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BEFORE THE ARIZONA CORPORATION COMMISSION

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7
8 IN THE MATTER OF THE APPLICATION OF
9 ARIZONA-AMERICAN WATER COMPANY,
10 AN ARIZONA CORPORATION, FOR A
11 DETERMINATION OF THE CURRENT FAIR
12 VALUE OF ITS UTILITY PLANT AND
13 PROPERTY AND FOR INCREASES IN ITS
14 RATES AND CHARGES BASED THERON
15 FOR UTILITY SERVICE BY ITS AGUA FRIA
16 WATER DISTRICT, HAVASU WATER
17 DISTRICT, AND MOHAVE WATER
18 DISTRICT.

Docket No. W-01303A-10-0448

Arizona Corporation Commission

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RUCO'S NOTICE OF FILING
DIRECT TESTIMONY

16 The Residential Utility Consumers Office ("RUCO") hereby provides notice of filing the
17 Direct Testimony of William A. Rigsby on the issue of infrastructure system replacement
18 surcharge in the above-referenced matter.

20 RESPECTFULLY SUBMITTED this 27th day of June, 2011.

Michelle L. Wood
Counsel

1 AN ORIGINAL AND THIRTEEN COPIES
of the foregoing filed this 27th day
2 of June, 2011 with:

3 Docket Control
Arizona Corporation Commission
4 1200 West Washington
Phoenix, Arizona 85007
5

6 COPIES of the foregoing hand delivered/
mailed this 27th day of June, 2011 to:

7
8 Teena Jibilian, Administrative Law Judge
Legal Division
Arizona Corporation Commission
9 1200 W. Washington St.
Phoenix, AZ 85007

Joan S. Burke
Law Office of Joan S. Burke
1650 N. First Avenue
Phoenix, AZ 85003

10
11 Janice Alward, Chief Counsel
Charles Hains, Attorney
Legal Division
12 Arizona Corporation Commission
1200 West Washington
13 Phoenix, Arizona 85007

Kenneth Hewitt
18729 N. Palermo Court
Surprise, AZ 85387

14 Steve Olea, Director
Utilities Division
15 Arizona Corporation Commission
1200 West Washington
16 Phoenix, Arizona 85007

Curtis S. Ekmark
Ekmark & Ekmark, L.L.C.
6720 N. Scottsdale Road, Suite 261
Scottsdale, Arizona 85253

17 Thomas H. Campbell
Michael T. Hallam
18 Lewis and Roca LLP
40 North Central Avenue
19 Phoenix, AZ 85004

Michele L. Van Quathem
Ryley Carlock & Applewhite, P. A.
One North Central Ave., Suite 1200
Phoenix, AZ 85004-4417

20 Greg Patterson, Director
Water Utility Association of Arizona
21 916 West Adams, Suite 3
Phoenix, AZ 85007
22
23
24

By 
Ernestine Gamble

ARIZONA-AMERICAN WATER COMPANY

DOCKET NO. W-01303A-10-0448

**DIRECT TESTIMONY
(Infrastructure System Replacement Surcharge)**

OF

WILLIAM A. RIGSBY

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JUNE 27, 2011

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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. Please describe your qualifications in the field of utility regulation and your
8 educational background.

9 A. I have been involved with utility regulation in Arizona since 1994. During
10 that period of time I have worked as a utilities rate analyst for both the
11 Arizona Corporation Commission ("ACC" or "Commission") and for RUCO.
12 I hold a Bachelor of Science degree in the field of finance from Arizona
13 State University and a Master of Business Administration degree, with an
14 emphasis in accounting, from the University of Phoenix. Appendix 1,
15 which is attached to my direct testimony on the cost of capital issues in
16 this case, further describes my educational background and also includes
17 a list of the rate cases and regulatory matters that I have been involved
18 with.

19
20 Q. What is the purpose of your testimony?

21 A. The purpose of my testimony is to present RUCO's position on Arizona-
22 American Water Company's ("AAWC" or "Company") request for an
23 infrastructure system replacement surcharge ("ISRS") for the Company's

1 Mohave and Havasu Water Districts. The Company-proposed ISRS is
2 explained in the direct testimony of AAWC witness Paul G. Townsley and
3 is part of AAWC's application for a permanent rate increase ("Application")
4 for the Company's Agua Fria, Mohave and Havasu Water Districts.
5

6 **SUMMARY OF TESTIMONY AND RECOMMENDATIONS**

7 Q. Briefly summarize how your direct testimony is organized.

8 A. My direct testimony is organized into three sections. First, the introduction
9 I have just presented and second, the summary of my testimony that I am
10 about to give. Third, I will present RUCO's position on the Company
11 proposed ISRS.
12

