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# EXCEPTION

BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION OF ARIZONA WATER COMPANY, AN ARIZONA CORPORATION, FOR ADJUSTMENTS TO ITS RATES AND CHARGES FOR UTILITY SERVICE FURNISHED BY ITS NORTHERN GROUP AND FOR CERTAIN RELATED APPROVALS.

Docket No. W-01445A-00-0962

## EXCEPTIONS OF THE RESIDENTIAL UTILITY CONSUMER OFFICE

The Residential Utility Consumer Office ("RUCO") makes the following exceptions to the recommended Opinion and Order ("RO&O") on Arizona Water Company's ("Arizona Water" or "Company") application for a rate increase.

### I. RATE BASE

The rate base recommended by the RO&O mismatches 1999 and 2000 amounts. The RO&O approves Staff's proposed fair value rate base which included the Company's adjustments for 2000 plant and depreciation balances. It does not, however, make corresponding adjustments from the 1999 test year for other rate base elements such as Contributions in Aid of Construction, Advances in Aid of Construction and deferred income taxes. RUCO recommends that the Company's fair value rate base adhere to the historical test year as required by A.A.C. R14-2-103 (B). In the alternative, RUCO recommends the Commission approve a rate base adhering to a 2000 projected test year for all of the rate base elements.

1 The RO&O's resolution of the rate base issue violates several basic regulatory  
 2 principles which are necessary to assure fair and reasonable rates. By restating the  
 3 Company's 1999 plant balances to reflect plant additions through 2000, the RO&O violates the  
 4 matching principle as well as the historical test year requirement set forth in A.A.C. R14-2-103  
 5 (B).<sup>1</sup>

6 Normally, the Commission relies on the historical test year to determine fair and  
 7 reasonable rates. Exh. R-1, pg. 5. Fair and reasonable rates can only be determined if there  
 8 is a matching of all ratemaking elements. Exh. R-1, pg. 4. The use of a historical test year  
 9 automatically guarantees a matching of all rate base and operating revenues. Likewise, the  
 10 use of a fully projected test year would also accomplish matching of all ratemaking elements.  
 11 The use of a combination of historical and projected test year balances, however, does not  
 12 match ratemaking elements, and therefore will generate unfair and unreasonable rates.

13 RUCO presented evidence at the hearing comparing the resulting rate increases based  
 14 on a 1999 test year, a 2000 projected test year, and the Company's mixed-year method. The  
 15 following chart illustrates the required revenue increase using the three different approaches:

16 Required Revenue Increase

17 <u>System</u>	<u>Historical T/Y</u>	<u>2000 Projected T/Y</u>	<u>Company Mixed T/Y</u>
18 Lakeside	\$166,297	157,334	616,167
19 Overgaard	37,740	(61,881)	401,059
20 Sedona	310,229	330,210	809,862
21 Pinewood	114,909	115,580	333,941
22 Rimrock	37,919	54,939	124,096

24 <sup>1</sup> At the hearing RUCO objected to several of the Company's adjustments as they violate the historical test year and matching principles. While the RO&O's resolution of the rate base issue does not adhere to a historical test year, RUCO's exceptions are intended to draw attention to the RO&O's violation of the matching principle.

1 Exh. R-2, pg. 6.

2 The analysis showed that the rate base for the five systems varies only slightly when  
3 comparing a 1999 test year to a 2000 test year. Exh. R-2 pg. 6. Inasmuch as the two test year  
4 results vary only slightly, each approach properly matches rate base and operating expense  
5 elements. The RO&O and the Company's application both suffer from the same flaw in that  
6 they both mismatch plant from one period with other rate base elements from a different  
7 period. While the dollar impact of the RO&O's mismatch is far less egregious than that of the  
8 Company's proposal (because Staff used plant balances of 12/31/2000 versus the Company's  
9 use of plant balances for 3/31/2001), the precedential effect of approving a mismatched rate  
10 base is the same. The Commission's approval of the RO&O would open the door to a  
11 methodology which would allow future applicants to intentionally and unjustifiably maximize  
12 their proposed rate increases. RUCO's proposed amendment on this issue is attached as  
13 Exhibit A.

