

TUCSON ELECTRIC POWER COMPANY

DOCKET NO. E-01933A-07-0402

DOCKET NO. E-01933A-05-0650

RESPONSIVE DIRECT SETTLEMENT TESTIMONY

OF

WILLIAM A. RIGSBY

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JULY 2, 2008

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1 **INTRODUCTION**

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

3 A. My name is William A. Rigsby. I am a Public Utilities Analyst V employed
4 by the Residential Utility Consumer Office ("RUCO") located at 1110 W.
5 Washington, Suite 220, Phoenix, Arizona 85007.

6

7 Q. Have you filed any previous testimony in this docket?

8 A. Yes. On February 29, 2008, I filed direct testimony on the cost of capital
9 issues associated with Tucson Electric Power Company's ("TEP" or "the
10 Company") application for a permanent rate increase ("Rate Application").
11 The filing of surrebuttal testimony was suspended as a result of settlement
12 discussions which began on April 10, 2008. On May 29, 2008, a proposed
13 settlement agreement ("Settlement Agreement" or "Settlement") was filed
14 with the Commission for the purpose of settling disputed issues related to
15 TEP's Rate Application. Appendix I, which is attached to my February 29,
16 2008 testimony, describes my experience and qualifications in the field of
17 utility regulation.

18

19 Q. Did RUCO play a role in the aforementioned settlement discussions?

20 A. Yes. Members of RUCO's staff, including myself, attended and monitored
21 the aforementioned settlement discussions.

22

23 ...

1 Q. Why didn't RUCO take a more active part in the settlement discussions?

2 A. RUCO became convinced early on that a satisfactory settlement (i.e. one
3 that would be in the best interests of residential ratepayers) could not be
4 reached. This assessment was based on the discussions that took place
5 during the first settlement meeting and the large disparity between TEP's
6 requested rate increase and the recommended levels of increases being
7 recommended by both RUCO and ACC Staff. As a result, RUCO elected
8 not to actively participate in the discussions but did monitor the meetings
9 and make minor suggestions on clarifying language contained in the
10 Settlement Agreement. RUCO has not entered into the Settlement
11 Agreement because RUCO does not believe the Settlement Agreement
12 results in fair and reasonable rates.

13

14 Q. What is the purpose of your testimony?

15 A. The purpose of my testimony is to present evidence that supports RUCO's
16 position that the Settlement Agreement does not result in fair and
17 reasonable rates.

18

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1 **OVERVIEW OF THE SETTLEMENT AGREEMENT**

2 Q. Please provide an overview of the Settlement Agreement that is currently
3 before the ACC.

4 A. The Settlement Agreement presently before the Commission was
5 negotiated over the seven-week period between April 10, 2008 and May
6 29, 2008. During that time, various parties to the case reached a
7 consensus to settle a number of disputed issues associated with TEP's
8 Rate Application, which was originally filed on July 2, 2007. The resulting
9 document addresses each of the issues that were resolved by the various
10 parties to the case. Among the issues addressed in the Settlement
11 Agreement are the method in which TEP's rates would be determined (i.e.
12 the traditional cost-of-service methodology), the Company's cost of
13 capital, depreciation and cost of asset removal, TEP's proposed
14 implementation cost recovery asset and Termination Cost Recovery Asset
15 ("TCRA"), a purchased power and fuel adjustment clause, a renewable
16 energy adjustor, a demand-side management adjustor mechanism, and
17 time-of-use rates. The Settlement Agreement also provides for a rate
18 freeze for low-income users and a rate moratorium that would remain in
19 effect until December 31, 2012. The Settlement Agreement also
20 stipulates that TEP shall forego all claims relating to any alleged breach of
21 contract resulting from or related to an earlier 1999 settlement agreement
22 ("1999 Settlement Agreement"), which established the Company's present

1 rates and/or Decision No. 62103, which approved the 1999 Settlement
2 Agreement.

