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BEFORE THE ARIZONA CORPORATION COMMISSION

13 IN THE MATTER OF THE APPLICATION
 OF ARIZONA WATER COMPANY, AN
 14 ARIZONA CORPORATION, FOR A
 DETERMINATION OF THE FAIR VALUE
 15 OF ITS UTILITY PLANT AND PROPERTY
 AND FOR ADJUSTMENTS TO ITS RATES
 16 AND CHARGES FOR UTILITY SERVICE
 FURNISHED BY ITS EASTERN GROUP
 17 AND FOR CERTAIN RELATED
 18 APPROVALS

DOCKET NO. W-01445A-11-0310

19
 20 **JOINT CLOSING BRIEF OF**
 21 **LIBERTY UTILITIES AND**
 22 **GLOBAL WATER**

April 29, 2013

Arizona Corporation Commission
DOCKETED
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1 Intervenors Rio Rico Utilities, Inc. d/b/a Liberty Utilities¹ (“Liberty”) and the
2 Global Water Utilities² (“Global Water”) submit this Joint Closing Brief in support of the
3 approval of the SIB Settlement.

4 **I. INTRODUCTION.**

5 RUCO rails against the System Improvement Benefits Mechanism (“SIB”) as new
6 and untraditional because it will change rates outside of a traditional general rate case.
7 John Locke wrote, “new opinions are always suspected, and usually opposed, without any
8 other reason but because they are not already common. But truth, like gold, is not the less
9 so for being newly brought out of the mine. It is trial and examination that must give it
10 price.” The SIB has been put on trial in this case, and the evidence shows that the SIB
11 will:

- 12 ● enable water utilities to meet the challenge of replacing aging infrastructure;
- 13 ● result in more gradual rate increases, as strongly preferred by ratepayers;
- 14 ● increase the time between rate cases;
- 15 ● provide a direct monetary benefit to ratepayers through the 5 percent efficiency
16 credit, a benefit not provided by any other water DSIC in the United States; and
- 17 ● keep the water utility financially healthy so it can continue to provide safe and
18 reliable water service.

19 In the face of these clear public benefits, RUCO focuses on legal arguments against the
20 SIB. RUCO’s legal objections must be rejected. The SIB is a type of adjustment
21

22 ¹ Liberty Utilities owns and operates RRUI, Litchfield Park Service Company, Bella Vista
23 Water Company, Gold Canyon Sewer Company, Entrada del Oro Sewer Company, and
24 Black Mountain Sewer Corporation in Arizona, as well as utilities in several other states.

25 ² Global Water – Palo Verde Utilities Company, Global Water – Santa Cruz Water
26 Company, Valencia Water Company – Town Division, Valencia Water Company –
 Greater Buckeye Division, Water Utility of Greater Tonopah, Willow Valley Water Co.
 and Water Utility of Northern Scottsdale.

1 mechanism that is lawful in Arizona when approved in a general rate case. The SIB here
2 is being approved as part of Arizona Water Company's general rate case, meeting this
3 requirement. Moreover, fair value findings will be made in each SIB surcharge order,
4 thus complying with Arizona's fair value requirement.

5 **II. THE SIB IS IN THE PUBLIC INTEREST.**

6 **A. The SIB Provides a Needed Mechanism To Finance Infrastructure**
7 **Replacement.**

8 Perhaps the best explanation of why the Commission should approve the SIB was
9 given by Steve Olea, the Director of the Utilities Division ("Staff"):

10 And in this case I can truly support this, and the main reason
11 is, and I walked into the first day of settlement and I think I
12 told everybody, I have to walk out of there with something I
13 can be on the stand right here and actually defend and
14 actually feel that it's the right thing to do. And I feel this is
the right thing to do, not just for the water companies, but for
the ratepayers. Systems are getting old. Systems need to be
replaced.³

15 There is no question that some water systems are weighed down by aging infrastructure,
16 some of it many decades old. This infrastructure must be replaced. But the sheer scale of
17 the investments needed is disconcerting.⁴ It would be very difficult—if not impossible—
18 for utilities to obtain the necessary investment (debt and equity) under the normal
19 ratemaking process.⁵ Even if the utility did manage to raise the necessary investments,
20 ratepayers would be faced with sudden and massive rate increases once the plant
21 replacements were "in service" and recognized in a rate case.

22 _____
23 ³ Tr. at 302:20 to 303:3.

24 ⁴ See e.g. Direct Testimony of Paul Walker, Exhibit Global-2, at Attachment 1, pages 8-4;
25 see also, Direct Testimony of Joseph D. Harris, Phase I Exhibit A-9, page 13, lines 18 to
26 28."

⁵ See e.g. Direct Testimony of Joseph D. Harris, Phase I Exhibit A-9, page 15, line 13 to
page 16, line 22.

1 There's a better way, one that allows for more gradual rate changes while enabling
2 utilities to raise the funds they need. The solution is the SIB. Staff and the settling parties
3 carefully designed the SIB to meet these challenges while protecting ratepayers. The SIB
4 will ensure that these necessary investments occur and that customers are protected.
5 Again, as Mr. Olea explained, utilities "have the obligation to actually provide that proper,
6 adequate, reliable, safe service; but along with that obligation, **they have to have the**
7 **funds to do that.** And I believe that the way that we have set up that SIB mechanism, it
8 will allow them a better chance to actually do that."⁶

9 **B. Benefits of SIB.**

10 **1. Safe and Reliable Service.**

11 The SIB promotes safe and reliable water and wastewater service. Mr. Olea
12 emphasized that both utilities and customers benefit from the increased safety and
13 reliability:

14 ... one of the reasons that I can support the SIB the way it is,
15 is that it actually benefits both sides, because you're going to
16 make sure that you keep providing proper and adequate
17 service. It is true that the companies have to do that
18 regardless, but if you can assist the companies to do that and
19 making sure that, you know, every time somebody turns on
20 the spigot, water comes out, that it's safe water, then, I think
21 that's not just a benefit to the company, but it's a benefit to
22 the ratepayers.⁷

23 RUCO Director Quinn agreed that "reducing the number of outages for water
24 companies is in the best interest of the residential consumer."⁸

25 ⁶ Tr. at 375:17-22 (emphasis added).

26 ⁷ Tr. at 304:13-44.

⁸ Tr. at 390:18-20; *see also* Direct Testimony of Joel M. Reiker, Exhibit A-2, page 12,
lines 16-25.

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2. Smaller rate increases – rate gradualism.

There is widespread agreement that a key benefit from the SIB is “rate gradualism, that is, smaller, more frequent rate adjustments rather than less frequent, but much larger rate increases.”⁹ Utility customers strongly prefer rate gradualism. A poll of 4,000 Arizonans asked “when utility rates have to go up, would you prefer: a) small annual changes, or b) large changes every few years?” The results were sharply in favor of (a), with 89.4 percent preferring the gradual changes.¹⁰

This preference for gradualism is no surprise. Mr. Broderick (EPCOR) has heard it from many customers over the years.¹¹ Mr. Quinn has also heard from ratepayers who prefer smaller, more frequent increases to “being hit with a large all-at-once increase.”¹² He elaborated that “I think it’s a benefit to customers, as long as they know what they’re getting into; that, you know, this is going to go up every year.”¹³ He even agreed that all things being equal, customers prefer smaller, more frequent increases rather than large, infrequent increases.¹⁴

As rate increases become more gradual, it stands to reason that contested rate cases with large increases at issue will become less frequent. That is what the evidence from states with DSICs suggests. For example, Pennsylvania’s DSIC mechanism increased the

⁹ Direct Testimony of Paul Walker, Exhibit Global-2, at page 2, lines 6-7; *see also* Direct Testimony of Steven M. Olea, Exhibit S-1, page 10, lines 3-6; Direct Testimony of Thomas M. Broderick, Exhibit EPCOR-1, page 3, lines 5-10; Direct Testimony of Gary Yaquinto, Exhibit AIC-1, page 6, lines 4-10; Direct Testimony of Greg Sorensen, Exhibit RRUI-1, page 2, lines 21-26 (adopted by Mr. Krygier).

