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BEFORE THE ARIZONA CORPORATION COMMISSION

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8 IN THE MATTER OF THE APPLICATION OF  
 9 ARIZONA WATER COMPANY, AN ARIZONA  
 10 CORPORATION, FOR A DETERMINATION  
 11 OF THE FAIR VALUE OF ITS UTILITY  
 12 PLANT AND PROPERTY, AND FOR  
 13 ADJUSTMENTS TO ITS RATES AND  
 14 CHARGES FOR UTILITY SERVICE  
 15 FURNISHED BY ITS NORTHERN GROUP  
 16 AND FOR CERTAIN RELATED  
 17 APPROVALS.

Docket No. W-01445A-12-0348

Arizona Corporation Commission  
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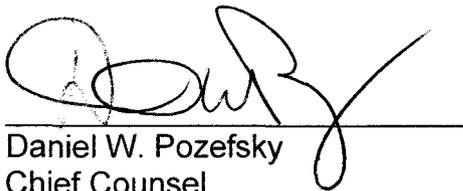
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**RUCO'S NOTICE OF FILING**

16 The RESIDENTIAL UTILITY CONSUMER OFFICE ("RUCO") hereby provides notice of  
 17 filing the Direct Testimony of William A. Rigsby in opposition to the Settlement Agreement, in  
 18 the above-referenced docket.

20 RESPECTFULLY SUBMITTED this 26th day of April, 2013.

21   
 22 Daniel W. Pozefsky  
 23 Chief Counsel

1 AN ORIGINAL AND THIRTEEN COPIES  
2 of the foregoing filed this 26th day  
3 of April, 2013 with:

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6 Phoenix, Arizona 85007

5 COPIES of the foregoing hand delivered/  
6 mailed this 26th day of April, 2013 to:

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ARIZONA WATER COMPANY  
DOCKET NO. W-01445A-12-0348

DIRECT SETTLEMENT TESTIMONY  
OF  
WILLIAM A. RIGSBY  
IN  
OPPOSITION TO THE SETTLEMENT AGREEMENT

ON BEHALF OF  
THE  
RESIDENTIAL UTILITY CONSUMER OFFICE

APRIL 26, 2013

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9

**EXECUTIVE SUMMARY**

RUCO Chief of Accounting and Rates, William Rigsby, recommends that the Arizona Corporation Commission (“ACC” or “Commission”) reject the proposed settlement agreement on Arizona Water Company Northern Group rate case which adopts a 10.00 percent return on common equity in addition to both a System Improvement Benefits (“SIB”) mechanism and a declining usage adjustment to the Company’s test year billing determinants.

In Mr. Rigsby’s opinion, the 10.00 percent return on common equity is in itself excessive for a regulated water utility and should be reduced, even for settlement purposes, to take into consideration the risk shifting aspects of the SIB and the declining usage adjustment.

RUCO further recommends that the Commission adopt an 8.80 percent cost of equity capital that takes into consideration the shift in risk attributed to the SIB mechanism and a possible windfall as a result of the declining usage adjustment.

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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 the Chief of Accounting and Rates  
4 for 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, I filed direct testimony presenting RUCO's recommendations on cost  
9 of capital and on the Company's request for a Distribution System  
10 Improvement Charge ("DSIC") mechanism on March 1, 2013.

11

12 **Q. Is RUCO a signatory to the proposed settlement agreement that is**  
13 **the subject of this phase of the proceeding?**

14 A. No. RUCO is not a signatory to the proposed settlement agreement  
15 ("Settlement Agreement").

16

17 **Q. Please state the purpose of your testimony.**

18 A. The purpose of my testimony is to present RUCO's reasons for opposing  
19 the proposed settlement agreement ("Settlement Agreement") on Arizona  
20 Water Company's Northern Group rate application. The Settlement  
21 Agreement was filed with the Arizona Corporation Commission ("ACC" or  
22 "Commission") on April 12, 2013. My testimony will address RUCO's  
23 concerns with the Settlement Agreement and why RUCO believes the

