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BEFORE THE ARIZONA CORPORATION COMMISSION

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ARIZONA CORPORATION COMMISSION
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Arizona Corporation Commission
DOCKETED

MAY 10 2013

DOCKETED BY

IN THE MATTER OF THE APPLICATION OF
RIO RICO UTILITIES, INC. FOR A RATE
INCREASE.

DOCKET NO. WS-02676A-12-0196

STAFF'S REPLY BRIEF

9 **I. INTRODUCTION.**

10 The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") has
11 already responded in its Closing Brief to many of the arguments made by RRUI and the Intervenors
12 and responds as follows to the closing briefs filed by the Company, the Residential Utility Consumer
13 Office ("RUCO") and the Combined Closing Brief of Santa Cruz County and Santa Cruz Valley
14 Unified School District #35 (collectively "Santa Cruz Intervenors"). The purpose of this Reply Brief
15 is not to repeat every point made in Staff's initial Closing Brief, nor will it attempt to refute every
16 single issue raised by the Company or Intervenors. Instead Staff relies upon its testimony on those
17 issues not specifically addressed in this Reply Brief. The recommendations of Staff and its positions
18 have been outlined in its Opening Brief as well as its testimony. Staff would note that, as the Santa
19 Cruz Intervenors presented no evidence at the hearing, their final positions on some issues were not
20 known at the time Staff filed its Opening Brief. As a result, that Opening Brief may at times mistake
21 the positions of those Intervenors. To that extent, this brief will supplant the Opening Brief. Staff
22 will highlight some of the major points of disagreement with the Company and the Intervenors in this
23 brief.

24 **II. RATE BASE ADJUSTMENTS/PLANT RETIREMENTS.**

25 Staff notes that in its Closing Brief in discussing the proposed adjustment to depreciation
26 expense, Staff inadvertently omitted the adjustment for the wastewater division. RRUI accepted
27 Staff's adjustment to depreciation expense of \$109,768 for the water division and of \$135,855 for the
28 wastewater division and RRUI's assurances of proper tracking of plant. Also Staff's closing brief

1 erroneously cited \$290,873 for the overstatement of depreciation expense, though the remainder of
2 that sentence was correct.¹ The corporate allocations adjustment was also misstated; corporate cost
3 allocations were decreased by \$32,583 for water \$22,431 for wastewater.²

4 **III. COMPLIANCE WITH ACC R14-2-103(B).**

5 A cost of service study or analysis is required to be filed with a rate application only when the
6 utility is in a segment of the utility industry that recognizes cost of service studies as important tools
7 for rate design and costs incurred by the utility are likely to vary significantly from one defined
8 segment of customers to another. ACC R14-2-103(B). No evidence has been presented in this case
9 that costs incurred by RRUI are likely to vary significantly between customer segments. The Santa
10 Cruz Intervenors assert that RRUI's submission of a cost of service study in its prior rate case is
11 evidence that both elements exist in this case. Staff disagrees. RRUI may have opted to obtain a cost
12 of service study in its earlier case for reasons other than a significant difference between costs among
13 customer segments. The logic of the Santa Cruz Intervenors is flawed.

14 Moreover, these Intervenors had an opportunity to raise this issue at or before hearing but
15 failed to do so. They could also have requested such information in Data Requests but failed to do
16 so. A cost of service study, as a practical matter, is relevant primarily, if not solely, in addressing rate
17 design issues. Yet rate design was not a disputed issue, even as to the Santa Cruz Intervenors.

18 **IV. COST OF CAPITAL.**

19 **A. Staff's Recommended Capital Structure of 100 Percent Equity and 0.0 Percent**
20 **Debt Should Be Adopted.**

21 Staff, RRUI, and RUCO all recommend that the Commission adopt a capital structure of 100
22 percent equity and 0.0 percent debt for RRUI. The Santa Cruz Intervenors recommend that the
23 Commission adopt a capital structure of 50 percent equity and 50 percent debt for RRUI. The Santa
24 Cruz Intervenors claim this capital structure is appropriate because it more closely resembles the
25 capital structure of the proxy group. However, the position of the Santa Cruz Intervenors should be
26

27 ¹ The subject sentence occurs at page 3, lines 2-3. It stated: "Because depreciation expense continued
28 to be recognized, that expense was also overstated by \$290,873." It should have stated "Because
depreciation expense continued to be recognized, that expense was also overstated."

² Exhibit A-17.

1 rejected because it is not based on evidence and completely ignores the actual capital structure of
2 RRUI.

