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BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP  
CHAIRMAN

GARY PIERCE  
COMMISSIONER

BRENDA BURNS  
COMMISSIONER

SUSAN BITTER SMITH  
COMMISSIONER

BOB BURNS  
COMMISSIONER

Arizona Corporation Commission  
**DOCKETED**

JUN 06 2013

DOCKETED BY

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

**EXCEPTIONS**

EPCOR Water Arizona, Inc. ("EWAZ"), a signatory to the Settlement Agreement in this docket, files these exceptions to the Recommended Opinion and Order ("ROO") dated May 28, 2013. EWAZ strongly urges the Arizona Corporation Commission ("Commission") to amend the ROO so that it adopts and implements the parties' Settlement Agreement, particularly as it relates to AWC's return on equity.

**AWC's Authorized ROE Should Not Be Lowered from 10.55% to 10.00%**

The ROO recommends AWC's return on equity ("ROE") authorized in Decision No. 73736 be lowered to 10.00% effective July 1, 2013. None of the parties to the Settlement Agreement, including Commission Staff, believed that a reduction in the

1 ROE was warranted or good public policy. This reduction represents a material and  
2 unacceptable change to the Settlement Agreement that EWAZ cannot support.

3           Similar to EWAZ's history in Arizona, AWC's history exhibits chronic  
4 under earning of authorized ROE. As has been the case historically, it is very likely that  
5 AWC will have a difficult time actually earning a 10% ROE even with a 10.55%  
6 authorized ROE and the SIB in the Settlement Agreement. As provided for in the  
7 Settlement Agreement, the Commission must authorize each SIB step increase and the  
8 ROO now includes an earnings test. In other words, the Commission will know what  
9 AWC is earning on an actual basis for more recent periods than the test year. After  
10 reviewing actual earnings, the Commission can apply the results of an earnings test to  
11 reduce, delay or deny any particular SIB step increase under the terms of the Settlement.

12           The 5% SIB efficiency credit was a significant concession acceptable to all  
13 signatories of the Settlement Agreement. As explained by Mr. Olea in his testimony, this  
14 concession is unique as compared to other DSIC-like mechanisms now in use.<sup>1</sup> To take the  
15 SIB mechanism, which is capped at five percent per year, and then make a determination  
16 that the return on the entire investment in the Company should also be reduced, is not  
17 warranted or good public policy. The 5% efficiency credit, which is strongly supported  
18 by each of the signatory parties, including Commission Staff, is an appropriate concession,  
19 as it is appropriately limited to the SIB itself. AWC has already indicated that the 5% SIB  
20 efficiency credit is equivalent to an 87 basis point ROE reduction on SIB eligible plant.  
21 Although EWAZ can accept a SIB earnings test as an additional concession to the  
22 Settlement Agreement, it does not support any further concessions.

23           It is important, of course, to EWAZ whether any SIB approved in this  
24 proceeding will serve as a useful template for other water companies to rely upon on a  
25 going forward basis. For example, the initial authorized Arsenic Cost Recovery

26 <sup>1</sup> Tr. at 317-19.

1 Mechanism (“ACRM”) was relied upon extensively with very little subsequent  
2 modification, which resulted in a significant public interest benefit in Arizona. However,  
3 in this instance, the explicit linking of a SIB with the authorized level of ROE would  
4 introduce an unwarranted degree of complexity and optionality that the signatory parties  
5 endeavored to avoid. By optionality, EWAZ means that going forward water utility  
6 applicants and participating parties would each have to evaluate and consider whether or  
7 not to apply for or to support a SIB, in large part, on the basis of the financial impact of a  
8 reduced ROE. In addition to the other important reasons noted above, EWAZ believes  
9 that it is in the public interest to avoid a linking of the SIB and a reduction in ROE, which  
10 will be costly and time consuming for all parties to litigate going forward.

11           Linking the SIB to a reduction in ROE is also not practical for multi-district  
12 rate cases. As is the case with many other utilities, EWAZ typically files rate cases  
13 involving multiple districts. In EWAZ’s next multi-district rate case, it is expected that  
14 older water districts would request a SIB and newer ones would not. However, because  
15 the ROE is authorized on a global basis in a rate case, if a reduced ROE is tied to the SIB,  
16 EWAZ would be required to consider the impact of a lower ROE on the rate bases not  
17 only of those districts requesting a SIB, but also on those districts not requesting a SIB.  
18 And, while a solution may be to put non-SIB districts in a separate simultaneously  
19 processed docket, in addition to being highly inefficient, such an approach would only  
20 serve to highlight the impact of an ROE reduction on a SIB district’s entire rate base in  
21 light of the potential value of a SIB in that district. It would also reinforce the importance  
22 of comparing the financial impact with and without a SIB, and therefore with a lower ROE  
23 or without a lower ROE. Although EWAZ strongly supports rate gradualism and the other  
24 benefits of a SIB identified in the Settlement Agreement, EWAZ cannot agree to a SIB  
25 that could lead to harm to the company’s financial condition, as it is possible that a lower  
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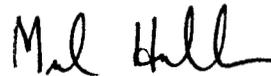
1 ROE affecting all rate base would more than offset the benefits of a SIB which impacts  
2 only incremental rate base.