1 Settlement Agreement is not in the public interest and should not be  
2 approved by the Commission.

3  
4 **Q. How is your testimony organized?**

5 A. My testimony contains six parts: the introduction that I have just  
6 presented; a section on the background of this proceeding; a section that  
7 discusses the Settlement Agreement; a section on the System  
8 Improvement Benefits ("SIB") mechanism that has been adopted by the  
9 Settlement Agreement; a section on the declining usage adjustment to test  
10 year billing determinants that has also been adopted in the Settlement  
11 Agreement; and a section on the rate of return adopted in the Settlement  
12 Agreement and why RUCO believes it should be reduced as a result of  
13 the adoption of the SIB mechanism and the declining usage adjustment.

14  
15 **BACKGROUND**

16 **Q. Please discuss the background on this proceeding.**

17 A. On August 1, 2012, AWC filed an application ("Application") with the  
18 Commission requesting a permanent rate increase for the Company's  
19 Northern Group systems.

20  
21 AWC's Northern Group is comprised of the Company's Navajo system  
22 (which provides service to Lakeside and Overgaard), and the Verde Valley  
23 system (which serves customers in Sedona, Pinewood and Rimrock).

1           During the test year ended December 31, 2011, AWC's Northern Group  
2           Systems provided water service to approximately 19,700 customers. In  
3           the Company's Application, AWC sought a total revenue increase of  
4           \$2,829,777 or an increase of 27.95 percent over test year revenues for the  
5           Northern Group.

6  
7           Pursuant to a Procedural Order issued on February 22, 2013 ACC Staff  
8           and RUCO filed their direct testimony on required revenue and cost of  
9           capital by March 1, 2013. Direct testimony on cost of service and rate  
10          design was filed on March 5, 2013.

11  
12          On March 13, 2013, ACC Staff filed a Notice of Settlement Discussions  
13          informing interested parties that AWC had approached ACC Staff with the  
14          possibility of attempting to settle the case.

15  
16          After a full day of negotiations on Tuesday, March 19, 2013, a tentative  
17          settlement agreement was reached between ACC Staff and AWC.

18  
19          **Q. Were the settlement discussions conducted in an open and**  
20          **transparent manner?**

21          **A.** Yes. I believe that the settlement discussions were conducted in an open  
22          and transparent manner. The parties to the case were made aware of the  
23          scheduled settlement meeting at the Commission's Phoenix offices and

1           were invited to participate in settlement discussions on an equal basis with  
2           each other.

3

4   **Q.    Did RUCO participate in the settlement discussions?**

5   A.    Yes.

6

7   **Q.    Is RUCO a signatory to the Settlement Agreement?**

8   A.    No. RUCO has chosen not to sign the Settlement Agreement because of  
9           its concerns with the overall rate of return, the SIB mechanism and a  
10          declining usage adjustment.

11

12   **Q.    Does RUCO believe that the Agreement itself is a good Agreement?**

13   A.    The Settlement Agreement has some good points in RUCO's view.  
14          However, as I will explain in the next two sections of my testimony, RUCO,  
15          among other things, believes that the overall shifting of risk from AWC to  
16          the Company's ratepayers – resulting from the adoption of a SIB  
17          mechanism and a declining usage adjustment – is not in the public  
18          interest.

19

20   **SETTLEMENT AGREEMENT**

21   **Q.    Have you reviewed the Settlement Agreement on AWC's Northern**  
22          **Group?**

23   A.    Yes.

1 **Q. Please describe the Settlement Agreement.**

2 A. The Settlement Agreement provides AWC with an increase in operating  
3 revenue of \$2,240,329, or 21.8 percent, over the Northern Group's  
4 settlement adjusted test year operating revenue of \$10,256,611. The  
5 increase in operating revenue adopted by the Settlement Agreement is  
6 \$589,448 lower than the \$2,829,777 increase that AWC requested in its  
7 Application, \$316,457 higher than the \$1,923,872 increase recommended  
8 by ACC Staff in its direct testimony, and \$548,523 higher than the  
9 \$1,691,806 increase recommended by RUCO in its direct testimony. The  
10 Settlement Agreement will provide AWC's Northern Group with an annual  
11 revenue requirement of \$12,496,939.

