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Subject: In The Matter Of The Application Of Tucson Electric Power Company For Approval Of New Partial Requirements Service Tariffs, Modification Of Existing Partial Requirements Service Tariff 101, And Elimination Of Qualifying Facility Tariffs., Arizona Corporation Commission Docket No. E-01933A-02-0345.

E-01933A-98-0471
E-01933A-02-0345

Arizona Corporation Commission
Docket Control
Attn: Ms. Viki Lasher
1200 West Washington Street
Phoenix, Arizona 85007

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Dear Ms. Lasher:

Enclosed for filing with the Arizona Corporation Commission are the original and ten copies of the Direct ~~Testimony~~ of Dan L. Neidlinger on behalf of the Department of Defense in the subject proceeding.

Copies of this Testimony have sent in accordance with the attached Certificate of Service. Inquiries concerning this matter may be directed to the undersigned at (703) 696-1644.

Sincerely,

Peter Q. Nyce Jr.
General Attorney
Regulatory Law Office

Enclosure

ARIZONA CORPORATION
COMMISSION

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Director of Utilities



BEFORE THE ARIZONA CORPORATION COMMISSION

TUCSON ELECTRIC POWER COMPANY

Docket Nos. E-01933A-02-0345 & E-01933A-98-0471

DIRECT TESTIMONY OF DAN L. NEIDLINGER

ON BEHALF OF

THE DEPARTMENT OF DEFENSE

SEPTEMBER 27, 2002

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**BEFORE THE ARIZONA CORPORATION COMMISSION
TUCSON ELECTRIC POWER COMPANY
Docket Nos. E-01933A-02-0345 & E-01933A-98-0471**

Direct Testimony of Dan L. Neidlinger

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

A. My name is Dan L. Neidlinger. My business address is 3020 North 17th Drive, Phoenix, Arizona. I am President of Neidlinger & Associates, Ltd., a consulting firm specializing in utility rate economics.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL QUALIFICATIONS AND EXPERIENCE.

A. A summary of my professional qualifications and experience is included in the attached Statement of Qualifications. In addition to the Arizona Corporation Commission ("ACC or the "Commission"), I have presented expert testimony before regulatory commissions and agencies in Alaska, California, Colorado, Guam, Idaho, New Mexico, Nevada, Texas, Utah, Wyoming and the Province of Alberta, Canada.

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. I am appearing on behalf of the United States Department of Defense ("DOD"). Two major DOD installations, Fort Huachuca located near Sierra Vista, Arizona and Davis-Monthan AFB located in Tucson, are served by Tucson Electric Power Company ("TEP" or "Company") under its Large Light & Power rate, Rate Schedule 14.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to comment, in general, on TEP's proposed partial requirements service ("PRS") tariffs and recommend certain changes to the Company's pricing proposals for partial requirements customers. My testimony does not address TEP's

proposed modification to the calculation of the Market Generation Credit ("MGC") under Docket No. E-01933A-98-0471.

II. TEP'S JUSTIFICATION FOR NEW PRS TARIFFS

Q. HAVE YOU REVIEWED THE DIRECT TESTIMONY OF MR. LELAND R. SNOOK, MANAGER OF CUSTOMER AND REGULATORY SERVICES FOR TEP?

A. Yes. Mr. Snook discusses the Company's rationale for filing new PRS tariffs at this time. He states many distributed generation ("DG") customers do not qualify for service under TEP's QF tariffs under PURPA and that the Company's full requirements tariffs are not designed to accommodate service to partial requirements customers.

Q. WHAT'S WRONG WITH PROVIDING SERVICE TO DG CUSTOMERS UNDER THE COMPANY'S CURRENT BUNDLED RATE SCHEDULES?

A. Mr. Snook states that the terms and conditions of TEP's full service requirement tariffs do not provide for PRS. He then states, starting on line 26, page 4 of his direct testimony, that providing service to DG customers under current rate schedules "would create an economic mismatch of costs and revenues that would result in a revenue shortfall". He continues on line 3, page 5, "If only the underlying assumptions for full customer utilization are changed, the cost to TEP of providing the transmission and distribution service will be the same, but there will be less customer usage from which TEP can recover the cost of service."

