

BEFORE THE ARIZONA CORPORATION COMMISSION

ERNEST GARFIELD
Chairman
AL FARON
Commissioner
BUD TIMS
Commissioner



IN THE MATTER OF THE APPLICATION OF)
TUCSON GAS & ELECTRIC COMPANY, A)
PUBLIC SERVICE CORPORATION, FOR)
DETERMINATION BY THE COMMISSION,)
FOR RATE-MAKING PURPOSES, OF THE)
FAIR VALUE OF ALL OF THE APPLICANT'S)
EXISTING PROPERTIES, OF A FAIR RATE)
OF RETURN, OF NEEDED REVENUES, AND)
FOR APPROVAL OF INCREASED RATES)
AND CHARGES BASED THEREON.)

DOCKET NO. U-1933
DECISION NO. 46930-A
OPINION AND ORDER

BY THE COMMISSION:

SUMMARY OF THE PROCEEDING

By way of introduction, the Commission herein incorporates by reference the text of the "Summary of the Proceeding" portion of its Decision No. 46930 as issued on April 30, 1976. On April 30, 1976, the Commission rendered said Decision No. 46930 with reference to Phase I of the instant proceeding. Therein it determined that the Applicant's fair value rate base should be established as \$553,000,000 and concluded that a fair rate of return of 8.67% should be allowed thereon. In this regard, the Commission authorized an operating income of \$47,945,000 and concluded that the Applicant's then effective rates produced a gross revenue deficiency of \$17,356,000. Accordingly, the Commission directed the Applicant to file revised electric and gas rate

schedules designed to earn the rates of return and operating revenues authorized for its electric and gas operations, respectively, said increased rates to be applied on a percentage basis as uniformly as is reasonably possible and to be effective with electric and gas consumption usage on and after May 1, 1976. Further, the Commission provided that the increase authorized should be subject to the prospect of refund to the extent that the Commission might thereafter determine that any classification of customers was entitled to a decrease in the authorized rates as a result of the Commission's decision on Phase II of the instant proceeding.

The Applicant filed its revised electric and gas rate schedules as directed and the same were made effective for consumption on and after May 1, 1976.

On May 19, 1976 the City of Tucson and eight other intervening parties of record (hereinafter collectively referred to as the "Joint Intervenors") filed a Petition For Rehearing requesting the Commission to rehear its Decision No. 46930 for the several reasons therein cited.^{1/} On May 20, 1976 the Attorney General, pursuant to the provisions of A.R.S. 40-253, filed a Petition For Rehearing wherein he requested a rehearing of Decision No. 46930. With one exception the reasons cited as the bases for the request for rehearing were identical in text in each Petition.

^{1/} The said Joint Intervenors were represented by the following Counsel or individual Intervenors of record, who were representing the several parties specified in the appearances of record as set forth as Appendix "A" hereto: James D. Webb; Marvin S. Cohen; Capt. Robert H. Dolle, USAF; Edward C. Vincent; Dwight M. Whitley, Jr.; Dan Cavett; Michael Addis; Charles A. Knowles; and Michael Levkowitz.

Subsequent thereto, the Commission's Executive Secretary provided official public notice that the Commission would consider the aforesaid Petitions For Rehearing at its regular meeting scheduled for June 2, 1976 in the Commission's Administrative Offices. On June 2, 1976, the Commission issued its Decision No. 47031. Therein it indicated it was desirous of correcting such errors of law or fact as may exist, but observed it was unable at that juncture to intelligently pass upon the contentions of the petitioners pending further specifications. Accordingly, it requested the Joint Intervenors and the Attorney General to file Statements of Position describing with specificity the precise manner in which it was believed the Commission had erred with respect to each of the averments set forth within each numbered paragraph of the Petitions For Rehearing. The Commission further requested that the Applicant file a Statement of Position describing its position with respect to the errors of law and fact alleged within the Petitions For Rehearing and further specified in the Statements of Position. In addition, the Commission provided for oral argument before the Commission on June 24, 1976 upon the question of whether Decision No. 46930 should be abrogated, changed or modified in any respect. In order to provide for these events, the Commission extended to and including July 1, 1976 the time for ruling on the Petitions For Rehearing.

