

**ORIGINAL**



0000144575

BEFORE THE ARIZONA CORPORATION CO.....

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24

BOB STUMP  
CHAIRMAN  
GARY PIERCE  
COMMISSIONER  
BRENDA BURNS  
COMMISSIONER  
BOB BURNS  
COMMISSIONER  
SUSAN BITTER SMITH  
COMMISSIONER

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  
FURNISHED BY ITS EASTERN GROUP  
AND FOR CERTAIN RELATED  
APPROVALS.

Docket No. W-01445A-11-0310

**RUCO'S CLOSING BRIEF - PHASE II**

Arizona Corporation Commission

**DOCKETED**

APR 29 2013

DOCKETED BY *ESM*

2013 APR 29 PM 1 03

RECEIVED  
AZ CORP COMMISSION  
DOCKET CONTROL

TABLE OF CONTENTS

1

2 1. INTRODUCTION ..... 1

3

4 2. THE SIB SHIFTS RISK FROM THE COMPANY TO THE RATEPAYER WITHOUT

5 ADEQUATE FINANCIAL CONSIDERATION TO THE RATEPAYER..... 2

6 3. THE SIB IS ILLEGAL IN ARIZONA ..... 4

7 4. THE SIB IS NOT AN ADJUSTOR MECHANISM..... 4

8 A) THE COMPANY HAS NOT REQUESTED INTERIM RATES ..... 6

9 B) THE SIB WILL INCREASE THE COMPANY'S FAIR VALUE RATE BASE WITHOUT

10 ANY DETERMINATION OF FAIR VALUE ..... 8

11 C) THE SETTLEMENT DOES NOT CURE THE CONSTITUTIONAL INFIRMITIES OF

12 THE SIB ..... 9

13 D) THERE IS NO CASE LAW WHICH SUPPORTS A MECHANISM LIKE THE SIB

14 UNDER THE CIRCUMSTANCES OF THIS CASE ..... 12

15 5. THE AGREEMENT ITSELF IS TOO BROAD UNDER THE CIRCUMSTANCES OF

16 THIS CASE AND MANY OF ITS PROVISIONS ARE FLAWED ..... 13

17 6. THE SETTLEMENT IS NOT IN THE PUBLIC INTEREST ..... 17

18

19 7. CONCLUSION ..... 19

20

21

22

23

24



1           **2. THE SIB SHIFTS RISK FROM THE COMPANY TO THE RATEPAYER**  
2           **WITHOUT ADEQUATE FINANCIAL CONSIDERATION TO THE RATEPAYER**

3           The SIB mechanism reduces regulatory lag in the favor of AWC because the Company  
4 will not have to wait until new rates go into effect to recover a return on SIB eligible plant or the  
5 depreciation expense associated with it. RUCO-12 at 10<sup>2</sup>. However, any actual cost savings,  
6 such as lower operating and maintenance expenses, attributable to the new plant are not  
7 captured by the mechanism and are not flowed through to ratepayers. Id. The reason for the  
8 mismatch is the SIB filings will consider eligible plant placed in service after the time period  
9 considered in the rate case. Transcript at 258. Hence, the operating expenses associated with  
10 the SIB plant as well as all of the other rate case elements normally considered in a rate case  
11 will not be considered. Id. This mismatch works against the ratepayer's interests and assures  
12 that ratepayers will not pay their actual cost of service and will more than likely pay more over  
13 time.

14           Ratepayers will be paying for the recovery of and return on routine plant placed into  
15 ratebase in between rate cases that the ratepayer would not otherwise pay until the next rate  
16 case. To the extent the ratepayer receives a benefit through the efficiency credit on the return  
17 associated with the SIB related plant that paltry benefit is only available until the next rate case  
18 filing when the relevant plant is rolled into the ratebase and subject to the COE awarded in the  
19 next rate case. Transcript at 457.

20           While no one will know the true extent of the efficiency credit until the Company actually  
21 makes its SIB filing, the Company's Schedule A-3 provides a good idea. Schedule A-3 shows a  
22 hypothetical calculation of the overall SIB revenue requirement for the Superstition Division. A-  
23  
24

1 3 at 1. With an overall SIB revenue requirement of \$292,300, the overall efficiency credit would  
2 be \$14,615. A-3. This hypothetical exemplifies the imbalance between the ratepayer's benefit  
3 and the shareholder's benefit.