¹⁰ Direct Testimony of Paul Walker, Exhibit Global-2, at Attachment 2, page 3.

¹¹ Tr. at 199:21 to 200:15.

¹² Tr. at 499:11-25.

¹³ Tr. at 499:11-25.

¹⁴ Tr. at 453:23 to 454:10.

1 period of time between rate case filings.¹⁵ In this case, all SIB increases must be gradual
2 because the SIB contains a 5 percent cap on annual SIB increases.¹⁶ This further embeds
3 gradualism directly into the structure of the SIB itself.

4 **3. Efficiency credit.**

5 An extraordinary feature of the SIB is the 5 percent efficiency credit. No other
6 water DSIC mechanism—in any state—has a direct monetary benefit for customers like
7 this.¹⁷ Mr. Olea also emphasized that the credit is “actual dollar benefit to the
8 ratepayers.”¹⁸ He also explained that the utility never gets the lost money back, the utility
9 is “not going to be made whole because it will never make up that 5 percent efficiency
10 credit.”¹⁹ While RUCO criticizes the efficiency credit for being insufficient, it is
11 undisputed that it is unique among DSICs in the nation, and the net effect of Arizona’s
12 efficiency credit is a reduction to the return on the SIB plant.

13 **4. Financial stability.**

14 Banks and bondholders aren’t going to lend money for replacement infrastructure
15 just because a utility needs it. Mr. Olea conceded that debt and equity investors look at
16 metrics like earnings and cash flow in deciding whether to invest in a utility.²⁰ Similarly,
17 Mr. Reiker explained that the SIB “enhances the capital attractiveness” of the utility, i.e.,
18 makes the utility more attractive to debt investors by improving the utility’s cash flow.²¹

19 _____
20 ¹⁵ See Direct Testimony of Paul Walker, Exhibit Global-2, at Attachment 2, page 2.

21 ¹⁶ Exhibit A-1, SIB Settlement Agreement, page 5, Section 3.4.

22 ¹⁷ Mr. Walker’s testimony reported that Arkansas’ DSIC-like mechanism for a gas utility
23 had an ROE adjustment. See Direct Testimony of Paul Walker, Exhibit Global-2, pages
24 3-4; Tr. at 162:5 to 164:5 and 184:13 to 184:18. Further research determined that was not
25 the case. Tr. 379:8-24 (stipulation of counsel correcting this point).

26 ¹⁸ Tr. at 265:4.

¹⁹ Tr. at 330:24-25.

²⁰ Tr. at 378:3-17.

²¹ Tr. at 70:13 to 71:10.

1 By improving earnings and cash flow, the SIB will protect the utility's financial integrity,
2 and thus its ability to raise funds.²² Even RUCO Director Quinn agrees that a financially
3 sound utility benefits customers testifying that, "I think what benefits the consumers is,
4 you have to have a healthy company."²³

5 **5. The SIB provides a useful template for other cases.**

6 The SIB provides a template for developing similar mechanisms for other water
7 and wastewater utilities. Mr. Olea explained, "we were hoping that the Commission
8 would approve some type of DSIC mechanism; and that once that was approved, that
9 mechanism could be used by other companies that met the requirements of whatever
10 mechanism was set up."²⁴ Having a standardized SIB is in the public interest because it
11 promotes uniformity of administration. A uniform SIB reduces Staff workload and
12 eliminates the need to "re-invent the wheel,"²⁵ a critical component of any DSIC-like
13 mechanism from Staff's perspective.²⁶

14 Because the SIB is intended as a template, it was carefully designed. For example,
15 a "lot of the burden [is] placed" on the utility, so Staff and RUCO "would have much less
16 to do than otherwise" and the SIB filings can be quickly processed.²⁷ A key part of the
17 SIB is SIB Table 1, a detailed list of projects that is closely reviewed by Staff and
18 approved by the Commission in a rate case. This detailed "upfront work" in the rate case
19 will significantly reduce the time it takes to review subsequent SIB filings.²⁸

21 _____
22 ²² Direct Testimony of Joel M. Reiker, Exhibit A-2, page 11, line 25 to page 12, line 9.

23 ²³ Tr. at 423:19-20.

24 ²⁴ Tr. at 248:1-14; *see also* Tr. at 316:16-21.

25 ²⁵ Tr. at 248:15 to 249:3.

26 ²⁶ Tr. at 208:17-18.

25 ²⁷ Tr. at 288:1-5 (Olea).

26 ²⁸ Tr. at 291-292 (Olea).

1 RUCO's Director, Mr. Quinn, acknowledged that the Settlement Agreement
2 contains "many parts" that "were well thought out and many compromises that were
3 agreed to."²⁹

4 **C. A.R.S. § 40-222 Is Not a Viable Alternative to the SIB.**

5 During the hearing, Judge Nodes asked some questions regarding A.R.S. § 40-
6 222.³⁰ The statute has two parts. The first part allows the Commission to set depreciation
7 rates for regulated utilities. This first part of the statute has been in use many years, and
8 the Commission has a depreciation rule based on this statute.³¹ The second part is an
9 obscure and long-dormant provision allowing the Commission to require a "depreciation
10 fund":

11 ...and shall set aside the money so provided for out of
12 earnings and carry such money in a depreciation fund and
13 expend the fund, and the income therefrom, only for the
14 purposes and under rules and regulations, both as to original
expenditure and subsequent replacement, as the commission
prescribes.³²

15 No witness testified in support of using this authority – in this case, or ever. The
16 Commission has never used the special "depreciation fund" authority.³³ This statute was
17 enacted in 1912—if a special, restricted depreciation fund was in the public interest, it
18 would have been used by now. There are four major reasons not to rouse this
19 anachronism from its long slumber.

20 First, it would cause higher rates.³⁴ This is because recovery of depreciation
21 expense also serves to provide the required cash flow to the utility. So if depreciation

22 ²⁹ Direct Testimony of Patrick J. Quinn, Exhibit RUCO-11, at page 3, lines 2-3.

23 ³⁰ See e.g. Tr. at 136:1-4; 139:8-21.

24 ³¹ See A.A.C. R14-2-102.

25 ³² A.R.S. § 40-222.

26 ³³ Tr. at 247:17-22; 303:9-10; 322:10-13.

³⁴ Tr. at 303:9-10; see also Tr. at 323:17 to 324:17; Tr. at 326:21 to 327:4 (Olea).