12  
13 The Settlement Agreement also adopts a Northern Group Fair Value Rate  
14 Base of \$36,045,295, which is \$12,320 lower than ACC Staff's direct  
15 testimony recommended rate base of \$36,057,615 and \$1,289,762 higher  
16 than RUCO's recommended rate base of \$34,755,533.

17  
18 In addition to a \$131,954 increase to adjusted test year operating revenue  
19 related to an adjustment to test year billing determinants, the Settlement  
20 Agreement also adopts a net \$105,490 decrease to total Northern Group  
21 test year operating & maintenance expense. The Settlement Agreement  
22 also adopts upward pro forma adjustments of \$10,084 for the Northern

1           Group's depreciation & amortization expense and \$54,528 for income tax  
2           and property tax expenses.

3  
4           In regard to rate of return, the Settlement Agreement adopts an  
5           undisputed capital structure comprised of 48.9 percent debt and 51.1  
6           percent common equity. During the underlying rate case proceeding the  
7           signatories, as well as RUCO, were in agreement on the 6.82 percent cost  
8           of debt which has been adopted for settlement and ratemaking purposes.  
9           The Settlement Agreement further adopts a 10.00 percent return on  
10          common equity ("COE") which is 130 basis points lower than the 11.30  
11          percent COE proposed by AWC's cost of capital witness prior to  
12          settlement discussions and is 90 and 125 basis points higher than the  
13          9.10 percent and 8.75 percent COE pre-settlement recommendations of  
14          ACC Staff and RUCO respectively.

15  
16          In addition to the aforementioned adjustment to the Northern Groups test  
17          year billing determinants, The Settlement Agreement also adopts a SIB  
18          mechanism that will allow AWC to implement a surcharge to recover a  
19          return on, and a return of the capital costs of certain eligible utility plant  
20          items that are placed into service between general rate case proceedings.

21  
22          ...

1 **SYSTEM IMPROVEMENT BENEFITS MECHANISM**

2 **Q. Does the Settlement Agreement adopt a SIB mechanism?**

3 A. Yes. The details of the SIB are displayed in Exhibit 1 of the Settlement  
4 Agreement.

5  
6 **Q. What exactly is a SIB mechanism?**

7 A. The SIB mechanism is the successor to the distribution system  
8 improvement charge ("DSIC") mechanisms that AWC and other Arizona  
9 water providers have unsuccessfully requested in a number of prior rate  
10 case proceedings before the ACC (both RUCO and ACC Staff consistently  
11 opposed such mechanisms that would allow for the recovery of non-  
12 extraordinary routine plant additions between general rate case  
13 proceedings). The SIB mechanism is the result of settlement discussions  
14 that were ordered by the Commission in Decision No. 73736, dated  
15 February 20, 2013, which established rates and charges for AWC's  
16 Eastern Group systems.<sup>1</sup> Decision No. 73736 adopted the  
17 recommendations of the Administrative Law Judge who heard the Eastern  
18 Group Case, but left the docket open (Phase 2 of the proceeding) in order  
19 for AWC, ACC Staff, RUCO and other intervenors to engage in settlement  
20 discussions on what eventually became known as the SIB mechanism.  
21 The SIB mechanism that was crafted in AWC's Eastern Group case is

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<sup>1</sup> Docket Number W-01445A-11-0310

1 intended to serve as a template for other water providers besides AWC  
2 that wish to request it in future rate case proceedings.

