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BEFORE THE ARIZONA CORPORATION COMMISSION

- 1
- 2 GARY PIERCE
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- 3 BOB STUMP
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- 4 SANDRA D. KENNEDY
COMMISSIONER
- 5 PAUL NEWMAN
COMMISSIONER
- 6 BRENDA BURNS
COMMISSIONER

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Arizona Corporation Commission

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AZ CORP COMMISSION
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7
8 IN THE MATTER OF THE APPLICATION OF
9 SOUTHWEST GAS CORPORATION FOR
10 THE ESTABLISHMENT OF JUST AND
11 REASONABLE RATES AND CHARGES
DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE
OF ITS PROPERTIES THROUGHOUT
ARIZONA

Docket No. G-01551A-10-0458

RUCO'S NOTICE OF FILING
TESTIMONY

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15
16 The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing
17 Testimonies of Jodi A. Jerich, William A. Rigsby and Dr. Ben Johnson in opposition to the
18 Proposed Settlement Agreement of July 15, 2011 in the above-referenced matter.

19 RESPECTFULLY SUBMITTED this 29th day of July, 2011.

20
21

22 Daniel W. Pozefsky
23 Chief Counsel

1 AN ORIGINAL AND THIRTEEN COPIES
of the foregoing filed this 29th day
2 of July, 2011 with:

3 Docket Control
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4 Phoenix, Arizona 85007

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SOUTHWEST GAS CORPORATION

DOCKET NO. G-01551A-10-0458

**TESTIMONY IN OPPOSITION TO
PROPOSED SETTLEMENT AGREEMENT
OF JULY 15, 2011**

OF

JODI A. JERICH

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JULY 29, 2011

TABLE OF CONTENTS

1		
2		
3	Statement of Qualifications.....	1
4	RUCO Philosophy Regarding Settlements.....	4
5	Reasons RUCO Opposes Settlement.....	5
6	RUCO Position On Decoupling.....	7
7	RUCO Alternative Option To Options A & B of the Settlement Agreement...	10

1 **INTRODUCTION**

2
3 **Q. Please state your name, occupation and business address for the**
4 **record.**

5
6 A. My name is Jodi Jerich. I am the Director of the Arizona Residential Utility
7 Consumer Office (RUCO). My business address is 1110 W. Washington
8 Street, Suite 220, Phoenix, Arizona 85007.

9
10 **Q. Please state your educational background and qualifications in the**
11 **utility regulation field.**

12
13 A. Governor Brewer appointed me to serve as the Director of RUCO in
14 February 2009. The Arizona State Senate found my qualifications met the
15 statutory requirements found in Arizona Revised Statutes §40-462 and
16 confirmed my appointment. As Director, I oversee and approve all testimony
17 and briefs filed by RUCO. In consultation with my staff, I direct the public
18 policy decisions of the office.

19
20 From 2003 through 2005, I was employed at the Arizona Corporation
21 Commission as the Policy Advisor to Corporation Commissioner Mike
22 Gleason. In that role, I advised the Commissioner on matters coming before

1 the Commission. I was actively involved in the utility policy-making decisions
2 of that Commissioner's office.

3
4 Except for the time I was employed by the Commission, from 1997 through
5 2008, I was employed at the Arizona House of Representatives. I held
6 several positions during my tenure, eventually becoming Chief of Staff and
7 Counsel to the Majority Caucus. Relevant to the question at hand, I advised
8 Legislators on matters involving water, energy, Commission jurisdiction and
9 utility security.

10
11 In 2006, when Governor Janet Napolitano appointed Barry Wong to fill the
12 Commission seat vacated by Commissioner Marc Spitzer's appointment to
13 the Federal Energy Regulatory Commission (FERC), I took a leave of
14 absence from the Legislature for a short time in order to assist
15 Commissioner Wong establish his office.

16
17 Finally, I am a Phi Beta Kappa graduate of Indiana University. I also have a
18 law degree from Indiana University and am a member of the Arizona and
19 Tennessee bars.

20
21 In my position as RUCO Director, I have filed testimony detailing RUCO's
22 position on numerous matters in several dockets.

23

1 **Q. Have you filed testimony previously in this docket?**

2

3 A. No.

4

5 **Q. What is the purpose of your surrebuttal testimony?**

6

7 A. The purpose of my testimony is to explain why RUCO is not a signatory to
8 the Proposed Settlement Agreement.

9

10 **Q. Does RUCO have an alternative proposal to the decoupling**
11 **mechanism(s) proposed in the settlement agreement?**

12

13 A. Yes. In the spirit of compromise, RUCO offers a "third" option for the
14 Commission's consideration. I will briefly summarize RUCO's proposal later
15 in my testimony and Dr. Johnson will provide the details.

16

17 **Q. Have you, in your capacity as Director of RUCO, signed proposed**
18 **settlement agreements in the past?**

19

20 A. Yes. As Director on behalf of RUCO, I have signed settlement agreements
21 in other rate cases. During my tenure as RUCO's Director, RUCO
22 supported the settlement agreements in the most recent APS rate case

1 (Docket No D-01345A-08-0172) and the Qwest/Century Link merger
2 (Docket No. T-04190A-10-0194).

3

4 **Q. What is RUCO's philosophy regarding settlements?**

5

6 A. RUCO supports the settlement process. RUCO will work hard to find a
7 compromise position but must walk away from the negotiating table when
8 the results of a settlement are not in the best interests of residential
9 ratepayers. And that is what happened here.

10

11 **Q. Do you believe the settlement process in this rate case was open and**
12 **transparent and did RUCO fully participate in the settlement**
13 **negotiations?**

14

15 A. Yes. RUCO fully participated in the settlement process. However, RUCO is
16 not able to support the proposed Settlement Agreement because RUCO
17 believes it is not in the best interests of ratepayers. RUCO is the only party
18 that is not a signatory to the proposed Settlement Agreement.