3

4 Q. Which of the parties to the case have entered into the Settlement
5 Agreement?

6 A. The Settlement Agreement was entered into by the following parties: TEP;
7 ACC Staff; Arizonans for Electric Choice and Competition and Phelps
8 Dodge Mining Company¹ (collectively "AECC"); Arizona Community Action
9 Association ("ACAA"); U.S. Department of Defense and all other Federal
10 Executive Agencies ("DOD"); Arizona Investment Council ("AIC"),
11 International Brotherhood of Electric Workers Local 1116 ("IBEW 1116"),
12 Mesquite Power, LLC, Southwestern Power Group II, LLC, Bowie Power
13 Station, LLC, and Sempra Energy Solutions, LLC ("Power Producers");
14 and Kroger Company (collectively referred to as "Signatories" or "Settling
15 Parties")

16

17 Q. Have the Settling Parties characterized the Settlement Agreement as fair,
18 reasonable, and in the public interest?

19 A. Yes. The testimonies of all the Settling Parties express this notion in
20 various manners. For example the testimony of Staff witness Ernest G.
21 Johnson states "In Staff's opinion, the Proposed Settlement is fair,

¹ Over the course of the TEP rate case proceeding, Phelps Dodge Mining Company was acquired by Freeport-McMoRan Copper & Gold Inc.

1 balanced, and in the public interest.”² The testimony of TEP witness
2 James S. Pignatelli states “Underlying this is the need to balance the
3 interests of customers, employees and shareholders. I believe the
4 settlement agreement strikes an appropriate balance and will provide
5 benefits for each of these important groups.”³ The testimony of AECC
6 witness Kevin C. Higgins states, “In my opinion, the 2008 Settlement
7 Agreement produces just and reasonable rates and is in the public
8 interest.”⁴

9

10 Q. What are some of the reasons the Settling Parties have reached this fair,
11 reasonable, and in the public interest conclusion regarding the Settlement
12 Agreement?

13 A. The predominant reasons claimed by the Settling Parties are as follows:

- 14 1) Minimal rate increase of 6%, or \$47.1 million;
- 15 2) Adoption of new depreciation rates and the resolution of the
16 FAS 143 issue;
- 17 3) Adoption of adjustor clauses for demand-side management
18 and renewable energy programs;
- 19 4) A moratorium on base rate increases through 2012;
- 20 5) The implementation of a Purchased Power and Fuel
21 Adjustor Charge (“PPFAC”);

² Direct testimony of Ernest G. Johnson at page 6, lines 25 – 26.

³ Direct Testimony of James S. Pignatelli at page 9, lines 1 – 3.

⁴ Direct Testimony of Kevin C. Higgins at page 2, lines 4 – 5.

- 1 6) Adoption of a cost of equity of 10.25% and an overall
2 weighted cost of capital of 8.03%;
- 3 7) Waiver of any claims under the 1999 Settlement Agreement;
4 and
- 5 8) Availability of Retail Competitive opportunities.

6

7 Q. Have the Settling Parties presented any Exhibits that portray the various
8 parties' original positions as compared to the Settlement Agreement?

9 A. Yes. TEP witness James S. Pignatelli presents such an Exhibit on page
10 10 of his direct testimony and the Settlement Agreement itself presents
11 Exhibit 2 demonstrating the differences between TEP's original position,
12 Staff's original position, and the Settlement Agreement. There is also an
13 Exhibit RCS-7, attached to Staff witness Ralph C. Smith's direct testimony
14 which shows the differences between the Staff's original position and the
15 Settlement position.

16

17 Q. Do the numbers in these exhibits appear to be accurate?

18 A. Yes, however the manner in which the Settling Parties have portrayed the
19 overall result of the Settlement Agreement presents a false impression of
20 the reasonableness of the Agreement.

21

22 ...

23

1 **THE FALSE IMPRESSION CREATED BY THE SETTLEMENT AGREEMENT**

2 Q. Please explain this false impression.

3 A. The \$47.1 million purported increase of 6% presents a false impression
4 because it is based on the false premise that the fixed CTC is a
5 permanent part of rates rather than a temporary surcharge that was fully
6 recovered earlier this year. The true increase, based on TEP's adjusted
7 current base rates without the fixed CTC equals 19.8%.⁵ The Settlement
8 Agreement revenue requirement comparison charts in Mr. Pignatelli's
9 testimony are misleading because they do not represent apples-to-apples
10 comparisons between the terms of the Settlement and the real increases
11 the customers will bear under the Settlement.

12
13 Q. Why are they not apples-to-apples comparisons?

