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BEFORE THE ARIZONA CORPORATION

COMMISSIONERS

BOB STUMP - Chairman  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH

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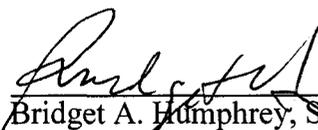
IN THE MATTER OF THE APPLICATION OF  
SOUTHWEST TRANSMISSION COOPERATIVE,  
INC. FOR A HEARING TO DETERMINE THE  
FAIR VALUE OF ITS PROPERTY FOR  
RATEMAKING PURPOSES, TO FIX A JUST AND  
REASONABLE RETURN THEREON AND TO  
APPROVE RATES DESIGNED TO DEVELOP  
SUCH RETURN.

DOCKET NO. E-04100A-12-0353

**STAFF'S NOTICE OF FILING DIRECT  
TESTIMONY**

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby files the Direct Testimony relating to rate design of Staff witness Dennis M. Kalbarczyk in the above-referenced matter.

RESPECTFULLY SUBMITTED this 22<sup>nd</sup> day of April, 2013.

  
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Scott M. Hesla, Staff 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 22<sup>nd</sup> day of April, 2013 with:

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

Arizona Corporation Commission  
**DOCKETED**

APR 22 2013

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

BOB STUMP  
Chairman  
GARY PIERCE  
Commissioner  
BRENDA BURNS  
Commissioner  
BOB BURNS  
Commissioner  
SUSAN BITTER SMITH  
Commissioner

IN THE MATTER OF THE APPLICATION OF ) DOCKET NO. E-04100A-12-0353  
SOUTHWEST TRANSMISSION )  
COOPERATIVE, INC. FOR A HEARING TO )  
DETERMINE THE FAIR VALUE OF ITS )  
PROPERTY FOR RATEMAKING PURPOSES, )  
TO FIX A JUST AND REASONABLE RETURN )  
THEREON AND TO APPROVE RATES )  
DESIGNED TO DEVELOP SUCH RETURN )  

---

DIRECT  
RATE DESIGN TESTIMONY  
OF  
DENNIS M. KALBARCZYK  
(CONSULTANT)  
ON BEHALF OF THE STAFF OF THE  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION

APRIL 22, 2013

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1 **I. INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Dennis M. Kalbarczyk. My business address is 910 Piketown Road, Harrisburg,  
4 Pennsylvania 17112.

5  
6 **Q. Have you previously submitted testimony in this proceeding?**

7 A. Yes. I previously submitted direct testimony on behalf of the Arizona Corporation  
8 Commission ("ACC" or "Commission"), Utilities Division ("Staff") in the review of  
9 Southwest Transmission Cooperative Inc.'s ("Southwest" or "SWTC") application for a  
10 general rate increase in the proceeding at Docket No. E-04100A-12-0353.

11  
12 The procedural schedule for this proceeding provided for the filing of Staff testimony  
13 addressing revenue requirement matters to be filed by April 4, 2013, and for testimony  
14 addressing rate design matters to be filed by April 22, 2013. I previously submitted direct  
15 testimony addressing revenue requirement matters. This supplemental testimony  
16 addresses rate design. My previous direct testimony set forth my professional background  
17 and experience.

18  
19 **Q. Please summarize the overall revenue increase impact, rate of return, Debt Service  
20 Coverage ("DSC"), and Times Interest Earned Ratio ("TIER") values based upon  
21 Liberty's recommendations contained in your direct testimony.**

22 A. Table 11 from my direct testimony (and provided here as well) addressed a downward  
23 adjustment to operating expenses of \$37,449 related to Memberships and Dues expenses, a  
24 net decrease to expenses and income, with no impact on margin. Mr. Vickroy's direct  
25 testimony filed on April 4, 2013, accepts SWTC's proposed 1.35 DSC ratio as appropriate  
26 for determination of the revenue requirement in this proceeding. Therefore, we recommend

