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**BEFORE THE ARIZONA CORPORATION COMMISSION**

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AZ CORP 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

Arizona Corporation Commission

**DOCKETED**

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**RUCO'S CLOSING BRIEF**

**INTRODUCTION**

The Residential Utility Consumer Office ("RUCO") submits the following points in support of its position that the Arizona Corporation Commission ("Commission") should not approve Arizona Water Company's ("AWC" or "Company") proposed Arsenic Cost Recovery Mechanism ("ACRM"). The Company's filing departs from generally accepted ratemaking principles and exposes ratepayers to unnecessary risk.

RUCO proposes that the Commission adopt a modified ACRM that includes completed used and useful arsenic plant in rates.

**THE COMPANY'S PROPOSED ARSENIC COST RECOVERY MECHANISM**

The Company's proposed ACRM is designed to provide a return on the arsenic capital costs for completed facilities placed in service and actually serving customers, and certain costs related to the operation and maintenance of that plant. Exhibit A-1 at 3, 6. The Company would recover its arsenic costs through a separate identified surcharge on each customer's

1 monthly bill. The Company proposes to file a limited number of rate increases, two or three,  
2 over the period when the plant is to be placed in service (2003-2006). Exhibit A-1 at 3.  
3 Finally, the Company proposes to file a general rate case with no date certain<sup>1</sup> after all its  
4 arsenic plant is in service, but with a test year no later than December 31, 2006. Exhibit A-1 at  
5 5.

6 RUCO supports much of the Company's proposal. However, there are several  
7 elements of the ACRM that RUCO proposes be modified.

### 8 **THE INCLUSION OF OPERATING AND MAINTENANCE COSTS**

9 The Company originally proposed an ACRM which included estimated operating and  
10 maintenance costs ("O&M"). Exhibit A-1 at 6. RUCO's primary area of disagreement with the  
11 Company's original proposal was the inclusion of estimated O&M costs. RUCO maintained, in  
12 accordance with generally accepted regulatory principles, that only those costs which are  
13 known and measurable are subject to inclusion in rates. Exhibit R-1 at 2. Estimated costs are  
14 not representative of actual costs, and when combined with actual plant in service will result in  
15 inaccurate and unreliable rates. In this case, the actual O&M costs will not be known until the  
16 plant is in operation for over one year. Exhibit S-3 at 7.

17 At the hearing in this matter, the Company changed its position to specify that it would  
18 only seek recovery of actual known and measurable O&M costs. Trans., Vol. 1 at 30-31.  
19 While the Company's clarification is appreciated, it creates additional difficulties that make it  
20 impractical. To include the actual O&M costs would require an analysis of those costs that  
21 would expand the proceeding to a point where it would virtually be a full rate case. Trans. Vol.

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22  
23 <sup>1</sup> At the hearing the Company agreed to a date certain for the filing of September 30, 2007. Trans., Vol. 1 at 44.  
24 RUCO originally proposed a date certain of May 2007, but has no objection to the September 2007 date.

1 | I at 89-90. If the Company intends to include the actual O&M costs, RUCO has no objection  
2 | to the filing of a full rate case. However, RUCO will only support an abbreviated procedure if  
3 | the O&M costs are excluded.

#### 4 | **LEGAL AUTHORITY FOR STEP INCREASES**

5 | While the Commission enjoys exclusive authority to set rates, it must nonetheless  
6 | comply with the requirements of the Constitution, as interpreted by the courts, in setting "just  
7 | and reasonable" rates. See Ariz. Const. Art. 15, § 14; *Scates v. Arizona Corp. Comm'n*, 118  
8 | Ariz. 531, 578 P.2d 612 (App. 1978); *Simms v. Round Valley Light & Power*, 80 Ariz. 145, 151,  
9 | 294 P.2d. 378, 382 (1956). These constitutionally-based requirements are set out in *Simms*  
10 | and expanded in *Scates*:

11 | It is clear . . . that under our constitution as interpreted by this court, the  
12 | commission is required to find the fair value of (the utility's) property and use  
13 | such finding as a rate base for the purpose of calculating what are just and  
14 | reasonable rates . . . While our constitution does not establish a formula for  
15 | arriving at fair value, it does require such value to be found and used as the base  
16 | in fixing rates. The reasonableness and justness of the rates must be related to  
17 | this finding of fair value.