14 A. The Company and RUCO's original revenue requirement positions were
15 based on a base cost of fuel and purchased power of \$.033 per kWh. The
16 Staff's original position and the Settlement Agreement include a base cost
17 of gas of only \$.028896 per kWh. The delta between the two amounts is
18 approximately \$.0041 per kWh, which when multiplied by test year
19 adjusted kWh sales renders a difference of over \$38 million. Since the
20 Settlement Agreement contains a PPFAC that will allow TEP to recover its
21 actual cost of fuel and purchased power no matter what it turns out to be,

⁵ The actual total increase as set forth in Exhibit WAR-1 is 21.15%. This testimony is explained in further detail below.

1 the differences between the two base costs of fuel and purchased power
2 artificially and misleadingly lead one to believe that the Settlement
3 Agreement is \$38 million less than it actually is when compared to the
4 Company and RUCO's original position.

5

6 Q. Have you prepared an Exhibit that restates the fallacies you have just
7 described (i.e. the assumption that the fixed CTC is a permanent part of
8 rates that has not already expired and the artificially low base cost of fuel
9 and purchased power)?

10 A. Yes. I have prepared Exhibit WAR-1 that restates the fallacies just
11 described and presents an accurate, as well as, apples-to-apples
12 comparison of the Company, RUCO, and Staff original positions relative to
13 the revenue requirement position contained in the Settlement Agreement.

14

15 Q. Please discuss how the parties positions compare to the Settlement once
16 restated and demystified on Exhibit WAR-1.

17 A. In summary the parties' positions compare with the Settlement Agreement
18 as follows:

19

	<u>Company As Filed</u>	<u>ACC Staff As Filed</u>	<u>RUCO As Filed</u>	<u>Settlement Agreement</u>
Required Increase	\$ 275,808,513	\$ 48,001,098	\$ 36,254,000	\$ 146,248,098
Percentage Increase (excluding fixed CTC)	39.89%	6.94%	5.24%	21.15%

20

1 The details supporting this restatement of the actual terms of the
2 Settlement Agreement are set forth in Exhibit WAR-1. This apples-to-
3 apples comparison clearly shows that the Settlement results in a far
4 greater rate increase than portrayed by the Settling Parties, and in fact is a
5 21.15% increase, not a 6% increase. This result is hardly “fair,
6 reasonable, and in the public interest”, as portrayed by the Settling
7 Parties.

8

9 Q. It appears that the rate increase recommended by the Settlement
10 Agreement represents an amount almost \$100 million greater than
11 originally recommended by Staff. Does the Settlement document or any
12 of the Settlement testimony attempt to explain this wide disparity?

13 A. Yes and no. Provided as Exhibit No. 2 of the Settlement Agreement is a
14 dollar for dollar reconciliation of the concessions agreed to in the
15 Settlement Agreement and such a reconciliation is also provided as
16 Attachment RCS-7 to the Direct Testimony of Staff witness Ralph C.
17 Smith. These two Exhibits identify each dollar disparity between the TEP
18 and Staff direct testimony and the Settlement Agreement by issue.
19 However, none of the documents explain the logic behind the Settlement
20 concessions and why this additional \$100 million rate increase is fair,
21 reasonable, and in the public interest.

22

23

1 **DISCUSSION OF THE CONCESSIONS MADE IN THE SETTLEMENT**

2 **AGREEMENT**

3

4 Q. Would you please discuss the more material items that comprise the \$100
5 million in Settlement concessions?

6 A. Yes. Below I will discuss each of the larger concessions identified on
7 Settlement Exhibit 2, pages 1 through 5.

8

9 The largest rate base concession identified on Settlement Exhibit 2 is the
10 reinstatement of \$99 million related to a FAS 143 write-off of accumulated
11 depreciation. Staff had originally increased the accumulated depreciation
12 balance by this write-off. RUCO also has a similar adjustment to increase
13 the accumulated depreciation balance by \$112.8 million related to this
14 same FAS 143 issue.

15

16 Q. Why has this \$99 million rate base concession been made as part of the
17 Settlement Agreement?

18 A. According to Settlement Exhibit 2, page 1, this concession was made "For
19 purposes of settlement."

20

21

22 ...

23

1 Q. Didn't both the Staff and RUCO make compelling arguments in their
2 respective direct testimonies regarding the appropriateness of this
3 adjustment?