1 no reduction to net/income or margin. SWTC's proposed \$12,757,213 revenue decrease  
2 along with Liberty's proposed additional revenue decrease of \$37,449 results in total  
3 proposed revenue decrease of \$12,794,662.  
4

5 SWTC's filing provided an analysis indicating that a 9.34 percent overall rate return value  
6 would result from using the traditional rate base rate of return approach. As described in my  
7 direct testimony, filed April 4, 2013, SWTC inappropriately reflected an increase of  
8 \$1,351,063 to rate base related to a corresponding increase in depreciation expense based  
9 upon new depreciation rates. The change in depreciation expenses does not impact net book  
10 values of assets at the end of the test year. Thus, the adjusted or lower rate base value would  
11 result in a 9.47 percent overall rate of return value.

**Table 11 – Summary Revenue Requirement Impact of Liberty's Recommended Adjustments**

	SWTC Pro Forma Request As-Filed			Liberty Recommended	
	Current	Change	Proposed	Adjustments	Proposed
Gross Revenue	\$46,434,286	(\$12,757,213)	\$33,677,073	(\$ 37,449)	\$33,639,624
Oper. Expenses	24,430,166		24,430,166	( 37,449)	24,392,417
Operating Income	\$22,004,120	(\$12,757,213)	\$ 9,246,907	\$ 0	\$ 9,247,207
Rate Base	\$99,009,871		\$99,009,871	(\$1,351,063)	\$97,658,808
Rate of Return	22.22%		9.34%		9.47%
Operating Income	\$22,004,120	(\$12,757,213)	\$ 9,246,907	\$ 0	\$ 9,247,207
Int. & Other Ded.	(5,170,450)		(5,170,450)		(5,170,450)
Other Income	307,780		307,780		307,780
Net Margin	\$17,141,450	(\$12,757,213)	\$4,384,237	\$ 0	\$4,384,237
Depr. & Amort.	4,033,584		4,033,584		4,033,584
Int. On L/T Debt	5,008,818		5,008,818		5,008,818
Avail For L/T Debt	\$26,183,852	(\$12,757,213)	\$13,426,639	\$ 0	\$13,426,639
Debt Service L/T	\$9,945,659		\$9,945,659		\$9,945,659
DSC	2.63		1.35		1.35

1 **II. BACKGROUND**

2  
3 **Q. What is the purpose of this testimony?**

4 A. I am addressing on behalf of the Staff SWTC's fully allocated cost of service study and  
5 proposed rate design as submitted by SWTC witness Gary E. Pierson. Table 11 above  
6 summarizes SWTC's proposed total cost of service compared to Liberty's recommendations  
7 based upon the proposed adjustments set forth in my direct testimony, previously filed. My  
8 current testimony discusses the overall concept in how rates are designed, including a general  
9 review of SWTC's rate design proposal to produce its total revenue requirement request.  
10 Additionally, I will provide the appropriate rate design necessary to produce Liberty's  
11 revenue requirement recommendation.

12  
13 **Q. Provide a brief overview of the rate design process.**

14 A. A fundamental criterion for establishing an adequate rate design is that it should reflect the  
15 cost of providing service to the customer or appropriate customer class based upon the  
16 cost causative factors commensurate with the customer or class service requirements. In  
17 order to determine appropriate rates, the total annual cost of providing service or the  
18 annual revenue requirement must be allocated among the various customers or customer  
19 classes based upon their respective cost causative factors. A detailed fully allocated cost  
20 of service study is generally performed to determine the cost of service for the respective  
21 customer classes. Then, an appropriate rate design is developed for the purpose of  
22 designing rates that will recover those costs. From a ratemaking perspective, rates based  
23 upon the fully allocated costs of service study ("COSS") are deemed to be cost-based.