Statements of Position were filed by the Attorney General and the Joint Intervenors, Intervenor Levkowitz in his individual capacity, and the Applicant within the filing dates provided in Decision No. 47031. On June 21, 1976, the Commission's Executive Secretary provided official public notice that the Commission would convene in a regular meeting upon conclusion of

the oral arguments of the parties on the Petitions For Rehearing and the Statements of Position for the purposes of (i) determining whether Decision No. 46930, or any part thereof, should be abrogated, changed or modified, and (ii) in the event it was determined some action was in any respect appropriate, to take such action and to further deliberate upon the application of the Applicant and render a final decision thereon.

On June 24, 1976 the Commission received oral argument on the Petitions For Rehearing and the Statements of Position. Messrs. Holub and Cohen presented the argument for the Joint Intervenors, and the representative for the Attorney General adopted that argument. Mr. Levkowitz presented argument with respect to his individual Statement of Position. Mr. Robertson presented oral argument on behalf of the Applicant. At the close of oral argument, the Commission took under advisement the question of whether or not Decision No. 46930 should be abrogated, changed or modified in any respect and continued its formal deliberations thereon until June 28, 1976 at its Administrative Offices. The Commission also continued its previously noticed regular meeting upon the subject until that date.

On June 28, 1976, the Commission publicly determined as a result of its consideration of the Petitions For Rehearing and the Statements of Position, together with the oral argument thereon, that certain portions of its Decision No. 46930 should be reconsidered. Thereupon, the Commission proceeded within the context of its previously noticed and continued regular meeting to reconsider its Decision No. 46930 and to deliberate upon the nature of modifications, if any, that should be made with respect thereto. The results of the Commission's determinations and its decision in this regard are set forth

below in this Opinion and Order which, in some respects, modifies Decision No. 46930 in accordance with the Commission's authority under A.R.S. 40-253(F).

SUMMARY OF THE COMMISSION'S DELIBERATIONS

The two principal questions to be resolved by the Commission incident to arriving at the rate-making determinations required of it relative to Phase I of the instant proceeding are as follows:

(1) What is the fair value of the properties of the Applicant that are used and useful in rendering service to the public; and

(2) What constitutes a fair and reasonable rate of return thereon?

In resolving these questions, and related matters, we have considered the evidence of record and applicable law, the Opening and Reply Briefs as filed by various parties, the recommendations of the Hearing Officer, the Exceptions filed by the Applicant and the Industrial Intervenors and the City of Tucson, and the Petitions For Rehearing and the Statements of Position hereinabove described, together with the oral argument thereon. Our determinations thereon are set forth below by topic.

Original Cost ("OCLD") Rate Base:

The Commission hereby affirms and incorporates by reference its discussion of and determinations upon the original cost rate base issues set forth under items (i) through (v) at pages 4 and 5 of Decision No. 46930. In this regard, the Commission expressly states for the record that its determinations have not been influenced by the decision of the Superior Court in Arizona Public Service Company v. Arizona Corporation Commission, et al (Civil No. C324342).

Reproduction Cost New ("RCND") Rate Base:

The Commission hereby affirms and incorporates by reference its discussion of and determinations upon the reproduction cost new rate base issues set forth at page 5 of Decision No. 46930. In this regard, the Commission expressly states for the record that its determinations have not been influenced by the decision of the Superior Court in Arizona Public Service Company v. Arizona Corporation Commission, et al (Civil No. C324342).

Fair Value Rate Base:

In establishing the fair value of the properties of the Applicant to be recognized for rate-making purposes in this proceeding, the Commission has reconsidered its earlier determination upon the question of the weighting to be assigned the original cost and reproduction cost new components of fair value rate base. In this regard, the Commission has determined to use a weighting ratio of 50/50 as reflected in the Findings of Fact set forth below.

Rate of Return:

After due consideration of the matter, and with appropriate reference to the Simms and Sun City decisions, the Commission has determined that a return of 8.66% constitutes a fair and reasonable total company return upon the fair value of the Applicant's properties which were used and useful in serving the public during the test period. Such a rate of return contemplates a return on common equity of 15.25%, which we believe represents a fair and reasonable return thereon from the perspectives of both the Applicant and its common equity investors and the ratepayers and one supported by the evidence.

As between the Applicant's electric and gas properties, we conclude

that the fair and reasonable rates of return are 8.61% and 9.24%, respectively.

Net Operating Income:

The Commission hereby affirms and incorporates by reference its discussion of and determinations upon the test period operating income to be utilized for rate-making, as set forth under items (i) through (v) at pages 6 and 7 of Decision No. 46930. In this regard, the Commission expressly states for the record that its determinations have not been influenced by the decision of the Superior Court in Arizona Public Service Company v. Arizona Corporation Commission, et al; rather, the Commission's determinations are based upon what it deems to be sound regulatory practice with reference to the facts of the instant proceeding.

