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DEC 17 2010

Commissioner Sandra Kennedy
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

In re: Dockets No. ACC-00000A-10-0466, and W-00000C-06-0149

DOCKETED BY

Dear Commissioner Kennedy:

On behalf of the members of Arizonans for Responsible Water Policy, I appreciate your letter regarding your concerns with the ACC's current rate case process.

Responsible Water is comprised of Arizona-American Water, Global Water, Liberty Water, and Pivotal Utilities. Collectively, our members serve more than 500,000 people in Arizona.

The members of Responsible Water have discussed the same concerns with Staff, Commissioners, and other stakeholders for some time and we are encouraged by your letter. The members of Responsible Water are also participating in the ACC's water workshop process with Staff, RUCO, and other interested parties to develop a set of policies that would improve Arizona's ability to plan for and develop sustainable, affordable water infrastructure that meets today's needs and tomorrow's challenges.

We believe that the issues your letter highlights should be a major part of that workshop process. Further, we believe that by engaging in a cooperative, collaborative, and open-minded dialogue on those issues the needs of the consumer, the utility, and the Commission can be fully addressed.

The Proposed Four Options for Companies filing a Rate Case

Your letter suggests that at the time of filing a rate case, the company could choose one of the following four options:

1. Follow the ACC's existing time clock rules (i.e., 365 days after Sufficiency, a final decision is made),
2. If no decision was reached within time clock, interim rates begin at day 365 (set at the lower of one-half the requested rate increase, or no more than a ten percent increase). If the final decision ends up providing lower revenues than the interim rates, refunds to customers would be made at nominal interest, perhaps the T-bill rate.
3. Interim rates could be granted after the issuance of a Staff Report or Staff Testimony containing Staff's proposed rate increase. The interim rates could be the lowest of Staff's proposed rates,

the company's proposed rates, or a ten percent increase. Refund would be subject to a higher interest rate, perhaps six percent, or prime plus two percent, whichever is higher.

4. Interim rates could be granted after Sufficiency (using the approach in option 2 above); but the refund would be subject to a higher interest rate, perhaps the authorized ROR.
 - a. The Staff suggestion at the November 1 workshop was for 3 to 5 times the over collection.

Responsible Water's Responses to the Four Options

1. Our members have already begun to mirror the Notice of Intent process the ACC ordered in the most recent Arizona Public Service Company case, E-01345A-08-0172 ("APS Settlement"). In the APS Settlement, the company agreed to notify Staff in advance of rate cases of the scope, complexity, and expected effects of the likely filing. This process allows Staff to begin coordinating its staffing and its need for expert witnesses.
 - a. Our members have also mirrored the APS Settlement's provision that the company develop a comprehensive set of pre-filed discovery responses ("DRs") with its Application to increase rates. Our members developed a comprehensive set of DRs and Arizona-American filed that DR set with its recent rate case application.
 - b. There are numerous further steps that the Commission could undertake to improve its ability to process within the time clock – one of which is to further streamline the process for small systems – Responsible Water will have numerous suggestions in the workshop process.

2. We appreciate the recognition of the lost revenues crisis that befell our members this year – collectively our members lost over \$12 million of revenues in 2010 as a result of cases exceeding the statutory time clock.¹ It is important to recall that small water systems have a much shorter time clock (270 days) so this proposed option would need to recognize that fact. Even still, most small systems do not run into time clock issues so the option of implementing interim rates at the time clock limit would not be overly helpful to some of the companies that most need interim rates. For larger systems, adopting interim rates at one-half of the requested increase at the time clock limit would be a positive signal and would mitigate lost revenues. However, capping the increase to 10% of existing rates would not be useful because most rate increases seek much higher percentages.
 - a. Briefly, the reason companies seek much higher increases is because of the following factors:

¹ Lost revenues are defined as the amount of monthly rate increase granted times the number of months past the statutory time clock such decision occurred.

