



0000053991

ORIGINAL

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

BEFORE THE ARIZONA CORPORATION COMMISSION

ARIZONA CORPORATION COMMISSION
DOCUMENT CONTROL
FEB 18 P 2:56

RECEIVED

MARC SPITZER
CHAIRMAN
WILLIAM MUNDELL
COMMISSIONER
JEFF HATCH-MILLER
COMMISSIONER
MIKE GLEASON
COMMISSIONER
KRISTIN K. MAYES
COMMISSIONER

Arizona Corporation Commission

DOCKETED

FEB 18 2004

DOCKETED BY

IN THE MATTER OF THE APPLICATION OF)
ARIZONA-AMERICAN WATER COMPANY, INC.,)
DETERMINATION OF THE CURRENT FAIR)
VALUE OF ITS UTILITY PLANT AND PROPERTY)
AND FOR INCREASES IN ITS RATES AND)
CHARGES BASED THEREON FOR UTILITY)
SERVICE BY ITS SUN CITY WEST WATER AND)
WASTEWATER DISTRICTS.)
_____)
)
AND RELATED MATTERS.)
_____)

DOCKET NOS.:
WS-01303A-02-0867
WS-01303A-02-0868
WS-01303A-02-0869
WS-01303A-02-0870
W-01303A-020908

YOUNGTOWN
REPLY BRIEF

The Town of Youngtown (Youngtown), by and through its attorneys undersigned, hereby responds to the positions presented by the Arizona-American Water Company, Inc. ("Company" or "Co."), the staff of the Arizona Corporation Commission ("Staff") and the Residential Utility Consumer Office ("RUCO"), Mr. Grimmelmann and the Arizona Utility Investors Association ("AUIA") in their closing briefs as they relate to the position advanced by Youngtown.

1 **I. “FAIR VALUE” DOES NOT EQUATE TO “REPLACEMENT COST”.**

2 There is no dispute among the parties that the Arizona Corporation
3 Commission (“Commission”) is required “to determine a fair value rate base [of the
4 Company] before setting rates.” *U.S. West Communications v. Arizona Corp. Comm’n*,
5 201 Ariz. 242, 34 P.3d 351 (2001)(*U.S. West II*); Staff at p.2, ll. 13-23; RUCO at p.3, ll.
6 13-18; Co. at p.4, ll. 23-25; Youngtown at p. 6, ll. 7-17. The dispute is over how the
7 Commission is to make that determination and how that determination is to be used in
8 setting rates. The Company and AIUA assert a Fair Value Rate Base (“FVRB”)
9 equivalent to the Reconstruction New Depreciated Rate Base (“RCRB”). All other
10 parties, except Staff, assert the Company’s FVRB is equivalent to the Original Cost Less
11 Depreciation Rate Base (“OCRB”). Staff advocates a FVRB that averages the OCRB
12 and the RCRB.
13
14
15

16 The Arizona Supreme Court recognized in *Simms v. Round Valley Light &*
17 *Power Co.*, 80 Ariz. 145, 151-54, 294 P.2d 378, 382-84 (1956) that “our constitution
18 does not establish a formula for arriving at fair value. * * * No set rigid formula is
19 required to be used. Only a reasonable judgment considering all relevant factors is
20 required.” This truism has been recently affirmed in *US West II* (“only our jurisprudence
21 requires this finding be plugged into a rigid formula as part of the rate-setting process”).
22
23 *See also, Phelps Dodge v. Arizona Electric Cooperative, Inc.*, ___ Ariz. ___, ___ P.3d
24
25
26

1 _____, 2004 WL117253 (App. 2004)¹ The *Simms* court, however, distinguished between
2 “fair value” (“the value of properties at the time of inquiry”) that allows for increases and
3 decreases in value, and “prudent investment” (“value at the time of investment”) that
4 does not. Despite recognizing the lack of any constitutionally-mandated formula to
5 determine “fair value,” the *Simms* court concluded the Commission could not use the
6 prudent investment theory as a guide to establishing a rate base.
7

