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**BEFORE THE ARIZONA CORPORATION (**

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IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR AN ACCOUNTING ORDER IN CONNECTION WITH THE ACQUISITION OF UP TO A 25% INTEREST IN GILA RIVER POWER PLANT UNIT 3.

DOCKET NO. E-04204A-13-0476

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

Staff of the Arizona Corporation Commission ("Staff") hereby files the Direct Testimony of Gerald Becker, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 28th day of October, 2014.

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Arizona Corporation Commission
DOCKETED
OCT 28 2014
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**Original and thirteen (13) copies of the foregoing filed this 28th day of October, 2014, with:**

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**Copy of the foregoing mailed this**
**28th day of October, 2014, to:**

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

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

| | |
|---|---|
| IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR APPROVAL OF AN ACCOUNTING ORDER IN CONNECTION WITH THE ACQUISITION OF UP TO A 25% INTEREST IN GILA RIVER POWER PLANT UNIT 3. | DOCKET NO. E-04204A-13-0476 |

DIRECT

TESTIMONY

OF

GERALD BECKER

EXECUTIVE CONSULTANT

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

OCTOBER 28, 2014

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**EXECUTIVE SUMMARY**
**UNS ELECTRIC, INC.**
**DOCKET NO. E-04204A-13-0476**

On December 31, 2013, UNS Electric, Inc. ("UNS" or "Company") filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to defer, for future recovery, non-fuel costs associated with the Company's prospective purchase of a 25% interest in Unit 3 at the Gila River Power Plant ("Gila 3") to supplant power that is presently purchased on the open market. Unit 3 has a capacity of 550 megawatts and costs $219 million of which Tucson Electric Power ("TEP") would purchase 75 percent and UNS would purchase 25 percent. While UNS is requesting an accounting order related to this planned purchase, TEP is not. The costs subject to deferral would include depreciation and amortization costs, property taxes, O&M expenses, carrying costs associated with owning, operating, and maintaining the plant, and other non-fuel Plant costs. UNS expects that these costs will be approximately $9 million by the end of 2015.

The direct testimony of Gerald W. Becker addresses the request for an accounting order.

Staff Recommendations:

Staff recommends denial of the accounting order as reflected in the application. First, the plan as filed by UNS would result in short-term bill reductions but would defer costs for later recovery, resulting in higher rates in a future proceeding. The short-term benefits via reductions would occur to the PPFAC ("Purchased Power and Fuel Adjustment Clause") rate, since only the fuel costs used at the proposed Gila 3 would be included in the current bills, as compared with the total cost of purchased fuel that would be reflected in the PPFAC absent the proposed purchase.

Staff has worked with the Company, and the Company has provided an alternative that Staff recommends. The alternative proposal would forego short-term bill reductions and help to keep customer bills more constant, and essentially defer the short-term savings to a future rate case when deferred savings and deferred costs would be evaluated together.

## I. INTRODUCTION

**Q. Please state your name, occupation, and business address.**

A. My name is Gerald Becker. I am an Executive Consultant III employed by the Arizona Corporation Commission ("Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

**Q. Briefly describe your responsibilities as an Executive Consultant III.**

A. I am responsible for the examination and verification of financial and statistical information included in utility rate applications. In addition, I develop revenue requirements, and prepare written reports, testimonies, and schedules that include Staff recommendations to the Commission. I am also responsible for testifying at formal hearings on these matters.

**Q. Please describe your educational background and professional experience.**

A. I received a Masters of Business Administration with an emphasis in Accounting from Pace University. I am a Certified Public Accountant and a Certified Internal Auditor.

I have participated in multiple rate, financing and other regulatory proceedings. I attended the National Association of Regulatory Utility Commissioners ("NARUC") Utilities Rate School.