3 During the Company's last rate case, the Commission approved a hypothetical capital
4 structure of 80 percent equity and 20 percent debt. That hypothetical capital structure was approved
5 upon the assurance of the Company that it would file a financing application wherein debt equivalent
6 to 20 percent of its capital structure would be infused into the Company by its parent company
7 (Algonquin Power and Utilities Corporation). However, the Company never filed that financing
8 application. As a result, the Company's actual capital structure continues to consist of 100 percent
9 equity.

10 Moreover, there is no evidence in the record to support a claim that a 50 percent debt/equity
11 capital structure is more appropriate than the capital structure recommended by every other party to
12 this proceeding. Although the Santa Cruz Intervenors argue that their approach of using the proxy
13 group capital structure and cost of equity estimate "is the most transparent approach" and "minimizes
14 judgment and miscalculation from the Hamada adjustment," there is no evidence in the record to
15 substantiate these claims. Accordingly, the Commission should reject the capital structure
16 recommendation of the Santa Cruz Intervenors in favor of the capital structure recommended by
17 Staff, RRUI, and RUCO.

18 **B. Staff's Economic Assessment Adjustment Is Reasonable and Appropriate.**

19 The Santa Cruz Intervenors argue that Staff's Economic Assessment Adjustment of 60 basis
20 points due to the uncertain status of the economy and the market that currently exists should be
21 rejected because the stock prices used in the DCF and CAPM beta estimates already reflect
22 expectations of uncertainty. Staff agrees that its market based cost of equity estimation methods
23 efficiently reflect market expectations at the time the analysis is conducted. However, while investor
24 expectations can be promptly estimated by these methods, the ratemaking process is less agile than
25 market responses and the cost of equity authorized in this case will remain in place until the
26 Company's next rate case.

27 Staff's Economic Assessment Adjustment is appropriate because it considers the disconnect
28 between the responsiveness of the market to changes in the cost of equity and the responsiveness of

1 the ratemaking process in recognizing these changes at a time when extraordinary macro-economic
2 conditions (e.g., countries with large GDPs teetering on the edge of defaulting on their debt, massive
3 debt by the United States, multi-year historical and projected spending deficits in the United States
4 with no consensus for resolution, long-term high unemployment in the United States and the
5 European Union, simultaneous near record high stock prices and near record low interest rates) exist.
6 In these unique and remarkable circumstances, Staff's Economic Assessment Adjustment is
7 warranted.

8 **C. Staff's Recommended ROE Is Just And Reasonable.**

9 For the reasons discussed more fully in Staff's Closing Brief, Staff's recommended ROE is
10 just and reasonable. RRUI nonetheless criticizes Staff's recommended ROE on the grounds that it is
11 lower than the average of the currently authorized ROEs for Staff's proxy water utilities.
12 Specifically, RRUI claims that Staff's recommended ROE is unreasonable because it does not take
13 into account the purported "small" size of RRUI relative to the proxy water utilities or the fact that
14 RRUI has "liquidity risk" in that it cannot publicly sell shares of its stock on the open market.
15 However, RRUI's arguments are flawed for several reasons.

16 First, RRUI's criticism that Staff's ROE is lower than the ROEs for its proxy water utilities is
17 undermined by RRUI's own recommendation in this case. Indeed, as RRUI concedes, RRUI's own
18 recommended ROE is also lower than the ROEs for the proxy water utilities.

19 Second, RRUI's claim that Staff's ROE is unreasonable because it ignores the purported
20 "small" size and liquidity risk of RRUI is without merit. As discussed more fully in Staff's Closing
21 Brief, RRUI's "small firm risk adjustment" to account for these firm specific risks is unnecessary and
22 unwarranted. Accordingly, the fact that Staff did not make a similar adjustment to its recommended
23 ROE is both just and reasonable.

24 **V. EMPLOYEE BENEFIT ADJUSTMENT.**

25 Contrary to the position of Santa Cruz County and Santa Cruz Valley Unified School District
26 #3, Staff asserts that RRUI submitted sufficient information to support including the employee
27 benefit adjustment in setting rates. Although the written plan is still being prepared for RRUI, the
28

1 plan is a national plan applicable to RRUI's affiliates.³ The Company provided details about the
2 names of employees to receive benefits and the anticipated amounts thereof.⁴ The Company also
3 testified regarding the annual cost of the plan, including payments to be made in 2013.⁵

4 **VI. CONCLUSION.**

5 The Commission should adopt the Staff recommendations as discussed herein and in the
6 Staff's Closing Brief as the rates produced thereby are just and reasonable and in the public interest.

7 RESPECTFULLY SUBMITTED this 10th day of May, 2013.

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9 
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³ Tr. vol. 2 at 361-363.
⁴ Tr. vol. 2 at 287-288.
⁵ Tr. vol. 2 at 281.

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