Q. DO YOU AGREE?

A. I do agree with the general proposition that full requirements tariffs are probably not appropriate for service to PRS customers. However, the economic mismatches that Mr. Snook discusses are largely the result of years of faulty ratemaking at TEP. PRS customers taking service under full requirements tariffs are merely taking advantage of inherent flaws in TEP's rates.

Q. PLEASE EXPLAIN.

A. TEP's current rates are the product of the incorrect costing and pricing methods used in past rate proceedings. As a result, the Company's commercial and industrial customers have been required to pay rates that exceed the cost to serve them. Price signals to these customers have been further blurred by improper rate designs; excessive amounts of demand costs are included in the energy component of TEP's commercial and industrial rates. Accordingly, customers with lower-than-average load factors, such as PRS customers, tend to under-recover demand related costs. Now, TEP is seeking to correct these rate design errors as related to PRS service.

Q. WHAT IS THE MAGNITUDE OF THE "WINDFALL" CURRENTLY REALIZED BY TEP'S PRS CUSTOMERS?

A. I don't know. The magnitude of the alleged windfall, in terms of dollars currently under-recovered, was not quantified by Mr. Snook. An estimate by TEP of current and future revenue shortfalls attributable to partial requirements customers would be helpful to the Commission in deciding this matter.

III. PROPOSED PRS TARIFFS

Q. HAVE YOU REVIEWED TEP'S PROPOSED PRS TARIFFS, PRS-10, PRS-13 AND PRS-14?

A. Yes. The Company is proposing three new rate schedules: PRS-10 for partial requirements service less than 200 kilowatts ("KW"), PRS-13 for partial requirements service from 200 KW to less than 3,000 KW and PRS-14 for partial requirements service of 3,000 KW and greater. In addition, the Company has proposed modifications to existing rate schedule PRS-101. The new PRS rate schedules include proposed customer, demand and energy charges for backup and/or standby service and separate demand and energy charges for supplemental service.

Q. HOW DOES THE COMPANY DETERMINE WHETHER A CUSTOMER SHOULD BE PLACED ON ONE OF THESE NEW TARIFFS?

A. The tariffs are silent on this issue. A definition of partial requirements is needed, expressed either as a percentage of maximum customer demand or, for larger customers, a defined level of self-generation capacity. Fort Huachuca, for instance, has a variety of experimental sources of energy generation that have been in operation for some time. These include a fuel cell and solar energy sources that provide an extremely tiny portion of the Fort's power requirements. Accordingly, the Fort should not, under any measure, be deemed a partial requirements customer.

Q. WHAT IS YOUR OVERALL REACTION TO THE PROPOSED PRS TARIFFS?

A. There are a number of problems, in my view, with the Company's proposals. First, the proposed rate design for the PRS tariffs is overly complicated with respect to small customers (less than 200 KW) and overly broad and economically unrealistic with respect to larger customers. Second, the proposed rates are based on load and cost information that is outdated. Finally, the method used to develop the rates does not accurately reflect, for certain cost components, the costs imposed by PRS customers on TEP's system.

Q. WHY IS THE PROPOSED TARIFF FOR SMALL CUSTOMERS, PRS-10, OVERLY COMPLICATED?

A. The proposed PRS-10 rate is comprised of customer, demand and seasonal energy charges for backup/standby service, demand and seasonal energy charges for supplemental service and a complicated market calculation for all generation-related charges. In addition, a variety of other calculations must be made (ratchets and PRUP) before a bill can be rendered. While appropriate for larger customers, these rate design elements represent "overkill" for the customers that would qualify for PRS-10 service. Full requirements customers in this class use, on average, only 3,880 kilowatt-hours ("KWH") per month. A simpler three-part rate, such as a seasonal time-of-use rate, is suggested as an alternative to PRS-10.

Q. WHAT ABOUT THE PROPOSED PRS-13 AND PRS-14 TARIFFS?

A. The scope of these tariffs, in my view, is too broad. These two rate schedules, and their common provisions, do not properly reflect the cost to service PRS customers with widely

varying demands (200 KW to 20,000 KW), load profiles and self-generation configurations. I suggest that partial requirements rates, with relevant terms and conditions, be developed on a case-by-case basis for these larger customers. This will ensure that the self-generation projects that are built by these customers are mutually beneficial to both the customer and the Company.

