

ORIGINAL
EXCEPTION



BEFORE THE ARIZONA CORPORATION COMMISSION

MARK SPITZER
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER
JEFF HATCH-MILLER
COMMISSIONER
MIKE GLEASON
COMMISSIONER

Arizona Corporation Commission

DOCKETED

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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 revised Recommended Opinion and Order ("RO&O") on Phase II of Arizona Water Company's ("Arizona Water" or "Company") application for a rate increase.

On April 8, 2003, the Administrative Law Judge issued his original ROO on Phase II which recommended the approval of an Arsenic Cost Recovery Mechanism ("ACRM"). The recommended ACRM excluded operation and maintenance ("O & M") expenses. The Commission considered the ROO at its Open Meeting on April 22, 2003 and referred the matter back to the Hearing Division to conduct additional proceedings regarding the inclusion of leasing options and financing of plant. Additional proceedings¹ took place and

¹ The parties engaged in settlement negotiations from which two of the parties, Staff and the Company reached a Settlement Agreement ("Settlement"). A hearing to consider the Settlement was held, and the parties submitted post-hearing briefs.

1 on August 25, 2003, the Administrative Law Judge issued a second ROO, approving the
2 Settlement reached between Staff and the Company. Among other things, the revised
3 ROO recommended approval of a revised ACRM which now included limited recovery of O
4 & M expenses (media related O & M expenses).

5 RUCO objects to the inclusion of any O&M expenses in the ACRM and
6 recommends that the Commission approve the ROO issued on April 8, 2003.

7 **THE ACRM SHOULD NOT INCLUDE O & M EXPENSES**

8 Single-issue ratemaking is fraught with peril. At the very least, it provides utilities
9 with an incentive to seek rate increases when expenses in a particular area increase. It is
10 contrary to generally accepted regulatory principles and is highly likely to result in unfair
11 and unreasonable rates. Only under very limited circumstances, and usually conditioned
12 upon certain procedural safeguards, have the Courts in Arizona permitted it.

13 The new federal arsenic standard has created a difficult situation for water
14 companies, like Arizona Water, that do not currently meet the standard. In order to
15 facilitate compliance with the standard, the parties have accepted the idea that some type
16 of abbreviated cost recovery mechanism is appropriate to allow the Company to recover its
17 arsenic related expenses.

18 Recognizing the need for an abbreviated procedure, RUCO endorses a step
19 increase mechanism that the Arizona Supreme Court has said is permissible. RUCO does
20 not support the revised ROO as inclusion of media related O & M expenses goes beyond
21 what the Arizona Supreme Court has determined is permissible. For the sake of brevity,
22 RUCO will defer to the arguments made in its closing brief of August 15, 2003 regarding its
23 interpretation of what the Arizona Supreme Court has said is permissible (See Exhibit 1,
24 RUCO's Closing Brief of August 15, 2003).

1 **THE ACRM IS NOT AN ADJUSTER MECHANISM**

2 Another component of the ROO which RUCO challenges is the characterization of
3 the ACRM as an "automatic adjustment mechanism." ROO at 20. The proposed ACRM is
4 an abbreviated procedure used to allow the Company to recover the costs associated with
5 arsenic treatment, but it is not an automatic adjustment mechanism. The purpose of an
6 automatic adjustment mechanism is to permit rates to changes without an additional fair
7 value analysis. In this case, the ACRM is not an adjuster mechanism because the ACRM
8 includes an analysis of plant and will result in a new fair value finding.

9 When the parties originally proposed the ACRM, they did not represent it to be an
10 adjustor mechanism². The Commission should avoid representing that the ACRM is an
11 adjustor when the issue was not fully developed. In addition, the question of what
12 expenses qualify for recovery under an adjustor mechanism is currently before the
13 Commission in Arizona Public Service Company's application for approval of adjustment
14 mechanism, Docket No. E-01345A-0200403. A decision in this matter that characterizes
15 the ACRM as an adjustor mechanism may pre-judge issues that were not litigated in this
16 proceeding, but were litigated in the APS proceeding. The Commission should avoid
17 deciding the scope of adjustor mechanism on this record.

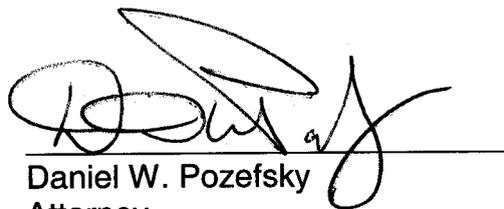
18 **CONCLUSION**

19 The Commission should not approve the ROO as the proposed ACRM goes beyond
20 what the Supreme Court in Arizona has said is permissible. The recommended ACRM is
21 an abbreviated mechanism which will allow for the Company to recover its arsenic related
22

23 _____
24 ² The Company made the reference of the ACRM as an adjuster mechanism in its final Brief. No other party
has had an opportunity to refute that position.