19

1 **Q. Please summarize why RUCO opposes the Proposed Settlement?**

2
3 A. RUCO finds the Proposed Settlement is not in the best interest of residential
4 ratepayers for the following reasons:

5
6 1. The Proposed Settlement provides two alternative decoupling
7 mechanisms for the utility – full decoupling and almost full decoupling.
8 After careful reflection, RUCO finds that neither proposed decoupling
9 mechanism for this utility, at this time, is in the best interest of residential
10 ratepayers.

11 2. RUCO believes that the utility is in a financially healthy position with
12 strong credit metrics as discussed in detail in Dr. Ben Johnson's Direct
13 Testimony and a decoupling mechanism is not necessary to preserve
14 the financial health of the utility.

15 3. Staff witness Dr. David Dismukes states in his Direct Testimony that
16 ***Southwest Gas would have collected an additional \$62 million from***
17 ***residential customers if its rates had been decoupled from 2007-***
18 ***2010.*** This equates to six percent of residential test year revenue. (page
19 16, lines 17-22, page 17, lines 1-6)

20 4. There is significant public opposition to a decoupling mechanism.¹ As
21 Director, I am very sensitive to the strong opposition to decoupling from
22 the very people RUCO represents. The concept of a decoupling

¹ A cursory review of this docket shows that literally hundreds of ratepayers have communicated their opposition to a decoupling mechanism in this rate case.

1 mechanism is a complex one. The public is concerned that decoupling
2 will result in higher rates regardless of conservation. In the absence of
3 further education and greater customer outreach, it is very likely that
4 decoupling will result in less conservation – the exact opposite of the
5 purpose of decoupling. Furthermore, the first utility to be authorized a
6 decoupling mechanism will need to provide significant consumer
7 education and outreach to its customers. And in light of how poorly the
8 utility communicated with customers during the outages on its system in
9 Southern Arizona this past winter, frankly, this utility may not be the best
10 company to shoulder this responsibility.

11 5. A decoupling mechanism in this case does not achieve one of the
12 primary purposes of a decoupling mechanism. A primary reason for a
13 decoupling mechanism is to delay building additional utility infrastructure
14 – such as additional generating capacity. That compelling reason for a
15 decoupling mechanism is not present for this utility. Southwest Gas, a
16 distribution utility, merely supplies natural gas to customers. The utility's
17 need to build additional infrastructure is predicated upon the growth of its
18 customers. Reduced consumption by existing customers will not defer
19 new infrastructure. There is no correlation between energy efficiency or
20 conservation efforts from existing customers with Southwest Gas' need
21 to expand its distribution system when new customers come on line in its
22 service territory.

1 6. The unique structure of this proposed Settlement Agreement is troubling
2 for RUCO. For the first time in my recollection of Settlement
3 Agreements, the settling parties offer more than one proposal for the
4 Commission's consideration. A settling party can prefer one option over
5 the other and can even oppose one of the options as long as it supports
6 the other option. Ultimately, that party must support the Commission's
7 decision even if it is for an option that party does not support. Where
8 there is so much at stake, it is doubtful that RUCO could ever support a
9 settlement structured this way. Even if RUCO could support one option,
10 RUCO could not give its tacit approval to another option RUCO does not
11 support, particularly when the options address decoupling.

12
13 **Q. Does RUCO oppose a decoupling mechanism in principle?**

14
15 **A.** No. RUCO continues to have concerns about how effective decoupling will
16 be in achieving the intended objective of encouraging reduced consumption
17 of natural gas. However, we recognize the potential for developing a
18 decoupling mechanism that is in the best interest of residential ratepayers
19 as well as the utility. At this time, in this case, given current economic
20 conditions and current ratepayer opposition, we don't believe either of the
21 decoupling mechanisms put forward in the Settlement should be adopted.
22 However, that does not mean RUCO is unalterably opposed to decoupling.

23

1 **Q. Is there a time in the future when RUCO might support a decoupling**
2 **mechanism?**

3

4 A. Yes. RUCO is not foreclosed to the possibility of a decoupling mechanism
5 for other utilities, or for Southwest Gas at a later time if the decoupling
6 mechanism makes sense and the circumstances warrant it.

7

8 **Q. In a nutshell, what arguments does RUCO find persuasive for**
9 **decoupling?**

10

11 A. The focus of decoupling should be to the benefit of the ratepayer while
12 holding the utility financially harmless. RUCO believes it is in the interests
13 of consumers to delay building additional infrastructure because the costs of
14 new infrastructure would most likely raise rates higher than the adjustments
15 made through a decoupling mechanism. That is definitely to the benefit of
16 the customer. But instead, here we have just the opposite. Under the
17 decoupling mechanism(s) offered in the proposed settlement, the benefit is
18 purely for the utility with no benefit for the ratepayer.

19

20

21

22

23

1 **Q. Please explain.**

2

3 A. Under a well-constructed decoupling mechanism, the utility would
4 implement robust and cost effective energy efficiency programs and the
5 individual ratepayers would use less energy and enjoy a reduced monthly
6 bill. Reduced consumption would result in the delay the need to build new
7 and very expensive generation, transmission and other infrastructure. A
8 decoupling mechanism would hold the utility harmless for the reduced
9 consumption and allow it to cover its fixed costs. In the end, the revenue
10 paid for by the ratepayers through the decoupling mechanism would be
11 vastly outweighed by the deferred costs to build new generation and
12 corresponding infrastructure.

13

14 **Q. Why isn't that the case here?**

15

16 A. No amount of reduced consumption will defer infrastructure growth because
17 the need for new infrastructure is based entirely on building new distribution
18 facilities to service new customers, and not to meet the needs of existing
19 customers due to increased consumption. Here, ratepayers who do reduce
20 their natural gas usage do not get to enjoy the full savings of their efforts.
21 And those customers who either choose to not reduce their consumption or
22 who have already reduced their consumption as far as they will see their

1 bills increase through the decoupling mechanism. And all of this will not
2 defer new infrastructure.

3

4 **Q. Does RUCO offer an alternative to the two options offered in the**
5 **proposed Settlement Proposal?**

6

7 A. Yes. In the spirit of compromise, RUCO offers a “third” option for the
8 Commission’s consideration. It is a slightly modified version of the
9 proposed Settlement Agreement’s Option B except for the following
10 changes:

11

12 1. In lieu of a decoupling proposal, RUCO recommends shifting a
13 portion of the revenue requirement into the fixed monthly rate. The
14 fixed monthly rate would increase to \$11.85 from \$10.70.