3

4 **Q. How does a SIB mechanism work?**

5 A. Based on the AWC Eastern Group settlement agreement, AWC will be  
6 permitted to implement a surcharge on the Company's Eastern Group  
7 ratepayers that will allow the Company to recover a return on, and a return  
8 of the capital costs of certain eligible utility plant items that are placed into  
9 service between general rate case proceedings.

10

11 **Q. When would the SIB surcharge go into effect?**

12 A. Under the terms of the Eastern Group settlement agreement, AWC will be  
13 able to, within twelve months from the date of the ACC's final decision on  
14 the Company's general rate case application, file a request with the  
15 Commission to implement the SIB surcharge to be collected from AWC's  
16 Eastern Group ratepayers. AWC would be able to file for additional SIB  
17 surcharges in subsequent years as long as the surcharges do not exceed  
18 a 5 percent cap of total authorized revenues. AWC would be required to  
19 file a rate case five years after the prior rate case in which the SIB  
20 mechanism was approved.

21

22 **Q. Is the Northern Group SIB the same as the Eastern Group SIB?**

23 A. Yes.

1 **Q. Has the Commission approved the SIB for AWC's Eastern Group?**

2 A. No, not yet. The evidentiary hearing on Phase 2 of the AWC Eastern  
3 Group concluded on April 11, 2013. Post hearing legal briefs are  
4 scheduled to be filed on Monday, April 29, 2013. Pursuant to Decision  
5 No. 73736, the Administrative Law Judge's Recommended Opinion and  
6 Order will be filed on May 28, 2013, and the Commission will consider a  
7 final order on the SIB mechanism during the Regular Open Meeting  
8 scheduled for Tuesday and Wednesday, June 11 and 12, 2013. A final  
9 decision on the Settlement Agreement will most likely not occur until  
10 sometime in late August or early September, 2013

11

12 **Q. Was RUCO a signatory to the Eastern Group settlement agreement**  
13 **which adopted the SIB mechanism?**

14 A. No. RUCO was not a signatory to the Eastern Group settlement  
15 agreement which adopted the SIB mechanism. During the Phase 2  
16 hearing both RUCO Director Patrick J. Quinn and I testified against the  
17 SIB mechanism adopted in the Eastern Group settlement.

18

19 **Q. What were RUCO's reasons for opposing the SIB mechanism during**  
20 **Phase 2 of the Eastern Group proceeding?**

21 A. First, and perhaps most important, the SIB mechanism shifts risk from the  
22 Company to ratepayers without adequate financial consideration to the  
23 ratepayers. Second, RUCO believes that the SIB is not legal in Arizona.

1 Third, there are a number of flaws with the SIB as proposed. Fourth, the  
2 SIB is not in the public interest.

3  
4 **Q. Please elaborate on each of the four reasons stated above beginning**  
5 **with RUCO's view that the SIB shifts risk from the Company to**  
6 **ratepayers.**

7 **A.** In RUCO's view, the SIB mechanism reduces regulatory lag for AWC  
8 because the Company will not have to wait until new rates go into effect to  
9 recover a return on SIB eligible plant or the depreciation expense  
10 associated with it. However, any actual cost savings, such as lower  
11 operating and maintenance expense, attributable to the new plant are not  
12 captured by the mechanism and flowed through to ratepayers. Unlike a  
13 typical adjustor mechanism for purchased fuel or natural gas which  
14 operates on a two way street basis by flowing both increases and  
15 decreases in costs to ratepayers the SIB operates on a one way street  
16 basis and only provides cost recovery to AWC. Ratepayers on the other  
17 hand see no actual cost savings that might be realized and will no longer  
18 benefit from the rate stability that exists under the present ratemaking  
19 procedure.

20  
21  
22 ...

1 **Q. What is regulatory lag?**

2 A. Regulatory lag is the time that it takes for a utility to recover the costs of  
3 plant additions placed into service between general rate case proceedings  
4 through new rates.