1 costs. The ACRM is not an automatic adjuster mechanism RUCO recommends that the
2 Commission approve the ROO dated April 8, 2003.

3 RESPECTFULLY SUBMITTED this 3rd day of September, 2003.

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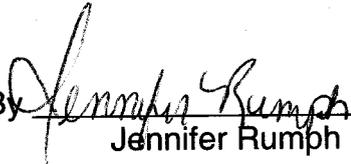
Daniel W. Pozefsky
Attorney

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8 Assistant Chief Administrative Law Judge
9 Arizona Corporation Commission
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11 Phoenix, Arizona 85007

By 
Jennifer Rumph

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Exhibit A
RUCO's Amendment No. 1

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

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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*

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Page 9 Line 21*

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Page 24 Line 23*

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

1 **Exhibit B**
2 **RUCO'S Amendment No. 2**

3 Page 15 lines 20-28

4 DELETE the paragraph

5 INSERT new paragraph as follows

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

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BEFORE THE ARIZONA CORPORATION COMMISSION

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- MARC SPITZER
CHAIRMAN
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Docket No. W-01445A-00-0962

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") and the Commission's Utilities Division ("Staff") proposed ("Staff-Company proposal") Arsenic Cost Recovery Mechanism ("ACRM"). The law in Arizona does not support the joint proposal.

RUCO proposes that the Commission adopt the April 8, 2003, Recommended Order and Opinion ("ROO").

OVERVIEW

Single-issue ratemaking is fraught with peril. At the very least, it provides utilities with an incentive to seek rate increases when costs in a particular area increase. It is

1 contrary to generally accepted regulatory principles and is highly likely to result in unfair
2 and unreasonable rates. Only under very limited circumstances, and usually conditioned
3 upon certain procedural safeguards, have the Courts in Arizona permitted it.

4 The new federal arsenic standard has created a difficult situation for water
5 companies, like AWC, that do not currently meet the standard. In order to facilitate
6 compliance with the standard, the parties have accepted the idea that some type of
7 abbreviated cost recovery mechanism is appropriate to allow the Company to recover its
8 arsenic related costs.

9 Recognizing the need for an ACRM, RUCO endorses what the Arizona Supreme
10 Court has said is permissible. For the legal and policy reasons cited below, RUCO does
11 not endorse the Staff-Company proposal which goes beyond what the Arizona Supreme
12 Court has said is permissible.

12 **BACKGROUND**

13 In Decision No. 64282, dated December 28, 2001, the Commission approved a rate
14 increase for Arizona Water Company's Northern Division (Phase I). That decision ordered
15 this docket to remain open to allow Staff, RUCO, City of Casa Grande, and AWC
16 ("Parties") to develop a proposed ACRM and to address the issue of rate consolidation of
17 the Company's systems. The parties met on a number of occasions and reached
18 agreement on some issues. The Commission scheduled a hearing to resolve the disputed
19 issues. Testimony was filed, a hearing was held, and closing briefs¹ were filed on the
20 Company's proposed ACRM and the issue of rate consolidation. The parties were in
21 agreement that an ACRM utilizing step-increases is an appropriate method to address
22 increased capital costs related to arsenic treatment. However, the parties disagreed on

23 ¹ Attached as Exhibit 1 is a copy of RUCO's Closing Brief filed prior to the issuance of the ROO (December
24 6, 2002). With the additions set forth below, RUCO's position and arguments are the same. RUCO
incorporates the arguments set forth in the attached Closing Brief into this Closing Brief.

1 the recovery of Operation and Maintenance ("O&M") costs associated with the new arsenic
2 treatment plant.

3 On April 8, 2003, the Administrative Law Judge issued his ROO. The ROO,
4 consistent with the arguments previously set forth by Staff and RUCO, recommended an
5 ACRM that excludes O&M costs. The Commission considered the ROO at its Open
6 Meeting on April 22, 2003. The Commission deferred a decision on the ROO, directing the
7 Hearing Division to conduct additional proceedings regarding the inclusion of potential
8 leasing options for arsenic treatment facilities and directing the Company to investigate all
9 possible loans and grants that may be available for financing installation of arsenic
treatment facilities.

10 On April 25, 2003, the Commission issued a Procedural Order directing (1) the
11 parties to engage in and complete settlement discussions on the leasing issues no later
12 than May 30, 2003; (2) the parties to file, by May 30, 2003, a joint recommendation for
13 resolving the leasing issues or if no agreement is reached for testimony to be filed by June
14 16, 2003, and a hearing to be held on June 26, 2003; and (3) the Company to separately
15 address the availability of grants and loans for arsenic treatment facilities.

