" (Decision No. 68487, at 37).

As discussed by Staff's witnesses, movement towards cost-based rates is just one of the many factors that must be considered in designing rates. The goal of moving closer to cost-based rates must be balanced with competing principles such as gradualism, fairness, and encouragement of conservation. Based on the testimony and evidence presented in the record, and considering the arguments raised regarding competing principles of the rate design equation, we believe that Staff's rate design recommendation appropriately makes significant movement towards cost-based rates and provides a reasonable level of protection for the customers who are affected by this base rate increase. Accordingly, we adopt Staff's recommended monthly charges, as set forth in the

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ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
KRISTIN K. MAYES, Chairman
GARY PIERCE
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IN THE MATTER OF THE 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 **STAFF'S INITIAL POST-HEARING BRIEF**

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[1] Decision No. 70011 (November 27, 2007).
[2] Ex UNSG-16 (Dukes Direct) at 3.

Company's proposal is actually a proposal for decoupling, as admitted by Company witness Bentley Edwurm.[45]

According to Mr. Edwurm, under the Company's proposal, in order for a customer to reduce the impact of the proposed customer charger, a customer would have to reduce usage by 25%.[46] He admits that, for such a reduction in usage, a customer would have to experience a substantial life style change.[47] As pointed out by RUCO witness Frank Radigan, the proposed change in the customer charge might be a disincentive to conserve.[48] Staff has proposed rates designed to recover the proposed base rate increase that are efficient, equitable, and would provide the Company the opportunity to recover its cost of providing service. The proposal by the Company could have an impact on conservation; with a high customer charge relative to volumetric charges, there could be a perceived disconnect between a customer's usage of natural gas and the cost of natural gas. This proposal should be rejected.

VI. COST OF CAPITAL.

In UNSG's previous rate proceeding, Staff Witness David Parcell stated that a utility's rate of return "is developed from the cost of capital, which is estimated by weighting the capital structure components (i.e., debt, preferred stock, and common equity) by their percentages in the capital structure and multiplying these values by their cost rates."[49] Thus, "[t]he first step in performing an analysis of the Company's cost of capital is the development of the appropriate capital structure."[50]

A. Capital Structure.

UNSG proposed using the June 30, 2008 test period capital structure of 49.99 percent common equity and 50.01 percent long-term debt.[51] Staff concurred.[52]

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[45] TR 425:22-25.
[46] TR 422:1-13.
[47] TR 469:1-3.
[48] TR 751:16-24.
[49] Docket No. G-04204A-06-0463, Parcell Direct, 5:18-21.
[50] Ex S-14 (Parcell Direct) at 2.
[51] Ex UNSG-13 (Grant Direct) at 8.
[52] Ex S-14 (Parcell Direct) at 3.

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BEFORE THE ARIZONA CORPORATION COMMISSION

EXHIBIT
UNSG-20
ADMITTED

COMMISSIONERS
MIKE GLEASON - CHAIRMAN
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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-____

Direct Testimony of

D. Bentley Erdwurm

on Behalf of

UNS Gas, Inc.

November 7, 2008

V. RATE DESIGN.

Q. What are the Company's objectives in rate design?

A. The Company has two primary objectives in rate design: i) to more equitably collect the Company's fixed costs; and ii) to expand programs for our low-income customers in collaboration with interested stakeholders.

Q. Please summarize your rate design recommendations.

A. First, UNS Gas proposes an increase in monthly customer charges to levels that better match the true customer-related costs, as indicated by the class cost-of-service study. Under the class cost-of-service study, the "bare bones" monthly customer charges are calculated to be $18.15 for residential service, approximately $19.00 for small commercial/industrial customers and approximately $220.00 for large commercial/industrial customers. "Bare-bones" customer charges restrict the customer classification to metering, meter-reading, service (service drop) to the specific customer, customer service and billing. No demand-related distribution mains or distribution regulators are included, as they may be under a minimum system or zero intercept approach. The "bare-bones" approach leads to relatively low customer charges. However, we do not propose increasing monthly customer charges all the way to the charges suggested by the class cost-of-service study.

For residential service, the increases will be phased-in over two years. Phase 1 will go into effect upon approval of the rate increase. The Phase 2 and Phase 3 rate designs (implemented one year and two years, respectively, after rates go into effect in Phase 1) are based on approved test-year billing determinants, and are revenue neutral with respect to Phase 1 rates, in that test-year proposed revenue remains unchanged. UNS Gas proposes to increase residential customer charges from the current $8.50 per month to

$10.00 per month when new rates are implemented. The proposed rates per therm (exclusive of gas commodity costs) are proposed initially (in Phase 1) to be $0.3920. One year after the rate implementation, UNS Gas proposes a $2.00 per month residential customer charge increase, bringing the customer charge to $12.00 per month in Phase 2. With the increase in the customer charge to $12.00, the volumetric charges will be lowered to achieve the approved revenue requirement. Revenue neutrality is maintained at the one-year mark by lowering rates per therm (exclusive of gas commodity costs) to $0.3479. In Phase 3, commencing two years after rates go into effect, the customer charge is increased to $14.00 and revenue neutrality is maintained at this two-year mark by lowering rates per therm (exclusive of gas commodity costs) to $0.3039. Even in Phase 3, the customer charge will still be less than the $18.15 "bare-bones" customer charge supported by the class cost-of-service study.

Customer charges for non-residential classes generally also are raised closer to levels indicated by the class cost-of-service study. UNS Gas is proposing customer charges of $15.50 for small commercial/industrial customers (from the current $13.50) and $105.00 for large commercial/industrial customers (from the current $100.00). The proposed commercial/industrial charges are aligned more closely to the true costs of providing service. Increased customer charges will aid in the recovery of fixed costs.