18 | *Scates*, 118 Ariz. at 534, 578 P.2d at 615 (quoting *Simms*, 80 Ariz. at 151, 294 P.2d at  
19 | 382)(internal citations omitted).

20 | The constitutional basis for these requirements leaves the Commission limited latitude  
21 | in setting rates outside a rate case that permits the examination of all costs and revenues, with  
22 |

1 sound reason. The court in *Scates* acknowledged that such "piecemeal" ratemaking is  
2 "fraught with potential abuse. Such a practice must inevitably serve both as an incentive for  
3 utilities to seek rate increases each time costs in a particular area rise, and as a disincentive  
4 for achieving countervailing economies in the same or other areas of their operations." 118  
5 Ariz. at 534, 578 P.2d at 615.

6  
7 The court in *Scates* invalidated the piecemeal ratemaking in that case because "the  
8 Commission was without authority to increase the rate without any consideration of the overall  
9 impact of that rate increase upon the [company's rate of return], and without, as specifically  
10 required by our law, a determination of [the company's] rate base." *Id.* at 537, 578 P.2d at  
11 618.

12 The Commission is free to deviate from the *Scates* requirement that rates be adjusted  
13 only after examination of all revenue and expenses in two clearly defined instances: 1) interim  
14 rates<sup>2</sup>, or 2) rates modified pursuant to an "automatic adjustment clause." *Id.* at 534-35, 578  
15 P.2d at 615-16; Op. Att'y Gen. 71-15 (1971)(automatic adjuster mechanisms) (cited with  
16 approval in *Scates* at 535, 578 P.2d at 616); Op. Att'y Gen. 71-17 (1971)(interim rates)(cited  
17 with approval in *Scates* at 535, 578 P.2d at 616). No party contends that either exception  
18 applies here.

19 The *Scates* Court did not close the door to the Commission's consideration of  
20 abbreviated fair value findings in every other situation. The Court stated:

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<sup>2</sup> RUCO is not suggesting that compliance with arsenic standards would never create an emergency that might justify interim  
24 relief. However, the Company's ACRM does not rely on the interim rate exception.

1           There may well be exceptional situations in which the Commission may  
2 authorize partial rate increases without requiring entirely new submissions. We  
3 do not decide in this case, for example, whether the Commission could have  
4 referred to previous submissions with some updating or whether it could have  
5 accepted summary financial information.

6 *Scates* at 537, 578 P. 2d 618.

7  
8           Given the unique and exceptional circumstances presented by the new arsenic  
9 standard, RUCO agreed to the limited step increase filings as "updates" to the financial  
10 information submitted in Phase I of this proceeding. Moreover, the Arizona Supreme Court  
11 has given what can best be described as tacit approval to the use of step increases. In  
12 *Arizona Community Action Association v. Arizona Corporation Commission*, 123 Az. 228, 599  
13 P. 2d. 184 (1979), the Supreme Court addressed APS' use of step increases which were  
14 triggered by the decline on the return of APS' common stock. While the Court suggested that  
15 a step increase based on construction work in progress for the preceding year might be  
16 permissible, it struck down the use of the step increases because it was triggered solely on the  
17 return on APS' stock. The Court's concern was the potential danger inherent in tying rates to a  
18 single factor over which APS exercises total control. *Id.* at 231, 599 P. 2d 187. The Court  
19 noted that it saw "...no reason why return on common stock equity may not be taken into  
20 account in fixing a rate increase." *Id.* In other words, the Court did not cite the fair value  
21 requirement as a legal impediment to the Company's use of step increases.

1 AN ORIGINAL AND THIRTEEN COPIES  
2 of the foregoing filed this 6th day  
3 of December, 2002 with:

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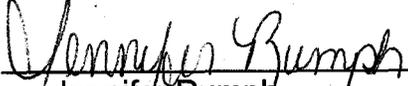
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1 **CONCLUSION**

2 RUCO recommends that the Commission approve the Company's original proposal  
3 modified to allow the maximum of two step increases, the exclusion of estimated and actual  
4 O&M costs, and a date certain for the filing of a rate case no later than September 30, 2007.  
5 RUCO further recommends that the Commission not approve the Company's new proposal of  
6 allowing for an abbreviated process which will include actual O&M costs. RUCO would  
7 recommend that the Company be required to file for a full rate case in that situation.

8 RESPECTFULLY SUBMITTED this 6th day of December, 2002

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10   
11 Daniel W. Pozefsky  
12 Attorney