8 The Company expends much of its Closing Brief arguing that the prudent
9 investment standard should not be used in this case. Yet not one party argued the prudent
10 investment standard should be adopted by the Commission in this case. Instead, in
11 rejecting the Company's use of RCRB as the FVRB, the parties argue that OCRB (or in
12 Staff's case, an averaging of the OCRB and the RCRB) more appropriately reflects the
13 Company's FVRB. Whether the use of the OCRB reaches a result similar to the prudent
14 investment standard is irrelevant. Unlike *Simms*, no party is suggesting the Commission
15
16
17

18 ¹ *Phelps Dodge* first recognized: Our constitution requires the Commission to ‘prescribe .
19 . . . just and reasonable rates and charges to be made and collected, by public service
20 corporations for services rendered in the state’. *Ariz. Const. Art. 15 §3*. To assist the
21 Commission in the ‘proper discharge of its duties,’ the Commission must ‘ascertain the
22 fair value of the property within the State of every public service corporation doing
23 business therein.’ *Ariz. Const. Art. 15 §14* . . . The Commission has traditionally used
24 fair value to set a utility’s rate base. *Scates v. Arizona Corp. Comm’n*, 118 Ariz. 531,
25 534, 578 P.2d 612, 615 (App. 1978). Thereafter, the Commission applies a rate of return
26 to the rate base in order to establish just and reasonable rates. *Phelps Dodge* at ¶ 18.
Then citing *US West II*, the Court emphasized that “fair value should be considered in
rate setting . . . , although the Commission has broad discretion in determining the weight
to be given that factor in any particular case.” *Id.* at ¶22.

1 may ignore the RCRB testimony offered by the Company. They merely argue it should
2 be given little or no weight because it is not reflective of the "fair value" of the plant at
3 the time of inquiry.
4

5 Staff argues the Commission should, as it has done for years, average the
6 OCRB and the RCRB to determine the FVRB. However, while the historical use of the
7 data by the Commission may be considered by the Commission, it is not a compelling
8 consideration in this case. Decision No. 63584 gave notice to the Company and its
9 shareholders (and to its future ratepayers) that the Company's ability to book "the
10 difference between the recorded book costs, less depreciation of Citizens' utility plant
11 and assets and the purchase price negotiated between Citizens and Arizona-American"
12 (i.e., the acquisition adjustment as defined by the Company at page 24 of its Closing
13 Brief) for ratemaking purposes must be "based on Arizona-American's ability to
14 demonstrate that clear, quantifiable and substantial net benefits have been realized by
15 ratepayers, which would not have been realized had the transaction not occurred."
16 Decision No. 63584 at 15-16. Therefore, when acquiring Citizens' assets, the Company
17 and its shareholders could not reasonably expect the FVRB to be greater than the OCRB
18 for ratemaking purposes unless and until the Company demonstrated "the clear,
19 quantifiable and substantial net benefits" realized by ratepayers due to its acquisition of
20 the property. The Company concedes it has made no such showing in this case.
21
22
23
24
25
26

1 Therefore, the RCRB must be given little or no weight in establishing the FVRB in this
2 case.²

3 The Company unabashedly equates the "purchase price," the "current
4 value," the "RCRB value," and "fair value" of its plant. See Company's Closing Brief pp.
5 23-24 - where the Company states "the use of each district's RCRB as its fair value rate
6 base is supported by the purchase price recently paid by Arizona-American for the water
7 and wastewater systems and related assets owned by Citizens. . . . The purchase price
8 reflected the current value of Citizens' utility plant and assets. . . . The fact that [the]
9 purchase price . . . was substantially greater than the original or book costs . . . clearly
10 establishes that the use of an OCRB to set rates in this proceeding would violate the fair
11 value standard"³. As such, the Company at least implicitly advocates the use of the RCRB
12 as the FVRB in order to secure ratemaking treatment similar to that which it might have
13 obtained through an acquisition adjustment. This circumvention of Decision No. 63584
14 should not be condoned. The OCRB should be used as the FVRB as advocated by
15 Youngtown and RUCO.⁴

16
17
18
19
20 ² Even Staff recommends that the Commission "not give great weight to reconstruction
21 cost estimates." (STAFF, p. 2 - our emphasis)

22 ³ The Supreme Court rejected the purchase price as the sole measure of fair value in
23 *Arizona Corp. Comm'n v. Arizona Water Company*, 85 Ariz. 198, 203, 335 P.2d 412, 415
(1959).

