ORIGINAL

0000103627

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

2009 OCT -5 P 3: 49

AZ CORP COMMISSION
DOCKET CONTROL

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE FO RETURN ON THE FAIR VALUE OF THE RPOPERTIES OF UNS GAS, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	DOCKET NO. G-04204A-08-0571 **STAFF'S POST-HEARING REPLY BRIEF**

The Arizona Corporation Commission ("Commission") Utilities Division Staff ("Staff") hereby files its Reply Brief in this matter in response to the arguments and assertions made in the initial closing briefs of the other parties to this matter.

I. SUMMARY OF STAFF'S POSITION.

Staff has considered the information presented and the arguments made by the various parties to this matter both at the hearing in this matter and in the various initial post-hearing briefs. However, Staff has not been persuaded that its findings and determinations were in error. Therefore, Staff continues to support the positions taken and the recommendations made in Staff's initial post-hearing brief.

II. RATE BASE.

As stated in Staff's initial closing brief, the most significant issues surrounding rate base that remain unresolved are the treatment of post test year plant and the treatment of customer advances.

A. <u>The Company's treatment of post test year plant is inconsistent with the Commission's established treatment of post test year plant.</u>

UNS Gas ("UNSG" or "Company") seeks inclusion in rate base of post-test-year plant in the amount of $1,527,888. Staff does not support the proposal. UNSG's assertion that Dr. Fish had "conceded that he did not review relevant Commission decisions concerning post test year plant in

preparing his testimony"[1] is simply irrelevant. Staff's recommendation to exclude post test year plant is not based upon any specific Commission precedent. It is based upon the standard ratemaking principle that revenues and expenses incurred during the test year must be matched to the rate base being used to provide service at the end of the test year. In that respect, Staff did not need to rely on any specific prior Commission decision because all prior Commission decisions have recognized this principle. The inclusion is the exception to the rule that UNSG must justify in order for the Commission to adopt its position. Staff simply sees no justification in the instant case for the Commission to do so.

UNSG has asserted that "[u]nder Staff's and RUCO's analyses, it appears that non-revenue producing Post Test Year Plant would never be included in rate base"[2] is incorrect, but even if true, would be irrelevant, since it is axiomatic that each and every case brought before the Commission must be decided on its own merits. In this case, UNSG has not sufficiently justified its proposed deviation from generally accepted ratemaking principles.

B. <u>UNSG's request to have customer advances included in rate base must be denied.</u>

For the same reason that Staff has recommended denial of the inclusion in rate base of post test year plant, Staff also recommends denial of UNSG's request to include Advances in Aid of Construction in rate base – to do so would be a violation of generally accepted ratemaking principles. One of the fundamental principles of ratemaking is that utilities are allowed to earn a reasonable return on the investment of its shareholders in plant being used to serve its customers. However, as Staff has previously stated, advances do not represent capital invested by shareholders. To allow shareholders to earn a return on money supplied by ratepayers would violate this fundamental premise. UNSG's request should be denied.

C. <u>Supplemental Executive Retirement Plan ("SERP").</u>

The SERP program is designed to assist UNSG's highest paid executives, those making more than $240,000 per year, in saving for retirement, at a time when a great many of UNSG's ratepayers,

---

[1] *UNSG Initial Post-Hearing Brief*, 3: 12-13.
[2] *Id.*, 5: 10-11.

who are being asked to fund the program, have either been laid off or are facing potential layoffs. These same ratepayers have seen their own retirement funds suffer in conjunction with the decline in financial markets. The program should be denied.

D. Rate Design.

In proposing a phased-in customer charge for its residential class, from $8.50 to $10.00 in the first year, to $12.00 in year two, and then $14.00 in year three, UNSG is seeking to capture more of its fixed costs through customer charges and make itself less reliant upon volumetric sales. Staff has recommended that the Commission reject this approach.

Despite UNSG's assertions that it "is not seeking to recover all of its fixed costs through the monthly charges,"[3] the ratemaking concept called "revenue decoupling", it readily acknowledges that its proposed rate design represents "another step towards realizing that goal to UNS Gas and its customers, which was started in the prior UNS Gas rate case."[4] The stated "goal" refers to "better matching customer charges to costs,"[5] the ratemaking concept called "revenue decoupling".