1 funds are diverted to some other purpose, the Commission would have to make it up
2 somewhere else, to ensure that the utility has sufficient cash flow. Mr. Olea candidly
3 explained that this is “the way the rates have been done here, that the companies have not
4 been given enough cash flow to put money aside and still pay their expenses.”³⁵

5 Second, it won’t work because it doesn’t put enough money aside. Depreciation
6 expense is based on the original cost of the asset; because plant costs increase over time,
7 simply putting away a small percent of the original cost over time will not provide enough
8 funds to pay for the higher cost of replacing the asset decades later.³⁶

9 Third, the statute itself doesn’t allow the Commission to act by *ad hoc* orders. If the
10 Commission were to ever require such an unprecedented special depreciation fund, the
11 statute requires the Commission to prescribe the uses of the funds by “rules and
12 regulations.”³⁷ Because the Commission has never enacted such a rule,³⁸ the special fund
13 idea cannot be used in this case, or in any case until such rules are in place.

14 Fourth, it would raise serious constitutional issues, likely sparking a firestorm of
15 litigation. As Mr. Olea explained, a basic principle of ratemaking is that “rates should be

17 ³⁵ Tr. at 343:13-15.

18 ³⁶ See Tr. at 360:21 to 362:10 (Olea); see also Tr. at 77:1-15 and 113:7 to 114:3 (Reiker).

19 ³⁷ A.R.S. § 40-222.

20 ³⁸ See Tr. at 145:22-25 (Testimony of Mr. Reiker that such rule does not exist); The
21 reference to “depreciation reserve” in A.A.C. R14-2-102(B)(2) does not refer to such a
22 special fund. “Depreciation reserve” is another name for “accumulated depreciation.”
23 See Tr. at 321:7 to 322:5 and 344:7-27 (Olea); see also *Simms v. Round Valley Light &*
24 *Power Co.*, 80 Ariz. 145, 151, 294 P.2d 378, 382 (1956)(Commission may deduct
25 depreciation reserve from rate base); *Turner Ranches Water & Sanitation Co. v. Arizona*
26 *Corp. Comm’n*, 195 Ariz. 574, 578, 991 P.2d 804, 808 (Ct. App. 1999)(referring to
“accumulated depreciation reserve”); James C. Bonbright *et al.*, *Principles of Public*
Utility Rates (2nd ed. 1988) at p. 282 (discussing “depreciation reserve as a measure of
accumulated depreciation”); Charles F. Phillips, *The Regulation of Public Utilities* (1984)
at 310-313 (“vast majority” of Commissions use depreciation reserve as the measure of
accumulated depreciation for purposes of determining rate base).

1 set so that the utility has recovery of and on its rate base.”³⁹ The recovery on the rate base
2 is through the rate of return, and the recovery of the rate base is through depreciation
3 expense.⁴⁰ That’s why the Commission defines “depreciation” as “an accounting process
4 which will permit the recovery of the original cost of an asset less its net salvage over the
5 service life.”⁴¹ Redirecting depreciation expense to a special restricted fund does not
6 provide the required return “of” the utility’s investment, creating constitutional issues
7 under the “takings clause” of the United States Constitution, the takings clause of Arizona
8 Constitution (Article 2, § 17), as well as under Article 15 §§ 3 and 14 of the Arizona
9 Constitution.

10 **D. RUCO’s Speculative Concerns Are Baseless.**

11 RUCO speculates that because one criteria for a SIB is water loss over 10 percent,
12 that companies would have a “perverse incentive” to increase water loss if they do not
13 quite meet the 10 percent threshold.⁴² There is no evidence to support this speculation,
14 only the unsupported imagination of RUCO’s witnesses.

15 Further, Mr. Olea made it clear that Staff would be on the lookout for such
16 behavior, and that it would result in the system being disqualified from having a SIB.⁴³
17 Mr. Olea further explained that if Staff “found out that a company intentionally did that,
18 there would be some kind of filing for an order to show cause, a complaint, something.
19 So that would be regardless of this agreement or not.”⁴⁴

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22 ³⁹ Tr. at 341:11-13.

23 ⁴⁰ Tr. at 341:16 to 342:15 (Olea); Tr. at 130:21 to 132:19 and 137:2 to 138:2 (Reiker).

24 ⁴¹ A.A.C. R14-2-102(A)(3)(emphasis added). *See also* Tr. at 246:13-15 (Olea).

25 ⁴² Direct Testimony of William Rigsby, Exhibit RUCO-12, at page 5, line 21.

26 ⁴³ Tr. at 313:14 to 315:9.

⁴⁴ Tr. at 253:12-16.

1 **III. THE SIB IS LEGAL.**

2 **A. Summary.**

3 Faced with the clear and unequivocal public benefits of the SIB, RUCO has little
4 choice but to resort to its mantra that the SIB is illegal and violates traditional principles
5 of ratemaking in Arizona. On these arguments, RUCO hopes that the Commission will be
6 swayed by use of catch phrases like “fair value,” or “piecemeal” and “single issue”
7 ratemaking. On these issues, however, the SIB mechanism complies with all applicable
8 requirements under Arizona law, including clearly meeting the fair value standard set
9 forth in Article 15, § 14 of the Arizona Constitution. In fact, the SIB is specifically
10 tailored to comply with applicable Arizona legal requirements regarding ratemaking,
11 including the fair value requirement.

12 Put simply, the SIB is a ratemaking adjuster mechanism designed to provide for the
13 timely recovery of capital costs (depreciation expense and pre-tax return on investment)
14 invested by utilities in distribution system improvement projects meeting the specific
15 criteria set forth in the SIB Settlement Agreement.⁴⁵ The question before the Commission
16 is whether to approve the proposed SIB as part of AWC’s pending general rate case.

17 No matter what RUCO says, the fundamental premise behind the SIB is for the
18 Commission to approve an adjustment mechanism in AWC’s pending general rate case to
19 authorize recovery of costs for utility investment in plant meeting specific criteria.
20 Arizona law does *not* prohibit such a ratemaking adjuster mechanism as long as the
21 mechanism is approved in a general rate case and comports with Arizona’s fair value
22 requirement in Article 15, § 14 of the Arizona Constitution. Here, in a general rate case,
23 the Commission has made its fair value finding in setting the rates, and the SIB requires

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25 ⁴⁵ Exhibit A-1, Settlement Agreement Regarding Distribution System Improvement
26 Charge and Other DSIC-Like Proposals (“SIB Settlement Agreement”), Docket No. W-
01445A-11-0310, at 4, ¶ 6.3.

1 an evaluation and finding of fair value as part of the required SIB filings. Therefore, the
2 SIB complies with Arizona law.

3 Not only does the SIB comply with Arizona law, it is virtually the same as other
4 ratemaking adjuster mechanisms approved by the Commission and accepted by RUCO
5 without any legal challenges. Perhaps the best illustration is the Commission's approval
6 of APS's Environmental Improvement Surcharge ("EIS") in Decision No. 73183 (May
7 24, 2012). Like the proposed SIB here, that EIS mechanism was approved in accordance
8 with a settlement agreement signed by APS, Staff, RUCO and various other parties on or
9 about January 6, 2012 without any challenge to that surcharge's legality.⁴⁶ The EIS and
10 SIB are materially identical adjuster mechanisms. In approving the EIS for APS, the
11 Commission affirmed the legality of the EIS, indirectly affirming the legality of the SIB
12 mechanism because of the close similarities between the SIB and the EIS. Put simply, if
13 the EIS is valid and legal, then so is the SIB.

14 Henry David Thoreau once said that "it's not what you look at that matters, it's
15 what you see." Here, when looking at the SIB, the Commission should see a new
16 adjustment mechanism benefiting customers and the utility through rate gradualism,
17 improved infrastructure, reduced outages, improved service quality, reduced maintenance
18 expense, a five percent efficiency credit, and improved utility ability to attract necessary
19 capital investment, while being specifically designed to comply with all applicable
20 Arizona laws regarding utility ratemaking.