The Commission further affirms and incorporates by reference its discussion and approval of the Applicant's selection of Option Two under the Internal Revenue Service's regulations relative to the treatment of investment tax credit.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

As previously noted, there are two principal questions that the Commission must resolve incident to a lawful exercise of its rate-making authority, namely, the determination of a fair value rate base and a fair and reasonable return thereon. In exercising the legislative function of rate-making, as entrusted by the United States and Arizona Constitutions and the Arizona statutes, all as interpreted by the courts, the Commission is required to discharge its rate-making responsibilities and to exercise

its judgment and discretion with a view to the applicable law and the facts established by the evidence. With this mandate in mind, and after consideration of the evidence of record, the contentions of the various parties (including matters set forth in the Petitions For Rehearing and the Statements of Position and addressed in oral argument), and the recommendations of the Hearing Officer, the Commission has arrived at its decision on each of the principal questions described above, as well as related matters. As previously noted, the Commission has upon re-consideration determined to modify Decision No. 46930 in certain respects. For ease in reference, the Commission's rate-making determinations are set forth below in a topical fashion, and on a company-wide and operating department basis.

RATE BASE (\$000's)

<u>Basis of Calculation</u>	<u>Total</u>	<u>Electric</u>	<u>Gas</u>
Original Cost (OCLD)	452,103	418,803	33,300
Reproduction Cost (RCND)	654,394	597,676	56,718
Fair Value (50/50 Weighting)	553,248	508,239	45,009

RATE OF RETURN (%)

	<u>Total</u>	<u>Electric</u>	<u>Gas</u>
50/50 Weighting	8.66	8.61	9.24

OPERATING INCOME (\$000's)

<u>Description</u>	<u>Total</u>	<u>Electric</u>	<u>Gas</u>
Test Year	40,225	36,522	3,703
Authorized	47,911	43,752	4,159
Deficiency	7,686	7,230	456
Gross Revenue Deficiency	17,278	16,250	1,028

We believe that the rate of return allowed on the fair value rate base as hereinabove established will provide the Applicant with operating revenues and income sufficient to enable it to meet its operating expenses, provide sufficient coverage to existing bond holders and preferred stock owners, provide a reasonable return to its existing common equity holders, maintain its ability to attract capital, and result in fair and reasonable rates for the consumers.

We hereby affirm and incorporate by reference the Commission's finding upon the monthly report requirement set forth at page 9 of Decision No. 46930.

In view of the foregoing findings of fact and the record as a whole, the Commission further concludes as a matter of law that the requirements of the laws of the State of Arizona and the United States Constitution, where applicable, relative to the justification of the Applicant's request for an increase in its permanent rates and charges have been satisfied.

ORDER

THEREFORE, IT IS HEREBY ORDERED THAT

1. The Original Cost Depreciated Rate Base (OCLD) of the Applicant's properties, used and useful, at September 30, 1975, is \$452,103,000.
2. The Reproduction Cost New Depreciated Rate Base (RCND) of the Applicant's properties, used and useful, at September 30, 1975, is \$654,394,000.
3. Utilizing a 50/50 ratio as to the weighting to be assigned the OCLD and the RCND components thereof, the Fair Value Rate Base of the

Applicant's properties, used and useful, at September 30, 1975, is \$553,248,000.

4. The Fair Rate of Return to be allowed on the Applicant's Fair Value Rate Base is 8.66% on a company-wide basis, which is comprised of a return of 8.61% on the electric properties and a return of 9.24% on the gas properties. Such a rate of return contemplates a return on common equity of 15.25%.

5. The Applicant is authorized to earn an Operating Income of \$47,911,000, consisting of \$43,752,000 with respect to its electric operations and \$4,159,000 with respect to its gas operations. Based upon the test year operating results, the Applicant has a company-wide operating revenue deficiency of \$7,686,000, of which \$7,230,000 is associated with its electric operations and \$456,000 with its gas operations, including all applicable revenue taxes.

IT IS FURTHER ORDERED that the Applicant shall revise and file with the Commission electric and gas rate schedules designed to earn the respective rates of return and operating revenues authorized above, said rates to be applied on a percentage basis as uniformly as is reasonably possible.

FOR GOOD CAUSE SHOWN, IT IS FURTHER ORDERED that said increased rates shall become effective with gas and electric consumption usage on and after July 1, 1976, subject to the prospect of refund, in a manner to be approved by the Commission, to the extent that the Commission may determine that any classification of customers may be entitled to a decrease in the rates authorized hereunder as a result of the Commission's decision on Phase II (cost of service and rate design) of this proceeding.