5

6 **Q. Please explain how regulatory lag works to the benefit of both**  
7 **utilities, such as AWC, and ratepayers.**

8 A. In my direct testimony I cited a report authored by Ken Costello of the  
9 National Regulatory Research Institute who stated that mechanisms such  
10 as the proposed SIB “undercut the positive effects of regulatory lag on a  
11 utility’s costs.” According to Mr. Costello, “economic theory predicts that  
12 the longer the regulatory lag, the more a utility has to control its costs.”  
13 Regulatory lag acts as a surrogate for the competitive pressures that force  
14 unregulated companies to keep their costs low. Under this scenario, both  
15 utilities and ratepayers see the benefits that come from higher earnings  
16 and lower rates.

17

18 **Q. Doesn’t the SIB incorporate a 5.00 percent efficiency credit?**

19 A. Yes, it does.

20

21

22 ...

23

1 **Q. Why does RUCO believe that the SIB mechanism is not legal in**  
2 **Arizona?**

3 A. Of course, this question suggests a legal analysis. I am not an attorney  
4 and not testifying as one. RUCO presented its legal analysis regarding  
5 the Company's proposed DSIC in its legal briefs during Phase 1 of the  
6 Eastern Group docket.<sup>2</sup> The legal objections are for the most part the  
7 same.

8  
9 **Q. From a layman's perspective, can you summarize the legal**  
10 **argument?**

11 A. Again, I would defer to the attorneys for the legal interpretation but the  
12 controversy centers on Arizona's fair value requirement and RUCO's  
13 belief that the SIB violates the Constitutional requirement of finding fair  
14 value when establishing rates. Perhaps Staff, who also believed the  
15 Company's proposed DSIC in the Eastern Group case was  
16 unconstitutional (See Staff Opening Brief at page 26), summed it up best  
17 when it said "The DSIC in this case does far more than simply pass on  
18 increasing and decreasing costs to AWC. It allows surcharges based on  
19 the cost of the new plant, effectively increasing the fair value rate base  
20 without any determination by the Commission of what that fair value is."<sup>3</sup>

21

---

<sup>2</sup> RUCO's legal arguments regarding the SIB mechanism will be filed in its legal brief in that case on April 29, 2013.

<sup>3</sup> See Staff's Reply Brief in the Eastern Group Case at page 22.

1 **Q. Does the SIB mechanism increase the fair value rate base without**  
2 **any determination by the Commission of what fair value is?**

3 A. Yes. The Company will be able to file for the SIB surcharge no more than  
4 five times between rate case decisions (AWC Eastern Group settlement  
5 agreement, section 4.4). The Commission will ultimately consider and  
6 then may approve each surcharge filing. The Commission, however, will  
7 not be making a meaningful fair value finding as part of each surcharge  
8 filing.

9  
10 **Q. What will be the result of the Commission's findings?**

11 A. Among other things, the result will be rates based on a period different  
12 than the period in which the Company's operating expenses were  
13 incurred.

14  
15 **Q. Are there other aspects to the legal argument that you have not**  
16 **discussed?**

17 A. Yes. Again I would refer the reader to the Briefs submitted by both  
18 RUCO and ACC Staff on the legality of the DSIC in the Eastern Group  
19 case. RUCO believes that the SIB mechanism has not overcome the  
20 legal hurdles raised by ACC Staff and RUCO in their respective Briefs.  
21 While it is true that the SIB mechanism would be authorized by the ACC in  
22 a general rate case proceeding, the SIB mechanism would recover the  
23 costs associated with new plant placed into service in the years between

1 general rate case proceedings. Because a SIB surcharge could be  
2 established within thirty days of the Company's request, the same level of  
3 scrutiny that occurs in a general rate case proceeding would not exist to  
4 insure that a meaningful finding of fair value is accomplished.  
5 Furthermore, the SIB surcharge would represent piecemeal ratemaking  
6 since it would only recover capital expenditures associated with the type of  
7 plant items that a regulated water utility, such as AWC, would replace  
8 under normal circumstances and seek rate base treatment for in a general  
9 rate case proceeding.