15 2. Instead of a 10-year weather normalization period, RUCO proposes
16 what it believes to be a more accurate 30-year weather normalization
17 period.

18 3. Instead of the FVROR methodology used in the settlement
19 agreement, RUCO recommends the FVROR methodology explained
20 in Dr. Johnson’s Direct Testimony.

21 4. All other components would be the same including the 9.50% ROE,
22 capital structure and inclusion of post test year plant.

23

1 The details of RUCO's third option is addressed in greater detail in Dr.
2 Johnson's testimony in response to the proposed Settlement Agreement.

3

	Option A	Option B	RUCO Option
ROE	9.75%	9.50%	9.50%
Revenue Increase	\$54.9M	\$52.6M	\$44.6M
FVROR	7.02%	6.92%	6.85%
Mechanism to compensate utility for lost fixed costs	Almost full decoupling with no cap	Full decoupling with 5% cap	No decoupling Shift more revenue into fixed monthly rate
Weather normalization period	10 years	10 years	30 years
Low Income programs	Yes	Yes	Agrees with Settlement
Commitment to energy efficiency	Yes	Yes	Agrees with Settlement
Rate Case moratorium	None	5 years	None

4

5

6 **Q. Does that conclude your testimony?**

7 **A. Yes.**

8

9

SOUTHWEST GAS CORPORATION

DOCKET NO. G-01551A-10-0458

**TESTIMONY IN OPPOSITION TO
PROPOSED SETTLEMENT AGREEMENT
OF JULY 15, 2011**

OF

WILLIAM A. RIGSBY

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JULY 29, 2011

TABLE OF CONTENTS

1		
2	INTRODUCTION.....	1
3	REVISED COST OF EQUITY RECOMMENDATION	2
4	FINAL RECOMMENDATION	4

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 prior testimony in this case on behalf of RUCO?

8 A. Yes. On June 10, 2011, I filed direct testimony with the Commission on
9 RUCO's recommended cost of capital for SWG.

10

11 Q. Please state the purpose of your testimony.

12 A. The purpose of my testimony is to present RUCO's revised cost of equity
13 capital, which is part of RUCO's proposed alternative ("Proposed
14 Alternative") to the proposed SWG settlement agreement ("Agreement")
15 that was entered into by SWG, ACC Staff and various other parties to the
16 case. The Agreement was filed on July 15, 2011.

17

18 Q. Is RUCO a signatory to the Agreement?

19 A. No. RUCO is not a signatory to the Agreement¹. My testimony provides
20 support for the recommendations of RUCO witness Ben Johnson, Ph.D.
21 and Jodi Jerich, who are filing testimony in opposition to the Agreement.

¹ Signatories to the Agreement include Southwest Gas Corporation, the Utilities Division of the Arizona Corporation Commission, Arizona Investment Council, Southwest Energy Efficiency Project, National Resources Defense Council and Ms. Cynthia Zwick.

1 **REVISED COST OF EQUITY RECOMMENDATION**

2 Q. What revised cost of equity is RUCO recommending in its Proposed
3 Alternative to the Agreement?

4 A. RUCO is recommending a cost of equity of 9.50 percent in its Proposed
5 Alternative to the Agreement.

6
7 Q. How does RUCO's revised cost of equity compare to the cost of equity
8 that you recommended in your direct testimony?

9 A. RUCO's revised 9.50 percent cost of equity is 50 basis points higher than
10 the 9.00 percent cost of equity that I recommended in my direct testimony.

11
12 Q. How does RUCO's revised 9.50 percent cost of equity compare with the
13 cost of equity contained in the Settlement Agreement?

14 A. RUCO's revised 9.50 percent cost of equity is equal to the 9.50 percent
15 return on equity ("ROE") under Alternative B of the Agreement, and is 25
16 basis points lower than the 9.75 percent ROE under Alternative A of the
17 Agreement.

18
19 Q. Please compare the costs of equity that were recommended by the
20 Company, ACC Staff and RUCO prior to the filing of the Agreement.

21 A. The costs of equity that were recommended by the Company, ACC Staff
22 and RUCO prior to the filing of the Agreement were as follows:

23

1	Company	11.00%
2	ACC Staff	9.75%
3	RUCO	9.00%

4

5 Q. Why Is RUCO recommending a cost of equity that is 50 basis points
6 higher than RUCO's 9.00 litigation recommendation?

7 A. RUCO is offering a higher cost of equity in the spirit of compromise.
8 RUCO's revised cost of equity is being offered as part of an alternative to
9 the Agreement that is now before the Commission.

10

11 Q. Do you believe that the 9.50 percent cost of equity, being offered in the
12 spirit of compromise, is reasonable given the results of your cost of equity
13 analysis?

14 A. Yes. After comparing the range of results of my cost of equity analysis
15 with the range of results obtained by ACC Staff's cost of capital witness;
16 Mr. David C. Parcel, I believe that RUCO's revised 9.50 percent cost of
17 equity is reasonable. RUCO's revised 9.50 percent cost of equity is 28
18 basis points higher than the 9.22 percent high end of the range of results
19 that I obtained in my cost of equity analysis, and is 42 basis points higher
20 than the 9.08 percent mid-range of cost of equity estimates obtained by
21 Mr. Parcel. RUCO's revised 9.50 percent cost of equity is 25 basis points
22 lower than Mr. Parcel's final recommended cost of equity estimate of 9.75
23 percent that is part of Alternative A of the Agreement.

1 Q. Does RUCO's Proposed Alternative adopt the proposed capital structure
2 and cost of debt contained in the Agreement?

3 A. Yes. Again in the spirit of compromise, RUCO's Proposed Alternative to
4 the Agreement adopts the proposed capital structure and cost of debt
5 contained in the Agreement.

6

7 **FINAL RECOMMENDATION**

8 Q. What is your final recommendation?

9 A. I am recommending that the Commission adopt the revised 9.50 percent
10 cost of equity that is part of RUCO's Proposed Alternative to the
11 Agreement.