IT IS FURTHER ORDERED that the Applicant shall refund, in a manner to be approved by the Commission, that portion of the difference between the revenue hereinbefore authorized and that increase previously authorized in Decision No. 46930 which is attributable to service rendered by the Applicant during the months of May and June, 1976.

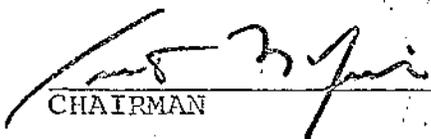
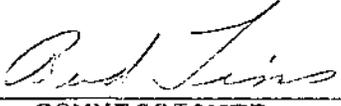
IT IS FURTHER ORDERED that the Applicant's selection of Option Two under the regulations of the United States Internal Revenue Service with regard to the treatment of the investment tax credit is hereby approved.

IT IS FURTHER ORDERED that the Applicant shall submit a monthly report to the Commission, demonstrating its operating results and earnings experience, said report to be filed within thirty (30) days from the end of the reported month.

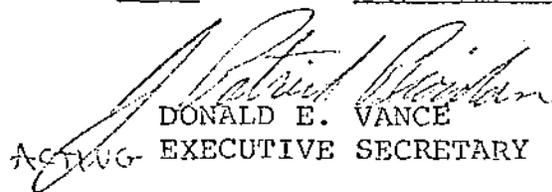
IT IS FURTHER ORDERED that Decision No. 46930, as hereinbefore modified, is hereby affirmed.

IT IS FURTHER ORDERED that this Opinion and Order shall become, and it is hereby made and declared to be, effective immediately and it shall be numbered as Decision No. 46930-A.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

 CHAIRMAN
 COMMISSIONER
COMMISSIONER

IN WITNESS WHEREOF, I, DONALD E. VANCE, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of this Commission to be affixed, at the Capitol in the City of Phoenix, this 18th day of June, 1976.


DONALD E. VANCE
ACTING EXECUTIVE SECRETARY

APPENDIX "A"

Appearances

Murphy & Storey by Robert T. Murphy; Divelbess & Gage by Roger Cheney; Charles S. Pierson, Assistant Attorney General; Robert G. Kircher, Director, Utilities Division; Donald E. Vance, Executive Secretary for the Arizona Corporation Commission.

Holesapple, Conner, Jones & Johnson by A. Y. Holesapple, Lawrence V. Robertson, Jr., Vice President and General Attorney, and Stephen A. Edwards, Attorney, Tucson Gas & Electric Company, for the Applicant, Tucson Gas & Electric Company.

John Michael Morris in proper person.

Bilby, Thompson, Shoenhair & Warnock by Marvin S. Cohen for Asarco, Duval Corporation, Duval Sierrita Corporation, and Cyprus Pima Mining Company.

James D. Webb, City Attorney and Hugh Holub, Assistant City Attorney for the City of Tucson, a Municipal Corporation.

Charles A. Knowles in proper person.

Michael Addis for Tucson Public Power.

Lt. Col. George M. Nakano, USAF, Staff Judge Advocate and Capt. Robert H. Dolle, USAF, Asst. Staff Judge Advocate for the United States of America.

Higgins & Vincent by Edward C. Vincent for Tucson Innkeepers, Ranch & Resort Association, Inc.

Donau, Bolt, Hickle & Whitley by Dwight M. Whitley, Jr. for the Arizona Mobile Housing Association, Tucson Unit.

Chandler, Tullar, Udall & Richmond by Thomas Chandler and Dan Cavett on behalf of Levy's Division of Federated Stores.

Michael Levkowitz in proper person.

BEFORE THE ARIZONA CORPORATION COMMISSION

with revised numbers per JRS

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ERNEST GARFIELD
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AL FARON
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BUD TIMS
Commissioner

IN THE MATTER OF THE APPLICATION)
OF TUCSON GAS & ELECTRIC COMPANY,)
A PUBLIC SERVICE CORPORATION, FOR)
DETERMINATION BY THE COMMISSION,)
FOR RATE-MAKING PURPOSES, OF THE)
FAIR VALUE OF ALL OF THE APPLICANT'S)
EXISTING PROPERTIES, OF A FAIR RATE)
OF RETURN OF NEEDED REVENUES, AND)
FOR APPROVAL OF INCREASED RATES AND)
CHARGES BASED THEREON.)