16 Thereafter, the parties met and engaged in settlement negotiations. Collectively,
17 the parties were unable to reach an accommodation. The Company and Staff, however,
18 were able to reach an accord. Transcript, Vol. III, 355-364.² The Company and Staff
19 agreed that their objectives could be met by permitting limited recovery of O & M costs in
20 the ACRM. A-3 at 6³. The Staff-Company proposal recommends recovery of the direct
21 cost (no overheads) for media replacement or regeneration, media replacement or

22
23 ² Reference to the Transcript throughout this Brief, unless indicated otherwise, will be to Volume III of the
Phase II Docket (W-01445A-00-0962) of the proceedings held on June 26, 2003.

24 ³ References will be made to exhibits as they appear in the Transcript of Proceedings of June 26, 2003.

1 regeneration service, and waste disposal ("recoverable O & M"). A-3 at 6-8, S-8 at 3. The
2 Staff-Company proposal further recommends recovery of capital and O & M costs under
3 lease obligations. Id. Staff and the Company testified that the amount that the Company
4 would recover would be the same under the lease provisions as if the Company purchased
5 the leased assets. Id.

6 The Staff-Company proposal would provide for recovery of recoverable O & M costs
7 in two parts. Id. The first part would allow deferral and recovery of O & M costs through a
8 surcharge. Id. The second part provides for the recovery of the recoverable O & M in the
9 ACRM revised rates on a prospective basis. Id.

10 RUCO agreed that the ACRM should be broadened to consider the ratemaking
11 treatment of leased plant. R-2 at 6. RUCO, however, maintained that the treatment of
12 lease costs should parallel the ROO's recommendation regarding capital costs. Id. In
13 other words, RUCO, consistent with its earlier position, recommends the exclusion of O &
14 M costs regardless of whether the ACRM includes capital or lease costs. Id.

15 **THE LAW AND POLICY IN ARIZONA DOES NOT SUPPORT INCLUDING O & M** 16 **EXPENSES IN THE STEP-INCREASES**

17 The Arizona Constitution requires the Commission to make a finding of fair value of
18 a utility's property when calculating the utilities rates. See *Scates v. Arizona Corp.*
19 *Comm'n*, 118 Ariz. at 534, 578 P.2d at 615 (quoting *Simms*, 80 Ariz. at 151, 294 P.2d at
20 382)(internal citations omitted). In only two clearly defined instances has the Court held
21 that the Commission is free to deviate from the fair value requirement. *Id.* at 534-35, 578
22 P.2d at 615-16; Op. Att'y Gen. 71-15 (1971)(automatic adjuster mechanisms) (cited with
23 approval in *Scates* at 535, 578 P.2d at 616); Op. Att'y Gen. 71-17 (1971)(interim
24 rates)(cited with approval in *Scates* at 535, 578 P.2d at 616).

The ACRM recommended in the ROO ("recommended ACRM") involves a step-
increase procedure. The Supreme Court of Arizona in *Arizona Community Action*

1 *Association v. Arizona Corporation Commission*, 123 Az. 228, 599 P. 2d. 184 (1979)
2 gave tacit approval for an abbreviated step-increase procedure. See RUCO's December
3 6, 2002 Closing Brief at page 5 (attached). The step-increase procedure in *Arizona*
4 *Community Action Association* was not an adjuster mechanism or interim rate, but involved
5 an abbreviated process by which the Commission made a new finding of fair value, to
6 which it applied its recently-approved rate of return. In *Arizona Community Action*
7 *Association* the Commission approved a step-increase procedure that would trigger a step-
8 increase based on a decline in return on common stock equity, and, if the trigger were met,
9 base the new rates on changes to the utility's rate base. *Id.* at 230, 599 P. 2d. 186. The
10 Court remanded the matter to the Commission, finding the trigger mechanism
11 objectionable, but impliedly approved the basis on which the rate step would be computed.
12 *Id.*

13 The Staff-Company proposal goes beyond the type of abbreviated procedure
14 contemplated by the Court in *Arizona Community Action Association*. Where the step-
15 increase in *Arizona Community Action Association* involved only updates to rate base, the
16 Staff-Company proposal includes updates to operating expenses. There is nothing in the
17 Court's opinion indicating that step-increases are appropriate for increases in O & M
18 expenses.