3 **CONCLUSION**

4 For the reasons set forth above, the Commission should not adopt the reduction to  
5 AWC's ROE as proposed by the ROO. EWAZ respectfully requests that the Commission  
6 amend the ROO to adopt the Settlement Agreement and to eliminate any reduction to  
7 AWC's return on equity.

8 RESPECTFULLY SUBMITTED this 6th day of June, 2013.

9  
10 LEWIS AND ROCA LLP

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Michael T. Hallam  
14 40 North Central Avenue  
15 Phoenix, AZ 85004  
Attorneys for EPCOR Water Arizona, Inc.

16 ORIGINAL AND thirteen (13) copies  
17 of the foregoing hand-delivered this  
6th day of June , 2013, to:

18 The Arizona Corporation Commission  
19 Utilities Division – Docket Control  
1200 W. Washington Street  
20 Phoenix, Arizona 85007

21 Copy of the foregoing hand-delivered  
22 this 6th day of June, 2013, to:  
Chairman Bob Stump  
23 Arizona Corporation Commission  
1200 W. Washington Street  
24 Phoenix, AZ 85007

25 Commissioner Gary Pierce  
26 Arizona Corporation Commission  
1200 W. Washington Street  
Phoenix, AZ 85007

1 Commissioner Brenda Burns  
Arizona Corporation Commission  
2 1200 W. Washington Street  
Phoenix, AZ 85007

3 Commissioner Bob Burns  
4 Arizona Corporation Commission  
1200 W. Washington Street  
5 Phoenix, AZ 85007

6 Commissioner Susan Bitter Smith  
Arizona Corporation Commission  
7 1200 W. Washington Street  
Phoenix, AZ 85007

8

9 Steve Olea  
Utilities Division  
10 Arizona Corporation Commission  
1200 W. Washington Street  
11 Phoenix, Arizona 85007

12 Lyn A. Farmer, Chief Law Judge  
Arizona Corporation Commission  
13 1200 W. Washington Street  
Phoenix, Arizona 85007

14

Janice Alward, Chief Counsel  
15 Charles Hains  
Legal Department  
16 Arizona Corporation Commission  
1200 W. Washington Street  
17 Phoenix, Arizona 85007

18

19 Copy of the foregoing mailed  
this 6th day of June, 2013, to:

20

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

23

24 Daniel W. Pozefsky, Chief Counsel  
Residential Utility Consumer Office  
1110 W. Washington Street, Suite 220  
25 Phoenix, AZ 85007

26

- 1 Jay L. Shapiro  
Fennemore Craig PC
- 2 2394 E. Camelback Road, Suite 600  
Phoenix, AZ 85016-3429
- 3 Attorneys for Intervenor Liberty Utilities
  
- 4 Christopher D. Krygier  
Liberty Utilities
- 5 12725 W. Indian School Road, Suite D101  
Avondale, AZ 85392
  
- 6 Michael Grant
- 7 Gallagher & Kennedy  
2575 E. Camelback Road
- 8 Phoenix, AZ 85016-9225  
Attorneys for Intervenor Arizona-Investment Council
  
- 9 Gary Yaquinto
- 10 Arizona Investment Council  
2100 N. Central Avenue, Suite 210
- 11 Phoenix, AZ 85004
  
- 12 Michael W. Patten  
Timothy J. Sabo
- 13 Roshka Dewulf & Patten, PLC  
One Arizona Center
- 14 400 E. Van Buren, Suite 800  
Phoenix, AZ 85004-2262
- 15 Attorneys for Intervenor Global Water
  
- 16 Ron Fleming  
Global Water Utilities
- 17 2140 N. 19th Avenue, Suite 201  
Phoenix, AZ 85027
  
- 18 Garry D. Hays
- 19 The Law Offices of Gary D. Hays  
1702 E. Highland Avenue, Suite 204
- 20 Phoenix, AZ 85016  
Attorneys for Intervenor City of Globe
  
- 21 Greg Patterson
- 22 916 W. Adams, Suite 3  
Phoenix, AZ 85007
- 23 Attorney for Intervenor Water Utility  
Association of Arizona
- 24
- 25
- 26

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

  
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