1 **Q. Should rate design be based strictly on the COSS?**

2 A. No. While a cost of service study is a useful tool in determining the indicated cost of  
3 service for a customer or class service requirements in developing an appropriate rate  
4 design, the ultimate decision on rate design must also consider political, legal, or other  
5 social economic factors. For example, regulatory commissions traditionally consider such  
6 factors as: public reaction to changes in rates, impact of cost shifts from a group of  
7 customers that has been overcharged to a group that has been subsidized under existing  
8 rates requiring gradual shifts in cost requirements over time, reluctance to depart from rate  
9 forms that have existed for a long time, and special economic impact consideration to  
10 customer groups and the overall financial viability of the utility when setting rates. Thus,  
11 departure from rates based on cost of service is generally a decision made by the regulator  
12 and not the rate designer.

13  
14 **Q. Please explain your understanding of SWTC's requested change in rates.**

15 A. SWTC is a non-profit electric transmission cooperative subject to certain Federal Energy  
16 Regulatory Commission ("FERC") jurisdictional requirements. SWTC must comply with  
17 FERC Order 888 and maintain an Open Access Transmission Tariff ("OATT"). Consistent  
18 with FERC's OATT requirements, SWTC seeks approval of proposed monthly Network  
19 Services Rate, a Point-to-Point Service Rate, and an ancillary service rate for System Control  
20 and Load Dispatch, one of six ancillary service rates provided for under regulation. The next  
21 table summarizes SWTC's and Staff's proposed rates necessary to meet the total cost of  
22 service requirements, as compared to present rates, along with the respective percentage  
23 increase under said proposals.

Table 12 – Current and Proposed SWTC / STAFF Rates With % Change					
RATE DESCRIPTION	PRESENT	SWTC PROPOSED	CHANGE	STAFF PROPOSED	CHANGE
<b>Transmission Services:</b>					
Firm Network Service - \$ Monthly Rev. Req.	\$ 2,187,176	\$ 1,570,730	-28%	\$ 1,568,836	-28%
Firm Network Service - \$ Annual Rev. Req.	\$ 26,246,111	\$18,848,758	-28%	\$18,826,032	-28%
Firm Network Service – Mohave Electric 2 \$ Monthly Rev. Req.	\$ 2,056,562	\$ 1,251,434	-39%	\$ 1,247,255	-39%
Firm Network Service – Mohave Electric 2 \$ Annual Rev. Req.	\$ 24,678,748	\$15,017,214	-39%	\$14,967,065	-39%
Firm Point-to-Point Transmission - \$/kW	\$ 3.608	\$ 2.558	-29%	\$ 2.555	-29%
<b>Mandatory Ancillary Services:</b>					
Schedule 1 - Network - System Control & Load Dispatch - \$/kW/mo.	\$ 0.245	\$ 0.173	-29%	\$ 0.173	-29%
Schedule 1 - Point-to-Point - System Control & Load Dispatch - \$/kW/mo.	\$ 0.245	\$ 0.173	-29%	\$ 0.173	-29%
Schedule 2 - Network – Var. Support/Voltage Control - \$/kW/mo.	\$ 0.067	\$ 0.096	44%	\$ 0.097	44%
Schedule 2 - Point-to-Point – Var. Support/Voltage Control - \$/kW/mo.	\$ 0.049	\$ 0.070	41%	\$ 0.071	41%
<b>FERC Optional Ancillary Services:</b>					
Schedule 3 - Network - Reg. & Freq. Resp. - \$/kW/mo.	\$ 0.5325	\$ 0.2602	-51%	\$ 0.2589	-51%
Schedule 4 - Network - Energy Imbalance - Eng. In Kind +/- 1.5% \$/MWh	\$0	\$0	0%	\$0	0%
AEPCO Pays Positive Imbalance	\$ 36.68	\$ 32.63	-11%	\$ 32.63	-11%
Customer Pays Negative Imbalance	\$ 100.00	\$ 100.00	0%	\$ 100.00	0%
Schedule 5 - Network - Operating Reserves - Spinning - \$/kW/mo.	\$ 0.7060	\$ 0.7232	2%	\$ 0.7196	2%
Schedule 6 - Network - Operating Reserves - Supplemental - \$/kW/mo.	\$ 0.4981	\$ 0.5009	1%	\$ 0.4985	1%
<b>Direct Assignment Facilities:</b>					
Trico Electric Only - \$/mo.	\$ 133,210	\$ 133,210	0%	\$ 133,210	0%