4 Of course, in this case, when considering the shareholder benefits, the Commission  
5 cannot limit its consideration to just the SIB. As stated above, the Company was awarded a  
6 higher COE in Decision No. 73736 to address the same problem as the SIB. Decision No.  
7 73736 at 61. The COE is just an additional shareholder benefit which further distorts the  
8 imbalance between the SIB financial benefit to the ratepayer and the SIB financial benefits to  
9 the shareholder.

10 Another argument advanced in support of the SIB that has a link to the financial benefit is  
11 that SIB will promote rate gradualism. Transcript at 283 and 317. Even if one were to buy into  
12 this argument, it comes at a cost. Ratepayers are likely to pay higher rates over time because  
13 of the failure to consider all of the rate case elements at each SIB filing. Gradualism will also  
14 come at the expense of rate stability. Transcript at 306-307. Ratepayer's rates will change  
15 yearly as the result of each SIB filing. Id., A-1 at 5.

16 Each filing will also result in a rate increase. For reasons which will be addressed below,  
17 the SIB is not an adjustor. Ratepayers will see no actual cost savings that might be realized  
18 and will no longer benefit from the rate stability that exists under the present ratemaking  
19 procedure. Id. The Commission should reject the SIB.

---

23 <sup>2</sup> For ease of reference, trial exhibits will be identified similar to their identification in the Transcript of  
24 Proceedings. The transcript volume number will identify references to the transcript

1           **3. THE SIB IS ILLEGAL IN ARIZONA**

2           RUCO incorporates the legal arguments made in the underlying case. The SIB is a  
3 DSIC, and the same arguments apply. See RUCO Opening Brief at 11-14 (Phase I), RUCO  
4 Reply Brief at 2-5, (Phase I). RUCO also incorporates the legal arguments made by Staff in its  
5 Opening Brief (pps. 25-28, Phase I) and Reply Brief (pps. 19-23, Phase I) to the extent they are  
6 consistent with RUCO's legal arguments. In all fairness to Staff, Staff did not foreclose the  
7 possibility that a DSIC mechanism could be constitutional. According to Staff, "...where  
8 exceptional circumstances exist, and a mechanism for a future rate adjustment is adopted in the  
9 context of a rate case as part of a utility's rate structure and if that mechanism meets the  
10 constitutional requirements that rate base is determined and the overall impact on the rate of  
11 return prescribed, that mechanism will not violate the Arizona Constitution." Staff's Opening  
12 Brief (Phase 1) at 26 citing *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 533, 578 P.2d 612,  
13 614 (App. 1978). While the signatories may contend that the SIB meets the Constitutional  
14 hurdles by such provisions as Schedule D in the Settlement, in truth, as will be more fully  
15 explained below, the SIB does not meet the Constitution's Fair Value Requirement.

16           **4. THE SIB IS NOT AN ADJUSTOR MECHANISM**

17           At the risk of being repetitive it is important to establish what the SIB is and what it is not  
18 when considering its constitutionality. The Arizona Constitution protects consumers by  
19 generally requiring that the Commission only change a utility's rates in conjunction with making  
20 a finding of the fair value of the utility's property.<sup>3</sup> However, Arizona's courts recognize that, "in  
21 limited circumstances," the Commission may engage in rate making without ascertaining a  
22  
23  
24

1 utility's rate base.<sup>4</sup> One of those circumstances exists where the Commission has established  
2 an automatic adjustor mechanism. *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 535, 578  
3 P.2d 612, 616; *Residential Util. Consumer Office v. Arizona Corp. Comm'n ("Rio Verde")*, 199  
4 Ariz. 588, 591 ¶ 11, 20 P.3d 1169, 1172. An automatic adjustor mechanism permits rates to  
5 adjust up or down "in relation to fluctuations in certain, narrowly defined, operating expenses."  
6 *Scates* at 535, 578 P.2d 616. An automatic adjustor permits a utility's rate of return to remain  
7 relatively constant despite fluctuations in the relevant expense. An automatic adjustor clause  
8 can only be implemented as part of a full rate hearing. *Rio Verde* at 592 ¶ 19, 20 P.3d 1173,  
9 *citing Scates* at 535, 578 P.2d 616.

10 The Commission has also defined adjustor mechanisms as applying to expenses that  
11 routinely fluctuate widely. In a prior decision in which it eliminated APS' fuel and power  
12 adjustor, the Commission stated:

13 The principle justification for a fuel adjustor is volatility in fuel prices. A  
14 fuel adjustor allows the Commission to approve changes in rates for a  
15 utility in response to volatile changes in fuel or purchased power  
prices without having to conduct a rate case. (Decision No. 56450,  
page 6, April 13, 1989).