13 Q. Please summarize RUCO's recommendation on the Company-proposed
14 ISRS.

15 A. For the reasons that are explained below, RUCO is recommending that
16 the Commission reject the Company-proposed ISRS.
17

18 **INFRASTRUCTURE SYSTEM REPLACEMENT SURCHARGE**

19 Q. Have you reviewed the direct testimony of AAWC witness Paul G.
20 Townsley?

21 A. Yes. I have reviewed Mr. Townsley's testimony which addresses AAWC's
22 request for an ISRS for the Company's Mohave and Havasu Water
23 Districts in this proceeding. Mr. Townsley believes that the ISRS should

1 be adopted for all of AAWC's districts should rate consolidation be
2 adopted in a future proceeding.

3
4 Q. Briefly explain AAWC's request.

5 A. According to Mr. Townsley's testimony, AAWC is seeking Commission
6 approval of a surcharge mechanism that would recover the costs of
7 certain plant additions placed into service between permanent rate case
8 proceedings. Mr. Townsley states that the selected plant additions would
9 include replacement mains, hydrants, meters, (including AMR
10 replacements), services, tanks, and booster stations. AAWC also seeks
11 to include infrastructure relocations as a selected addition that would be
12 eligible for cost recovery under the Company-proposed surcharge.

13
14 Q. How would the Company-proposed recovery mechanism work?

15 A. Mr. Townsley explains that the Company would analyze the qualifying
16 assets placed into service twice a year. The calculation of the actual
17 surcharge would be based on factors that are established in AAWC's most
18 recent rate case before the ACC. The Company would essentially
19 calculate a required level of revenue associated with the plant additions as
20 it would in a general rate case proceeding in order to arrive at the
21 surcharge amount. The surcharge would then be revised as needed
22 during general rate case filings. The Company further proposes that
23 customers be notified of any surcharge increases through a billing insert,

1 and that Commission Staff be required to review the Company's regular
2 infrastructure surcharge requests within a "reasonable period of time
3 (perhaps sixty days)" before the Commission votes on the surcharge as
4 an open meeting item during a scheduled Open Meeting. Because ACC
5 Staff would only be checking on the mechanics of the infrastructure
6 surcharge mechanism between general rate case proceedings, Mr.
7 Townsley states that the ISRS would be subject to a 10 percent cap, and
8 that the plant additions would be subject to the normal prudence review in
9 the Company's next general rate case proceeding. Mr. Townsley believes
10 that the implementation of the Company-proposed ISRS would mitigate
11 the amount of rate shock that would be encountered under traditional
12 ratemaking procedures.

13
14 Q. What is RUCO's recommendation regarding the Company-proposed
15 ISRS?

16 A. RUCO recommends that the Commission reject the Company-proposed
17 ISRS for two reasons. First, AAWC is seeking recovery of routine plant
18 improvements that would normally be recovered in a general rate case
19 proceeding. Second, there is no federal or state requirement mandating
20 the types of routine plant additions that AAWC seeks recovery for through
21 the Company-proposed ISRS. Therefore, there is no need for the
22 Commission to adopt a special surcharge for such additions.

23

1 Q. In regard to RUCO's first reason for rejecting the Company-proposed
2 ISRS, are the types of infrastructure improvements that would be
3 recovered through the ISRS extraordinary in nature?

4 A. No. The types of infrastructure improvements for which Mr. Townsley
5 seeks cost recovery through the company-proposed ISRS are routine in
6 nature. These are plant improvements that any regulated utility would
7 normally make as existing assets reach the end of their useful lives.
8 There is nothing extraordinary about this. The normal regulatory
9 procedures allow cost recovery for these types of plant additions after a
10 determination of prudence and that the additions meet the used and useful
11 standard during a general rate case proceeding when all of the various
12 ratemaking elements are taken into consideration.

13
14 Q. Why is it important to consider all of the ratemaking elements when setting
15 new rates?

16 A. Because the addition of new plant that replaces aging plant can have an
17 impact on operating expenses which are recovered by a utility on a dollar-
18 for-dollar basis in new rates. For example, new additions may be
19 responsible for lower purchased pumping power costs as a result of
20 improved system efficiency and lower employee wage expense as a result
21 of less time spent on repairing aging plant items after normal hours.
22 Under the Company-proposed ISRS, AAWC would enjoy the benefit of
23 receiving a return on and a return of its investment in new plant through a

1 surcharge established between general rate case proceedings in addition
2 to a return on and a return of the plant that it is replacing. Unfortunately,
3 ratepayers receive no benefit from any cost savings that are related to the
4 plant additions that they will be paying for through the ISRS. Any cost
5 savings resulting from new plant additions recovered through the
6 Company-proposed ISRS would be pocketed by AAWC between general
7 rate case proceedings.