10  
11 **Q. Please discuss some of the other flaws with the proposed SIB**  
12 **settlement.**

13 **A.** The 5.00 percent efficiency credit is inadequate to compensate ratepayers  
14 for the shift in risk. The settlement awards a higher cost of common equity  
15 than what ACC Staff and RUCO recommended. The Commission will be  
16 considering a SIB mechanism in addition to a higher COE. In exchange,  
17 the only financial benefit to the Company's ratepayers is the 5.00 percent  
18 efficiency credit. RUCO believes that the Settlement Agreement is  
19 woefully inadequate here, at the ratepayer's expense.

20  
21 In RUCO's view, none of the plant items are extraordinary in nature and  
22 none of the plant is being replaced under extraordinary circumstances,  
23 such as a government mandate. In addition to the failure of taking into

1 consideration all of the ratemaking elements that are reflected in rates  
2 approved by the Commission in a general rate case proceeding, the SIB  
3 has been tied to the Commission's policy of keeping water loss under  
4 10.00 percent. While this might seem laudable, given the fact that much  
5 of Arizona is in an arid climate, the SIB could have the unintended effect  
6 of encouraging utilities to exceed the 10.00 percent threshold just to  
7 qualify for a SIB surcharge in order to get faster recovery of routine plant  
8 additions. As noted earlier, the short period of time in which the request  
9 for a SIB surcharge is filed and the time it is approved circumvents a  
10 proper regulatory review for prudence and reasonableness.

11  
12 The settlement also does not specifically address the issue of fire flow  
13 upgrades that have been problematic in the past. Finally, there is no  
14 reason to believe that AWC would not be able to ensure safe and reliable  
15 water service or achieve cost recovery absent the SIB mechanism.  
16 Therefore, there is no need for the Commission to adopt a special  
17 surcharge for routine plant additions. I will refer the reader to RUCO's  
18 Closing Brief, Phase 2 in the eastern docket case at pages 14 through 18,  
19 for further elaboration on why RUCO believes certain provisions of the SIB  
20 Agreement are flawed.

21  
22  
23

1 **Q. Please explain why RUCO believes the SIB mechanism is not in the**  
2 **public interest.**

3 A. The National Association of State Utility Advocates (“NASUCA”) passed a  
4 resolution in 1999 that states a number of reasons why the SIB  
5 mechanism is not in the public interest. NASUCA’s Ad Hoc Water  
6 Committee stated that rate stability is reduced and proper price signals are  
7 distorted by frequent rate increases. According to the NASUCA  
8 resolution, no convincing evidence has been shown to support the claim  
9 that the frequency of rate case proceedings is reduced by mechanisms  
10 such as the SIB. NASUCA’s findings are consistent with the recent  
11 findings of the Regulatory Affairs and Public Advocacy (“RAPA”) section of  
12 the Alaska Attorney General’s Office. RAPA found that, among other  
13 things, that a review of ten states that have implemented some sort of  
14 DSIC-type mechanism, there does not appear to be support for the  
15 conclusion that DSIC adoption reduces rate case frequency.<sup>4</sup>  
16 Furthermore, special incentives are not needed in order ensure adequate  
17 water quality, pressure, and a proper reduction of service interruptions. In  
18 NASUCA’s view, SIB-like mechanisms can inappropriately reward water  
19 companies that have imprudently fallen behind in infrastructure  
20 improvements. Finally, the NASUCA resolution expressed the belief that it  
21 is inappropriate to tilt the regulatory balance against consumers and shift  
22 business risk away from water companies simply for the purpose of

---

<sup>4</sup> See RUCO’s Closing Brief at 8-10.

1           creating an incentive for those companies to fulfill their basic obligation to  
2           provide safe and adequate service.

