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Arizona Corporation Commission
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JUL 29 2010

Attorneys for Intervenor IBEW Local 387

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**BEFORE THE ARIZONA
CORPORATION COMMISSION**

IN THE MATTER OF THE
APPLICATION OF ARIZONA WATER
COMPANY, AN ARIZONA
CORPORATION, FOR A
DETERMINATION OF THE FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY, AND FOR
ADJUSTMENTS TO ITS RATES AND
CHARGES FOR UTILITY SERVICE
AND FOR CERTAIN RELATED
APPROVALS BASED THEREON.

Docket No. W-01445A-08-0440

**INTERVENOR IBEW LOCAL
387'S EXCEPTIONS TO THE
RECOMMENDED OPINION AND
ORDER**

Pursuant to A.A.C. R14-3-110(B) and the Procedural Order of Assistant Chief Administrative Law Judge Dwight D. Nodes dated July 19, 2010, Intervenor Local Union 387, International Brotherhood of Electrical Workers, AFL-CIO, CLC ("IBEW Local 387" or "the Union"), by and through undersigned counsel, hereby submits its exceptions to the Recommended Opinion and Order ("ROO") in this docket.

The Union's exceptions to the ROO, which the Union finds to be overall well-reasoned and balanced in light of the evidence offered in this case and the public interest, are two-fold and concern the recommended return on equity ("ROE") for Arizona Water Company ("Arizona Water" or "the Company") and the proposed normalization of the Company's requested labor expense. First, as explained herein, Local 387 believes that the recommended ROE is too low to ensure a reasonable return and does not reflect the anticipated risks facing the Company. The Union urges the Commission to accept, at a minimum, Staff's proposed ROE of 10.0% rather than the ROO's downward adjustment

1 to 9.5%. Second, the Union submits that the normalization of the labor expense here is
2 unwarranted and may very well have a negative impact on the Company's ability to
3 provide safe and reliable service and on employment at Arizona Water going forward.

4 **I. IBEW LOCAL 387 SUPPORTS GRANTING THE COMPANY A RETURN
5 ON EQUITY OF AT LEAST 10.0%, AS RECOMMENDED BY STAFF.**

6 The Union submits that there is a compelling basis in the record for setting the
7 Company's return on equity at a rate higher than the ROO's proposed 9.5%, especially in
8 light of the substantial challenges and the anticipated risks the Company faces during this
9 economic downturn and given the aging and under-utilized water systems it must operate
10 and maintain. However, although the Union has previously supported the higher ROE
11 requested by the Company (12.4%), the Union believes that the Staff's recommended
12 ROE of 10.0% would be at least minimally adequate to ensure a reasonable return and
13 would be reasonably reflective of the probable risks.

14 The ROO would follow the Commission's approach in the recent UNS Gas case
15 by "set[ting] the ROE at the low end of the range [9.5% - 10.5%]" proposed by Staff
16 witness, Mr. David Parcell, in light of prevailing economic conditions (p. 39, ll. 4-7) and
17 suggests that the "adoption of an estimated ROE of 9.5 percent . . . strikes a reasonable
18 balance between [Arizona Water's] proposal for an estimated 12.4 percent ROE, Staff's
19 10.0 percent recommendation, and RUCO's 8.33 percent proposal" (*id.*, ll. 14-17). Since
20 the ROO is concerned with striking the proper balance between the submitted
21 recommendations, the Union notes that the ROO's proposed ROE is not only on the low
22 end of Mr. Parcell's recommended range, it is also well below the mean of the ROE
23 recommendations proposed by the parties (10.24%)¹ and below the median
24 recommendation (10.0%) as well. Therefore, while the Union certainly does not propose

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26 ¹ By comparison, the mean of the ROE recommendations in the UNS Gas case was
27 9.87%, a level that is much closer to the 9.5% ROE ultimately adopted in that case and nearly
28 half a percentage point lower than the mean here.

1 that the Commission should simply adopt the mean or median ROE proposal in setting a
2 utility's return on equity (an approach that would obviously create perverse incentives and
3 lead to unjustified rates of return), the Union respectfully disagrees with the notion that
4 the recommended ROE of 9.5% strikes a proper balance between the proposals set forth
5 and supported by the witnesses and evidence in this matter.