12

13 Q. Does your silence on any of the provisions of the Agreement constitute
14 your acceptance of those provisions?

15 A. No, it does not.

16

17 Q. Does this conclude your testimony?

18 A. Yes, it does.

SOUTHWEST GAS CORPORATION

DOCKET NO. G-01551A-10-0458

**TESTIMONY IN OPPOSITION TO
PROPOSED SETTLEMENT AGREEMENT
OF JULY 15, 2011**

OF

BEN JOHNSON, Ph.D.

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JULY 29, 2011

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TESTIMONY
OF BEN JOHNSON, PH.D.
On Behalf of
The Residential Utility Consumer Office
Before the
Arizona Corporation Commission

Docket No. G-01551A-10-0458

Introduction

- Q. Would you please state your name and address?**
- A. Ben Johnson, 3854-2 Killearn Court, Tallahassee, Florida.

- Q. What is your present occupation?**
- A. I am a consulting economist and president of Ben Johnson Associates, Inc.®, an economic research firm specializing in public utility regulation.

- Q. Have you prepared an appendix that describes your qualifications in regulatory and utility economics?**
- A. Yes. Appendix A, attached to my testimony, will serve this purpose.

1 **Q. Are you the same Ben Johnson that filed revenue requirements testimony on June 10, 2011**
2 **and rate design testimony on June 24, 2011?**

3 A. Yes, I am.
4

5 **Q. What is the nature of this testimony?**

6 A. Our firm has been retained by the Residential Utility Consumer Office ("RUCO") to assist with
7 RUCO's evaluation of Southwest Gas Corporation's (SWG's) application for a rate increase.
8 The purpose of this testimony is to explain why RUCO objects to the proposed settlement
9 agreement ("Proposed Settlement", or "Settlement") filed by the Commission Staff and other
10 parties on July 15, 2011.
11

12 **Q. How is your testimony organized?**

13 A. Following this introduction, my testimony has four sections. In the first section, I briefly
14 discuss the procedural background of this proceeding, focusing on events that have occurred
15 after the parties filed their direct testimony. In the second section, I briefly summarize some key
16 provisions of the Proposed Settlement. In the third section, I explain RUCO's objections to the
17 Proposed Settlement. In the final section I present my conclusions and recommendations.
18

19 **Q. Can you please briefly summarize RUCO's position concerning the Settlement?**

20 A. Yes. RUCO objects to the Proposed Settlement, primarily because of the provisions concerning
21 decoupling. While the Settlement differs somewhat from the Company's originally filed
22 proposal, it is not significantly better – in fact, it would be fair to analogize the Settlement
23 modifications to the decoupling proposal as being largely cosmetic when complete rejection, or
24 drastic modifications were needed. Accordingly, I recommend the Commission reject the
25 Settlement as filed. It should tell the parties to negotiate drastic changes to the Settlement or

1 resubmit it without the decoupling provisions, or the Commission should issue an order ruling
2 on the issues in this proceeding based upon the filed evidence, and as part of that ruling it
3 should reject the various decoupling proposals.
4

5 **I. Background**
6

7 **Q. Can you briefly discuss what has transpired since the parties filed revenue requirements**
8 **and rate design testimony in this proceeding?**

9 A. Yes. On June 21, 2011, SWG filed a Notice of Settlement Discussions inviting all parties to
10 participate. Settlement discussions began on June 28, 2011, and RUCO participated in the
11 settlement discussions until it became clear that the other parties were insisting upon including
12 decoupling as part of the Settlement – despite the fact that this is a highly controversial issue
13 which RUCO believes needs to be fully litigated. The Settlement does not craft an approach
14 which would resolve the concerns set forth in my testimony concerning decoupling, which was
15 filed in this proceeding on June 24, 2011 behalf of RUCO.
16
17

18 **II. Summary of Proposed Settlement Agreement**
19

20 **Q. Can you briefly summarize the proposed settlement filed on July 15, 2011?**

21 A. Yes. The proposed agreement puts forth two alternative revenue requirements, tied to two
22 different decoupling alternatives. "Alternative A" includes a Lost Fixed Cost Recovery (LFCR)
23 component and a weather component. This

24 partial revenue decoupling mechanism permits Southwest Gas to recover
25 lost base revenues attributable to achievement of the Commission's
26 required annual energy savings and to adjust customer bills each month

1 when actual weather during the billing cycle differs from the average
2 weather used in the calculation of rates. [Proposed Settlement, para. 3.4]
3

4 Under Alternative A, the initial LFCR surcharge will be set at \$0.00213 per therm, based on the
5 assumption that the Company will achieve 100% of the Commission's required annual energy
6 savings. The amount recovered through the surcharge would be tried up on an annual basis to
7 actual lost base revenues caused by energy efficiency. If the Company fails to meet 100% of the
8 required energy savings, the difference between the 100% it was allowed to collect and the
9 actual lost revenue would be refunded to customers during the next annual reconciliation
10 process. If SWG exceeds the 100% energy efficiency goal,

11 the Company will be permitted to recover, through the surcharge, in the
12 following year the difference between the 100 percent collected from
13 customers and the actual amount of the lost base revenues associated
14 with attaining energy savings greater than 100 percent of the year's goal,
15 as limited by the Commission's required annual energy savings. [Id.,
16 para. 3.7]
17

18 Under Alternative A, the weather component will be incorporated through a monthly true-up to
19 winter bills. "When actual weather during the billing cycle differs from the average weather
20 used in the calculation of rates there will be either an upward or downward adjustment to the
21 customers' bill." [Id., para. 3.10]

22 Under Alternative A, the Company will be authorized to increase rates by an amount
23 designed to increase revenues by \$54,927,101, based upon an authorized return on common
24 equity capital of 9.75%, and a Fair Value Rate of Return (FVROR) of 7.02% on Fair Value Rate
25 Base (FVRB). The latter calculations are apparently based upon one the approaches offered by
26 the Staff in its direct testimony concerning FVROR. [Id., p. 3.3] SWG would not be subject to
27 any rate case moratorium under Alternative A.