16 The Commission went on to discuss the undesirability of such adjustors because they can  
17 cause piecemeal regulation that is inefficient and undesirable. *Id.* at 8. *See also Scates* at 534,  
18 578 P.2d 615.

19 In the subject case, the SIB clearly is not an adjustor mechanism – its purpose is not to  
20 account for fluctuating operating expenses. Its purpose is to allow for recovery of plant costs  
21

---

22 <sup>3</sup> Arizona Constitution. Art. XV, § 14; *Simms v. Round Valley Light & Power Company*, 80 Ariz. 145, 151, 294 P.2d  
23 378, 382 (1956); see also *State v. Tucson Gas*, 15 Ariz. 294, 308; 138 P.781, 786 (1914); *Arizona Corporation  
Commission v. State ex rel. Woods*, 171 Ariz. 286, 295, 830 P.2d 807, 816 (1992).

1 which increase rate base and thereby increase operating income. Unlike an adjustor, the SIB  
2 does not allow for rates to adjust "in relation to fluctuations in certain, narrowly defined,  
3 operating expenses." Moreover, the SIB only permits rates to adjust up, not down as the result  
4 of allowing for the SIB related plant recovery. RUCO -12 at 11.

5 Staff also recognized the *Scates* definition when it concluded that the Company's  
6 proposed DSIC was not an adjustor<sup>5</sup>. Staff Reply Brief at 21-22. For the very same reasons,  
7 the SIB is not an adjustor.

8 Even if one could set aside the argument that Arizona's courts have only recognized  
9 adjustors for very limited operating expenses and not for operating income, the SIB mechanism  
10 still would not qualify as an adjustor because the justification for the mechanism is not the  
11 volatility in the price of the plant. As explained, the concern here is the amount of the  
12 investment, and no case law parities the need for an adjustor mechanism with the magnitude of  
13 investment in plant. The SIB is not an adjustor mechanism nor should the exception be  
14 expanded in any manner to treat it as such.

15 **a) THE COMPANY HAS NOT REQUESTED INTERIM RATES**

16 The only other circumstance where the Commission may engage in rate making without  
17 ascertaining a utility's rate base involves requests for interim rates.<sup>6</sup> The Commission's  
18 authority to establish interim rates is limited to circumstances in which 1) an emergency exists;  
19 2) a bond is posted guaranteeing a refund if interim rates are higher than final rates determined  
20 by the Commission; and 3) the Commission undertakes to determine final rates after making a  
21  
22

---

23 <sup>4</sup> *Residential Utility Consumer Office v. Arizona Corporation Commission*, 199 Ariz. 588, 591 ¶11, 20 P.3d  
24 1169, 1172 (App. 2001).

1 finding of fair value.<sup>7</sup> The Arizona Attorney General has opined that an emergency exists when  
2 "sudden change brings hardship to a company, when a company is insolvent, or when the  
3 condition of the company is such that its ability to maintain service pending a formal rate  
4 determination is in serious doubt."<sup>8</sup>

5 The Company has not asserted an emergency nor requested interim rates. Regardless,  
6 and perhaps the reason why the Company has not asserted an emergency, is because the  
7 Company would not meet the legal criteria – there is no evidence of a sudden change that has  
8 brought hardship,<sup>9</sup> no insolvency issue, or evidence that the Company has an inability to  
9 maintain service in the interim or long term for that matter.

10 The provisions of Arizona's Constitution should be liberally construed to carry out the  
11 purposes for which they were adopted.<sup>10</sup> Conversely, exceptions to a constitutional  
12 requirement should be narrowly construed.<sup>11</sup> Essentially, the Commission should not use the  
13 "emergency" exception or the adjustor mechanism exception liberally as an excuse to set aside  
14 the rule of finding fair value when setting rates.<sup>12</sup>

---

15  
16  
17  
18  
19 <sup>5</sup> There seems to be a difference of opinion in Staff on whether the Company's DSIC was an adjustor. Transcript at 297, Decision No. 73736 at 101, S-3 at 35 (Phase I). However, it appears that the legal section does not believe it was an adjustor.

20 <sup>6</sup> *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 533-35, 578 P.2d 612, 614-16 (App. 1978).

21 <sup>7</sup> 199 Ariz. at 591, ¶12, citing *Scates*.

22 <sup>8</sup> 71-17 Opinion Arizona Attorney General at 50. (1971).

23 <sup>9</sup> The Company acknowledges that it has operated the Bisbee system for over 60 years and that much of the infrastructure is from the early 1900's. (Tr. At 400-401)

24 <sup>10</sup> *Laos v. Arnold*, 141 Ariz. 46, 685 P.2d 111 (1984).