8
9 Q. Has RUCO recommended that the Commission reject mechanisms, such
10 as the Company-proposed ISRS, in prior cases?

11 A. Yes. RUCO has consistently opposed the use of cost recovery
12 mechanisms that do not allow for the type of thorough analysis that takes
13 place in a general rate case proceeding. Quite simply, what the Company
14 is proposing here is nothing more than a surcharge that is similar to a Step
15 One Arsenic Cost Recovery Mechanism ("ACRM") which the Commission
16 has approved in the past to allow Arizona water providers to recover the
17 costs associated with meeting more stringent arsenic level standards
18 imposed by the federal government. The fact that water providers had to
19 comply with new federal regulations was an extraordinary circumstance
20 that required an extraordinary ratemaking mechanism.

21
22 ...
23

1 Q. In regard to RUCO's second reason for rejecting the Company-proposed
2 ISRS, are there any federal or state regulations that require the
3 Commission to approve a mechanism that is similar to the ACRM?

4 A. No. Unlike the circumstances surrounding plant that was required for
5 reducing the level of arsenic in drinking water, there are no federal or state
6 requirements that warrant an ACRM-like mechanism for the recovery of
7 aging plant. RUCO believes that adjustor mechanisms are extraordinary
8 rate recovery devices that are permitted for certain narrow circumstances.
9 In RUCO's view, the routine replacement of aging infrastructure, that
10 would be recovered through the Company-proposed ISRS, does not
11 qualify as an extraordinary circumstance that requires a mechanism such
12 as the ACRM which was specifically designed to address a one-time event
13 that impacted dozens of Arizona water companies simultaneously.

14

15 Q. Has the Commission rejected such mechanisms in prior cases?

16 A. Yes, in the prior AAWC rate case proceeding, the Commission adopted
17 the recommendations of ACC Staff and RUCO and rejected a similar cost
18 recovery mechanism identified as an Infrastructure Improvement
19 Surcharge ("IIS") for the same reasons offered above. Decision No.
20 72047 stated the following:

21 "The Company admits the surcharge would cover routine
22 investments in such items as meters, mains, hydrants, tanks and
23 booster stations, and while the Company proposed a cap on the
24 increase between rates, the Company has not quantified the
25 amount of the proposed surcharge. We agree with RUCO and Staff
26 that the recovery of expenditures for plant additions and

1 improvements does not warrant the extraordinary ratemaking device
2 of an adjuster mechanism, and will therefore not grant the request
3 for institution of an IIS.”
4

5 Q. Please address Mr. Townsley’s position that the implementation of the
6 Company-proposed ISRS would mitigate the amount of rate shock that
7 would be encountered under traditional ratemaking procedures.

8 A. An argument could be made that the Company-proposed ISRS would
9 result in gradual rate increases that would be more palatable to both ACC
10 Commissioners and to ratepayers. However, if the Commission were to
11 adopt the Company-proposed ISRS, ratepayers could be looking at two
12 rate increases per year every year between general rate cases – a
13 situation that municipal systems don’t impose on their water and
14 wastewater customers. This steady stream of rate increases is certainly a
15 departure from the Commission’s prior preference for rate stability
16 between general rate cases. While it is possible that the adoption of the
17 Company-proposed ISRS may mitigate rate shock in future general rate
18 cases, the Commission would have to weigh this with the fact that this
19 steady stream of rate increases will benefit the Company more than
20 AAWC ratepayers given the fact that the surcharge amounts will not
21 reflect any dollar-for-dollar cost reductions in operating expenses that are
22 associated with the new plant. Because ACC Staff, and intervenors such
23 as RUCO, will not have the opportunity to look closely at the plant
24 additions being placed into service between rate cases, the possibility
25 exists that imprudent expenditures would not be discovered until a general

1 rate case proceeding and by then ratepayers could have been
2 overcharged for imprudent plant expenditures for a number of years.
3 Furthermore, ratepayers who leave the affected systems will not even see
4 any savings from new rates, established in a general rate case
5 proceeding, that reflect lower operating costs or the disallowance of
6 imprudent plant expenditures. For the reasons that I've given above, I
7 believe that the Commission should reject the Company-proposed ISRS.

8
9 Q. Does your silence on any of the issues, matters or findings addressed in
10 the testimony of any of the witnesses for AAWC constitute your
11 acceptance of their positions on such issues, matters or findings?

12 A. No, it does not.

13
14 Q. Does this conclude your testimony on AAWC?

15 A. Yes, it does.