28 Alternative B is similar to Alternative A, except that it includes an even more drastic or
29 comprehensive decoupling mechanism which is described as "full" decoupling. This more

1 extreme decoupling approach is coupled with an overall revenue increase of \$52,607,414, a
2 return on common equity capital of 9.50%, and a fair value rate of return of 6.92% on FVRB
3 (again using Staff’s fair value methodology). [Id., para. 3.17] Under the “full” decoupling
4 mechanism, rates will adjust to reflect any and all differences between authorized revenues per
5 customer and actual revenues per customer. This is the mechanism largely the same as the one
6 originally proposed by SWG in its Application. Alternative B includes the same weather
7 component as included under Alternative A. Under Alternative B, SWG would be prohibited
8 from filing a general rate case application prior to April 30, 2016. [Id., para. 3.30]

9
10 **Q. Can you now briefly describe some of the other provisions included in the proposed**
11 **settlement?**

12 A. The parties to the settlement will be filing testimony simultaneously with this filing, and I
13 assume they will explain in some detail how they arrived at the specific provisions set forth in
14 the Settlement Agreement, so I will not make any attempt to fully summarize those details.
15 However, I would like to briefly mention a few items. First, the settling parties agreed to a
16 capital structure comprised of 47.70 percent long-term debt and 52.30 percent common equity,
17 and an embedded cost of debt of 8.34% [Id., paras. 5.2-5.3] Second, the settling parties agreed
18 to an OCRB for the test year ending June 30, 2010 of \$1,070,115,558, a RCND rate base of
19 \$1,835,749,225, and a fair value rate base of \$1,452,932,391. [Id., paras. 5.4-5.6] Third, the
20 settling parties agreed to a base rate revenue allocation resulting in an equal percentage increase
21 among all customer classes, with the exception of low income customers, who would not share
22 in any of the burden of the rate increase. [Id., para. 5.36]

1 **III. Response to Proposed Settlement Agreement**

2

3 **Q. Why did RUCO decide not to join the settlement?**

4 A. As I alluded to a moment ago, RUCO was troubled by the insistence by other parties that the
5 Settlement include revenue decoupling. As explained in my originally filed testimony, I am not
6 convinced that decoupling will actually accomplish its stated purpose of encouraging energy
7 efficiency and conservation. To the contrary, it may actually have the unintended consequence
8 of discouraging customers from conserving energy. Furthermore, decoupling will tend to force
9 customers to pay higher rates, increasing the Company's cash flows and profits, at the expense
10 of consumers. RUCO could not, and does not, understand why other parties insisted upon
11 embarking into such risky, uncharted waters, nor why they insisted upon imposing a resolution
12 to this controversial issue as part of the Settlement, nor why they were so reluctant to have it be
13 fully litigated before the Commission.

14

15 **Q. Can you explain RUCO's opposition to the revenue decoupling provisions in greater**
16 **detail?**

17 A. The revenue decoupling provision contained in Alternative B is essentially the same as the
18 original proposal included by SWG in its application. For a full discussion of RUCO's concerns
19 with Alternative B, I refer the Commission to my previously filed testimony. The decoupling
20 mechanism in Alternative A is not quite as extreme, since it is intended to be limited to revenues
21 that are lost as a result of SWG's compliance with the Commission's energy savings goals. It is
22 not clear exactly how Alternative A will be implemented, nor how the Commission will
23 determine the extent to which changes in per-customer usage are "attributable to achievement of
24 the Commission's required annual energy savings," the extent to which this achievement is
25 attributable to the Company's efforts, or the manner in which offsetting factors (e.g. the impact

1 of changes in economic conditions or changes in consumer attitudes) will be accounted for in
2 determining how to implement Alternative A.

3 However, both provisions have certain elements in common. As I explained in my
4 previously filed testimony, Alternatives A and B will both benefit SWG's shareholders, while
5 customers will receive little or no net benefit. Both alternatives will shift significant non-gas
6 costs from shareholders to customers. Alternative B will also have the effect of reducing year-
7 to-year volatility in non-gas revenues and profits. While both provisions are clearly beneficial
8 to shareholders, they are not so attractive from the perspective of customers, and they are both
9 fraught with risks for customers – if for no other reason than because they involve a
10 fundamental upending of the regulatory system, with substantial unknown consequences.

11 Yet, there is no evidence showing that the alleged existing "disincentives" for SWG to
12 promote energy efficiency are actually influencing the Company's behavior in any way – much
13 less that the negative impact of these alleged disincentives is significant enough to justify a
14 complex, risky overhaul of the entire regulatory schema. The stated purpose of decoupling is to
15 encourage energy conservation, yet the proposed decoupling provisions will weaken the
16 incentives customers, builders and developers currently have to be more energy efficient. If the
17 Commission adopts decoupling it will be sending the message to customers that future
18 reductions in usage will automatically lead to higher rates per therm. In other words, the more
19 consumers conserve, the more they are going to be forced to pay per therm. To the extent
20 consumers learn about decoupling, and understand this linkage between efforts to conserve and
21 higher rates, the more severe the risk is that decoupling will have the opposite effect as the one
22 that is intended – it may actually have the effect of discouraging consumers from conserving,
23 thereby offsetting the beneficial impact of efforts by the Company and this Commission to
24 accelerate the long term trend toward greater energy efficiency and conservation.

25

1 **Q. Can you elaborate on the first major problem you mentioned?**

2 A. Decoupling is based in part on the theory that the Company has a disincentive to promote
3 energy efficiency, and it has an incentive to try to encourage customers to use energy in a
4 profligate manner. However, I am not aware of any evidence that the Company has responded
5 to these incentives. Without any evidence that these supposed "disincentives" are causing
6 problems, it would be unwise for the Commission to embark on such a massive restructuring of
7 the existing regulatory regime.

8

9 **Q. Can you please elaborate on the second major problem - how decoupling could weaken
10 the incentives for customers to be more energy efficient?**

11 A. As I explained in greater detail in my rate design testimony, the decoupling program will reduce
12 the benefits obtained from more energy efficient decisions – with rates automatically increasing
13 as per-customer usage declines, customers as a group will not get the same short term benefit
14 they currently receive as a reward for increased energy efficiency. After the next annual true up,
15 the per unit cost of gas will increase under decoupling – so that the more customers conserve,
16 the higher rates will increase.