24 ⁴ Youngtown takes no position on which of the OCRB values presented by the parties is
25 the more accurate. Youngtown notes that by accepting the OCRB as the FVRB, the
26 Commission avoids the Company's challenge to the so-called "backing-in" methodology
to setting rates.

1 **II. STAFF AND RUCO ADVOCATE A "JUST AND REASONABLE"**
2 **REVENUE REQUIRMENT**

3 The Commission's focus for a determination of its duties should be on the
4 language in the Arizona Constitution and in the appellate decisions that interpret that
5 duty, not on the out-of-state decisions cited by Company. The focus of Article 15,
6 Section 3 is *just and reasonable* rates. This requires the rates to be fair both to the
7 consumers and the utility. The revenue levels advocated by RUCO and by Staff meet this
8 standard, while the revenue levels advocated by the Company do not.⁵

9
10 **III. THE IRRIGATION TARIFF SHOULD BE EXPANDED**

11 Youngtown intervened in this proceeding, *inter alia*, to request a slight
12 expansion of the Company's interruptible irrigation tariff rate. The rate is currently
13 available to certain customers in Sun City, but to no one else. Youngtown recommends
14 the rate be expanded to allow governmental entities to receive reduced rates for certain
15 existing uses that are open to all ratepayers. The focus of Youngtown's request is

16
17
18

⁵ While the revenue levels advocated be either Staff or RUCO will result in fair and
19 reasonable rates for the Company, Youngtown cautions the Commission to avoid using a
20 rationale in its decision that even appears to act in a manner rejected by *Simms* at 180
21 Ariz. 155 (i.e., first determining what the Company should be allowed to earn in order to
22 pay a fair return on common equity and then "backing into" either the rate base or the
23 return thereon). It is therefore respectfully suggested that the Commission either use the
24 OCRB rate base as the FVRB (as advocated by Youngtown, RUCO and Mr.
25 Grimmelmann) or expressly find the revenue requirement derived by multiplying the
26 weighted cost of capital by any FVRB greater than the OCRB to be unreasonable and
 unjust.

1 Maricopa Lake, a small residential lake created in 1955 and having only 2.8 surface
2 acres.

3
4 In its Closing Brief, Staff opposes the change solely because "it will shift
5 cost to residential consumers." STAFF at p. 20. This argument ignores the fact that the
6 lake is an amenity available to the residential customers. Staff has not demonstrated that
7 the requested change in the tariff would cause any appreciable shift in revenues or that
8 the additional revenues would fall predominantly on the residential class. Since the
9 residential minimums and first rate tier will be unchanged by this shift, the responsibility
10 will fall on larger water users in any event. Moreover, the Staff has conceded that the
11 limited access to the present tariff is discriminatory (Dennis Rogers at TR VI p. 1128-
12 1129). The recent *Phelps Dodge* decision, *supra*, reaffirms the judiciary's intent to
13 enforce constitutional and statutory provisions regarding discriminatory practices in the
14 "rates charged for rendering a like and contemporaneous service." *Id* at ¶22.
15
16

17 It is reasonable to provide a price break for certain municipal activities as a
18 matter of public policy. It is also reasonable to provide a price break for accepting
19 service on an interruptible basis, as is the case with this tariff. For these reasons,
20 Youngtown respectfully requests that its proposal to expand the irrigation tariff be
21 approved by the Commission.
22
23
24
25
26