<sup>11</sup> See *Spokane & I.E.R. Co. v. U.S.*, 241 U.S. 344, 350, 36 S.Ct. 668, 671 (1916) (an "elementary rule" that exceptions from a general policy embodied in the law should be strictly construed).

<sup>12</sup> Arizona case law and the Attorney General Opinion 71-17 set forth the legal parameters within which the Commission should act when considering emergency rate relief.

1                   **b) THE SIB WILL INCREASE THE COMPANY'S FAIR VALUE RATE BASE**  
2                   **WITHOUT ANY DETERMINATION OF FAIR VALUE**

3                   Having established that the SIB does not meet any of the criteria required by Arizona's  
4 Courts to side-step the Constitution's fair value requirement, the question then becomes  
5 whether or not the SIB complies with the Constitution's fair value requirement. First, it is  
6 important to recognize what the SIB is – it is a mechanism, not an adjustor mechanism, which  
7 will allow for the recovery of, and a return on routine plant in between rate cases, needed to  
8 address the Company's plant and improvement needs<sup>13</sup>.

9                   Next, as Staff noted, there is a question of whether exceptional circumstances exist for  
10 the extraordinary ratemaking being contemplated. The Commission has also determined that  
11 cost recovery mechanisms designed to side-step the fair value requirement should only be  
12 allowed in extraordinary circumstances. For example, see Decision No. 70351 at 36. Staff's  
13 Director, Steve Olea provided insight on this important consideration. Staff concluded that the  
14 Company had not demonstrated extraordinary circumstances in the underlying case to justify  
15 the Company's proposed. S-3 at 35 (Phase I). When asked in this Phase what has changed,  
16 Mr. Olea responded the Commission's request that the parties were all directed to talk about the  
17 DSIC. Transcript at 301. In Staff's view, a Commission directive to look at the DSIC constitutes  
18 an extraordinary circumstance. Staff's definition of "extraordinary" is even more murky and  
19 inconsistent<sup>14</sup> when one considers that the Commission in the last company-wide rate case  
20 ordered the Company to do a DSIC study and report on it in this case. Decision No. 73736 at  
21 14-15. While it does not appear that Arizona's case law defines extraordinary or exceptional, it

---

22  
23 <sup>13</sup> Again, its purpose is the same as the higher ROE that the Commission awarded in the underlying case.

1 is doubtful that it would include the Commission's directive in this case. For example, *Scates*  
2 did define what was needed for interim rates – an emergency which is far more tangible than a  
3 mere directive. *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 535, 578 P.2d 612, 616 (App.  
4 1978).

5 Finally, comes the question of exactly how the SIB works mechanically and whether it  
6 meets the fair value requirement. The mechanism itself will be established as part of the  
7 pending rate case. Within 12 months of the date of the Commission's final decision, AWC will  
8 be able to file a request to implement the SIB surcharge. A-1 at 5, Section 4.2. The Company  
9 will be able to file for the SIB surcharge no more than five times between rate case decisions.  
10 A-1 at 5, Section 4.4. The Commission will ultimately consider and then may approve each  
11 surcharge filing. The Commission, however, will not be making a new FVRB finding as part of  
12 each surcharge filing in such a way as to make fair value meaningful. RUCO-12 at 13. As  
13 Staff noted concerning the DSIC, the SIB will do far more than simply pass on increasing costs  
14 to the Company - it will allow "...surcharges based on the cost of the new plant, effectively  
15 increasing the fair value rate base without any determination by the Commission of what that  
16 fair value is." (See Staff Opening Brief at page 26). The SIB suffers from the same  
17 constitutional deficiency effectively making it illegal in Arizona.

18 **c) THE SETTLEMENT DOES NOT CURE THE CONSTITUTIONAL**  
19 **INFIRMITIES OF THE SIB**

20 Undoubtedly, the signatories will claim that the necessary constitutional safeguards are  
21 in place and the SIB passes constitutional scrutiny. RUCO challenges such a conclusion – the  
22

---

23 <sup>14</sup> I.e. it was not extraordinary when Staff considered the Company's proposed DSIC but is extraordinary in  
24 consideration of the Settlement's proposed DSIC.

1 facts are the facts and the fact is that each SIB filing will not result in a meaningful FVRB finding  
2 nor will there be any finding by the Commission of what fair value is:

3 "It is clear . . . that under our constitution as  
4 interpreted by this court, the commission is required to find the fair  
5 value of (the utility's) property and use such finding as a rate base for  
6 the purpose of calculating what are just and reasonable rates. . . . While  
7 our constitution does not establish a formula for arriving at fair value, it  
8 does require such value to be found and used as the base in fixing  
9 rates. The reasonableness and justness of the rates must be related to  
10 this finding of fair value." Simms v. Round Valley Light & Power Co., 80  
11 Ariz. 145, 151, 294 P.2d 378, 382 (1956).