17

18 **Q. What is the danger to the ratepayer if decoupling discourages customers from conserving,
19 resulting in less energy efficiency?**

20

21 A. At least under Option B, the Company will receive higher revenues due to decoupling, and
22 customers will be paying higher bills, yet the end result may be little or no net improvement in
23 efficiency and thus insufficient benefits, or no benefits, for ratepayers even over the long term.
24 In other words, customers will be paying permanently higher rates without a commensurate
25 benefit in the form of lower gas usage and improved efficiency.

1 **Q. The settlement includes a provision requiring cost cutting; will this benefit customers?**

2 A. Not necessarily. The proposed settlement includes a provision requiring SWG to reduce its
3 expenses on an annual basis by an average of \$2.5 million per year beginning in 2012 and
4 continuing through the end of the test year in the Company's next general rate case. [Id., para.
5 5.20] It is not clear how this reduction will be measured, or how the Commission will
6 differentiate between cost reductions attributable to this provision and cost reductions which
7 would occur in the ordinary course of business. Regardless, it is important to remember that
8 costs are reduced, the immediate beneficiaries are stockholders. True, customers eventually
9 share in the benefit of cost reductions, but this occurs after the cost reductions show up in a test
10 year and are reflected in a new set of rates established in a rate case. Because the Settlement
11 will automatically increase per-unit rates between rate cases, it will bolster the Company's cash
12 flow and income, and extend the time period between rate cases. In turn, this will put less
13 pressure on management to cut costs. The requirement for \$2.5 million per year in cost cutting
14 may offset or ameliorate this problem, but to the extent rates will be increasing and costs will be
15 decreasing, it is far from clear whether, or when, consumers will benefit. To the contrary, the
16 benefits of the \$2.5 million in cost reductions will be retained by stockholders until the next rate
17 case, and with the benefit of automatically increasing rates attributable to decoupling, the period
18 between rate cases will presumably be longer than it would otherwise have been. The delay in
19 any potential sharing of the benefits of the \$2.5 million in cost reductions is even more obvious
20 under Alternative A, which includes a rate case moratorium.

21

22 **Q. You've made clear that RUCO's primary objection to the Settlement relates to the**
23 **decoupling issue. Are there any other issues you would like to briefly discuss?**

24 A. Yes. There are two issues I'd like to briefly mention, although they are relatively minor. To put
25 these issues into perspective, please consider the following table, which compares the

1 Alternative A and Alternative B revenue requirements in the Settlement to the amounts
2 originally recommended by the Company, Staff and RUCO:

3

	Revenue Requirement
SWG	\$73.2M
Staff	\$54.9M
Alternative A	\$54.9M
Alternative B	\$52.6M
RUCO	\$29.2M

5 As this table indicates, the Settlement revenue requirement is roughly midway between
6 the Company's request and RUCO's recommendation – and it is approximately the same as
7 Staff's recommendation. In and of itself, this is not disturbing, since it is not uncommon for the
8 Commission's findings on revenue requirement to be somewhere in the middle of the range of
9 options presented in the evidence. However RUCO is troubled by two specific aspects of the
10 Settlement. First, the revenue requirements were supposedly developed using Staff's
11 recommended Fair Value Rate of Return (FVROR) methodology, but in reality the Settlement
12 relies upon the less appropriate of two methods offered by the Staff in its direct testimony – a
13 method which is clearly inferior to the one I recommended in my testimony. Second, the
14 revenue requirements incorporate an erroneous measure of “normal” weather, as proposed by
15 the Company, without correcting the errors which I pointed out in my testimony.

16

17

18 **Q. Can you explain RUCO's concerns regarding the FVROR method?**

19 A. Yes. According to the Settlement, the FVROR was purportedly developed using the
20 methodology proposed by Staff in its revenue requirement testimony. This is not true – or, at
21 best is misleading. In his direct testimony, Staff witness David Parcell recommended including

1 the increment between fair value rate base and original cost rate base in the proposed capital
2 structure, and applying a cost of zero to this increment. He explains:

3 Since the increment between fair value rate base and original cost rate
4 base is not financed with investor-supplied funds, it is logical and
5 appropriate, from a financial standpoint, to assume that this increment
6 has no financing cost. As a result, the cost of capital, through the capital
7 structure, can be modified to account for a level of cost-free capital in an
8 equal dollar amount to the increment of FVRB over the OCRB. Such a
9 procedure would still provide for a return being earned on all investor-
10 supplied funds and would thus be consistent with financial standards.
11 [Parcells Direct, p. 50]
12

13 Using this methodology, Staff witness Parcell developed a FVROR of 6.69%. He further
14 concluded:

15 Applying this 6.69 percent to the FVRB provides for a return on all
16 investor-supplied capital and is therefore an appropriate rate to apply to
17 the FVRB from a financial and economic standpoint. As such, it provides
18 for an appropriate fair value rate of return to be applied to a FVRB. [Id.,
19 pp. 50-51]
20
21

22 Mr. Parcell also developed an alternative approach to developing the FVROR, but this
23 was not his preferred methodology,¹ and it was only offered for use in the event "the
24 Commission determine[s] that there should be a specific return (greater than zero) applied to the
25 FVRB Increment". [Id., p. 51] Under Mr. Parcell's alternative approach, half the rate of inflation
26 (estimated to be 1.25%) would be applied to the fair value increment.

27 In summarizing the parties' positions filed on direct, the Settlement provides:

28 Staff agreed with the Company's capital structure and embedded cost of
29 long-term debt, but recommended a cost of common equity capital of
30 9.75 percent and a FVROR of 7.02 percent using a 1.25 percent inflation-
31 adjusted risk-free return on the fair value increment (differential between
32 FVRB and OCRB). [Proposed Settlement, para. 2.2]
33

34 The language in the Settlement suggests it is based upon the FVROR methodology

1 recommended by Staff, yet it is actually using an approach the Staff offered as a fallback or
 2 compromise position, to be used only in the event that the Commission determines some level
 3 of cost needs to be applied to the fair value increment. The Commission has made no such
 4 determination in this case, and there is nothing in the Settlement that justifies using this
 5 approach. The parties could just as easily, and far more appropriately, used the methodology
 6 adopted in Docket No. E-04204A-09-0206, as I recommended in my testimony. This approach
 7 would be more theoretically sound than the one used in the Settlement, while yielding a result
 8 that falls between the one recommended by Mr. Parcell and the one used in the Settlement.