4 A. Yes. The Staff arguments are presented in the Direct Testimony of Ralph
5 C. Smith, pages 31 through 34 and RUCO's arguments presented in the
6 Direct Testimony of Marylee Diaz Cortez at pages 13 – 16. In summary
7 original arguments in support of this adjustment were as follows:

8 Utilities have historically recognized the cost of asset retirement through
9 annual depreciation accruals. These retirement costs, prior to Statement
10 No. 143, resided in TEP's Accumulated Depreciation account, which under
11 the ratemaking formula serves to reduce rate base. The account serves
12 as a rate base reduction because it represents the portion of TEP's plant
13 investment that it has already recovered through its depreciation accruals.
14 Depreciation accruals (expenses) are included in the ratemaking formula,
15 thus, by definition the Accumulated Depreciation account is comprised of
16 amounts paid for by ratepayers. As just mentioned this account reduces
17 rate base, thereby ensuring that ratepayers do not continue to pay a return
18 on that portion of TEP's rate base investment for which ratepayers have
19 already provided reimbursement. Statement No. 143, however, has upset
20 the equity of depreciation accounting because it requires TEP to write-off
21 a portion of the accumulated depreciation balance that ratepayers have
22 already paid for. This write-off decreases the Accumulated Depreciation
23 balance, which in turn increases rate base. The overall result of this

1 accounting is that ratepayers will have to pay a return on portions of the
2 Company's plant investment that ratepayers have already paid for through
3 their utility rates. Thus, while Statement No. 143 may be appropriate from
4 a financial accounting standpoint it is inappropriate for regulatory
5 accounting. Financial and regulatory accounting have two entirely different
6 objectives and thus often by necessity result in two sets of accounting. In
7 this instance, application of the financial accounting for FAS 143 has
8 unintended consequences when used for regulatory accounting purposes.
9 In this case, if FAS 143 is recognized for ratemaking purposes the result
10 will be double recovery of the previously accrued asset retirement costs.

11
12 Q. Please discuss the next material concession shown on Settlement Exhibit
13 2.

14 A. The next material rate base concession is for \$41.6 million and is also
15 related to accumulated depreciation. In 2004 TEP began recording
16 depreciation expense on its generation assets at rates that were
17 significantly lower than those that had been authorized by the
18 Commission. As a result the accumulated depreciation reserve on the
19 Company's books and records was significantly understated. Both Staff
20 and RUCO in their direct testimonies made an adjustment to increase the
21 accumulated depreciation balance to reflect the depreciation rates that
22 had been authorized by the Commission.

23

1 Q. Where can Staff and RUCO's entire arguments on this issue be found?

2 A. Staff's arguments can be found in the direct testimony of Ralph C. Smith
3 at pages 34 through 42 and RUCO's arguments in the direct testimony of
4 Marylee Diaz Cortez at pages 5 through 8.

5

6 Q. Why have the Settling Parties conceded this point?

7 A. Settlement Exhibit 2 explains this \$41.6 million concession as "For
8 purpose of settlement and to be reflected in rates in this proceeding TEP's
9 original position was accepted."

10

11 Q. Please discuss the next significant revenue requirement concession of the
12 Settlement Agreement.

13 A. Settlement Exhibit 2 shows a concession to increase operating expenses
14 by \$29 million related to Springerville Unit 1. The Settling Parties have
15 now agreed to include the Springerville Unit 1 lease in operating expense
16 at an estimated market price of \$25.67 per kilowatt-month fixed cost.

17

18 Q. What had been the parties' original positions on this issue?

19 A. The ACC Staff position was that Springerville Unit 1 should be included in
20 rates a \$15 per kilowatt-month fixed cost, which was consistent with the
21 amount authorized in Decision No. 56659. A full discussion of the Staff's
22 position can be found in the direct testimony of Ralph C. Smith at pages
23 49 through 52. RUCO's position on this issue was that Springerville Unit 1

1 should be included in rates at its embedded cost. A full discussion of
2 RUCO's position is included in the direct testimony of Marylee Diaz Cortez
3 at pages 8 through 10.

4
5 Q. Why have the settling parties now agreed to the much higher estimated
6 market price of \$25.67 per kilowatt-month?