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**III. ALLOCATED COST OF SERVICE STUDY**

**Q. Please describe SWTC'S allocated cost of service study and proposed rate design methods.**

**A.** I reviewed SWTC's COSS and proposed rate design methods. SWTC witness Pierson prepared a fully allocated cost of service study based upon SWTC's as-filed transmission

1 revenue requirement study; *i.e.*, total pro forma operating expenses less other revenues plus  
2 requested margin requirements. Witness Pierson's direct testimony (at pages 13-16) explains  
3 the underlying process and methods employed in preparing the study and proposed rate  
4 design. His testimony explains that SWTC is using the same cost allocation and rate design  
5 methods in this proceeding that it used in its prior rate proceeding. SWTC has used the same  
6 basic approach since it commenced operations in 2001. Witness Pierson's study updates the  
7 elements of the claimed, underlying revenue requirements and billing determinants, as they  
8 relate to the pro forma test period discussed by SWTC witness Pierson in his testimony  
9 (presented in Schedules A through F).

10  
11 **Q. What is your opinion of SWTC's fully allocated cost of service study and proposed rate**  
12 **design?**

13 A. I have reviewed SWTC witness Pierson's testimony, supporting exhibits, and workpapers,  
14 and SWTC's responses to interrogatories. SWTC provides the costs for ancillary services,  
15 broken down by FERC-defined types of ancillary services.<sup>1</sup> Additionally, SWTC provides a  
16 breakdown of the Direct Assignment Facilities ("DAF") costs and related monthly charge to  
17 which Trico, the only distribution cooperative member which has a DAF. I believe that the  
18 fully allocated cost of service study based upon the as-filed revenue requirements and  
19 proposed rate design methods is reasonably consistent with the prior rate case filing methods.

20  
21 **Q. Briefly describe your review process.**

22 A. I validated SWTC's allocated cost of service study calculations and the flow through of  
23 calculation results to the schedules submitted with SWTC's application. I reviewed the  
24 methods used to develop the underlying allocation factors. I examined the allocated costs  
25 that resulted from the application of these factors to the as-filed revenue requirement

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<sup>1</sup> See SWTC filing Schedule G-2A, pages 2-14.

1 elements for each rate-design component proposed by SWTC. I also compared the methods  
2 used here and in the prior rate-case filing. This review confirmed that the methods and  
3 approach here were the same as applied in the prior rate case filing.

4  
5 I confirmed that the derivation of the various transmission rates provided for under FERC  
6 Order 888 (firm or non-firm Point-to-Point and firm Network services and mandatory/option  
7 ancillary service charges) consistently used the same annual revenue requirement carrying  
8 costs elements to develop the fully allocated cost of service for each type of service to be  
9 provided. I also confirmed that the development of each respective rate was: (a) based upon  
10 the resultant allocated revenue requirement for each transmission service offered, and then  
11 (b) divided by the same appropriate billing determinant approach as used in the prior rate  
12 case proceeding. For example, the development of the firm Point-to-Point rate in the instant  
13 filing was based upon the annual transmission requirement divided by the coincident peak  
14 demand divided by 12 to arrive at the proposed monthly rate. The same approach was  
15 applied in the prior proceeding. Similar to the prior rate proceeding, the development of the  
16 Network annual service rate was based upon the product of the annual transmission revenue  
17 requirement less the Point-to-Point revenues divided by 12 to arrive at the proposed monthly  
18 rate. I did observe two minor errors in SWTC's schedules related to rate summary  
19 calculations, but they did not have any impact on the determination of the overall rate  
20 design.<sup>2</sup>

21  
22 My overall conclusion is that the approach used to develop rate design in the instant  
23 proceeding mirrors the approach used in the prior proceeding.