I began employment with the Commission as a utilities regulatory analyst in April 2006. Prior to joining the Commission, I worked as an Auditor at the Department of Economic Security and Department of Revenue in the Taxpayer Assistance Section. Prior to those jobs, I worked for 15 years as an Auditor, Analyst, Financial Analyst, and Budget Manager at United Illuminating, an investor-owned electric company in New Haven, CT.

**Q. What is the scope of your testimony in this case?**

A. I am presenting Staff's analysis and recommendations regarding UNS Electric, Inc. ("UNS") request for an accounting order. The UNS accounting order would provide for the deferral of depreciation and amortization costs; property taxes; O&M expenses; carrying costs associated with owning, operating, and maintaining the Gila River Power Plant ("Gila 3"); and any other non-fuel plant costs associated with Gila 3. UNS expects that these costs will be approximately $9 million by the end of 2015.

## II. UNS' REQUEST FOR AN ACCOUNTING ORDER

**Q. Please provide a synopsis of the accounting order requested by UNS.**

A. UNS' proposed accounting order would authorize the Company to defer for future recovery:

(1) depreciation and amortization costs

(2) property taxes,

(3) O&M expenses,

(4) carrying costs[1] associated with owning, operating, and maintaining the plant, and

(5) other non-fuel Plant costs.

**Q. Did UNS provide language for the accounting order it requests?**

A. Yes, the language UNS provided is as follows:

"IT IS THEREFORE ORDERED that UNS Electric, Inc. is authorized to defer for possible later recovery through rates, all non-fuel costs (as defined herein) of owning, operating and maintaining up to an acquired 25 percent interest in Gila River Power Plant Unit 3 and associated facilities. Nothing in this Decision shall be construed in any way to limit this Commission's authority to review the entirety of the acquisition and to make any disallowances thereof due to imprudence, errors or inappropriate application of the requirements of this Decision.

[1] UNS originally proposed that carrying costs would be calculated using an average cost of debt of 5.97 percent as approved in Decision No. 74235 for UNS' recent rate case in Docket No. E-04204A-12-0504.

> IT IS FURTHER ORDERED that UNS Electric, Inc. shall reduce the deferrals by any fuel and purchased power savings and off-system sales not otherwise reflected in its Purchased Power and Fuel Adjustment Clause.
>
> IT IS FURTHER ORDERED that the accumulated deferred balance associated with all amounts deferred pursuant to this Decision will be included in the cost of service for rate-making purposes in UNS Electric, Inc.'s next general rate case. Nothing in this Decision shall be construed to limit this Commission's authority to review such balance and to make disallowances thereof due to imprudence, errors or inappropriate allocation of the requirements of this Decision.
>
> IT IS FURTHER ORDERED that UNS Electric, Inc. shall prepare and retain accounting records sufficient to permit detailed review, in a rate proceeding, of all deferred costs and cost benefits as authorized herein.
>
> IT IS FURTHER ORDERED that UNS Electric, Inc. shall prepare a separate detailed report of all costs deferred under this authorization and shall include that report as an integral component of each of its general rate applications in which requests recovery of those deferred costs.
>
> IT IS FURTHER ORDERED that UNS Electric, Inc. shall file an annual status report for each preceding calendar year, of all matters related to the deferrals, and the cumulative costs thereof every April 1 with Docket Control, as a compliance item in this Docket, with the first such report due not later than April 1, 2015.[2]

## III. STAFF'S ANALYSIS OF UNS' PROPOSED ACCOUNTING ORDER.

**Q. What is an accounting order?**

A. An accounting order is a rate-making mechanism occasionally authorized by regulatory authorities in order to provide regulated utilities the ability to defer costs that would otherwise be expensed under generally accepted accounting principles ("GAAP"). Such accounting orders provide for alternative rate-making treatment of capital costs and other costs via creation of regulatory assets and liabilities. Under GAAP, operations and maintenance ("O&M") costs are expensed in the period incurred. Therefore, a utility could not retroactively request recovery of these costs subsequent to closing its books for a prior

[2] Company application 7 -8

period. However, with the appropriate regulatory authority, a utility can defer costs incurred in one period for consideration for recovery in a future period.

