



2100 N. Central, Ste. 210
P. O. Box 34805
Phoenix, AZ 85067
Tel: (602) 257-9200
Fax: (602) 254-4300
Email: info@auia.org
Web Site: www.auia.org

ORIGINAL



BEFORE THE ARIZONA CORPORATION COMMISSION

3252

Jeff Hatch-Miller
Chairman
William A. Mundell
Commissioner
Marc Spitzer
Commissioner
Mike Gleason
Commissioner
Kristin Mayes
Commissioner

IN THE MATTER OF THE APPLICATION OF
SOUTHWEST GAS CORPORATION FOR
THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES
DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF
THE PROPERTIES OF SOUTHWEST GAS
CORPORATION DEVOTED TO ITS
OPERATIONS THROUGHOUT THE STATE
OF ARIZONA.

Docket No
G-0155A-04-0876

NOTICE OF FILING TESTIMONY

Pursuant to the Amended Procedural Order in this matter issued on March 10, 2005, the Arizona Utility Investors Association (AUJA) hereby provides notice that it has filed the surrebuttal testimony of Walter W. Meek.

Respectfully submitted, this 13th day of September, 2005.

Walter W. Meek

Walter W. Meek, President

CERTIFICATE OF SERVICE

An original and 13 copies of the foregoing testimony filed this 13th day of September, 2005, with:

Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Copies of the foregoing testimony hand delivered
this 13th day of September, 2005, to:

Jeff Hatch-Miller, Chairman
William A. Mundell, Commissioner
Marc Spitzer, Commissioner
Mike Gleason, Commissioner
Kristin Mayes, Commissioner
Christopher Kempley, Esq., Legal Division
Jane Rodda, Esq., Hearing Division
Ernest Johnson, Esq., Utilities Division

A copy of the foregoing testimony was
mailed this 13th day of September, 2005, to:

Andrew W. Bettwy, Esq.
Southwest Gas Corporation
5241 Spring Mountain Road
Las Vegas, NV 89012

Scott Wakefield, Esq.
RUCO
1110 W. Washington
Phoenix, AZ 85007

All Parties of Record


Walter W. Meek

1 **SURREBUTTAL TESTIMONY OF WALTER W. MEEK**

2

3 **I. INTRODUCTION, QUALIFICATIONS AND PURPOSE OF TESTIMONY**

4 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

5 A. My name is Walter W. Meek. My business address is 2100 North Central
6 Avenue, Suite 210, Phoenix, Arizona 85004.

7 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

8 A. I am the president of the Arizona Utility Investors Association (“AUIA”), a
9 non-profit organization formed to represent the interests of equity owners
10 and bondholders who are invested in utility companies that are based in or
11 do business in the State of Arizona.

12 **Q. DOES AUIA’S MEMBERSHIP INCLUDE SHAREHOLDERS WHO HAVE**
13 **EQUITY INTERESTS IN SOUTHWEST GAS CORPORATION (SWG)?**

14 A. Yes. AUIA’S membership has always included owners of the common stock
15 of Southwest Gas Corporation.

16 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?**

17 A. On behalf of AUIA, an intervenor in this proceeding.

18 **Q. HAS AUIA INTERVENED IN PREVIOUS SOUTHWEST GAS RATE**
19 **CASES?**

20 A. Yes. AUIA was a party to the company’s 2000 rate case (Docket No. G-
21 02552A-00-0309).

22 **Q. HAS AUIA SUBMITTED TESTIMONY PREVIOUSLY IN THIS CASE?**

23 A. Yes. AUIA submitted my direct testimony on March 10, 2005.

24 **Q. CAN YOU SUMMARIZE AUIA’S POSITION IN THAT TESTIMONY?**

25 A. Yes. AUIA agreed with the company’s assertion that it needs a significant

1 increase in margin based on a competitive authorized rate of return in order
2 to maintain its financial integrity. However, we were equally supportive of
3 the company's proposals to uncouple its margin requirements from
4 volumetric sales and to increase its fixed cost recovery through a major
5 increase in its fixed monthly charge.

6 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

7 A. In my surrebuttal, I take issue with Staff and RUCO witnesses who reject the
8 concept of the conservation margin tracker (CMT) proposed by the company
9 and who support inadequate increases in the fixed monthly charge. I will
10 also include comments in response to Staff recommendations for overall
11 revenue requirements and cost of capital.

12 **Q. CAN YOU SUMMARIZE YOUR POSITION?**

13 A. Yes. AUIA is chagrined that Staff and RUCO are advocating policies that will
14 perpetuate Southwest Gas Corporation's inability to earn its authorized rate
15 of return by continuing to couple the company's margin to declining
16 volumetric gas sales. These policies will also sentence Southwest Gas to
17 ongoing residence in the credit ratings basement and continuing devaluation
18 of the company's securities.