12 Section 7.17 of the Settlement requires the filing of Schedule D which will show an  
13 analysis of the impact of the SIB plant on the fair value rate base, revenue, and the fair value  
14 rate of return as set forth in Decision No. 73736. A-1 at 9. This provision was obviously put in to  
15 satisfy *Scates*, but it does not go far enough:

16 We do not need to decide in this case whether as a matter of law  
17 there must be a de novo compliance with all provisions of the order in  
18 connection with every increase in rates. The Commission here not only  
19 failed to require any such submissions, but also failed to make any  
20 examination whatsoever of the company's financial condition, and to  
21 make any determination of whether the increase would affect the  
22 utility's rate of return. There may well be exceptional situations in which  
23 the Commission may authorize partial rate increases without requiring  
24 entirely new submissions. We do not decide in this case, for example,  
whether the Commission could have referred to previous submissions  
with some updating or whether it could have accepted summary  
financial information. *We do hold that the Commission was without  
authority to increase the rate without any consideration of the overall  
impact of that rate increase upon the return of Mountain States, and  
without, as specifically required by our law, a determination of Mountain  
States' rate base. Simms v. Round Valley Light & Power Co., 80 Ariz.*  
145, 294 P.2d 378 (1956); Ariz.Const. art. 15, section 3; A.R.S. section  
40-250. The Commission not only failed to make any findings to support  
its conclusion that the increases were just and reasonable, but it  
received no evidence upon which such findings could be based. *Scates*  
at 537, 578 P.2d 618. (Emphasis added).

1 While the SIB Schedule (D) may show the impact of the SIB plant on the rate base, the  
2 revenue and the fair value rate of return, the Commission will not, as required by law, make a  
3 meaningful finding of fair value and use that finding as a rate base for the purpose of  
4 establishing rates. R-12 at 13-15. In order to meet *Scates*, and hence fair value, the SIB filing  
5 would have to be on the scale of a rate case or at least a mini-type rate case where all of the  
6 rate case elements are considered. Schedule D shows the rate base (O.C.L.D.) but it only  
7 shows the capital costs and the depreciation expense associated with the plant additions. A-1,  
8 Schedule D, Transcript at 469. Hence, the SIB filings will only consider one piece – the SIB  
9 plant. Transcript at 258 and 469. It will not consider the operating expenses associated with  
10 that plant, the working capital, etc. Id. at 258, 292. The operating expenses that will be included  
11 in the rates that the Commission will approve after each SIB filing will be the operating  
12 expenses approved in Decision No. 73736 - operating expenses from a completely different  
13 period than the SIB plant under consideration. Id. In sum, there is no tie back to fair value and  
14 the SIB raises the specter of single issue ratemaking which was a concern of the *Scates* Court,  
15 the Commission's judges but apparently is no longer a concern of Staff<sup>15</sup>. *Scates* at 534, 578  
16 P.2d. 615, RUCO 5 at 5. **The SIB mechanism is single issue ratemaking, it is not fair value**  
17 **ratemaking - Schedule D renders fair value meaningless.**

18 There are other provisions of the Agreement which will assure Commission oversight and  
19 approval of the SIB filings but nothing that requires a meaningful finding of fair value as required  
20 by Arizona's Constitution. The SIB is illegal and should be rejected.

21  
22  
23 <sup>15</sup> Staff was concerned about the element of single issue ratemaking as concerns the DSIC in the underlying  
24 case. S-4 at 2-3.

1                   d)     **THERE IS NO CASE LAW WHICH SUPPORTS A MECHANISM LIKE THE**  
2                                   **SIB UNDER THE CIRCUMSTANCES OF THIS CASE**

3                   RUCO is unaware of any case law which would support an argument that the SIB is  
4 constitutional under the circumstances of this case. Staff, in its Reply Brief distinguishes the  
5 relevant cases as they relate to the DSIC – the same distinctions can be said for the SIB.  
6 Staff's Reply Brief 19-23, Phase I. In *US West Communications, Inc. v. Arizona Corp. Comm'n*,  
7 201 *Ariz.* 242,245-46,34 P.2d 351,354-55 2001), the Arizona Supreme Court addressed the  
8 issue of whether the Constitutional mandate that requires the Commission find fair value applies  
9 to the Commission's method of setting rates for competitive local exchange carriers. The  
10 Commission determined that the fair value methodology applies to monopoly situations,  
11 whereas it is inappropriate when the concern is a competitive utility. *Id.*, 201 *Ariz.* at 246, 34  
12 P.2d at 355. This case is clearly distinguished from the present as the Company is a monopoly  
13 and not a competitive utility.