21 **B. The SIB Complies With All Requirements for an Adjustment**
22 **Mechanism Under Arizona Law.**

23 Based on the testimony of Mr. Rigsby and the arguments set forth in RUCO's
24 Opening Brief relating to the DSIC, RUCO contends the SIB is illegal because the SIB is

25 ⁴⁶ Decision No. 73183, Ex. A, Arizona Public Service Company Proposed Settlement
26 Agreement, Docket No. E-01345A-11-0224, dated January 6, 2012.

1 “extraordinary ratemaking” that is legally impermissible.⁴⁷ Boiled down, RUCO argues
2 that the SIB is illegal because it is something new and does not follow the traditional rate
3 case format used by the Commission. Just because the SIB is a new mechanism doesn’t
4 mean it violates Arizona law.

5 RUCO’s arguments on this point fall flat for several reasons. To start, any decision
6 by the Commission approving the SIB is part and parcel of AWC’s general rate case.
7 Thus, the SIB is not extraordinary ratemaking conducted outside the norm. The
8 Commission has approved many types of adjusters and similar mechanisms in other
9 dockets. The fact that the SIB is part of AWC’s rate case, including consideration of all
10 ratemaking elements and standards used in a general rate case, belies RUCO’s argument.

11 As RUCO reasons, the SIB concept must be illegal because it doesn’t fall into any
12 accepted category of ratemaking mechanism previously used by the Commission. RUCO
13 gets caught up in semantics as to whether the SIB is an automatic adjuster mechanism
14 designed around specific expenses incurred by the utility. Under Arizona case law, “such
15 clauses usually embody a formula established during a rate hearing to permit adjustment
16 of rates in the future to reflect changes in specific operating costs, such as the wholesale
17 cost of gas or electricity.”⁴⁸ The SIB may not fall into that specific category of automatic
18 cost adjustment clause for gas or power, but that doesn’t mean the SIB is illegal.

19 Rather, the SIB is simply a different type of adjuster mechanism designed around
20 recovery of the costs of plant investment in distribution system improvements. On its
21 terms, the SIB meets the fundamental requirements of *Scates*—“when courts have upheld
22 automatic adjustment provisions, they have generally done so because the clauses are
23 initially adopted as part of the utility’s rate structure in accordance with all statutory and
24 constitutional requirements and, further, because they are designed to insure that, through

25 ⁴⁷ RUCO Opening Brief (DSIC) filed June 26, 2012 at 11.

26 ⁴⁸ *Scates v. Ariz. Corp. Comm’n*, 118 Ariz. 531, 535, 578 P.2d 612, 616 (App. 1978).

1 the adoption of a set formula geared to a specific readily identifiable cost, the utility's
2 profit or rate of return does not change."⁴⁹ The SIB is an adjuster mechanism, as Mr. Olea
3 testified.⁵⁰ Moreover, the SIB is a type of DSIC, and the courts in Pennsylvania have
4 recognized that DSICs are adjuster mechanisms.⁵¹ The SIB also meets the definition of
5 adjusters used in many ratemaking authorities and treatises.⁵²

6 Unlike the circumstances at issue in *Scates*, approval of the SIB in this general rate
7 case would be done as part of AWC's rate structure in accordance with statutory and
8 constitutional ratemaking requirements. Further, the SIB only applies to projects meeting
9 specific criteria, and the SIB applies a set formula to readily identifiable and defined plant
10 for calculation of the SIB surcharge.⁵³ On top of those requirements, the SIB uses the rate
11 of return set in Decision No. 73736, thereby ensuring that the utility's authorized rate of
12 return does not change.⁵⁴ Under these circumstances, the SIB is a lawful adjuster
13 mechanism under *Scates* and other Arizona case law.

14 ⁴⁹ *Id.* (citations omitted).

15 ⁵⁰ Tr. at 297:21 – 298:3 (testimony by Mr. Olea that the SIB is “an adjuster.”)

16 ⁵¹ See *Popowsky v. Pennsylvania Pub. Util. Comm'n*, 869 A.2d 1144, 1158 (Pa. Comm.
17 Ct. 2005) (stating that “water utilities may recover certain capital costs through an
18 automatic adjustment clause in its tariff” and treating a DSIC for water as an automatic
19 adjustment clause).

20 ⁵² These definitions focus on “costs” not “expenses” as RUCO would have it. See, e.g.,
21 ROGER A. MORIN, NEW REGULATORY FINANCE 556 (2006) (defining adjusters relative to
22 costs and noting that “[u]nder this style of regulation, an automatic adjustment factor is
23 applied to individual cost components that are outside the control of management.”); 73B
24 C.J.S. *Public Utilities* § 120 (“Approval by a public utility regulatory commission of tariff
25 provisions for automatic adjustments in rates according to a predetermined formula,
26 without the necessity for proceedings by the commission whenever specified costs of the
utility change by a certain amount, may be permissible.”); 16 U.S.C. § 824d(f)(4) (“As
used in this subsection, the term “automatic adjustment clause” means a provision of a
rate schedule which provides for increases or decreases (or both), without prior hearing, in
rates reflecting increases or decreases (or both) in costs incurred by an electric utility...”).

⁵³ SIB Settlement Agreement at 5-8, ¶¶ 3.0, 6.3.

⁵⁴ *Id.* at 5, ¶ 3.2.

1 Further, even if the Commission were to determine that the SIB is not a ratemaking
2 adjuster mechanism, it is still a lawful ratemaking surcharge authorizing rate increases
3 based on a determination and evaluation of the Company's fair value rate base (FVRB).⁵⁵
4 Under *RUCO v. Arizona Corp. Comm'n*, the Commission is authorized to impose rate
5 surcharges for specific costs or issues if the Commission first determines and considers
6 the utility's FVRB.⁵⁶

7 Here, it is undisputed that the SIB requires an evaluation and finding of FVRB
8 before the Commission can approve the SIB. Paragraph 7.17 of the SIB Settlement
9 Agreement requires the utility to provide "SIB Schedule D ... showing an analysis of the
10 impact of the SIB Plant on the fair value rate base, revenue, and the fair value rate of
11 return as set forth in Decision No. 73736."⁵⁷ As testified by Utilities Director Steve Olea,
12 paragraph 7.1.7 of the Settlement Agreement requires that SIB Schedule D include a
13 determination of FVRB and a "fair value rate of return."⁵⁸ Mr. Olea also testified that SIB
14 Schedule D "would support a finding of fair value" and that any order approving a SIB
15 would include a determination of FVRB.⁵⁹

16 At hearing, RUCO witness Mr. Rigsby agreed that Arizona's requirement for "a
17 determination of fair value is a determination of the utility's assets dedicated to providing
18 that particular utility service."⁶⁰ Ultimately, Mr. Rigsby did not quibble with the SIB's
19 requirement to evaluate FVRB; rather, he argued "you can't get to fair rates unless you

20 ⁵⁵ *RUCO v. Ariz. Corp. Comm'n*, 199 Ariz. 588, 589, 20 P.3d 1169, 1170 (App. 2001)
21 ("We hold that in the absence of an emergency or automatic adjustment clause, the
22 Arizona Corporation Commission cannot impose a rate surcharge based on a specific cost
increase without first determining a utility's fair value rate base.")(emphasis added).