**Q. Describe how the primary effects of accounting orders are recorded under the Federal Regulatory Energy Commission ("FERC") Uniform System of Accounts ("USOA")?**

A. The primary accounting effect of accounting orders is the creation of regulatory assets and liabilities. Regulatory assets and liabilities are assets and liabilities that result from rate actions of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses, gains or losses that would have been included in the determination of net income in one period under the general requirements of the USOA but for it being probable, due to actions of regulatory authorities, that: 1) such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services, or 2) in the case of regulatory liabilities, that refunds to the customers, not provided for in other accounts, will be required.

**Q. What reasons has UNS provided to support its request for an accounting order?**

A. UNS provided multiple reasons to support its request. First, UNS estimates that it will incur $9 million through 2015 in non-fuel expenses. Second, UNS states that the size of the investment ($55 million) represents approximately 28 percent of the original cost rate base approved in the most recently complete rate case. Third, the Company cites to its recent Integrated Resource Plan ("IRP") and Decision No. 73884 (May 8, 2013) which expressed concern regarding reliance on short-term market purchases. In its application, the Company cites:

> The cost and availability of such purchases are subject to a wide array of influences that are difficult, if not impossible to predict. For example, if a large number of older coal-fired generating plants are retired in the western region, the availability of such purchases will decline dramatically, and the cost of such purchases will increase significantly. Reliance on short term market purchases in a long-term plan is difficult, if not impossible, to justify. (Decision No. 73884, Page 4)[3]

The Company also cites to its own IRP plan:

> UNS Electric will monitor the market for economically attractive plant acquisition opportunities. A low cost, multi-owner acquisition of an existing combined cycle gas fired plant would enable UNS Electric to firm up its longer-term capacity needs while realizing economies of scale through a multi-owner plant configuration (UNSE IRP at Page 13)[4]

**Q. Does Staff agree with UNS' interpretation of its IRP per Decision No. 73884?**

A. No. In UNS' IRP plan, acknowledged in Decision No. 73884, Staff concluded that UNS should reduce its reliance on short-term purchases to meet its long term needs, and this could be achieved by pursuing long-term purchased power and not just the purchase of the power plant as the Company seems to represent in its application. Decision No. 73884 did not order UNS to buy a power plant, nor has UNS sent any proposals to secure long term power contracts as an alternative to purchasing Gila 3.

**Q. Regardless of the above clarification, does Staff recommend approval of changes to UNS' PPFAC calculation and the use of certain monies to cover certain costs of Gila 3?**

A. Yes. After discussions with the Company, the Company has provided the following revisions to its original proposal:[5]

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[3] Company application at 2

[4] *Id.*

[5] Email dated September 15, 2014 from Jo Smith, Sr. Director, Regulatory Services.

"Deferred Costs and Savings

> Non-fuel costs associated with owning, operating and maintaining UNSE's share of Unit 3 shall be deferred including: O&M expenses, depreciation and amortization expense, property taxes and carrying costs. Carrying costs are to be accrued on the Company's investment in the Plant at a debt cost of 5.0%, which is less than UNS Electric's 5.97% cost of debt adopted by the Commission in the Company's 2013 Rate Order (Decision No.74689).
>
> The cost savings and benefits (purchased power and capacity and short-term wholesale sales margins) resulting from ownership of Unit 3 that would otherwise be passed through the Company's Purchased Power and Fuel Adjustor Mechanism ("PPFAC") shall be deferred.
>
> The energy cost savings resulting from ownership of Unit 3 shall be based on the difference between the market value of Unit 3 energy production used to serve retail load, calculated using published on and off-peak market prices from the Intercontinental Exchange ("ICE") and (ii) the actual fuel costs for Unit 3 allocated to retail load.
>
> The avoided cost of capacity purchases shall be $1.52 per kW/month, which is based on 3rd party quotes for 2015 demand (capacity) options, which is approximately $2.5 million on an annual basis.
>
> The margin from short-term wholesale sales shall be based on revenues from short-term wholesale sales less the actual fuel costs for Unit 3 allocated to wholesale sales.
>
> Reductions to UNS Electric's purchased energy and capacity costs, and the increases in the margin on short-term wholesale sales, resulting from the ownership of Unit 3, shall be calculated monthly.
>
> The amount of these deferred cost savings recovered through UNSE's PPFAC shall not be included in the Accumulated PPFAC Bank Balance for purposes of calculating accrued interest."