9
 10 **Q. Can you briefly elaborate on the FVROR methodology you are recommending, and how it**
 11 **compares to the approach used in the Settlement?**

12 A. I would refer the Commission to my direct testimony for an in depth explanation of my
 13 recommended approach, and the underlying theory that supports its use. In essence, I
 14 recommended subtracting the rate of inflation component from both the cost of equity and cost
 15 of debt. This is the methodology adopted by the Commission in UNS Electric's most recent rate
 16 case, Docket No. E-04204A-09-0206. [See, Decision 71914, pp. 49-50]

17 As shown in the table below, using the 9.50% cost of equity recommended by RUCO
 18 witness Rigsby in his settlement testimony, and the capital structure and debt costs assumed in
 19 the Settlement, results in a FVROR of 6.85%, rather than 6.92% as calculated in the Settlement:

20
 21
 22 **RUCO Approach – Using Settled Capital Structure**

Type of Capital	Amount	Percent	Cost Rate	Inflation Component	Modified Cost Rate	Weighted Avg. Cost Rate
Common Equity	561,545,431	52.30%	9.50%	2.10%	7.40%	3.87%
Long Term Debt	512,155,202	47.70%	8.34%	2.10%	6.24%	2.98%
Total	1,073,700,633	100.00%				6.85%

1 Thus, this difference in methodology results in a difference in the FVROR of .07%. By way of
2 further illustration, I would note that if the Commission were to adopt a 9.75% cost of equity, as
3 set forth in the Settlement in the context of Alternative A, using the more appropriate
4 methodology I recommend FVROR would be 6.98%, rather than 7.02% as put forth in the
5 Settlement, a difference of just .04%.

6
7 **Q. The end result of using a theoretically sound methodology is not greatly different than the**
8 **end result adopted in the Settlement. Why are you even raising this issue?**

9 A. As I stated earlier, the primary reason RUCO objects to the Settlement is because of the
10 provisions concerning decoupling. However, the FVROR methodology is also an important
11 issue – one which is still somewhat in flux, and one that has wide implications for future
12 proceedings. There is no logical reason to adopt Staff's fallback alternative, when a more
13 theoretically sound approach is available – particularly when that theoretically sound
14 methodology has previously been adopted by the Commission, and its adoption in this case
15 would not drastically change the overall revenue requirement agreed upon by the settling
16 parties.

17
18 **Q. Can you discuss RUCO's second minor concern, relating to weather normalization?**

19 A. Yes. The proposed settlement apparently incorporates SWG's proposed "Revenues and
20 Volumes" adjustment, including SWG's so-called "weather normalization" calculations. This
21 component of the revenue requirement calculations is intended to adjust the test year non-gas
22 revenues (margin) to reflect 12 months of consumption under supposedly "normal" weather
23 conditions. Properly developed, this is unobjectionable. The problem is that SWG developed
24 it's interpretation of the "normal" number of heating degree days, using a relatively brief ten-
25 year average (for the 120 months ended June 2010), incorporating an adjustment for alleged

1 “outliers” which greatly distorts the final result.

2 As I explained in my direct testimony, it isn't logical to replace the actual test year
3 results with hypothetical calculations based upon supposedly “normal” weather data that is
4 based on just ten years of data. Since weather patterns can vary widely from one year to the
5 next, it is not unreasonable to attempt to “normalize” the test year based on a long term average,
6 but even a ten year period can be a bit warmer, or cooler, than normal. The Company tried to
7 compensate for this problem by providing an adjustment to remove supposed “outliers” from
8 the 10 years of data, but the effect of this step was to greatly distort their calculations, pushing
9 the so-called “normal” measure of HDD away from a true norm.

10 During the discovery process, SWG provided certain data in response to RUCO data
11 request 6-1. That data shows that for Tucson SWG developed an adjusted 10-year average
12 heating degree day value of 1,440. That value is put forward as supposedly representing some
13 sort of “normal” weather, but in reality it is a purely hypothetical calculation which is lower
14 than the actual heating degree days during the majority of the previous 30 years. Similarly,
15 SWG developed an adjusted 10-year average heating degree day value for Phoenix of 892.
16 Although that value is put forward as representing “normal,” in reality it a distorted calculation
17 which reflects fewer heating degree days than actually occurred during 20 of the previous 30
18 years.

19 In fact, the heating degree day values used in the Settlement far from “normal” -- as
20 indicated by the fact that they are lower than the historical averages actually experienced in
21 Tucson during the past 10, 11, 12, 13, 14, 15,16, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29
22 and 30 year periods. The one (partial) exception to this lopsided pattern: the 1440 figure
23 happens to match the 17 year average. Similarly, the heating degree day values used in the
24 Settlement are lower than the historical averages actually experienced in Phoenix during the
25 past 10, 11, 12, 13, 14, 15,16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29 and 30 year

1 periods. There are no exceptions – the supposed “normal” figure advocated by SWG is so
2 abnormal it is lower than the actual data for every one of these historical time periods, spanning
3 the entire range from 10 to 30 years in duration.

4 This not only distorts the revenue requirement, it ensures that the weather decoupling
5 calculations will be invalid. Regardless of how hot or cold the actual weather turns out to be in
6 any given month or year, if the Settlement is accepted customers will be forced to pay
7 artificially high rates, based upon hypothetical weather conditions that are supposedly “normal”
8 but in reality are warmer than normal.