3  
4           For the various reasons cited above, RUCO believes that the Commission  
5           should reject the proposed SIB mechanism.

6  
7   **Q.   Does RUCO believe that a downward adjustment to the 10.00 percent**  
8   **COE adopted by the Settlement Agreement is warranted given the**  
9   **workings of the SIB mechanism?**

10  A.   Yes.  As I will explain in the Rate of Return section of my testimony,  
11       RUCO believes that a downward adjustment is warranted.

12

13  **DECLINING USAGE ADJUSTMENT**

14  **Q.   Please explain the purpose of a declining usage adjustment.**

15  A.   A declining usage adjustment allows a utility to recover lost revenues  
16       associated with declines in projected water consumption.

17

18  **Q.   How does a declining usage adjustment work?**

19  A.   Under the method proposed by AWC, forecasted shortfalls of revenue are  
20       recovered through a rate design in which the rates are calculated with  
21       usage-adjusted billing determinants.

22

23

1 **Q. So a downward adjustment is made to test year billing determinants?**

2 A. Yes. The adjustment purposely decreases the actual number of bills  
3 recorded during the test year. In theory, the resulting rate design with  
4 higher rates will provide the Company with additional revenue that will  
5 make up for anticipated declines in water consumption.

6  
7 **Q. What if the anticipated declines in water consumption do not occur?**

8 A. Then the Company will over collect its authorized level of revenue and  
9 possibly see a windfall in operating income.

10  
11 **Q. Is it common to make this type of adjustment to test year billing  
12 determinants?**

13 A. No. Typically the only adjustment to test year billing determinants are  
14 adjustments that annualize the bill count to take into consideration the  
15 increase or decrease in customers at the end of the test year.

16  
17 **Q. Did AWC request a declining usage adjustment in this proceeding?**

18 A. Yes.

19  
20 **Q. Has AWC sought a declining usage adjustment in prior proceedings  
21 before the Commission?**

22 A. Yes. The Company has requested such an adjustment in various forms in  
23 prior proceedings before the Commission.

1 **Q. Has the Commission ever approved a declining usage adjustment for**  
2 **AWC prior to this proceeding?**

3 A. No. AWC's requests for a declining usage adjustment was either rejected  
4 or dropped, as part of a negotiated settlement agreement, in three of the  
5 Company's prior rate case proceedings.<sup>5</sup>

6  
7 **Q. Does the Settlement Agreement adopt a declining usage adjustment**  
8 **for the AWC Northern Group?**

9 A. Yes.

10

11 **Q. Did RUCO oppose the declining usage adjustment in the underlying**  
12 **rate case?**

13 A. Yes.

14

15 **Q. Why did RUCO oppose the declining usage adjustment in this and**  
16 **prior AWC cases?**

17 A. RUCO has consistently opposed AWC's declining usage adjustment  
18 because it is not convinced that the level of declining usage per customer  
19 will continue into the future. RUCO also has doubts that the declining  
20 usage experienced by AWC is the result of conservation efforts. Further,  
21 RUCO is not convinced that any projected or forecasted declining usage  
22 will result in AWC's inability to earn its authorized return from such

---

<sup>5</sup> Docket No.'s W-01445A-11-0310, W-01445A-10-0517 and W-01445A-08-0440

1 customers. The potential for ongoing conservation will be mitigated and  
2 usage levels stabilized over time; thus, minimizing the declining usage that  
3 impacts the Company's revenues.

4  
5 **Q. Does RUCO believe that a downward adjustment to the 10.00 percent**  
6 **COE adopted by the Settlement Agreement is warranted if a**  
7 **declining usage adjustment is adopted?**

8 A. Yes. As in the case of the SIB mechanism, RUCO believes that a  
9 downward adjustment is merited.

10  
11 **RATE OF RETURN**

12 **Q. Why does RUCO believe that the 10.00 percent COE adopted in the**  
13 **Settlement Agreement should be lower?**

14 A. RUCO believes that the 10.00 percent COE should be lower because of  
15 the adoption of the SIB mechanism and the declining usage adjustment in  
16 the Settlement Agreement. Both the SIB mechanism and the declining  
17 usage adjustment shift risk from AWC and onto the Company's ratepayers  
18 in the form of annual SIB surcharges and higher rates than what the actual  
19 test year billing determinates would produce.