DOCKET NO. U-1933
DECISION NO. _____
OPINION AND ORDER

Presiding Officer: Hearing Officer Stuart B. Schoenburg
Place of Hearing: Tucson, Arizona
Dates of Hearing: January 12, 1976 through February 24, 1976

Appearances:

Murphy & Storey by Robert T. Murphy; Divelbess & Gage by Roger Cheney; Charles S. Pierson, Assistant Attorney General; Robert G. Kircher, Director, Utilities Division; Donald E. Vance, Executive Secretary for the Arizona Corporation Commission.

Holesapple, Connor, Jones & Johnson by A. Y. Holesapple, Lawrence V. Robertson, Jr., Vice-President, General Counsel legal department and Stephen Edwards, legal department, Tucson Gas & Electric Co. for the Applicant, Tucson Gas & Electric Company.

John Michael Morris in proper person.

Bilby, Thompson, Schoenhair & Warnock by Marvin S. Cohen for Asarco, Duval Corporation, Duval Sierrita Corporation, and Cyprus Pima Mining Company.

James D. Webb, City Attorney and Hugh Hollub, Assistant City Attorney for the City of Tucson, a Municipal Corporation.

Charles A. Knowles in proper person.

Michael Addis for Tucson Public Power.

Lt. Col. George M. Nakano, USAF, Staff Judge Advocate and Capt. Robert H. Dolle, USAF, Asst. Staff Judge Advocate for the United States of America.

Higgins & Vincent by Edward C. Vincent for Tucson Innkeepers, Ranch & Resort Association, Inc.

1 Donau, Bolt, Hickle & Whitley by Dwight M. Whitley, Jr.
2 for the Arizona Mobile Housing Association, Tucson Unit.

3 Chandler, Tullar, Udall & Richmond by Thomas Chandler &
4 Dan Cavett on behalf of Levy's Division of Federated Stores.

5 Michael Levkowitz in proper person.

6 OPINION

7 On November 7, 1975, Tucson Gas & Electric Company filed an
8 application with the Commission requesting that a time and place
9 be established to hear evidence to determine the fair value of the
10 company's properties for rate-making purposes, to fix a just and
11 reasonable rate of return thereon and to determine revenue needs.

12 On November 13, 1975 we entered our Order Decision No. 46542
13 setting forth the procedural rules for the hearing, establishing
14 a test year ending September 30, 19⁷⁵/~~A~~ and ordering a hearing to
15 commence on January 12, 1976, or as soon thereafter as possible.

16 At the hearing, it was determined to procedurally divide the
17 proceedings into a "Phase I" and a "Phase II" segment. In Phase I
18 of the hearing, we received evidence on the fair value of the
19 company's properties for the test year, established an operating
20 income, determined a fair return on the fair value of the company
21 and determined the revenue needs of the company. Phase II will be
22 devoted to reviewing the rate structure and cost of service of
23 the company.

24 It was further determined at the hearing, without objection
25 from any party, to separate Phase I and Phase II determinations and
26 to render a decision on Phase I before the commencement of the
27 hearing on that portion of the proceedings devoted to Phase II.
28 , inter alia,

29 This order will determine the revenue needs of the company
30 and will allow the company to immediately begin to earn such revenue
31 requirement its based upon ~~the~~ present rate structure. At the hearing, the
32 company stipulated, and we will order, that such rate relief as
33 is granted/ under the present structure shall be subject to refund
34 in a manner to be prescribed by this Commission
35 /to those classification/ of customers we determine in Phase II to

1 be entitled to a reduction in their rates.

2 At the conclusion of the hearing on Phase I, simultaneous
3 opening briefs were allowed all parties within 20 days. Response
4 briefs were allowed within 10 days thereafter. Opening briefs
5 were filed by the Applicant; the staff; Intervenors Asarco, Duval
6 Corporation, Duval Sierrita Corporation and Cyprus Pima Mining
7 Company (industrial intervenors); Intervenor City of Tucson;
8 Intervenor Tucson Public Power; and Intervenor United States of
9 America. Response briefs were received from the Company, the
10 industrial intervenors, Intervenor City of Tucson, and Intervenor
11 Levkowitz.

12 ORIGINAL COST RATE BASE

13 In establishing the Original Cost Rate Base of the Applicant^A
14 for the test year, we have reviewed all of the evidence on record
15 relating thereto. The company witnesses testified to an original
16 Cost Rate Base for the test year of \$455,327,000.