14                   In *Arizona Community Action Ass'n. v. Arizona Corp. Comm'n.*, 123 *Ariz.* 228,599 P.2d  
15 184 (1979), the Court considered a Company's methodology to determine an increase based  
16 solely on the Company's common equity falling below a certain level. The Court determined that  
17 the company's methodology was not constitutional because the Company had the ability to  
18 influence the return on equity which would be beneficial only to shareholders. *Id.* at 231, 599  
19 P.2d at 187.

20                   The case law in Arizona does not appear to spell out exactly what fair value is. We know  
21 that there is no exact formula to find fair value. We also know that fair value must be found.  
22 The cases do shed some light on what fair value is not – it is not single issue ratemaking which  
23  
24

1 is what the SIB is. The SIB runs afoul of Arizona Constitution's requirement of fair value. The  
2 Commission should reject the SIB as it is illegal.

3 **5. THE AGREEMENT ITSELF IS TOO BROAD UNDER THE CIRCUMSTANCES OF**  
4 **THIS CASE AND MANY OF ITS PROVISIONS ARE FLAWED**

5 The Settlement goes far beyond its original purpose. Moreover, many of its provisions  
6 and the Agreement as a whole raise more questions than answers. Admittedly, no Agreement  
7 is perfect. RUCO understands that, but this is going to act as a "template" for other cases so it  
8 should be tight and not subject to different interpretations.

9 RUCO takes issue with the following:

- 10 1) Section 3.3. The 5.00 percent efficiency credit is inadequate to compensate  
11 ratepayers for the shift in risk – discussed above.
- 12 2) Section 4.6 and 4.7. These provisions explain when the Company is  
13 required to file its next rate case and reset of the SIB surcharge. They do  
14 not, nor does the Settlement, explain what happens to the SIB after the  
15 next rate case. The circumstance after 2016 will be different than now and  
16 leaving such an important point open to interpretation is perilous.
- 17 3) Section 6 – Eligibility of SIB Plant. The Commission was originally  
18 concerned with the Company's water loss and looking at DSIC's designed  
19 to implement leak detection devices and make conservation-based repairs.  
20 The objective was to replace/repair/improve the infrastructure specifically to  
21 address the water loss. Decision No. 73736 at 15. The SIB expands the  
22 purpose to include almost every type of plant. For example, the SIB  
23 includes upgrades to fire mains which could clearly include upgrades

1 whose sole purpose is for fire flow improvement. The Commission has  
2 made clear that such improvements do not warrant extraordinary  
3 ratemaking treatment. See for example Decision No. 70351 at 36. Staff  
4 claims it will be diligent in its review of the plant but Staff's personnel  
5 change as does the Company's personnel and who can say how such  
6 excess will be controlled in the future. This is only one example of how  
7 unintended plant could easily fit into the broad "categories" described in  
8 paragraph 6.4. The better question to ask is what plant is not eligible under  
9 the terms of the Agreement? Mr. Olea responded at hearing that plant not  
10 described in 6.4 would be ineligible. Transcript at 331. Staff's answer is of  
11 little to no value since 6.4 only describes categories (and a lot of them) and  
12 not specific types of plant.

13 RUCO's concern here, like most of the following concerns could  
14 easily be addressed with more detailed provisions. Instead, many of the  
15 provisions of the agreement are subject to different interpretations. On the  
16 issue of eligibility, it is worth noting that Section 6.3.1 lists as one of the  
17 eligibility criteria, water loss of a system that exceeds 10 percent. This  
18 specific provision, standing alone, could create perverse incentives. A  
19 Company with a water loss less than 10 percent could easily be motivated  
20 to ignore or neglect the issue or even take measures to worsen the  
21 situation to achieve eligibility. SIB approval would reward such impure  
22 conduct. This concern is not hollow – to be eligible all a utility needs to do  
23 is meet the standard – it then becomes the burden of Staff/RUCO and

1 ultimately the Commission to ascertain whether the Companies motives are  
2 pure or not. It would not be difficult to hide such conduct – ascertaining  
3 one’s intent is one of the most difficult things in the law to prove. Towards  
4 this end, a provision in this section which provides that eligibility is subject  
5 to the consideration of all of the facts and circumstances of any given case  
6 would tighten the agreement and perhaps provide a disincentive to  
7 questionable conduct.