19 **Q. WHY DO THE STAFF AND RUCO OPPOSE A DECOUPLING
20 MECHANISM?**

21 A. Basically, they don't like it because it is different. Both Staff witness William
22 Musgrove and RUCO witness Marylee Diaz Cortez describe the conservation
23 margin tracker in pejorative terms like "extreme," "radical" and
24 "unprecedented," but they offer no analytical evidence to show that the CMT
25 is an inappropriate response to the problem of dependence on volume sales.

1 They choose to ignore the fact that three other states – California, Oregon and
2 Maryland – have adopted similar proposals.

3 Mr. Musgrove and Ms. Diaz Cortez also argue that the company's
4 CMT proposal is "unfair" because it focuses on residential customers to the
5 exclusion of commercial users. My response is that the evidence is clear that
6 the problem of declining usage is attributable primarily to the residential
7 class and that's where the solution should be focused.

8 SWG may be amenable to a proposal to include commercial customers
9 in the CMT and if Staff and RUCO were anxious to cure this inequity, they
10 would provide recommendations on how to do that. Instead, they offer
11 nothing but criticism.

12 **Q. IS THAT THE EXTENT OF STAFF AND RUCO ARGUMENTS AGAINST**
13 **THE CMT?**

14 **A.** No. Both Staff and RUCO witnesses lament that it would be "unfair" under
15 the CMT to charge residential customers "for therms they don't use." Staff
16 witness Musgrove – in a challenging flight of gibberish – also seems to argue
17 that SWG is off base in arguing that per capita usage is declining because, in
18 fact, the proximate cause of reduced usage relates to overall customer growth.
19 He also asserts that the profiles of the commercial and residential classes are
20 virtually identical.

21 **Q. HOW DO YOU RESPOND TO THESE ARGUMENTS?**

22 **A.** The fairness argument is entirely specious. The way SWG's rates are
23 structured today, the company's shareholders are forced to give up legitimate
24 earnings under an approved rate of return because of therms the customers
25 don't use. I don't hear Staff and RUCO sermonizing over the unfairness in

1 that scheme.

2 In response to Mr. Musgrove's usage argument, if the company's
3 margin rates are based, to any significant degree, on commodity sales and
4 those sales don't materialize, it's largely irrelevant whether it is traceable to
5 old customers or new ones. In fact, the evidence is clear that usage has
6 declined among SWG's long established customers. The solution is to reduce
7 the company's dependence on commodity sales for its earnings.

8 Finally, I don't know what he means by identical profiles, but the load
9 factors for residential and general service customers are very different. They
10 are 40 percent and 67 percent, respectively.

11 **Q. WHAT IS THE CONSEQUENCE OF REJECTING THE CMT?**

12 A. In rejecting the CMT out of hand, with no attempt to amend or improve the
13 concept, Staff and RUCO simply wash their hands of the basic problem raised
14 by the company in its direct case. As long as SWG is dependent on
15 commodity sales, its earnings will be subverted by improved housing,
16 weather, price elasticity and conservation messages and its fixed cost
17 recovery will continue to be unacceptable.

18 **Q. HAVE STAFF AND RUCO RECOMMENDED INCREASING THE**
19 **MONTHLY FIXED COST CHARGE?**

20 A. Yes. Staff proposes to raise the charge from \$8.00 per month to \$9.50, an
21 increase of 18.75 percent, and RUCO proposes a new charge of \$9.36, an
22 increase of 17 percent.

23 **Q. WOULD THESE INCREASES HELP TO ALLEVIATE THE CURRENT**
24 **COST RECOVERY PROBLEM?**

25 A. They would be helpful, but both fall far short of what is needed to make a

1 real dent in the problem.

2 **Q. WHAT KIND OF INCREASE IS NEEDED?**

3 A. In his direct testimony, Southwest Gas CEO Jeffrey Shaw asserted that SWG's
4 current residential rate design recovers 38 percent of costs through the fixed
5 charge and 62 percent from commodity sales, which are subject to
6 consumption. As far as I know, that testimony is uncontested.

7 According to my information, the RUCO proposal would improve the
8 fixed charge recovery ratio to only 41 percent, while the Staff proposal would
9 improve the ratio to 39 percent. Clearly, this is not sufficient, especially
10 without a decoupling mechanism.

11 In its direct case, the company argued for a 50 percent increase in the
12 basic monthly charge, to \$12.00, in conjunction with the CMT or a 100 percent
13 increase, to \$16.00, without the CMT. To have any impact on SWG's earnings
14 dilemma, an increase in the fixed monthly charge would have to be much
15 closer to the company's proposal.