While, UNSG devotes a great deal of time extolling the value to the Company of recovering a greater amount of its fixed costs through fixed customer charges, the arrangement is not so attractive from a customer standpoint. If UNSG customers' monthly bills are composed of larger fixed charges and are tied only tangentially to the amount of product they consume, they will have very little incentive to conserve energy, since reduced usage will have very little effect on their overall bill. Even while attempting to downplay the seriousness of this, UNSG witness Erdwurm acknowledged that, if the Commission adopted UNSG's recommendation on the subject, UNSG customers would still be able to achieve savings through conservation as long as they were willing to undertake the substantial lifestyle change involved in reducing their energy consumption by 25%.

If customers attempt to reduce their energy consumption in an effort to reduce their bills, only to realize that their lifestyles will have to be significantly modified in order to do so, they simply won't do it. Staff believes that adoption of UNSG's proposed customer charges will reduce ratepayers' incentives to conserve energy and will result in reduced efforts to do so. For that reason,

---

[3] *Id.*, 40: 18-19.
[4] *Id.*, 40: 19-20.
[5] *Id.*, 40: 21.

the Commission should reject UNGS's proposed increases in customer charges and adopt Staff's recommended charges.

E. Cost of Capital.

Staff and UNSG both used the same financial models to calculate the proper ROE in this matter. Both parties arrived at a range of values using each methodology. The primary area of disagreement between the parties involved the assignment of risk. UNSG has asserted that Staff's ROE calculations are undermined by Staff's failure to adjust its ROE recommendation to reflect the "fact" that UNSG is "riskier than the sample group."[6] Staff did not adjust for greater risk because Staff does not believe that UNSG is more risky as an investment than other comparable utilities.

UNSG cites Staff witness Parcell's recognition of higher risk in a recent case involving Tucson Electric Power ("TEP") due to TEP's "[l]ower bond ratings … versus the bond ratings of the proxy companies" and a "[l]ower equity ratio … versus the proxy companies."[7] However, this comparison is incomplete. At the time Staff labeled TEP as higher in risk, TEP had an equity ratio of 39.90% and had a bond rating that was a mixture of investment-grade and non-investment-grade credit ratings. Staff arrived at a potential ROE range of 9.5% to 10.5% and, based upon TEP's riskier circumstances, chose 10.25%, which was slightly above the middle of the potential range.

In the instant matter, UNSG has reached a substantially higher equity ratio of 49.99% and has been assigned an investment-grade credit rating, making it substantially safer than TEP was under its circumstances. In addition, direct comparison with TEP is inappropriate, since UNSG will not access the capital markets directly, but rather through its parent company UniSource Energy. Staff's recommendation in this matter stands on its own merits.

UNSG asserts that Staff witness Parcell's recommended 10% ROE is inappropriate because it is "below the average ROE authorized for other utilities,"[8] and because it is less than the 11% ROE he recommended in a rate case involving Arizona Public Service ("APS"). As stated before, however, each rate case before the Commission is decided on its own merits. By its own statement,

---

[6] *Id.*, 27: 18-19.
[7] *Id.*, 27: 21- 28: 1.
[8] *Id.*, 33: 18-19.

UNSG acknowledges that there is an "average" ROE across multiple other utilities, which by definition means that these utilities do not all receive the same ROE.

UNSG makes no claim that there is anything inappropriate in this fact. UNSG simply complains that there exists a well-known utility that has been authorized the opportunity to earn a greater return. Since there is no impropriety in assigning various different utilities individual ROEs based upon their individual circumstances, there is nothing wrong with doing so for UNSG in this matter.

As for the complaint that APS was given a higher ROE, Staff would once again state that each rate case is decided on its own merits. UNSG has failed to show that the facts of the APS case and the facts of the instant matter are sufficiently similar to require an equivalent result. Given that APS is acknowledged as the largest utility in the State, and that UNSG admits that it is smaller than most of the utilities in its proxy groups (hence the claimed risk), it is difficult to imagine that UNSG would now assert for ROE purposes that its situation is so nearly identical to that of APS as to require identical ROEs.