23 ⁵⁶ *Id.*

24 ⁵⁷ SIB Settlement Agreement at 9, ¶ 7.1.7.

25 ⁵⁸ Tr. at 332:21-333:7.

26 ⁵⁹ *Id.* at 333:5-7.

⁶⁰ *Id.* at 485:21-24.

1 take all of the ratemaking elements into consideration” for the SIB “as you would in a
2 general rate case.”⁶¹ But Arizona’s Constitution doesn’t contain the words “general rate
3 case.” What the Constitution does require, is that the Commission must “ascertain the fair
4 value of the property” of a utility when setting rates.⁶² Once that is done, the Commission
5 then has ample discretion in terms of using that fair value in setting rates or approving a
6 surcharge as set forth in the cases noted below.

7 Here, the SIB mechanism for AWC is part and parcel of the Company’s general
8 rate case, including consideration of all ratemaking elements in accordance with Arizona
9 law. As such, the SIB satisfies all ratemaking requirements set forth in the Arizona
10 Constitution and *Scates*.

11 **C. The SIB Complies With Arizona’s Fair Value Requirement.**

12 RUCO argues that the SIB effectively increases FVRB without any determination
13 by the Commission of FVRB.⁶³ On this point, Mr. Rigsby testified that “the Company
14 will be able to file for the SIB surcharge no more than five times between rate case
15 decisions The Commission will ultimately consider and then approve each surcharge
16 filing. The Commission, however, will not be making a new FVRB finding as part of
17 each surcharge filing.”⁶⁴

18 RUCO is mistaken. Mr. Rigsby’s statement that the Commission “will not be
19 making a new FVRB finding as part of each surcharge filing” is incorrect under the terms
20 of the SIB. As set forth on SIB Schedule D, and as testified by Mr. Olea, the SIB
21 mechanism requires a finding of FVRB for the Company as established in Decision
22

23 _____
24 ⁶¹ *Id.* at 501: 4-11.

25 ⁶² Arizona Constitution, Article XV, § 14.

26 ⁶³ Direct Testimony of William Rigsby, Exhibit RUCO-12 at 13.

⁶⁴ *Id.*

1 No. 73736 plus SIB plant, along with the rate of return as applied to that FVRB and
2 associated revenue.⁶⁵

3 As stated in the Settlement Agreement, the SIB mechanism requires the evaluation
4 and consideration of FVRB relating to any SIB filing and approved surcharge. The
5 proposed SIB fully complies with Arizona's fair value standard. As the Arizona Supreme
6 Court explained in *Simms*, "While our constitution does not establish a formula for
7 arriving at fair value, it does require such value to be found and used as the base in fixing
8 rates. The reasonable and justness of the rates must be related to this finding of fair
9 value."⁶⁶ "Fair value means the value of properties at the time of inquiry."⁶⁷ Here, the SIB
10 requires a determination of the fair value of the Company's rate base along with the SIB
11 plant at the time that the surcharges are proposed.

12 Under these circumstances, the SIB mechanism clearly complies with Arizona's
13 fair value standard and accompanying case law. In fact, the SIB itself guarantees
14 compliance with *Scates* by expressly limiting the rate of return to that approved in
15 Decision No. 73736. Ultimately, all the Constitution requires is that the Commission
16 determine and consider fair value in setting rates or approving a mechanism like the SIB.

17
18
19 ⁶⁵ Tr. at 332:21-333:7 (Olea).

20 ⁶⁶ *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 151, 294 P.2d 378, 382
(1956).

21 ⁶⁷ *Id.* (internal citation omitted); see also *Consolidated Water Utilities, Ltd., v. Arizona*
22 *Corp. Comm'n*, 178 Ariz. 478, 482 n. 6, 875 P.2d 137, 141 n. 6 (App. 1993) ("The fair
23 value rate base is the fair value of the company's properties within the state at the time the
24 rate is fixed."); *Los Angeles Gas & Electric v. RR Comm'n of California*, 289 U.S. 287,
25 305 (1933) (a utility is entitled to "a fair return upon the reasonable value of the property
26 at the time it is being used for the public"); *Missouri ex rel. Southwestern Bell Tel. Co. v.*
Public Serv. Comm'n, 262 U.S. 276, 287 (1923) ("[T]he value of the property is to be
determined as of the time when the inquiry is made regarding the rates."), quoting
Willcox v. Consol. Gas Co., 212 U.S. 19, 52 (1909).

1 The Arizona Supreme Court's decision in *US West Comm., Inc. v. Arizona Corp.*
2 *Comm'n*, illustrates that point:

3 ...We hold that a determination of fair value is necessary with
4 respect to a public service corporation. But what is to be
5 done with such a finding? In the past, fair value has been the
6 factor by which a reasonable rate of return was multiplied to
7 yield, with the addition of operating expenses, the total
8 revenue that the corporation could earn. That revenue figure
9 was then used to set rates...But while the Constitution clearly
10 requires the Arizona Corporation Commission to perform a
11 fair value determination, only our jurisprudence dictates that
12 this finding be plugged into a rigid formula as part of the rate-
setting process. Neither section 3 nor section 14 of the
constitution requires the corporation commission to use fair
value as the *exclusive* rate basis...In this and any other
fashion that the corporation commission deems appropriate,
the fair value determination should be considered. The
commission has broad discretion, however, to determine the
weight to be given this factor in any particular case.⁶⁸

13 The Court of Appeals' decision in *Phelps Dodge Corp. v. Arizona Elec. Power Co-op.,*
14 *Inc.* echoes those sentiments: "...consistent with the pronouncement in *US West II*...the
15 Commission should consider fair value when setting rates within a competitive market,
16 although the Commission has broad discretion in determining the weight to be given that
17 factor in any particular case."⁶⁹ Here, the SIB requires consideration of FVRB in
18 determining the surcharge, thus complying with Arizona's fair value requirement.

19 Likewise, the Commission has broad discretion in setting rates, including
20 consideration and use of various ratemaking mechanisms used in other states as long as
21 the method complies with the fair value mandate set forth in Article 15, § 14.⁷⁰ Put
22

23 ⁶⁸ 201 Ariz. 242, 245-46, 34 P.3d 351, 354-355 (2001) (internal citations omitted).

24 ⁶⁹ 207 Ariz. 95, 106, 83 P.3d 573, 584 (Ct App. 2004).

25 ⁷⁰ See *Arizona Cmty. Action Ass'n v. Arizona Corp. Comm'n*, 123 Ariz. 228, 230, 599
26 P.2d 184, 186 (1979) (quoting *Arizona Corp. Comm'n v. Arizona Pub. Serv. Co.*, 113
Ariz. 368, 371, 555 P.2d 326, 329 (1976)).

1 simply, the Commission has discretion to adopt mechanisms necessary to address
2 particular ratemaking issues, including matters subsequent to an historic test year,⁷¹
3 construction projects contracted and commenced during the test year,⁷² and construction
4 work in progress but not yet in service.⁷³ Further, the Commission may adopt interim
5 rates or automatic adjustment mechanisms without first determining fair value rate base.⁷⁴

6 With this broad discretion in hand, for example, the Commission has approved
7 Arsenic Cost Recovery Mechanisms to enable water utilities to meet the federal arsenic
8 drinking water standards. The Commission has approved all of these mechanisms without
9 legal challenge and those decisions support approval of the SIB in this case.