8 A catch all provision would also cover the concerns Judge Harping  
9 raised in her ROO and Judge Nodes raised in the hearing concerning the  
10 Company’s recent payout of dividends in view of its need for infrastructure  
11 improvement. ROO at 105. The Company complains of underearning and  
12 its inability to cover its expenses. When asked by Judge Nodes whether it  
13 would be appropriate for the Company to account for all of its depreciation  
14 expense before being eligible for a SIB, the Company believed such a  
15 requirement would be unnecessary. The Company appears to believe that  
16 the issue is not accountability, but strictly cost recovery. Transcript at 116.  
17 The Company claims to have lost approximately \$41 million since 1996.  
18 Transcript at 118. Nonetheless, as the Judge noted, the Company still  
19 managed to pay \$5 million in dividends a year which over the same time  
20 period exceeded the \$41 million it lost. Id. at 119. While Judge Harping  
21 would not go so far as accusing the Company of malfeasance, she did note  
22 that the Company was in a position to ameliorate its situation. The point  
23  
24

1 should not be lost - such circumstances should be considered when  
2 contemplating the SIB.

3 It is not entirely clear under Section 6 of the Settlement that the  
4 history of company, its past financial circumstances, etc. are considerations  
5 for eligibility. Section 6.3.3 provides for the engineering, operational and  
6 financial justification for SIB eligibility, but the language, again is subject to  
7 interpretation.

8 4) Section 6.5. This provision provides for the procedure after the Company  
9 makes its request to modify or add SIB projects. Staff and RUCO will then  
10 have 30 days to object. A-1 at 8. If either objects, it is left unstated what  
11 will happen and subject to interpretation as was made obvious in the  
12 hearing. Transcript at 250-252, 286-287.

13 5) Section 7.17. This provision provides for an impact statement. It appears  
14 to be a provision put in place in an effort to meet the *Scates* requirements.  
15 But as discussed above, it falls short of meeting *Scates* and the fair value  
16 requirement. Like SIB Schedule C, it also falls short of an earnings test  
17 which would be helpful from the ratepayer standpoint in following the  
18 Company's earnings in view of the fact that it will have in place a surcharge  
19 mechanism designed to ameliorate regulatory lag.

20 6) RUCO is concerned that the SIB projects could generate revenues by  
21 serving new customers. It is not made clear in the provisions of the  
22 Agreement that the SIB plant is to be non-revenue producing. To some  
23 degree RUCO's concern is diminished by the verbiage in Table 1 which

1 indicates for each project that it is not being constructed to serve new  
2 customers. A-1, Exhibit A. Again, it is not spelled out in the Settlement's  
3 provisions and it is easy to see how this point could get lost or just amount  
4 to lip service as time goes by.

5 7) There is no language in the Agreement concerning the SIB and its  
6 relationship to the COE. This is a concern to RUCO because in the  
7 February 12, 2013 Open Meeting it was made clear to RUCO that the  
8 Commission does not believe that a relationship exists between the SIB  
9 and the ROE. The alleged 100 basis point efficiency credit reduction to the  
10 ROE related to the SIB plant is paltry especially when compared to the  
11 effect that the efficiency credit has on the overall ROE. The Settlement, as  
12 a "template" established under the circumstances of this case, could easily  
13 be interpreted to forbid for future purposes consideration of the relationship  
14 between the ROE and the SIB.<sup>16</sup> Of course, RUCO could, and most  
15 probably would object to every proposed SIB, but it still is not only bad  
16 public policy but contrary to ratepayer's interests to place conditions on any  
17 future negotiations.

## 18 6. THE SETTLEMENT IS NOT IN THE PUBLIC INTEREST

19 There are numerous reasons why RUCO does not believe the Settlement is in the public  
20 interest. The SIB is illegal in Arizona, and hence not in the public interest. The SIB does not  
21 adequately compensate ratepayers for the shift in risk that will result – a five percent efficiency

---

22  
23 <sup>16</sup> We have already seen one Company interpret the Commission's Open Meeting that way in the Rio Rico  
24 matter. See Procedural Order dated March 20, 2013, Docket No.WS-02676A-12-0196 at 3.