14 **II. MONITORING ASSISTANCE PROGRAM COSTS**

15 The RO&O improperly permits recovery of future Monitoring Assistance Program  
16 ("MAP") costs through an adjuster mechanism. The Company pays the Arizona Department of  
17 Environmental Quality ("ADEQ") an annual fee to test the quality of its drinking water for some  
18 of the Northern Group systems as part of ADEQ's MAP. The Company currently recovers  
19 these water-testing costs through an automatic adjustment mechanism approved by the  
20 Commission subsequent to the Company's last rate case (Decision No. 62141, December 14,  
21 1999). The RO&O properly includes test year MAP costs in the Company's base rates.  
22 However, the Company requests, and the RO&O recommends, that the Company be allowed  
23 to adjust rates in the future for variations in MAP costs. RUCO takes exception to the RO&O,  
24 as MAP costs do not meet the criteria established by Arizona case law and Commission  
precedent for an automatic adjustment mechanism.

1 In Scates v. Arizona Corporation Commission, 118 Ariz. 531, 578 P.2d 612 (1978) the  
2 court described the automatic adjustment clause as a "...device to permit rates to adjust  
3 automatically, either up or down, in relation to fluctuations in certain, narrowly defined,  
4 operating expenses." Id. at 535, 578 P.2d at 616. In 1989, the Commission provided further  
5 insight in Decision No. 56450 (Arizona Public Service, April 13, 1989):

6 "The principal justification for a fuel adjustor is volatility in fuel  
7 prices. A fuel adjustor allows the Commission to approve changes  
8 in rates for a utility in response to volatile changes in fuel or  
9 purchased power prices without having to conduct a rate case."  
10 Decision No. 56450 at pg. 6. (emphasis added)

11 Unlike purchased power or fuel costs, which are subject to the whims of the market,  
12 MAP costs are not tied into the market and are not characterized by wide fluctuations. MAP  
13 expenses are expected to change gradually and are not expected to be volatile. The Company  
14 experienced an approximate six percent increase in MAP expenses for the Northern group  
15 between 1999 and 2000. Exh. R-9, pg. 2. The RO&O singles out MAP expenses for special  
16 treatment, while allowing other expenses (including other systems' water testing expenses) to  
17 be collected through the Company's base rates. This piecemeal approach allows the  
18 Company to recover select cost increases, while at the same time ignore decreases in other  
19 costs, or increases in revenues. Exh. R-1, pg. 36. Such a proposal, as the court recognized  
20 in Scates, is "fraught with potential abuse" and would provide incentive for utilities to seek rate  
21 increases each time costs in a particular area rise. Scates, 118 Az. at 534, 378 P.2d at 615.  
22 The RO&O's recommended treatment of the MAP costs is contrary to Scates and prior  
23 Commission Decisions. RUCO recommends that the Company's MAP costs, like its other  
24 water testing costs, be collected through its base rates. A proposed amendment is attached  
as Exhibit B.



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Exhibit A  
RUCO's Amendment No. 1

Page 4 Lines 26-28, Page 5 lines 1-9

DELETE paragraph

INSERT new paragraph as follows:

The Commission's rules require that the test year selected by a rate applicant for determining rate base, operating income, and rate of return to be "the most recent practical date available prior to the filing." A.A.C. R14-2-103 (A)(3)(p). The cases cited by the Company to support its 15-month post-test year proposal are distinguishable because they involved the need to resolve water quality issues on an expedited basis. Moreover, as Staff points out, Arizona Water had exclusive control over the timing of its rate application and selection of the test year and the Company should have been aware of the Commission's rules precedent involving post-test year additions. We believe that there are no circumstances in this case that justify allowing post-test year plant additions, and adopt the 1999 historical test year for inclusion of plant in rate base.

Page 9 Line 20\*

DELETE \$16,494,859

INSERT \$15,393,115

Page 9 Line 21\*

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Page 19 Line 17\*

DELETE \$1,589,486

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1 Page 19 Line 19\*

2 DELETE \$949,098

3 INSERT \$756,785

4 DELETE \$575,121

5 INSERT \$485,585

6 DELETE 16.02

7 INSERT 12.77

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9 Page 24 Line 23\*

10 DELETE \$16,494,858

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15 \* The corresponding changes to Exhibit A, Exhibit C and Exhibit D charts of the RO&O  
16 will be made available at the Open Meeting.

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Exhibit B  
RUCO'S Amendment No. 2

Page 15 lines 20-28

DELETE the paragraph

INSERT new paragraph as follows

We do not believe that it is appropriate for the Company to continue to collect the previously authorized MAP surcharge. In this case MAP costs have historically been subject to small increases and have not met the criteria for an automatic adjustment mechanism as defined in Scates and prior Commission Decisions. Accordingly, we will only allow MAP costs to be included in base rates and not subject to an automatic adjustment mechanism.