10 As a matter of law, therefore, the SIB mechanism at issue here falls within the
11 Commission's broad discretion and is consistent with these prior decisions and approved
12 ratemaking methods. In Phase 1 of this rate case, the Commission has determined the
13 "fair value" of AWC's rate base. Any SIB surcharge will, in turn, be based on specific
14 infrastructure added to that approved rate base. Under the SIB, AWC is required to file
15 annual summary schedules itemizing the actual cost of constructing such SIB plant with
16 supporting documents, along with FVRB information sufficient for the Commission to
17 determine how the proposed SIB surcharges will impact the Company's rate of return.⁷⁵
18 A SIB surcharge would be allowed only to the extent that the Company's return on rate
19 base for a particular system does not exceed the Company's authorized rate of return set
20 forth in Decision No. 73736. On top of all that, the SIB revenue requirement will be

23 ⁷¹ *Arizona Pub. Serv. Co.*, 113 Ariz. at 371, 555 P.2d at 329.

24 ⁷² *Id.*

25 ⁷³ *Arizona Cmty. Action*, 123 Ariz. at 230, 599 P.2d at 186.

26 ⁷⁴ *RUCO*, 199 Ariz. at 591, 20 P.2d at 1172.

⁷⁵ *See Scates*, 118 Ariz. at 535, 578 P.2d at 616.

1 reduced by 5 percent for the Efficiency Credit, in essence accounting for efficiencies and
2 reduced operating expenses as a result of the SIB plant.

3 **D. The SIB Requires Detailed Information That Exceeds All Arizona**
4 **Legal Requirements.**

5 RUCO objects that the SIB allows “recovery of plant improvements outside of a
6 rate case.” That argument can be readily rejected because the SIB is part of the
7 Company’s ongoing general rate case as phased by the Commission. The SIB mechanism
8 would be approved in the Company’s general rate case, authorizing the Company to
9 implement the surcharge in the years before the Company’s next general rate case. On its
10 own terms, the SIB mechanism is linked to the Company’s general rate case by requiring
11 that the rate of return, depreciation rates and gross revenue conversion factor approved in
12 Decision No. 73736 be applied to any SIB filings. That is not determination of rates
13 outside of a rate case or piecemeal ratemaking in any way, shape or form.

14 RUCO also argues that the SIB is illegal because it could be approved in as little as
15 30 days and, therefore, “the same level of scrutiny that occurs in a general rate case
16 proceeding would not exist to insure that a real finding of fair value is accomplished.”⁷⁶
17 Apparently, RUCO believes that a SIB mechanism can be legal only if it takes as long as a
18 general rate case. That argument is meritless and, in fact, supports the need for a SIB
19 mechanism by demonstrating RUCO’s preference for regulatory lag. That’s not to
20 mention that a SIB surcharge is subject to review by Staff, RUCO and Commissioners
21 before any such surcharge can be implemented. Indeed, Mr. Olea testified that the SIB
22 plant “might actually have more scrutiny” because Staff only does a “spot-check” on plant
23 in a rate case.⁷⁷ In contrast, SIB plant is subject to a detailed review before the project is
24

25 ⁷⁶ Direct Testimony of W. Rigsby, Exhibit RUCO-12 at 14.

26 ⁷⁷ Tr. at 286:6-12.

1 included on the list of SIB-eligible plant, and then a subsequent review after the project is
2 completed.

3 On its own terms, the SIB mechanism satisfies all required ratemaking elements
4 under Arizona law. To start, the “amount to be collected by the SIB Surcharge (‘SIB
5 Authorized Revenue’) shall be equal to the SIB revenue requirement minus the SIB
6 efficiency credit.”⁷⁸ The SIB revenue requirement is “equal to the required pre-tax return
7 on investment and depreciation expense associated with SIB-eligible projects that have
8 been completed and placed into service . . . net of associated retirements.”⁷⁹

9 Further, “the required rate of return is equal to the overall rate of return authorized
10 in Decision No. 73736.”⁸⁰ In other words, the SIB recognizes and applies the rate of
11 return for the Company as approved by the Commission in this general rate case. The
12 same holds true for the Company’s gross revenue conversion factor/tax multiplier and
13 depreciation rates, which are specified to be the same as approved in Decision No.
14 73736.⁸¹ Not only is the rate of return from the Company’s general rate case used in
15 calculating the SIB, but the SIB mandates that a “SIB Efficiency Credit shall be equal to
16 five percent of the SIB revenue requirement.”⁸² That five percent efficiency credit is then
17 deducted from the SIB revenue requirement, directly reducing the SIB revenue
18 requirement and effectively reducing the return on equity for plant investments under the
19 SIB, in turn assuring AWC’s rate of return does not increase.

20 Under the proposed SIB, the Company is limited to one SIB filing every twelve
21 months and no more than five SIB filings between rate case decisions.⁸³ Further, the

22 ⁷⁸ SIB Settlement Agreement at 5, ¶ 3.1.

23 ⁷⁹ *Id.* at 5, ¶ 3.2.

24 ⁸⁰ *Id.* at 5, ¶ 3.2.1.

25 ⁸¹ *Id.* at 5, ¶¶ 3.2.2, 3.2.3.

26 ⁸² *Id.* at 5, ¶ 3.3.

⁸³ *Id.* at 5, ¶¶ 4.4, 4.5.

1 Company is required “to make an annual SIB surcharge filing to true-up its collections
2 under the SIB surcharge and establish the surcharge for the new surcharge period.”⁸⁴ The
3 SIB also requires reconciliation and true-up of any and all amounts collected.
4 Specifically, “the revenue collected by the SIB surcharge over the preceding twelve
5 months shall be trued-up and reconciled with the SIB Authorized Revenue for that
6 period,” including the recovery or refund of any over/under collected balances.⁸⁵

7 For ratemaking purposes, the Company is required to submit specific and detailed
8 information with each SIB surcharge filing. Chief among those filings is SIB Schedule D
9 “showing an analysis of the impact of the SIB Plant on the fair value rate base, revenue
10 and the fair value rate of return as set forth in Decision No. 73736.”⁸⁶ As set forth on SIB
11 Schedule D, the SIB mechanism requires a finding of fair value rate base for the Company
12 as established in Decision No. 73736 plus SIB plant, along with the rate of return as
13 applied to that FVRB and associated revenue. On its terms, the SIB requires evaluation
14 and consideration of FVRB relating to any SIB filings and approved surcharges.

15 Finally, the SIB surcharge is subject to review by both Staff and RUCO before any
16 such surcharge can be implemented.⁸⁷ Specifically, Staff and RUCO have 30 days to
17 review and, if necessary, dispute a SIB Surcharge filing, and, of course, the SIB surcharge
18 is subject to review and approval by the Commissioners.

19 **E. RUCO’s Matching Argument Is Without Merit.**

20 RUCO next attempts to undercut the SIB by claiming “the result will be rates based
21 on a fair value finding for a period different than the period in which the Company’s
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23

24 ⁸⁴ *Id.* at 6, ¶ 4.9.

25 ⁸⁵ *Id.* at 6, ¶¶ 5.1-5.4.

26 ⁸⁶ *Id.* at 9, ¶ 7.1.7.

⁸⁷ *Id.* at 10, ¶¶ 9.4, 10.1-10.2.