Q. Why are customer charges preferred to volumetric (per therm) charges in recovering fixed costs?

A. UNS Gas currently collects the bulk of its fixed costs through a volumetric charge. Within the residential class, however, the periodic variation in throughput has limited impact on the true, non-commodity cost of serving customers Because most non-commodity costs are fixed, there is a potential for a mismatch between costs and revenue if a substantial portion of revenue is recovered through weather-sensitive sales. To help

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BEFORE THE ARIZONA CORPORATION COMMISSION

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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:

that the customers see in the APS rates. I have a house here and --

Q. Can you talk into the microphone?

A. Oh, sorry.

I think that the customers are attuned to changing utility prices now, and I don't think that people pay a whole lot of attention to whether it's a PGA adjustment or a customer charge adjustment. I just think people, most people don't get into that. They look at their total bill.

I don't think that you would have too much customer acceptance problems, especially in light of the fact that the average customer would see the customer -- well, all customers would see the customer charge increase, but an average customer would see basically no net change in the bill because they would see a per therm decrease.

This is not a rate increase as we move forward. It is a revenue neutral redesign. And so with the customer charge increase comes a decrease in the non-gas price per therm, and the average customer wouldn't even see it.

Q. Well, that may be true on an average basis, but let's take the example of a customer who is attempting to reduce usage through either demand-side management type programs or just through efforts to reduce their bill. If they're using less gas than they were previously, this, in fact, would be an increase. The subsequent customer charge increases would cause an overall increase of the customer's bill, would it not?

A. The overall customer charge increase is $4 per month. If a customer were able to -- an average customer reduced his usage by 25 percent, which would be pretty hefty for most customers, they would still -- they would only be about $1 behind. They would see about a $1 increase, because they're still getting the lower per therm price on three quarters of the usage that they saw. So it's not going to be a $4 impact.

An average customer who reduces his usage by 25 percent is only going to see a net increase in a monthly bill of about $1. And in exchange for that, what you get is we are able to cover our fixed costs.

Actually, what you say may be a concern to a customer, first of all, I don't think it's as big of a concern as you're thinking it is, because it's not going to be a $4 change. An average customer reducing 25 percent is only going to see a $1 change.

But what it does is it allows us to cover the fixed costs that don't disappear when that customer does reduce. And I think when we move forward with energy efficiency and conservation, I think that's a good thing, not a bad thing, because --

Q. But isn't this -- doesn't this proposal defeat the whole purpose of encouraging customers to engage in reduced usage programs because --

A. No --

Q. Why not?

A. -- not at all. Because the largest part -- for instance, right now, our per therm noncommodity gas cost is around 33 cents per therm. Okay? Back in June of the test year end, the PGA portion, the purchased gas adjustor, was 82 cents a therm. So the lion's share of the variable cost, the lion's share of the price per therm is PGA. So when a customer is able to reduce his usage, the customer avoids the full gas cost.

All we're asking is that there be some consideration of the company that our fixed costs don't disappear. And so I think the customer still has plenty of incentive, because they still get to avoid the 82 cents per therm from the PGA. That's a pretty big incentive.

Q. What do you mean they get to avoid?

A. Well, if you reduce your usage, if you decide by conservation you're not going to use a therm, we don't charge the gas cost on gas that you don't use. So by reducing that, you've absolutely reduced your bill.

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Direct Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

November 7, 2008

recovered position, is the 3-month Financial Commercial Paper rate as published in the Federal Reserve Statistical Release H.15.

Q. Does this rate reflect the actual cost to UNS Gas of financing PGA cost deferrals?

A. No. Under the joint revolving credit facility shared with UNS Electric, UNS Gas may borrow at a rate of LIBOR plus 1.0%. This rate is typically much higher than the interest rate on commercial paper issued by large creditworthy financial institutions. As may be seen in Exhibit KCG-13, financial commercial paper rates and LIBOR tracked very closely to one another through mid-2007. However, since that time, rates on 3-month LIBOR borrowings have been significantly more expensive than rates on 3-month financial commercial paper. When the additional 1.0% credit margin is added to LIBOR to reflect the cost of short-term borrowing to UNS Gas, it is readily apparent that the financial commercial paper rate is not adequate in terms of providing full cost recovery to UNS Gas.

Q. What carrying cost do you recommend be applied to the Company's PGA balances?

A. I recommend use of the 3-month LIBOR rate as published by the Wall Street Journal ~~Federal Reserve~~, plus 1.0% to cover the additional margin that UNS Gas must pay for short-term borrowings.

Q. Is the Company recommending any other modification to the PGA mechanism adopted by the Commission in Decision No. 70011?

A. No.

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CARES Customer Analysis

Census data shows that around 27% of households in our service territory have household incomes less than or equal to 150% of the Federal poverty levels, and another 12% of households have incomes between 150% and 200% of poverty

Our CARES program has around 8,000 subscribers out of around 132,000 residential customers (May 2009).

Applying poverty percentages to our customer base, the customer estimates are:

Poverty Level	Customers	Share
150% or less	35,640	27%
150%-200%	15,840	12%
over 200%	80,520	61%
Total	132,000	100%

Applying a 22.4% low income program participation rate (actual current participation rate), the estimated subscription is:

Poverty Level	Participating Customers
150% or less	8,000
150%-200%	3,556

Rate impact on non-CARES customers of current CARES program and participation rate is approximately $4.00 per customer annually.

Rate impact on non-CARES customers if CARES program is expanded to 200% FPL and participation rate remains constant is approximately an additional $2.00 for an overall impact of $6.00 per customer annually.

EXHIBIT
UNSG 44
ADMITTED