20  
21  
22 ...

1 **Q. Earlier you stated that the declining usage adjustment adopted in the**  
2 **Settlement Agreement would produce a windfall for AWC if the**  
3 **declining usage trend flattens out. How much additional revenue will**  
4 **the Northern Group realize in the event that the declining usage does**  
5 **flatten out?**

6 A. RUCO has calculated that the Northern Group would realize an additional  
7 \$419,644 in operating revenue over the \$12,496,939 in operating revenue  
8 produced by the adjusted test year billing determinants adopted in the  
9 Settlement Agreement. RUCO believes that this amount of potential  
10 additional operating revenue, which would be provided by AWC's  
11 ratepayers, is simply not equitable.

12  
13 **Q. What amount of potential additional operating revenue is equitable in**  
14 **RUCO's view?**

15 A. RUCO believes that an equitable amount of additional operating revenue  
16 would be \$209,060 which is approximately one half of the \$419,644 in  
17 additional operating revenue cited above.

18  
19 **Q. What COE would produce additional operating revenue of \$209,060?**

20 A. RUCO has calculated that a COE of 9.30 percent would result in a rate of  
21 return of 8.09 percent which would generate additional operating revenue  
22 of \$209,060 if the Company's declining usage flattens out.

23

1 **Q. What further adjustment to RUCO's recommended 9.30 percent COE**  
2 **figure would take into account the lower risk associated with the SIB**  
3 **mechanism adopted in the settlement agreement?**

4 A. RUCO believes that an additional 50 basis point reduction should be  
5 made to RUCO's 9.30 percent COE (which reflects the lower risk  
6 associated with the declining usage adjustment). This results in a COE of  
7 8.80 percent. RUCO's 8.80 percent COE produces a rate of return of 7.83  
8 percent which RUCO believes to be acceptable given the amount of risk  
9 that would be shifted to AWC's ratepayers under the Settlement  
10 Agreement.

11  
12 **Q. What level of increase in gross revenue is produced by RUCO's**  
13 **recommended 7.83 percent rate of return?**

14 A. RUCO's 7.83 percent rate of return produces an increase in gross  
15 revenue of \$1,875,047 which is \$365,282 less than the \$2,240,329  
16 adopted in the Settlement Agreement. RUCO's recommended total  
17 proposed annual revenue for AWC's Northern Group would be  
18 \$12,131,658.

19  
20  
21  
22 ...

1 **Q. Please compare RUCO's recommended 7.83 percent rate of return**  
2 **with the rates of return recommended by AWC, ACC Staff and RUCO**  
3 **in the underlying case.**

4 A. RUCO's 7.83 percent rate of return is 128 basis points lower than the 9.11  
5 percent recommended by AWC, 7 basis points lower than the 7.90  
6 percent rate of return recommended by ACC Staff, and 2 basis points  
7 higher than RUCO's recommended 7.81 percent rate of return.

8

9 **Q. Does RUCO believe that its recommended 7.83 percent rate of return**  
10 **is a reasonable figure given the shift in risk attributed to the SIB**  
11 **mechanism and the possible effects of the declining usage**  
12 **adjustment are taken into consideration?**

13 A. Yes.

14

15 **Q. Does your silence on any other issues, matters or findings**  
16 **addressed in the testimony of the parties who support the Settlement**  
17 **Agreement constitute your acceptance of the Company's positions**  
18 **on such issues, matters or findings?**

19 A. No, it does not.

20

21 **Q. Does this conclude your testimony on the Settlement Agreement?**

22 A. Yes, it does.