Mr. Parcell testified that one of the factors he considered when settling on a 10% ROE in this matter was the fact that the Commission authorized the same 10% ROE in the previous UNSG rate case. UNSG agrees that the ROE should be set high enough to allow the utility the opportunity to earn a return that is great enough to "maintain its credit and to attract capital."[9] UNSG then asserts that Staff's recommendation fails to meet that standard, citing in support of the proposition Mr. Grant's testimony that UNSG has "historically not earned its authorized ROE."[10] But as UNSG readily admits "the analysis does not revolve around 'authorized' returns, but rather on actual earned returns." Since the Commission does not set actual earned returns, one must look to the 10% ROE the Commission authorized in the last UNSG rate case and see what the Company was actually able to accomplish with that ROE in order to determine whether what the Commission authorized was adequate under the standard.

---

[9] *Id.*, 34: 3.
[10] *Ex. UNSG-14,* Grant Rebuttal, at 23.

Despite UNSG's assertions that it failed to actually earn the 10% ROE authorized in that matter, what UNSG readily admits that it *was* able to do was to "steadily improve its equity ratio over time" and to "obtain an investment grade debt rating,"[11] which UNSG further acknowledges "would not have been possible without the Commission's assistance."[12] Since UNSG acknowledges that the standard for ROE is that the utility be able to *maintain* its credit, the 10% ROE authorized in the last rate case seems to have been more than adequate, considering that UNSG previously had no access to credit markets but now has managed to achieve an investment grade "debt rating of Baa3 from Moody's."[13] UNSG was able to significantly improve its credit rating.

In addition, the second aspect of the ROE requirement was that the utility be able to attract capital. Again, by UNSG's own admission, since the previous rate case decision, it has been able to steadily improve its equity ratio. Either UNSG has been able to attract new capital or it has been able to generate sufficient revenue that it has been able to reinvest in the company and pay down its debt. This, too is evidence that the 10% ROE set in UNSG's last rate case was sufficient to ensure the Company's financial health.

As Mr. Parcell testified, he saw nothing in his analysis that led him to believe that UNSG was any riskier an investment currently than it was at the time of the previous rate case. Therefore, the 10% ROE adopted in UNSG's previous rate case is appropriate at this time as well.

III. CONCLUSION.

Nothing that UNSG has filed in its initial brief leads Staff to believe that its initial recommendations were inappropriate. Therefore, Staff continues to support the positions it proposed in its initial post-hearing brief.

. . .

. . .

. . .

. . .

---

[11] *UNSG Intial Post-Hearing Brief*, 35: 13-14.
[12] *Id.*, 35: 14-15.
[13] *Ex, UNSG-19*, Moody's Report

RESPECTFULLY SUBMITTED this 5th day of October, 2009.

Robin R. Mitchell, Attorney
Kevin O. Torrey, Attorney
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and thirteen (13) copies
of the foregoing were filed this
5th day of October, 2009 with:

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

Copy of the foregoing mailed/emailed
this 5th day of October, 2009 to:

Raymond S. Heyman
Phillip J. Dion
Michelle Livengood
UNISOURCE ENERGY SERVICES
One South Church Avenue, Suite 200
Tucson, Arizona 85701
rheyman@uns.com
pdion@tep.com
athatcher@tep.com

Michel W. Patten
Jason D. Gellman
ROSHKA DEWULF & PATTEN, PLC
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004
mpatten@rdp-law.com
tsabo@rdp-law.com
mippolito@rdp-law.com

Daniel Pozefsky, Chief Counsel
RESIDENTIAL UTILITY CONSUMER OFFICE
1110 West Washington Street, Suite 220
Phoenix, Arizona 85007
dpozeksky@azruco.gov

Nicholas J. Enoch
Jarrett J. Haskovec
LUBIN & ENOCH, P.C.
349 North Fourth Avenue
Phoenix, Arizona 85003
Attorneys for IBEW Local 1116
nicholas.enoch@azbar.org

Cynthia Zwick
1940 East Luke Avenue
Phoenix, Arizona 85016
czwick@azcaa.org