16 **Q. WOULD RUCO'S FLAT RATE PROPOSAL MITIGATE THE PROBLEM**
17 **RELATED TO COMMODITY SALES?**

18 A. No. It would make it worse. RUCO wants to eliminate the two-tiered
19 declining block structure, which would also eliminate the seasonal rate
20 differential. In other words, the effect would be to flatten the rate structure
21 and make every therm cost the same. But this simply increases the threat to
22 earnings.

23 First, eliminating the lower cost block simply increases the likelihood
24 that some customers will buy less gas. Second, by adding a revenue increase
25 on top of a flattened rate structure, each therm becomes more valuable and

1 any loss of sales will be magnified on a unit basis.

2 It is probably not RUCO's intention, but the fact is that any rate
3 structure that relies heavily on commodity sales is a shell game for the
4 company's shareholders and it doesn't matter where the pea is hidden.

5 **Q. DO YOU HAVE ANY REACTION TO STAFF'S AND RUCO'S**
6 **POSITIONS ON REVENUE REQUIREMENTS AND COST OF CAPITAL?**

7 A. On balance, the recommended increases in margin requirements by Staff and
8 RUCO are encouraging because they acknowledge that Southwest Gas is in
9 need of serious financial relief. However, the cost-of-equity
10 recommendations (RUCO 10.15%, Staff 9.5%) are too low, considering that
11 similar companies with better credit profiles and stronger balance sheets are
12 actually earning more than 12 percent return on equity in the marketplace.

13 **Q. WILL STAFF'S RATE OF RETURN FORMULATION ASSURE AN**
14 **INVESTMENT GRADE CREDIT RATING FOR SOUTHWEST GAS?**

15 A. Staff Witness Stephen Hill asserts that the overall rate of return he
16 recommends (8.40%) will give the company an opportunity to achieve pre-tax
17 interest coverage of 2.38 times, which he says is sufficient to allow SWG to
18 retain an investment grade rating under Standard & Poor's benchmarks. He
19 also claims that his recommended return on equity will enable the company
20 to achieve higher interest coverage and improve its risk profile.

21 Mr. Hill's calculations appear to be accurate and his credit rating
22 projections would be comforting if the company actually had a chance to earn
23 the rate of return he recommends. But the history of this company over the
24 past 11 years is that it can't earn its way out of the hole created by declining
25 gas usage and, barring snow on the ground in Gila Bend in July, it will never

1 do so while its margin rates depend on volume sales of gas.

2 **Q. SHOULD SWG BE REQUIRED TO INCREASE ITS EQUITY RATIO TO 40**
3 **PERCENT, AS STAFF RECOMMENDS?**

4 **A.** This is another gross departure from reality.

5 I know of only two ways to increase equity. One is through retained
6 earnings, but as Mr. Shaw testified, Southwest Gas has given up more than
7 \$145 million in net income in Arizona through its inability to earn its
8 authorized rate of return in 10 of the last 11 years. Nothing that Staff has
9 proposed in this case is likely to cure the SWG earnings syndrome.

10 The second method of increasing equity is through a common stock
11 offering. But where is the investor who is willing to buy a high-risk security
12 with restricted earnings potential and poor growth prospects? It's certainly
13 not the existing shareholder who would see the value of his or her stock
14 diluted severely by any new offering.

15 Oh, I nearly forgot. There is a third method. You could simply stop
16 paying dividends and bank the money instead. But I suspect that even Mr.
17 Hill would concede that such a strategy in today's market would consign
18 SWG to the bottom rung of utility stocks.

19 In reality, if the Commission is unwilling to author a substantial
20 change in SWG's ability to earn a reasonable rate of return, any attempt to
21 force an increase in the company's equity ratio will simply be punitive.

22 **Q. DO YOU HAVE ANY FURTHER COMMENTS?**

23 **A.** The positions taken by Staff and RUCO in their rebuttal testimonies are very
24 disappointing. They display a dedication to the status quo and business as
25 usual when the recent history of this company and the evidence in this case

1 point to the need for a major course correction in setting rates for Southwest
2 Gas.

3 If the Commission continues down this path, it will sentence the
4 company to a formula of inadequate earnings, poor credit ratings, high
5 interest costs, a herniated capital structure and revolving rate cases. That is
6 the regulatory definition of purgatory.

7 There is no glory in this behavior and no benefit to consumers, only
8 short-term political gain for those who perpetuate it. Sooner or later, all of
9 this translates into higher charges to customers.

10 Mr. Hill, the Staff's witness, recommended that Southwest Gas be
11 required to develop a plan to increase the equity ratio in its capital structure.
12 AUIA agrees with that recommendation, provided that the Commission also
13 adopts a plan to align SWG's rates with its costs and to free the company
14 from the oppression of commodity sales.

15 **Q. DOES THAT CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

16 **A.** Yes, it does.