1 **IV. RATE DESIGN**

2 Youngtown did not, and could not afford to, prepare and present evidence
3 on the cost of service or a new rate design. Mr. Burton, however, did testify that rate
4 redesign should not accompany a significant increase in rates (TR VII, pp. 1298-1300).
5 Alternatively, he suggested that the rate design be examined separately, after a revenue
6 level has been set. Finally, he opposed the Staff's proposed rate design as having too
7 significant a break in the tiers and therefore penalizing persons rather than encouraging
8 water conservation (TR VII, pp. 1301-1302). For these reasons, Mr. Burton advocated
9 spreading the rate increase evenly across the existing rates as proposed by the Company.
10 However, if the Commission is inclined to adopt a new rate design, Youngtown requests
11 that the rate design issue be dealt with after the revenue level is established. In this
12 manner, the late filed rate design proposed by the Company can be compared and
13 contrasted with Staff's rate design on the actual approved rates. Moreover, the additional
14 impacts on particular customers could be delayed and implemented only after providing
15 some notice to afford those customers an opportunity to proactively prepare for the new
16 rate design. Finally this will send a clearer price signal than if it is combined with a
17 general rate increase.⁶

18
19
20
21
22 _____
23 ⁶ Youngtown recognizes ALJ Wolfe, by Procedural Order dated February 11, 2004,
24 ordered parties wishing to respond to the inverted-block rate design schedule submitted
25 by Arizona American to do so in their February 18, 2004, closing briefs. While Arizona-
26 American had provided a draft of its inverted-block rate prior to the formal filing on
 February 4, 2004, Youngtown has had insufficient time to decide whether to budget

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

**Original and twenty-one (21) copies of
the foregoing filed this 18th day of February, 2004, with:**

Docket Control Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

**Copies of the foregoing hand-delivered and/or mailed
this 18th day of February, 2004 to:**

Teena Wolfe, Administrative Law Judge
ARIZONA CORPORATION COMMISSION
Hearing Division
1200 West Washington Street
Phoenix, Arizona 85007

Christopher Kempsey, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Tim Sabo, Staff Attorney
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Ernest Johnson, Director
Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Daniel Pozefsky, Esq.
RUCO
1110 West Washington Street, Suite 220
Phoenix, Arizona 85007

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

**Original and twenty-one (21) copies of
the foregoing filed this 18th day of February, 2004, with:**

Docket Control Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

**Copies of the foregoing hand-delivered and/or mailed
this 18th day of February, 2004 to:**

Teena Wolfe, Administrative Law Judge
ARIZONA CORPORATION COMMISSION
Hearing Division
1200 West Washington Street
Phoenix, Arizona 85007

Christopher Kempley, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Tim Sabo, Staff Attorney
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Ernest Johnson, Director
Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Daniel Pozefsky, Esq.
RUCO
1110 West Washington Street, Suite 220
Phoenix, Arizona 85007

1 Norman D. James
Jay L. Shapiro
2 FENNEMORE CRAIG
3003 North Central Avenue, Suite 2600
3 Phoenix, Arizona 85012
4 Attorneys for Arizona-American Water Company

5 Carlton G. Young
3203 W. Steinbeck Drive
6 Anthem, Arizona 85086-1540

7 Frank J. Grimmelmann
42441 N. Cross Timbers Court
8 Anthem, Arizona 85086

9 Raymond E. Dare
10 SUN CITY TAXPAYERS' ASSOCIATION
12630 North 103rd Avenue, Suite 144
11 Sun City, Arizona 85351-3476

12 Walter W. Meek
13 AUIA
2100 N. Central Avenue
14 Suite 210
Phoenix, Arizona 85004

15 John A. Buric
16 WARNER ANGLE HALLAM JACKSON & FORMANEK, PLC
3550 North Central Avenue, Suite 1500
17 Phoenix, Arizona 85012

18 Kenneth C. Sundlof, Jr.
19 Robert Taylor
The Collier Center, 11th Floor
20 201 E. Washington Street
Phoenix, Arizona 85004-2385

21
22 
23 _____
F:\1753\10-1 ACC Proceeding\Pleadings\Reply brief.doc

24
25
26