Q. HOW WERE THE PRS TARIFFS DEVELOPED?

A. The rates were developed using the Company's GS Rates 10, 13 and 14, bundled and unbundled. Average customer load factors for full requirements customers were used to calculate average unbundled costs, expressed as a percentage of the total average bundled rate. To develop the PRS rates, the unbundled component costs were increased, proportionately, based upon a bundled rate calculation assuming an average load factor of 10% for PRS customers. As a final step, 80% of energy costs were allocated to customer and demand costs (in contrast to the Company's traditional cost of service practice of allocating approximately 50% of demand costs based on energy).

Q. DO YOU HAVE ANY CONCERNS WITH RESPECT TO THIS RATE DESIGN PROCESS?

A. There are two. First, the information used to develop the rates is woefully outdated. The bundled and unbundled rates are based upon a 1996 cost of service study and the rate class load factor data is based upon load research from 1994. Accordingly, the Company's proposed rates should be revised based on updated cost of service and load research information. Second, the unbundled transmission demand costs used to calculate PRS rates are based on demand allocators (12CP and 4CP) for customer classes with load factors that are much greater than the assumed 10% load factor for PRS customers. Average load factors used in the Company's calculations for the GS-10, GS-13 and LLP-14 full requirements customers were 48%, 58% and 83%, respectively. A 10% load factor class of customers would exhibit much lower coincident demand factors and, accordingly, lower allocated transmission costs.

Q. WHY UPDATE COST OF SERVICE FOR ONE TARIFF – PRS-10?

- A. Updated costing, in the manner I have discussed, is needed not only to revise PRS-10 rates but also to provide better information for setting partial requirements rates for larger customers on a case-by-case basis

IV. SUMMARY CONCLUSIONS AND RECOMMENDATIONS

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATIONS WITH REGARD TO TEP'S PROPOSED PRS TARIFFS.

A. My conclusions and recommendations are as follows:

1. The need for TEP to file partial requirements tariffs at this time is largely due to flawed costing and pricing practices for its commercial and industrial customers;
2. The proposed PRS-10 rate schedule for small commercial customers should be simplified;
3. The proposed PRS-13 and 14 rate schedules should be discarded. Partial requirements service for customers with demands greater than 200 KW should be negotiated on a case-by-case basis; and
4. PRS rates should be revised based on updated cost of service and load research data; the updated cost of service analysis should reflect lower coincident transmission demand factors for partial requirements customers.

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

DAN L. NEIDLINGER

SUMMARY STATEMENT OF QUALIFICATIONS

I. General:

Mr. Neidlinger is President of Neidlinger & Associates, Ltd., a Phoenix consulting firm specializing in utility rate economics and financial management. During his consulting career, he has managed and performed numerous assignments related to utility ratemaking and energy management.

II. Education:

Mr. Neidlinger was graduated from Purdue University with a Bachelor of Science degree in Electrical Engineering. He also holds a Master of Science degree in Industrial Management from Purdue's Krannert Graduate School of Management. He is a licensed Certified Public Accountant in Arizona and Ohio.

III. Consulting Experience:

Mr. Neidlinger has presented expert testimony on financial, accounting, cost of service and rate design issues in regulatory proceedings throughout the western United States involving companies from every segment of the utility industry. Testimony presented to these regulatory bodies has been on behalf of commission staffs, applicant utilities, industrial intervenors and consumer agencies. He has also testified in a number of civil litigation matters involving utility ratemaking and once served as a Special Master to a Nevada court in a lawsuit involving a Nevada public utility.

Mr. Neidlinger has performed feasibility studies related to energy management including cogeneration, self-generation, peak shaving and load-shifting analyses for clients with large electric loads. In addition, he has conducted electric and gas privatization studies for U.S. Army installations and assisted these and other consumer clients in contract negotiations with utility providers of electric, gas and wastewater service.

Mr. Neidlinger has extensive experience in the costing and pricing of utility services. During his consulting career, he has been responsible for the design and implementation of utility rates for over 30 electric, gas, water and wastewater utility clients ranging in size from 50 to 25,000 customers.

IV. Professional Affiliations:

Professional affiliations include the American Institute of Certified Public Accountants and the Association of Energy Engineers.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Direct Testimony of Dan L. Neidlinger on behalf of the United States Department of Defense was sent to the parties on the attached service list either by Federal Express or by first class mail, postage prepaid on September 26, 2002.

Dated at Arlington County, Virginia, this 26th day of September 2002.


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