9
10
11 **IV. Conclusions and Recommendations**

12
13 **Q. What do you recommend the Commission do regarding the proposed settlement**
14 **agreement?**

15 A. I recommend the Commission reject the Settlement for the reasons I have just given. I
16 recognize that the Commission has expressed an interest in decoupling, and that the issues
17 surrounding decoupling are not unique to SWG, or even to Arizona. However, I see no
18 pressing need to adopt any form of decoupling at this time. Instead, the Commission should
19 continue to investigate decoupling in the context of individual rate proceedings, in which there
20 is an opportunity to fully litigate the issue, and to explore the pros and cons in the context of
21 specific utilities.

22 If the Commission is inclined to approve the settlement, I strongly recommend it do so
23 only if the parties to the Settlement accept certain modifications. First, I recommend the
24 Commission remove the decoupling provisions. If the Commission feels some further
25 concession to the Company will be necessary if the decoupling provisions are rejected, I

1 recommend increasing SWG's flat monthly customer charges to \$11.85 per month, rather than
2 freezing this rate element at its current level of \$10.70 (as the Company proposed) or reducing
3 this rate element (as I originally recommended, on behalf of RUCO). Second, I recommend the
4 Commission modify the revenue requirement to reflect a more theoretically sound FVROR
5 methodology, and a valid measure of "normal" weather, based upon the 30 year average data
6 (eliminating any need to adjust for alleged "outliers.")

7
8 **Q. It is your recommendation that the Commission reject decoupling. Is it RUCO's position**
9 **that the Commission should reject decoupling in principle and/or modify its policy on**
10 **decoupling?**

11
12 A. No. My analysis is limited to the facts and circumstances applicable to this particular case. As
13 Ms. Jerich testifies in her testimony, RUCO has some general concerns about how effective
14 decoupling will be in achieving the intended goal of energy conservation, but the agency
15 recognizes that decoupling does have some attractive attributes, and a well formulated
16 decoupling policy could potentially be in the ratepayers' best interest under appropriate
17 circumstances. If the Commission is going to experiment with decoupling, it makes sense to
18 wait for an appropriate set of circumstances – unlike the situation in this case. For the reasons I
19 have stated, in addition to the reasons stated in Ms. Jerich's testimony, decoupling is not an
20 appropriate solution in this case, but that does not preclude the possibility that decoupling might
21 be more beneficial and appropriate under a different set of circumstances (e.g. for an electric
22 utility).

1 **Q. In your direct case, you offered a decoupling proposal. Why is RUCO not recommending**
2 **that proposal at this time?**

3
4 A. That portion of my direct testimony case, was offered as a potential alternative if the
5 Commission determined that decoupling should be adopted for this Company. Subsequent to
6 that filing, RUCO has come to the conclusion there is not enough interest in this potential
7 compromise to merit offering it in this filing. Instead, I have suggested the possibility of further
8 increasing the fixed monthly customer charge as an alternative to decoupling.

9
10 **Q. In your direct testimony, you expressed concerns that SWG's customer charges were**
11 **already higher than would be cost-justified. Why are you suggesting RUCO's willingness**
12 **to move further away from cost-based rates, if decoupling is rejected?**

13 A. RUCO is offering this suggestion in the spirit of compromise. RUCO recognizes that SWG is
14 seeking decoupling in part because this would help maintain or boost its cash flows and income
15 in the face of a trend towards energy conservation, and to reduce the volatility of its revenues
16 and income in the face of wide fluctuations in weather conditions. While a further increase in
17 the monthly customer charge is not cost-justified, a modest increase can reasonably be justified
18 as an effort to help mitigate two of the concerns that are motivating the Company to seek
19 decoupling.

20 A modestly higher customer charge would change the trajectory of future cash flows and
21 income in the presence of a continued trend toward energy conservation, and it would help
22 reduce volatility in the Companys' revenue and income in the face of changing weather
23 conditions. Thus RUCO is offering this suggestion as a compromise – it is not cost-justified,
24 but it is less objectionable than the decoupling provisions included in the proposed Settlement.

25

1 **Q. Have you estimated the impact of changing the revenue requirements in the Settlement to**
2 **reflect the use of a more appropriate FVROR methodology, and the use of the 30 year**
3 **average for “normal” weather?**

4 A. Yes. I was not provided with a copy of the workpapers underlying the Settlement, so I instead
5 used a copy of the workpapers filed with Staff's direct testimony to estimate these impacts.
6 More specifically, using a Return on Equity of 9.50% but a FVROR of 6.85% based on RUCO's
7 methodology, and replacing the inappropriately adjusted 10 year average weather data with the
8 unadjusted 30 year average weather data, I estimate the \$52.6 million revenue requirement set
9 forth in the Settlement would be reduced to approximately \$44.6 million.

10

11 **Q. In summary, what is RUCO's proposed resolution of the issues in this case?**

12 A. In the spirit of compromise, and in recognition of the efforts by other parties to resolve the
13 issues through the proposed Settlement, RUCO is willing to accept all elements of the
14 Settlement except for the three issues I've discussed in this testimony: decoupling, fair value
15 methodology, and weather normalization. Accordingly, RUCO recommends the Commission
16 reject the Settlement as filed, but resolve the issues in this proceeding in accordance with the
17 provisions of the Settlement with these exceptions: reject decoupling, calculate the FVROR
18 using the methodology adopted in Docket No. E-04204A-09-0206, and normalize weather
19 based upon the unadjusted 30 year average. I estimate this will result in a revenue requirement
20 of approximately \$44.6 million. Finally, in an effort to alleviate to some degree the financial
21 concerns which underly the Company's preference for decoupling, I recommend increasing
22 SWG's flat monthly customer charges to \$11.85 per month, notwithstanding the fact that this
23 would push this rate further above a cost-justified level.

24

25

1 **Q. Will you be filing additional schedules to this testimony??**

2

3 A. Yes. RUCO recently asked me to prepare one or more schedules showing the impact of
4 RUCO's recommendations on residential rates. Once I have had an opportunity to prepare this
5 analysis, RUCO intends to provide it to the Commission and other parties. If possible, this will
6 be done prior to the hearing in this case, and RUCO anticipates asking permission to introduce
7 the schedules into evidence.

8

9 **Q. Does this conclude your testimony pre-filed on July 29, 2011?**

10 A. Yes, it does.

11

12