19 Including media-related O & M expenses results in piecemeal ratemaking. As the
20 Court in *Scates* noted, such piecemeal ratemaking is fraught with abuse. 118 Ariz. at 534,
21 578 P.2d at 615. Among the many policy reasons why the Commission should not
22 consider O & M expenses are the following:

23 First, inclusion of O & M expenses presents matching problems, which even Staff
24 acknowledges will not be resolved by its proposal. R-2 at 43, Transcript, Vol. III at 405.
The ACRM rates will be based on the revenues, expenses, cost of capital and plant
determined in the last rate case (which used a historical test-year of 1999). The only thing

1 that will be trued-up is the incremental arsenic plant. Id. at 428. However, the Staff-
2 Company proposal will true up the incremental media plant expenses, which will create
3 additional mis-matches between costs based on the 1999 test-year and costs based on
4 more recent periods. Id.

5 Second, the media related expenses are no more intertwined with lease cost
6 recovery than they are with capital cost recovery. Id. at 424. The utility's legal relationship
7 to the plant has no bearing on what the plant's media related expenses will be. Id.

8 Third, an ACRM which is limited to consideration of capital costs is by itself single-
9 issue ratemaking fraught with all the perils associated with single-issue ratemaking.
10 Nonetheless, the level of risk is acceptable in order to strike a balance given the
11 extraordinary requirements presented by the new arsenic standard. Id. at 426-427. The
12 balance becomes miscued when the Commission adjusts for additional rate making
factors.

13 Fourth, the Staff-Company proposal creates additional disconnects between
14 changes that will be recognized and changes that will not. Id. at 427. It is important to
15 consider the rate-case elements that are going to be changed by the ACRM. It is equally
16 important to consider the rate-case elements that are not going to be changed. The Staff-
17 Company proposal to include media related expenses and exclude other expenses is
18 arbitrary. In other words, there is no distinction between the incremental media expenses
19 that will be considered under the Staff-Company proposal and the other incremental
20 expenses that will not be considered.

21 Fifth, the Commission can put leasing on equal footing with purchasing by simply
22 allowing all the capital costs of the lease to be included in the ACRM. Id. at 429.

23 Finally, the prospect of arsenic compliance resulting in the Company facing dire
24 financial consequences should not be resolved by allowing incremental media expenses in
the ACRM. The parties had considered an emergency rate increase as the basis for a

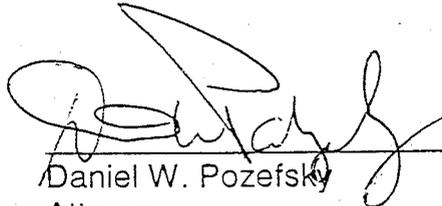
1 possible ACRM. However, the Company did not feel that the criteria for an emergency
2 existed. In the end, the parties agreed not to base the ACRM on an emergency. Id at 430.
3 Should the Company face an emergency; the Company will always have access to
4 emergency rates via application to the Commission.

5 **CONCLUSION**

6 RUCO recommends that the Commission approve the ROO. RUCO further
7 recommends that the Commission not approve the Staff-Company proposal.

8 RESPECTFULLY SUBMITTED this 15th day of August, 2003.

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Daniel W. Pozefsky
Attorney

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By 
Jennifer Rumph

Exhibit

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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 WILLIAM A. MUNDELL
 CHAIRMAN
3 JIM IRVIN
 COMMISSIONER
4 MARC SPITZER
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Docket No. W-01445A-00-0962

5 IN THE MATTER OF THE APPLICATION OF
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8 ITS RATES AND CHARGES FOR UTILITY
9 SERVICE FURNISHED BY ITS NORTHERN
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 APPROVALS.

10 **RUCO'S CLOSING BRIEF**

11 **INTRODUCTION**

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

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

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

20 The Company's proposed ACRM is designed to provide a return on the arsenic capital
21 costs for completed facilities placed in service and actually serving customers, and certain
22 costs related to the operation and maintenance of that plant. Exhibit A-1 at 3, 6. The Company
23 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 certain¹ 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.

22

23 ¹ 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 The court in *Scates* invalidated the piecemeal ratemaking in that case because "the
7 Commission was without authority to increase the rate without any consideration of the overall
8 impact of that rate increase upon the [company's rate of return], and without, as specifically
9 required by our law, a determination of [the company's] rate base." *Id.* at 537, 578 P.2d at
10 618.

11
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 rates², 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:

21
22
23 ² 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.

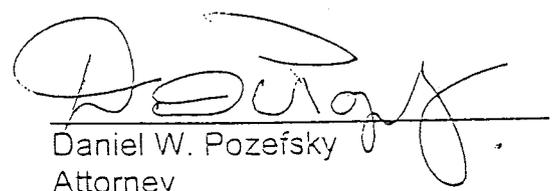
6 *Scates* at 537, 578 P. 2d 618.

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 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

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8 mailed this 6th day of December, 2002 to:

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