17 The staff recommended an original cost rate base of
18 \$444,347,000. We will specifically consider only the matters in
19 dispute.

20 The staff and Intervenors advocate an adjustment of \$4,769,000
21 to Original Cost for the allocation of the tax effect of AFDC. We
22 find this area to be most complex and ripe with ramifications
23 beyond the adjustment advocated. For purposes of this order
24 only, we will accept the staff adjustment. We intend to call a
25 hearing to determine the appropriate treatment to be given con-
26 struction work in progress for all utilities in the State of
27 Arizona, at which time we will establish a firm policy in this
28 area to govern future rate hearings.

29 Intervenor, City of Tucson proposes an adjustment be made to
30 Original Cost because TG & E had an excessive number of trans-
31 formers in inventory which were not used or useful. They point to
32 the proportionate excess of the TG & E inventory levels as compared

1 with the inventory levels maintained by Arizona Public Service.
2 We reject the foundation and value of this comparison. However,
3 it is clear that an excessively large inventory in transformers
4 was maintained in the test year which could have been prevented
5 if proper inventory management practices and procedures were in
6 effect. We determine that the excess number of transformers in
7 inventory not used or useful for the test year is \$1,100,000:

8 The staff and the Intervenors, City of Tucson, and Levkowitz
9 strongly advocate an adjustment to Original Cost Rate Base on the
10 basis of excess generating capacity of the company. The industrial
11 intervenors oppose the adjustment. For the test year, the company
12 had 43% reserve generating capacity over its peak need. Clearly,
13 this amount of reserve is excessive.

14 However, the decisions to build the plants that came on line
15 during the test year and the preceding year were made at least
16 5 years prior to the test year. At that time, load projections
17 were made based upon the experience in the service area and the
18 factors then known. It was only after the company entered into
19 legal obligations to build the plant, that events occurred of a
20 startling and unexpected nature; namely, the Arab oil embargo in
21 late 1973 and the resulting deep recession of 1974 which altered
22 actual loads. It would appear that, but for these events, the
23 reserve generating capacity of TG & E in the test year would not
24 have been excessive. We must first judge the decisions to build
25 the generating capacity in the light and knowledge possessed by
26 the company at the time the decisions were made and not from the
27 viewpoint of knowledge obtained from perfect 20-20 hindsight.

28 After the events mentioned above occurred, the company sold
29 its interest in the Palo Verde Nuclear Power Plant, a facility
30 which would have added 600 megawatts of additional power to the
31 TG & E system, and delayed for one year, each of two units of the
32 San Juan Plant. We conclude that the initial management decisions

1 to build the additional generating capacity, and the management
2 reaction to the unexpected events, were reasonable and acceptable.
3 We do not feel the company should be penalized in the test year on
4 the basis that in one point in time, too much generating capacity
5 was on line.

6 We have also considered that each new generating plant brings
7 on line more coal fired base plant which replaces more expensive
8 oil-fired units. The construction program of TG & E is not simply
9 adding additional capacity, but is converting the system from fuel
10 oil to coal-fired generating plants, a goal with which we ^{concur.} ~~approve~~.
11 The saving in the cost of fuel has been and will be beneficial to
12 the rate payers.

13 As the City of Tucson correctly pointed out in its response
14 brief, mere good faith and reasonable management decisions cannot,
15 in and of itself, justify excessive plant not used and useful.
16 We are not convinced that all of the present generating capacity of
17 TG & E will not, in fact, be needed shortly. We do not approve ^{past.}
18 of a 43% reserve capacity. If it continues, or if evidence were
19 elicited establishing that it would continue at such levels, we will
20 require retirement of older oil-fired generating plants.

21 We would also not wish our remarks to be construed as approving
22 the company's methodology for load projection. The techniques and
23 the assumptions valid in the 50's and 60's now appear insufficient.
24 New factors must now be considered. TG & E must update its load
25 projection techniques. We are in the process of taking significant
26 action in this area.

27 For the test year, we reject any adjustments to rate base
28 founded upon excess reserve generating capacity.

29 The City of Tucson advocates that we deduct a portion of
30 the right-of-way cost of the San Juan Line from Original Cost
31 Rate Base. We reject this proposed adjustment.

32 The staff advocates a revision of the allowance for working

1 capital. The staff uses the "balance sheet approach" or "lead-lag
2 study" approach. We have in the past and we again reject this
3 adjustment.