6 Finally, the Union believes that the adoption of the ROE proposed by Staff
7 represents, without any further downward adjustment, an appropriate recognition by the
8 Commission that customers, and the Arizona economy more generally, have been
9 significantly impacted by the present downturn. After all, Mr. Parcell considered and
10 already factor into his analysis the current economic and financial conditions, including
11 their impact on AWC customers specifically, in arriving at his recommendation of 10.0%
12 ROE for Arizona Water. (*See* Direct Testimony of David C. Parcell (June 12, 2009), p.
13 10 ("It is clear that a serious recession also has negative impacts on AWC's customers, in
14 terms of income levels, unemployment and higher poverty rates. In addition, it is likely
15 that AWC's business customers are experiencing lower profits as a result of the
16 recession."); *see also id.*, pp. 2, 8-11, 13, 29-30).² Thus, there is no cause to impose a
17 further downward adjustment to the Company's ROE. IBEW Local 387 respectfully
18 requests that the Commission adopt a ROE of 10.0% here.

19 **II. LABOR EXPENSES SHOULD NOT BE NORMALIZED IN THIS CASE.**

20 The ROO accepts RUCO's proposed four-year average of overtime expenses from
21 2005 to 2008, excluding overtime costs that were capitalized rather than expensed, in
22 order to normalize overtime costs (pp. 24-25). The result of these modifications is a
23 \$182,023 total labor expense reduction (*id.*). RUCO's proposed reduction was accepted
24 notwithstanding the fact that a "precise quantification of reduced [post-test-year] labor
25 costs are not in the record," as the ROO concedes.

26
27 ² With regard to Mr. Parcell's view concerning how the current economic and financial
28 crisis impacts the cost of equity for AWC in particular, *see id.*, pp. 29-30.

1 On this record, such a reduction in labor expenses is not warranted under the
2 prevailing standard and will likely have a negative impact on the Company's ability to
3 provide safe and reliable service and on employment at Arizona Water going forward.
4 First, as the Commission agreed in a recent case involving another water company,
5 *Chaparral City Water Company* (Decision No. 71308, October 21, 2009), a "test year is
6 presumed to be normal, and adjustments should be based on known and measurable
7 changes" (p. 22). Here, RUCO failed to demonstrate how the test year labor expenses
8 were changed in a manner that is both known and measurable and therefore failed to rebut
9 the presumption that such expenses are normal.

10 Even though RUCO did not come forward with requisite evidence and despite the
11 fact that any "precise quantification of reduced labor costs in the record" is wholly
12 lacking, the ROO nevertheless adopts a reduction on account of reduced labor expenses
13 since the end of the test year (p. 25). This reduction is based on testimony that 18
14 employees had been laid off (including 8 bargaining unit employees) and capital projects'
15 budgets slashed.

16 What this reduction fails to recognize is that even though the Company now has
17 fewer employees, there nevertheless exists an undiminished need to operate and maintain
18 systems and infrastructure in order to ensure the uninterrupted provision of service to
19 both current and future customers (Tr. 71:23 – 74:10). Therefore, assuming that the
20 overall non-construction workload remains relatively unchanged (or at least does not drop
21 off in a commensurate or proportionate way), it is entirely probable that remaining
22 workers will have to put in more hours to accomplish the work formerly performed by a
23 larger contingent of workers, almost certainly resulting in more overtime. In addition, it
24 is generally prudent to ensure that overtime is not artificially capped or underestimated,
25 given that overtime, especially for a utility, may be notoriously difficult to estimate
26 considering the unpredictability and range of circumstances necessitating overtime that
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1 may arise, including interruptions or diminution in service due to the forces of nature or
2 the age of the line, equipment, and systems being operated and maintained.

3 What is more, adopting the reduced expense figure would serve to lock in labor
4 expenses more generally at the current reduced employee levels and would cabin the
5 utility's ability to proceed with capital projects and workforce and/or work expansion
6 when growth returns. At a time when job creation and payroll expansion are to be
7 promoted in order to pull our state and nation out of the mire we find ourselves in today,
8 the Union believes that the natural and probable consequence of such a reduction in labor
9 expenses will be to limit job growth and the flow of wages spent into Arizona
10 communities. Therefore, IBEW Local 387 respectfully requests that RUCO's proposed
11 reduction, as modified, be rejected and the Company's asserted expense from the test year
12 be adopted.

13 III. CONCLUSION

14 For the foregoing reasons, IBEW Local 387 respectfully requests that the
15 Commission: 1) adopt Staff's proposed ROE of 10.0% in this case; and 2) allow the
16 Company's labor expense from the test year and reject RUCO's proposed normalization.

17 RESPECTFULLY SUBMITTED this 29th day of July, 2010.

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1 Original and thirteen (13) copies
2 of IBEW Local 387's Exceptions
3 filed this 29th day of July, 2010, with:

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