**Q. Does Staff have any comments regarding the Company's revised proposal?**

A. Yes. Staff agrees that the avoided cost of capacity and energy should be based on a readily available market value. Staff clarifies that the energy savings should be calculated based on the difference between the non-firm market price of energy and the fuel cost to serve its native load, since the difference between the firm and the non-firm energy is already represented by capacity values calculated based upon the $1.52 per KW/month. Staff agrees that the net benefit of any wholesale value arising from the ownership of Gila 3 should also be deferred. The total of the deferral benefits associated with capacity, energy, and wholesale savings would continue to be included in the amounts subject to recovery via the PPFAC. The deferred benefits would be compared with eligible deferred costs for consideration in a future rate case.

**Q. Does Staff have any additional comments?**

A. Yes. Further discussion with UNS indicates that UNS expects the maximum amount of costs subject to deferral would be approximately $10.5 million[6] for the period January 2015 through April 2016. Accordingly, Staff concludes that the costs subject to deferral should have both time and dollar limitations. The maximum amount of costs subject to deferral should be $10.5 million and that any such deferral shall cease on May 1, 2016. Any expense incurred after April 30, 2016 would not be eligible for deferral.

Regarding the costs eligible for deferral, Staff recommends the exclusion of "other non-fuel plant costs" proposed by the Company because the term is overly broad. Any costs eligible for deferral should be specified at this time.

## IV STAFF'S ACCOUNTING ORDER RECOMMENDATIONS

**Q. What are Staff's recommendations regarding the Company's proposed accounting order?**

A. Staff recommends approval of an accounting order reflecting the Company's revised proposal subject to Staff's clarifications above. Staff recommends:

1. That costs subject to deferral be limited to:
    a. depreciation and amortization costs,

[6] The Company's original estimate of $9 million per year was revised and recalculated for the above time frame.

b. property taxes,

c. O&M expenses, and

d. carrying costs[7] associated with owning, operating, and maintaining the plant

2. that certain benefits of owning the plant shall also be deferred,

   a. the avoided cost of capacity should be based on the readily available market value as proposed by the Company,

   b. that that the energy savings related to power production at Gila 3 should be calculated based on the difference between the non firm market price of energy and the fuel cost,

   c. that the net benefit of any wholesale value arising from the ownership of Gila 3 should also be deferred,

3. that the value of deferred benefits shall be subject to inclusion in the Company's ongoing PPFAC calculations,

4. that the deferred costs and deferred benefits shall be evaluated in a future rate proceeding,

5. that the ratepayers be held harmless for any deferred costs in excess of deferred benefits,

6. that the amount of any deferred benefits in excess of deferred costs shall be used as a reduction to the running balance in the PPFAC arising from non - Gila 3 activity,

7. that any authorizations to defer costs shall be limited to $10.5 million,

8. that any authorizations to defer costs shall expire no later than May 1, 2016. Any expense incurred after April 30, 2016 would not be eligible for deferral.

9. that no prudency determination be made at this time and that the prudency of the purchase of Gila 3 will be determined in a future rate proceeding,

10. that there shall be no carrying costs on any under-recovered PPFAC balance resulting from the purchase of Gila 3, and

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[7] Calculated at 5 percent.

11. that the Company file a plan of administration within 30 days of the filing of this testimony for consideration and inclusion in the final decision.

**Q. Does this conclude your direct testimony?**

A. Yes.