4 Having dealt with each of the proposed adjustments we con-
5 clude that the Original Cost Rate Base for the company for the test
6 year is \$^{452,103}~~449,334~~,000. The original Cost Rate Base for electric is
7 \$^{418,803}~~416,034~~,000 and for gas is \$33,300,000.^{OK}

8 RECONSTRUCTION COST NEW DEPRECIATED RATE BASE

9 The company witnesses testified to a new cost rate base for
10 the test year of \$658,797,000. The staff recommends \$644,424,000.
11 We settled most items in controversy in discussing original cost
12 rate base and have made corresponding adjustments for new cost
13 rate base.

14 One additional item in controversy remains, involving the
15 increase in the value of fuel inventories in the allowance for
16 working capital. We accept the staff adjustment thereto.

17 We therefore arrive at a Reconstruction Cost New Depreciated
18 Rate Base for the company for the test year of \$^{654,394}~~650,590~~,000. The
19 new cost rate base for electric is \$^{597,676}~~593,872~~,000 and for gas of
20 \$^{56,718}~~56,718~~,000.^{OK}

21 FAIR VALUE

22 Having established the Original Cost and the Reconstruction
23 Cost New Depreciated Rate Base for the company for the test period
24 we determine, having given additional weight to the original cost
25 rate base, that the fair value of the properties of the company
26 for the test period is \$^{553,000}~~547,993~~,000. The fair value rate base for
27 electric is \$^{508,015}~~503,213~~,000, and for gas is \$^{44,985}~~44,780~~,000.

28 NET OPERATING INCOME

29 The company witnesses testified to a net operating income
30 for the test year of \$38,862,000. The staff has determined a net
31 operating income of \$41,777,000. We will discuss the items in
32 dispute.

1 The staff proposes to disallow the annualization of the depreci-
2 ation and property taxes on the Navajo project unit which came
3 on line in the spring of the test year. The Industrial Intervenors
4 oppose this position. The remaining intervenors support this
5 disallowance.

6 We have consistently allowed the annualization of expenses
7 for a major unit of plant coming into operation during a test year.
8 We see no reason to vary from our precedent in this case. There-
9 fore, the staff position is disallowed.

10 The staff and all intervenors suggest a disallowance of
11 normalization of wage costs for certain employees of the company
12 for two reasons. First, a portion of the wage increase occurred
13 subsequent to the test year. Second, a normalization of the wage
14 expenses is unjustified because of the decrease in the number of
15 employees and the resulting decrease in labor expenses.

16 The second point we reject. We have traditionally and will
17 continue to annualize wage increases that have occurred within the
18 test year.

19 However, the wage increases that occurred subsequent to the
20 test year constitutes a forward-look. The company contends that
21 this is not forward-look, as forward-look only relates to the
22 determination of the fair value of the company. We specifically
23 reject this interpretation. Forward-look is applicable not only to
24 fair value, but also to operating income determinations. Since
25 the portion of the wage increase occurred outside the test year,
26 we find that it is a forward-look which we disallow.

27 The Commission staff recommends adjustments in the earnings
28 of Western Coal Company. We find in the test year that the price
29 paid by TG & E to Western Coal Company for coal was reasonable.
30 Therefore, we reject the recommendation of the staff.

31 A further staff adjustment concerns the period over which the
32 synthetic natural (SNG) plant is to be amortized. The company
wishes to amortize it over five years; the staff proposes ten

1 years. We have in the past and we again expressly require that
 2 the SNG Plant be amortized over a period of ten years. The staff
 3 adjustment is therefore allowed.

4 The last item in contention deals with the normalization of
 5 the interest expense over the test year. We find that the company
 6 normalization is unjustified. We accept the staff adjustments.

7 One treatment that is not in dispute we feel deserves mention.
 8 The treatment of the investment tax credit under the Internal Rev-
 9 enue Laws allows the company two options. The company has recently
 10 chosen to alter its options and use Option Two of the regulations
 11 of the I.R.S. The staff recommends that we approve this treatment
 12 by the company. We specifically approve the option chosen by the
 13 company.

14 Having settled the issues in contention concerning net operating
 15 income, we find that the net operating income of the company for
 16 the test year was \$^{40,255}~~40,274~~,000. the net operating income for elec-
 17 tric was \$^{36,522}~~36,549~~,000 and for gas was \$^{3,703}~~37,725~~,000.