7 A. Settlement Exhibit 2 explains this \$41.6 million concession as "For
8 purpose of settlement and to be reflected in rates the parties agree to
9 adjustments that reflect the cost based recovery of Springerville Unit 1
10 non-fuel cost."

11
12 Q. Do you agree with the accuracy of this statement?

13 A. No. The \$29 million concession would more accurately be described as
14 allowing for adjustments that reflect the **estimated current market based**
15 **cost** recovery of Springerville Unit 1 non-fuel cost. Obviously there is a
16 vast difference between agreeing to cost based rates in a cost of service
17 regulatory model (which is the model being adopted by the Settlement
18 Agreement) and agreeing to estimated market-based rates in a cost of
19 service model.

20
21
22 ...

23

1 Q. Please discuss the next significant concession in the Settlement
2 Agreement.

3 A. Settlement Exhibit shows that the parties have agreed to a \$21.6 million
4 increase in operating expenses for additional depreciation rates. The
5 Settlement's \$21.6 million increase in depreciation expenses is in fact
6 \$21.6 million in excess of what TEP had originally requested in its
7 application.

8

9 Q. What explanation is given on Settlement Exhibit 2 for this \$21.6 million in
10 depreciation expenses beyond what the Company had even requested?

11 A. Settlement Exhibit 2 explains the \$21.6 million increase as "For purpose of
12 settlement and to be reflected in rates the parties agree on an adjustment
13 of generation depreciation rates for the inclusion of \$21.6 million (ACC
14 Jurisdictional) in additional depreciation expense annually to recover cost
15 of removal prospectively."

16

17 Q. Did any party in their direct testimony advocate the need for \$21.6 million
18 in additional depreciation for generation cost of removal?

19 A. No. No party advocated such a position, including TEP itself.

20

21

22 ...

23

1 Q. Are there any other concessions made on particular issues in the context
2 of the Settlement Agreement?

3 A. Yes. However the remaining concessions are far less significant than
4 those already discussed. RUCO believes the original positions on these
5 remaining concessions are clearly presented in the Settling Parties direct
6 testimony and reading of those coupled with a comparison to the
7 Settlement Agreement resolution of those same issues is self-explanatory.
8

9 Q. What is total revenue requirement impact of the above-discussed large
10 concessions?

11 A. The revenue requirement of just the discussed concessions is as follows:
12

	<u>Revenue Req. Impact⁶</u>
13 Rate Base Items	
14 FAS 143 Write-off	\$13,296,484
15 Unauthorized Depreciation Changes	5,537,314
16	
17	
18 Operating Expenses	
19 Springerville Unit 1	44,268,529
20 Generation Depreciation Rates	<u>20,050,384</u>
21	
22 Total	<u>\$83,152,771</u>
23	

24

25 ...

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⁶ Revenue Requirement Impacts are per the Direct Settlement Testimony of Ralph C. Smith at page 6.

1 Q. Given the large and unexplained (or inadequately explained)
2 discrepancies between the parties original positions and the settlement
3 position is it possible to reach a conclusion the Settlement Agreement
4 revenue requirement is fair, reasonable, and in the public interest?

5 A. No.

6

7 **OTHER SETTLEMENT AGREEMENT ISSUES**

8 Q. Are there any other aspects of the Settlement agreement you would like to
9 address beside the just discussed revenue requirement?

10 A. Yes. There are a few other items I would like to discuss.

11

12 Q. What is the first additional issue you would like to discuss?

13 A. The Settlement Agreement provides for a PPFAC for TEP that is in large
14 part patterned after that which was authorized for APS. Because of the
15 overall make-up of TEP's generation, which is largely coal, RUCO does
16 not believe a mechanism that is as broad based as that authorized for
17 APS, which has a significant portion of its generation derived from gas, is
18 warranted for TEP. RUCO recommended in its direct testimony⁷ adoption
19 of a limited PPFAC that was applicable only to incremental sales.

20

21 ...

22

⁷ See the Direct Testimony of Marylee Diaz Cortez at pages 26 through 32.

1 Q. What other flaws does RUCO see in the PPFAC proposed under the
2 Settlement Agreement?

3 A. APS' fuel and power supply adjustor calls for a 90/10 sharing between
4 ratepayers and shareholders of fuel and purchased power costs in excess
5 of the base rate cost. This provision is intended to incent the Company to
6 use prudent procurement practices. The PPFAC proposed for TEP would
7 not have such a safeguard and as a result is deficient.