1 operating expenses were incurred.”⁸⁸ This argument is illusory. Here, the SIB would be
2 approved as part of AWC’s rate design in a general rate case, which included the
3 necessary evaluation and approval of operating costs going forward. No Arizona law,
4 statute or case requires the added cost analysis suggested by RUCO. Further, the
5 Commission has broad discretion in the ratemaking process, including consideration of
6 operating costs. Moreover, the 5 percent efficiency credit accounts for any reduced
7 operating costs resulting from efficiencies due to distribution system upgrades.⁸⁹

8 **F. If the APS Environmental Improvement Surcharge Is Legal, Then So Is**
9 **the SIB.**

10 Not only is the SIB legal under Arizona law, it is virtually the same as other
11 ratemaking mechanisms approved by the Commission *and accepted by RUCO* without
12 any challenges as to the legality of such mechanisms under Arizona law. As mentioned,
13 the EIS in Decision No. 73183 (May 24, 2012) was approved by the Commission as part
14 of a settlement agreement signed by APS, Staff, RUCO and various other parties in 2012
15 without any legal challenge.⁹⁰ In approving that settlement and the EIS for APS, the
16 Commission affirmed the legality of the EIS. Due to the close similarities between the
17 SIB and the EIS, the SIB must also be legal. Put simply, if the EIS is valid and legal, then
18 so is the SIB. Or, put another way, if the Commission determines that the SIB is illegal in
19

20 ⁸⁸ *Id.* at 14.

21 ⁸⁹ Tr. at 486:15-18 (testimony by Mr. Olea that the efficiency credit is “supposed to credit
22 customers for efficiencies associated with the new plant.”). *See also* Tr. at 33:11-13
23 (opening statement by Mr. Pozefsky that “the rate payers are going to get a 5 percent
efficiency credit of the SIB revenue requirement to recognize cost-savings.”).

24 ⁹⁰ Decision No. 73183, Ex. A, Arizona Public Service Company Proposed Settlement
25 Agreement, Docket No. E-01345A-11-0224, dated January 6, 2012. In fact, Mr. Rigsby
26 testified at hearing that RUCO also has never challenged the renewable energy adjuster or
the demand side management adjuster for APS, both which include plant investment.
Tr. at 471:9-25 (Rigsby).

1 this case, the Commission likewise would have to nullify the EIS as illegal, in turn
2 unraveling the APS rate case settlement.

3 Interestingly, by challenging the SIB mechanism as illegal in this docket, RUCO
4 has indirectly challenged the EIS as illegal. That is a violation of the APS Settlement
5 Agreement approved by the Commission and signed by RUCO, which requires that “the
6 Signatories [including RUCO] will support and defend the Commission’s order before
7 any court or regulatory agency in which it may be at issue.”⁹¹ RUCO may try to assert
8 otherwise, but the SIB is a virtual mirror image of the EIS for APS. The similarities are
9 striking and demonstrative.

10 Prior to its rate case in 2011, APS had an approved EIS for compliance costs
11 associated with environmental regulations. That EIS treated the customer surcharges as
12 contributions in aid of construction. In its 2011 rate filing, that utility requested
13 modifications to its EIS to provide APS with a return on capital it invested in
14 environmental compliance. Subsequently, APS, Staff, RUCO and various other parties
15 reached a settlement of the 2011 rate case. RUCO signed and supported that settlement
16 agreement including an agreement relating to amendments to the EIS for APS: “As
17 amended, APS shall no longer receive customer dollars through the EIS to pay for
18 government-mandated environmental controls. However, when APS invests capital to
19 fund any government-mandated environmental controls, the EIS will recover the
20 associated capital carrying costs, subject to a cap equal to the charge currently in place for
21 the EIS.”⁹² The SIB here is subject to the same type of cap.

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23

24

25 ⁹¹ APS Settlement Agreement, at 22, ¶ 21.6.

26 ⁹² *Id.* at 16, ¶ 11.2.

1 To qualify as an EIS eligible project, APS investments must be classified in one or
2 more of 20 FERC accounts listed in APS's EIS Plan of Administration.⁹³ To qualify as a
3 SIB eligible project, the Company's plant investments must be classified in one or more
4 of five (5) NARUC accounts listed in the SIB Settlement Agreement.⁹⁴

5 The EIS is calculated based on capital carrying costs, including "(1) Return on EIS
6 Qualified Investments based on the Company's Weighted Average Cost of Capital
7 ('WACC') approved by the Commission in Decision NO. [73183]; (2) depreciation
8 expense; (3) income taxes; (4) property taxes; (5) deferred income taxes and tax credits
9 where appropriate; and (6) associated O&M."⁹⁵ The SIB is likewise based on the first
10 three of the items used to calculate APS's EIS. In this way, both the SIB and EIS provide
11 a return on utility investment in plant based on each company's WACC as approved by
12 the Commission in each company's recent general rate case.

13 The parallels don't stop there. A side-by-side comparison of the SIB and the EIS
14 illustrates that if one is legal, then so is the other:

- 15 • **Authorized Expenses:** The SIB and EIS both provide for
16 depreciation expense, income tax expense for the surcharge revenues,
17 recalculation and gross up of taxes. The EIS even authorizes APS to
18 recover O&M expenses, while the SIB reduces the surcharge revenue
19 requirement by 5 percent for the Efficiency Credit as a direct benefit
20 to customers that doesn't occur for the EIS.⁹⁶
- 21 • **Application of the Authorized Rate of Return to Plant After the
22 General Rate Case:** For all intents and purposes, the EIS authorizes
23 a surcharge for APS to recover capital costs, including depreciation
24 expense and taxes, calculated by applying APS's authorized rate of

22 ⁹³ *Id.* at Exhibit H ("Environmental Improvement Surcharge Plan of Administration), § 3
(listing of qualified FERC accounts).

23 ⁹⁴ SIB Settlement Agreement, Exhibit A (Information to be included with SIB-Eligible
24 Projects Notification), Table 1 (listing of qualified NARUC accounts).

25 ⁹⁵ APS Settlement Agreement. at Exhibit H ("Environmental Improvement Surcharge
26 Plan of Administration), § 4 (calculation of EIS capital carrying costs).

⁹⁶ SIB Settlement Agreement at 5, ¶¶ 3.1, 3.2.3.

1 return (WACC) to the EIS eligible plant—all occurring after
2 determination of APS’s rate case. The SIB does the same thing.⁹⁷

- 3 • **Timing and Procedural Deadlines:** The EIS provides a 60-day
4 review period for Staff or the Commission to object or the EIS goes
5 into effect.”⁹⁸ The SIB has similar provisions, only with a 30-day
6 review period instead of the 60-day review period for the EIS.⁹⁹
7 That’s not to mention that SIB projects will be listed and evaluated as
8 part of a general rate application, essentially meaning that SIB
9 projects are evaluated on multiple occasions.¹⁰⁰ The SIB also
10 expressly allows RUCO to object, which the EIS does not.

11 As stated in Decision No. 73183, “Staff believe[d] that the changes to the EIS are
12 in the public interest because now APS will invest its own funds to pay for government-
13 mandated environmental controls, and the EIS will only collect the capital carrying costs,
14 subject to a cap equal to the charge currently in place for the EIS. The EIS will be reset to
15 zero on the effective date of new rates.”¹⁰¹ Those findings also apply to the SIB.

16 Decision No. 73183 also noted that “APS will benefit because amounts paid under
17 the EIS will no longer be treated as contributions-in-aid of construction, but as revenues
18 that are collected more timely and that will help “the company continue on that path of
19 financial health.”¹⁰² The Commission did not condition its approval of the EIS based on
20 extraordinary circumstances. In fact, the word “extraordinary” does not appear in

21 ⁹⁷ *Id.* at 5, ¶ 3.2.