18 RATE OF RETURN AND REVENUE DEFICIENCY

19 Having determined the fair value of the property of the com-
 20 pany for the test year to be \$^{553,000}~~547,993~~,000, we hereby establish that
 21 a fair rate of return on the fair value of the company for the test
 22 period to be ^{8.67%}~~8.64%~~. This would allow the company a net operati^{ng}
 23 income of \$^{47,945}~~47,366~~,000. From this we take the actual net operating
 24 income of the company of \$^{40,225}~~40,274~~,000 and find a deficiency in the
 25 amount of \$^{7,720}~~7,092~~,000. When this is adjusted for tax effect, we
 26 find the revenue deficiency for the company for the test period to
 27 be \$^{17,356}~~15,943~~,000.

28 The rate of return on the fair value of the properties of the
 29 company established herein would allow the company a 15.08% return
 30 on common equity and ^{10.60}~~10.54~~% return on total capital. We further
 31 find coverages are sufficient to maintain the financial integrity of
 32 the company.

1 will only result in far higher rates in the future necessitated by
 2 the need to re-establish financial integrity for a company that
 3 would be near bankruptcy. It is of interest to us, that all parties,
 4 except Levkowitz and Tucson Public Power, have recommended revenue
 5 increases in differing amounts. Only by totally ignoring the Con-
 6 stitution of this state, its laws, and the case decisions, can a
 7 denial of a rate increase be advocated. We do not feel this approach
 8 to be responsible and therefore reject it.

9
 10 The above constitutes the findings of fact and conclusions of
 11 law of the Commission.

12 ORDER

13 WHEREFORE, IT IS ORDERED: (1) that the Original Cost
 14 Depreciated Rate Base of the company's property, used and useful,
 15 for the test period ending September 30, 1975 is ^{452,103} ~~\$449,534~~,000

16 (2) that the Reconstruction Cost
 17 New Depreciated Rate Base of the company's property, used and use-
 18 ful for the test year ending September 30, 1975 is ^{654,394} ~~\$650,590~~,000

19 (3) that the Fair Value Rate Base
 20 of the company's property, used and useful, for the test year end-
 21 ing September 30, 1975 is ^{553,000} ~~\$547,993~~,000.

22 (4) that the Fair Rate of Return
 23 to be allowed on the determined Fair Value Rate Base for the elec-
 24 tric division is ^{8.62} ~~8.59~~%, for the gas division is ^{OK} 9.25%, for a company
 25 wide Fair Rate of Return on Fair Value of ^{8.67} ~~8.64~~%, which will allow
 26 the company to earn a net operation^{ng} income ^{47,945} ~~\$47,566~~,000.

27 IT IS FURTHER ORDERED: that the company has a revenue defi-
 28 ciency of ^{17,356} ~~\$15,945~~,000 including all applicable revenue taxes.

29 The company shall be allowed to increase its rates in each of the
 30 gas and electric divisions to earn the rate of return specified
 31 above commencing _____ . This increase, however, shall
 32 , in a manner to be prescribed by this Commission
 be subject to refund/for any classification of customers which we

1 shall determine shall be entitled to a decrease in ^{its} ~~their~~ rates, in
2 the Phase II portion of this proceeding.

3 IT IS FURTHER ORDERED: that the company shall submit a monthly
4 report to the Commission following the format attached. Said
5 monthly report shall be commenced with the month of _____
6 1976 and shall be due within 30 days from the end of each subsequent
7 month.

8
9 BY ORDER OF THE ARIZONA CORPORATION COMMISSION

10
11
12 CHAIRMAN

COMMISSIONER

COMMISSIONER

13
14
15 IN WITNESS WHEREOF, I, DONALD E.
16 VANCE, Secretary of the Corporation
17 Commission have hereunto set my
18 hand and caused the official seal
19 of the Arizona Corporation Commission
20 to be affixed at the Capitol in the
21 City of Phoenix, this _____ day
22 of _____, 1976.

23
24 DONALD E. VANCE
25 SECRETARY
26
27
28
29
30
31
32

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused to be mailed five (5) copies of the foregoing document to the Phoenix office of the Arizona Corporation Commission addressed as follows:

Donald E. Vance
Executive Secretary
Arizona Corporation Commission
2222 West Encanto Blvd.
Phoenix, Arizona 85009

I further certify that I have this day served the foregoing document on all parties of record in this proceeding by mailing a copy thereof, properly addressed, with first class postage prepaid, to the following named individuals:

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Arizona Corporation Commission
State Office Building
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Tucson, Arizona 85701

Dated at Tucson, Arizona, this 16th day of April, 1976.

By Stephen A. Edwards
Stephen A. Edwards
Attorney for the Applicant