- i. Infrastructure investments are 'lumpy'. Capacity and production cannot be added in infinitesimally small increments, and as a result there are minimum infrastructure increments that are most efficient from a construction and operations perspective. Critically, the ACC's aversion to allowing Distribution System Improvement Charges, future test years, and post-test year plant exacerbate the 'lumpiness' by making it impossible to recover capital expenditures until they are fully complete. For small systems the ACC's aversions to ameliorative relief make rate increase percentages much larger – they simply have no ability to smooth out the rate increase,
- ii. Rate cases are costly and time-consuming. Rate cases in Arizona take far longer than in other states and are far more costly. Companies, especially those with smaller systems, have a difficult time bearing those costs and the impact on their staff time. The going rate for legal work on a small system's "short-form rate case" is \$50,000. Thus, fewer rate cases are filed – for some very small systems, virtually no rate cases are filed – and for all companies the rate increase has to grow to a very significant percentage before the cost and time impact make the filing imperative. The Commission should consider an even simpler rate case process for very small systems and should include DSICs, interim rates and cost adjustor mechanisms in that process; and finally
- iii. Every system must face its costs on its own – the ACC has historically opposed consolidation of rates and systems and even today the ACC's position is unclear: Arizona American Water Company's just-decided case W-01303A-09-0343, orders the Company to file both a de-consolidation proposal and a statewide consolidation proposal. Because systems are thus left on their own to face all cost increases, the Company cannot address the 'lumpiness' issue by spreading capital improvement costs across multiple systems.

3. Granting interim rates upon Staff's filing of its recommendation would allow the ACC a strong factual basis for its rate increase which addresses the legal question of interim rates, and we believe that this is worth further discussion.

4. Granting interim rates at sufficiency is, obviously, the most beneficial to Companies but it would raise concerns about the ACC's legal justification for doing so – a point we fully expect RUCO to highlight extensively and repeatedly.

You will note that we did not address the different options for calculating refunds in points two, three, and four – we will address those now, along with the Staff suggestion of a 3X or 5 X penalties.

We believe that refunds should be made at the rate of return the ACC adopts in the final order.

Your letter suggested calculating refunds at much lower rates (e.g., the one-year T bill rate which is around 0.3%, or a one-year prime + 2 which would be around 5.25%). While we very much appreciate your willingness to consider more pro-company numbers, we believe that fair is fair. For evidence of our commitment to fairness please note that every one of our members has offered to use Staff's ROE in their recent rate cases; every one of our members has committed to not shutting off service to any customer who lets us know their situation and simply stays in contact with us; and every one of our members has developed and implemented low-income assistance programs. We believe fair is fair, and in the context of refunds, fairness means that the customer should be given the same rate of return we would get, not a penny less.

As to the 3X and 5X penalty provision – that would be very harmful to our publicly-traded members. We would hear massive concerns from the investment community the second we received interim rates subject to a huge penalty provision – it is very likely that interim rates under that scenario would actually decrease share price as investors would be forced to hedge against the possibility of massive penalties.

For small systems, a 3X or 5X provision would make interim rates a truly life-or-death situation.

For example, a small system with \$250,000 in revenue that had to emplace infrastructure and thus requests a 20% increase would be seeking \$50,000. A 5X penalty on that \$50,000 could completely consume the system's entire revenue and would literally bankrupt the system; so to take that kind of a gamble on a rate increase would be, truly, a life-or-death moment.

As a final note, we want to highlight the fact that while several Commissioners have expressed concerns over the rate case process (including time, staffing, and budget impacts on all parties), it is indisputable that the Commission's recent history of re-trying every aspect of water rate cases at the Open Meeting has the inexorable effect of forcing future rate cases to be more complex, more lengthy and more costly.

As all of the members of our group have recently experienced, the Commission has adopted positions on Returns on Equity, Line Extension Agreements, Financing Options and true-up mechanisms that no party offered during the hearings. Staff and the Administrative Law Judges, along with the Companies, have no opportunity to investigate these issues because they were not offered at the hearing, no witness testified on it, and no cross-examination occurred. Thus the Commissioners are left with unexamined evidence and public comments as the basis of their decision.

As a result of the Commission's decisions to go beyond the scope of the evidentiary record, companies may have no choice in future cases other than to hire expert witnesses to address, investigate, and rebut every fact that exists in every model of every party at every stage in the process. Staff, RUCO, the Hearing Division, and the Commissioners can expect to see all stages of rate cases double in length and in cost. This dramatic increase in the scope of hearings will have significant cost

impacts on all parties including the Commission and RUCO which frequently rely on outside experts in complex disputes.

It is our belief that one of the major steps the ACC can take to reduce the cost and length of rate cases is to rely on the record that exists in the case when it comes before the Commissioners in Open Meeting. Commissioners can and should participate in the hearing process – expressing their concerns, policy goals, and questions to all parties – parties who will be under oath and who will be able to examine evidence and cross-examine each other's witnesses when they respond to Commissioners. In conclusion, we again thank Commissioner Kennedy for her letter. We ask that this issue be included in the water workshops, and we again ask all interested parties to participate in that process with a cooperative spirit and an open mind.

Sincerely,

Paul Walker
Chairman, Arizonans for Responsible Water Policy

CC:
Chairman Kristin Mayes
Commissioner Gary Pierce
Commissioner Paul Newman
Commissioner Bob Stump