8
9 Q. Please discuss RUCO's second issue.

10 A. The Settlement Agreement specifically leaves open two issues of
11 significant importance. These two issues are the 1) how the fixed CTC
12 revenues that have been collected in excess of the \$450 million
13 authorized in Decision No. 62103 should be calculated and treated for
14 ratemaking purposes, and 2) on what date any rate increase authorized in
15 this docket should become effective.

16
17 Q. How significant are these two issues?

18 A. Very significant. On the first issue, Staff witness Ralph C. Smith testifies
19 that the over collected CTC revenues will total approximately \$68 million
20 by the end of 2008. On the second issue, if the Settlement Agreement
21 revenue increase of \$136.8 million is adopted, this will generate monthly
22 additional revenue of approximately \$11.4 million, making the date on
23 which the increase becomes effective highly significant.

1 Q. Can the fairness and the reasonableness of the Settlement Agreement be
2 determined with these two issues outstanding?

3 A. No. These two issues have a potential impact of almost \$100 million.
4 Further, the Settling Parties have taken widely disparate positions on
5 these two issues in their direct Settlement testimonies. It is difficult to
6 image how a determination of the fairness and the reasonableness of the
7 Settlement Agreement was reached by the Parties when two issues of this
8 significance remain outstanding.

9
10 Q. Please address RUCO's third issue.

11 A. The Settlement Agreement leaves open the question of whether or not
12 TEP's service territory is eligible for retail competition. While paragraph
13 14.1 of the Agreement recognizes that "the transition to retail electric
14 competition has thus far not occurred and the time periods applicable to
15 Decision No. 62103 and to the 1999 Settlement Agreement have passed,
16 the Signatories recognize that it is necessary to address the prospective
17 regulatory treatment that is appropriate for TEP under these
18 circumstances.", the Settlement Agreement defers this important issue to
19 a later generic docket. Since 2002, RUCO has consistently taken the
20 position that retail competition is not in the best interests of residential
21 ratepayers and that even if it were the possible benefits to residential
22 ratepayers, if any, are far outweighed by the risks. The Settlement's
23 deferral of this important issue is yet another deficit in the Agreement.

1 Q. Does this conclude your responsive direct Settlement Agreement

2 Testimony?

3 A. Yes.

RUCO'S EXHIBIT WAR-1

**TUCSON ELECTRIC POWER COMPANY
PROPOSED SETTLEMENT AGREEMENT
COMPARISON TO AS FILED POSITIONS**

**DOCKET NO. E-01933A-07-0402
DOCKET NO. E-01933A-05-0650
EXHIBIT WAR-1**

<u>LINE NO.</u>	<u>DESCRIPTION</u>	<u>COMPANY AS FILED</u>	<u>ACC STAFF AS FILED</u>	<u>RUCO</u>	<u>SETTLEMENT AGREEMENT</u>
1	REQUIRED REVENUE INCREASE	\$158,186,000	9,753,000	36,254,000	136,800,000
2	TCRAC	117,622,513	0	0	0
3	FUEL COST CONVERSION	<u>0 (a)</u>	<u>38,248,098 (b)</u>	<u>0 (a)</u>	<u>38,248,098 (b)</u>
4	SUBTOTAL	275,808,513	48,001,098	36,254,000	175,048,098
5	CREDITS TO PPFAC	0	0	0	(28,800,000) (C)
6	TOTAL	275,808,513	48,001,098	36,254,000	146,248,098
7	PERCENTAGE INCREASE	39.89%	6.94%	5.24%	21.15% (d)

(a) TEP BASE COST OF FUEL =
 $\$307,525,562 / 9,318,849,104 = .033$

(b) STAFF BASE COST OF FUEL =
 $\$269,276,010 / 9,318,849,104 = .028896$
 INCREMENTAL DIFFERENCE =
 $.033 - .028896 = .00410438 \times 9,318,849,104 = \$38,248,098$

(C) SHORT TERM SALES \$25,300,000
 SO2 ALLOWANCE \$3,300,000
 10% OF WHOLESALE REVENUE \$200,000

(d) ADJUSTED CURRENT REVENUES EXCLUDING CTC =
 $\$691,372,378$