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<sup>2</sup> Schedule H-2, page 12.

1 **Q. Briefly identify the primary rates which SWTC requests that the Commission approve.**

2 A. The primary rates identified by SWTC in witness Pierson's testimony are: (a) Network  
3 Services Rate's monthly revenue requirement of \$1,570,730, (b) Point-to-Point Services Rate  
4 of \$2.558/kW month, and (c) a System Control and Load Dispatch Rate of \$0.173/kW  
5 month. In addition to the above, his study and rate design also reflect a MEC2 Network  
6 Services Rate's monthly revenue requirement of \$1,251,434.

7  
8 **Q. Are you recommending approval of SWTC's fully allocated cost of service study and  
9 rate design as-filed and requested?**

10 A. I have no reason to oppose SWTC's fully allocated cost of service study methods. However,  
11 I have proposed some minor adjustments to SWTC's pro forma test year revenue  
12 requirement, operating expenses, and rate base values. Additionally, I have submitted  
13 testimony in SWTC's rate case filing in which I also recommended adjustments to operating  
14 expense and rate base claims. Thus, I have updated the fully allocated cost of service study  
15 using SWTC's cost of service study methods, which incorporates these revenue requirement  
16 adjustments. The updated study includes my proposed rate design necessary to produce  
17 Staff's proposed revenue requirement and are attached to my testimony as DMK-Schedules  
18 G and H, respectively. In order to provide for ease of comparison, I used the same Schedule  
19 G and H references as those in SWTC witness Pierson's testimony and supporting exhibits.

20  
21 DMK- Schedule A-1 provides a proof of revenue by rate class which demonstrates that  
22 Staff's proposed rates and other revenues, with resultant decrease, will produce  
23 approximately the same \$12,794,662 revenue decrease as reflected in my direct testimony.

1 For the reasons noted herein, I recommend adoption of Staff's proposed rates as summarized  
2 in my testimony at Table 12 above.

3  
4 **Q. Are there any other rate design matters you would like to discuss at this time?**

5 A. Yes, Mr. Pierson briefly references SWTC witness Scott's testimony in which he proposes a  
6 Transmission Revenue Adjustor ("TRA") mechanism. While Mr. Pierson briefly describes  
7 the concept in which the TRA would increase or decrease based upon the loss or the  
8 acquisition of a long-term Point-to-Point transmission service agreement, he defers to Mr.  
9 Scott stating that he provides more details concerning the request. Mr. Pierson, at page 17 of  
10 his testimony, indicates that SWTC has not yet developed any precise tariff language to  
11 propose for the TRA at this time, noting SWTC only recently raised the concept with Staff  
12 indicating that SWTC anticipates filing such a request in this docket by the end of October  
13 (2012). However, I note that SWTC in a January 17, 2013 data request response stated that it  
14 still has not yet developed a specific tariff for such a proposal.<sup>3</sup> I note that SWTC did not  
15 provide any further detail regarding this matter during my initial field work on site in late  
16 January. Absent sufficient information to support the overall request from both a technical  
17 and procedural basis, Liberty cannot recommend acceptance of such a request at this time.

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<sup>3</sup> DK – 1.52.

1 **Q. Do you have any other comments with regard to the instant filing?**

2 A. Yes, I would like to retain the ability to amend my recommendations following any changes  
3 that may come to light as a result of further discussions, including updated cost information,  
4 possible stipulated issues and other various revenue requirement elements that may have an  
5 impact on revenue requirements.

6

7 **Q. Does that conclude your direct testimony?**

8 A. Yes, it does.