22 ⁹⁸ APS Settlement Agreement, Exhibit H, at 3, § 6 (filing and procedural deadlines).

23 ⁹⁹ SIB Settlement Agreement at 10, ¶ 9.4.

24 ¹⁰⁰ *Id.* at ¶ 4.8; Tr. at 288:6-23 (description by Mr. Olea of multiple reviews and analyses
25 of SIB plant in the rate case and subsequent filings, and concluding “that’s much more
26 detailed analysis than you get in a normal rate case...”).

¹⁰¹ Decision No. 73183 at 25:26-26:4.

¹⁰² *Id.* at 33:2-5.

1 Decision No. 73183.¹⁰³ In that respect, the SIB and EIS involve similar plant investments
2 that are necessary to ensure safe and reliable utility service.

3 Not only are the SIB and EIS virtually identical rate adjustment mechanisms, but
4 the SIB contains additional protections over and above the approved EIS. For example,
5 the EIS doesn't require any quarterly or semi-annual filings regarding actual investment in
6 plant. The SIB, on the other hand, requires that "[e]very six (6) months AWC shall file a
7 report with Docket Control delineating the status of all SIB eligible projects."¹⁰⁴

8 Further, the EIS only requires APS to file required information listed on two one-
9 page schedules, (though admittedly the data APS provides is much more voluminous than
10 two pages.)¹⁰⁵ The SIB requires AWC to file required information listed on four
11 schedules, and two additional tables listing detailed plant information, including:¹⁰⁶

- 12 1. A SIB-Eligible Project Notification (SIB Settlement Agreement,
13 Exhibit A), which, for AWC, is a 55 page schedule identifying each
14 system and every single project proposed by the Company, by
15 NARUC account, and the estimated costs of each project.
- 16 2. A Calculation of Overall SIB True-Up and Individual True-Up
17 Surcharge/Credit (SIB Settlement Agreement, Exhibit B), which is a
18 two page schedule that identifies each customer class, and establishes
19 its fixed surcharge/credit.
- 20 3. A "SIB PLANT TABLE II" containing Information to be included
21 with SIB-Eligible Completed Project Filings" (SIB Settlement
22 Agreement, Exhibit C), which is a six page schedule that provides the
23 estimated and the actual costs of every SIB-Eligible project and
24 requires an explanation when an actual cost exceeded and estimated
25 costs by more than 10% for any project.

22 ¹⁰³ Decision No. 71448, which also included the EIS has the word "extraordinary" three
23 times – twice in reference to the financial crisis enveloping America and the world in
24 2009, and once in a force majeure provision in the APS Settlement Agreement.

24 ¹⁰⁴ SIB Settlement Agreement, at 6, ¶ 4.8.

25 ¹⁰⁵ Decision No. 73183, Attachment H at 4, Schedule 1: "Qualified Investments for EIS"
26 and Attachment H at 5, "Schedule 2: Capital Carrying Costs and Adjustor Calculation."

¹⁰⁶ SIB Settlement Agreement, Exhibits A-F.

- 1 4. A “Schedule A, Calculation of Overall SIB Revenue Requirement
2 and Individual Surcharge” (SIB Settlement Agreement, Exhibit D),
3 which is a two page schedule that establishes the Overall SIB
4 Revenue Requirement and deducts the 5% Efficiency Factor; and that
5 provides the Individual SIB Fixed Surcharge and Efficiency Credit
6 by customer class.
- 7 5. A “Schedule C, Typical Bill Analysis” (SIB Settlement Agreement,
8 Exhibit E), which is a one page schedule that shows the impact on
9 customers bills from the SIB for every one thousand gallons of usage.
- 10 6. A “Schedule D, Fair Value Rate Base, Revenues, and Rate of
11 Return” (SIB Settlement Agreement, Exhibit F), which is a one page
12 schedule that shows the company’s Operating Expenses, Operating
13 Income, Interest Expense, Net Income, Rate Base (Original Cost Less
14 Depreciation), Actual Return on Rate Base, Authorized Return on
15 Rate Base, Capital Structure, Total Equity, Authorized Return on
16 Equity, and actual Return on Equity.

17 Perhaps more importantly, RUCO did not challenge the EIS as illegal or in
18 violation of Arizona ratemaking standards. To the contrary, RUCO signed the APS
19 Settlement Agreement and provided testimony supporting the EIS. Yet RUCO’s various
20 arguments in support of the EIS likewise support and apply to the SIB.

21 In direct testimony provided by its former director, RUCO stated “the new EIS
22 reimburses APS for shareholder funds used for environmental improvements and is
23 treated as revenues.”¹⁰⁷ Ms. Jerich also listed “[t]he establishment of the Environmental
24 Improvement Surcharge adjuster” as one of the “benefits to the Company.”¹⁰⁸ On that
25 issue, if the EIS qualifies as an adjuster, then so does the SIB.

26 As suggested at hearing, RUCO may argue that adjuster mechanisms like the EIS
or ACRM should be treated differently than the SIB because they are the result of
government mandated projects. That argument doesn’t apply to the constitutionality or
legality of the SIB or any other ratemaking adjustment method. Put simply, compliance

¹⁰⁷ Direct Testimony of Ms. J. Jerich dated January 18, 2012, at 8, Docket No. E-01345A-11-0224.

¹⁰⁸ *Id.* at 10.

1 with the Arizona constitutional requirements for ratemaking does not hinge on whether a
2 project is mandated by any government regulations or requirements. The legal issues
3 revolve around the ratemaking aspects of the SIB, the EIS or the ACRM, not whether
4 some sort of governmental requirement necessitates each project. Government
5 regulations or mandates do not override the ratemaking requirements in Article 15 of the
6 Constitution or the various ratemaking standards set forth in *Scates* and other decisions.
7 RUCO does not cite any case or authority recognizing any exceptions to the Constitution
8 or established precedent for government-mandated projects.

9 So, in summary, and as stated in Decision No. 73183, “[t]he Joint Signatories
10 believe that the changes to the EIS will benefit customers and protect APS.”¹⁰⁹ What’s
11 good for APS is good for AWC. If the APS EIS is valid and legal, then so is the SIB.
12 There simply is no justification for treating the SIB differently than the EIS.

13 **CONCLUSION**

14 Based on the foregoing, Liberty Utilities and Global Water request that the
15 Commission issue an order:

- 16 a. finding approving the SIB Settlement to be in the public interest;
- 17 b. finding that the SIB Settlement is legal; and
- 18 c. approving the SIB Settlement.

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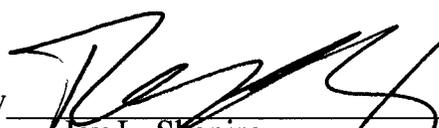
¹⁰⁹ Decision No. 73183 at 32:21-22 (citing Joint Signatories Opening Brief).

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DATED this 29th day of April, 2013.

FENNEMORE CRAIG, P.C.

By

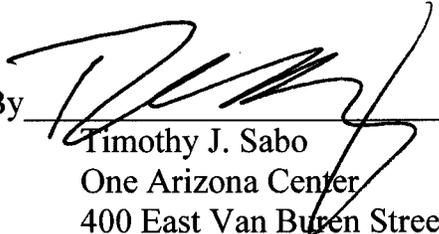


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