1 credit is a paltry quid pro quo - all one needs to do is look at Exhibit A-3 to put it into  
2 perspective. The Commission's statements in the February 12, 2013 Open Meeting regarding  
3 the relationship (actually the lack of a relationship) between the ROE and DSIC for all intents  
4 and purposes placed conditions on the negotiations. Such conditions and the effect that they  
5 had on the final Settlement are not in the public interest – it surely did not benefit the ratepayers  
6 in any way. Judge Harping in this case and Judge Rodda in the Rio Rico<sup>17</sup> case seem to have  
7 a different opinion on the relationship between a DSIC and the ROE – such conflict on such an  
8 important issue is not good. Perhaps even more compelling is the fact that the Commission  
9 addressed the infrastructure needs by awarding a higher ROE. If the Commission approves the  
10 SIB it will have approved two mechanisms to address the same issue. RUCO questions how  
11 that is in the public interest.

12 It will also establish precedent - why would a Company not ask for both a higher ROE  
13 and a SIB to address its water loss related infrastructure needs in the future? How will the  
14 Commission distinguish any future case and not allow for the approval of two mechanisms to  
15 address the same thing? Seriously, can a reasonable argument be made that it is fair to the  
16 ratepayer for the Commission to approve two mechanisms to address the same thing? Approval  
17 of the SIB in this case under these circumstances will no doubt send the Commission down a  
18 slippery slope.

19 The fact that the Commission is the "extraordinary" catalyst that now makes it necessary  
20 to use extraordinary ratemaking is not in the public interest. In fact, its potential future  
21

---

22  
23 <sup>17</sup> Judge Rodda noted that bifurcation as proposed by the Company in that case "hinders the ability of parties  
24 to argue their positions as to whether and how the DSIC affects the cost of capital and/or operating  
expenses, and could adversely affect the Commission's ability to set just and reasonable rates." Clearly,

1 ramifications are nothing short of just plain scary. The Settlement itself is loaded with provisions  
2 that are subject to different interpretations and omissions on important points as explained  
3 above. The Commission need only go back to the TEP Settlement in 1999 and how the  
4 different interpretations of that settlement became the central focus of TEP's last rate case.  
5 See Docket No. E-01933A-07-0472. The Commission should be wary of repeating that  
6 situation – such confusion is surely not in the public interest.

7 RUCO could go on with numerous other reasons why the Settlement is not in the public  
8 interest - but the point is made. The Settlement under the circumstances of this case is not in  
9 the public interest.

10 **7. CONCLUSION**

11 For all of the above reasons the Commission should reject the Settlement.

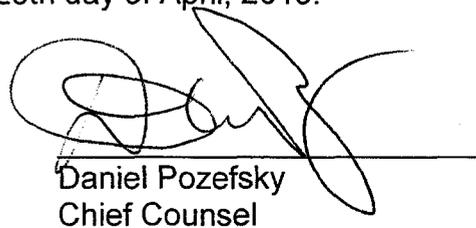
12

13 RESPECTFULLY SUBMITTED this 29th day of April, 2013.

14

15

16



Daniel Pozefsky  
Chief Counsel

17

18

19

20

21

22

---

23 Judge Rodda was at least willing to consider that a relationship between the DSIC and ROE exists. See  
24 Procedural Order dated March 20, 2013, Docket No. WS-02676A-12-0196, at pp. 5-6.

1 AN ORIGINAL AND THIRTEEN COPIES  
of the foregoing filed this 29th day  
2 of April, 2013 with:

3 Docket Control  
Arizona Corporation Commission  
4 1200 West Washington  
Phoenix, Arizona 85007

5 COPIES of the foregoing hand delivered/  
6 mailed this 29<sup>th</sup> day of April, 2013 to:

7 The Honorable Lyn Farmer  
Dwight Nodes  
8 Administrative Law Judges  
Hearing Division  
9 Arizona Corporation Commission  
1200 West Washington  
10 Phoenix, Arizona 85007

Kathie Wyatt  
1940 N. Monterey Drive  
Apache Junction, AZ 85120

11 Janice Alward, Chief Counsel  
Bridgette Humpries  
12 Wes Van Cleve  
Legal Division  
13 Arizona Corporation Commission  
1200 West Washington  
14 Phoenix, Arizona 85007

By Cheryl Fraulob  
Cheryl Fraulob

15 Steven M. Olea, Director  
Utilities Division  
16 Arizona Corporation Commission  
1200 West Washington  
17 Phoenix, Arizona 85007

18 William Garfield  
Vice President and General Counsel  
19 Arizona Water Company  
Post Office Box 29006  
20 Phoenix, Arizona 85038-9006

21 Steven A. Hirsch  
Stanley B. Lutz  
22 Bryan Cave LLP  
Two North Central Avenue, Suite 2200  
23 Phoenix, AZ 85004