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Arizona Corporation Commission

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JUN 06 2013

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

DOCKET NO. W-01445A-11-0310

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**JOINT EXCEPTIONS OF
LIBERTY UTILITIES AND
GLOBAL WATER**

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June 6, 2013

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1 Intervenors Rio Rico Utilities, Inc. d/b/a Liberty Utilities¹ (“Liberty”) and the
2 Global Water Utilities² (“Global Water”) hereby make this joint filing in exception to the
3 Recommended Opinion and Order (“ROO”) filed by Judge Nodes on May 28, 2013.

4 **I. INTRODUCTION.**

5 Liberty and Global Water operate water and wastewater systems serving more than
6 100,000 customers across Arizona. Global Water and Liberty intervened in the second
7 phase of this rate case for a singular purpose—to assist the Commission in creating a
8 template for DSIC-like adjuster mechanisms that can be used by public service
9 corporations furnishing water and wastewater utility services in Arizona. The evidence in
10 this case demonstrates—and experience throughout the country shows—that a properly-
11 constructed DSIC-like mechanism is a tool available to the Commission to: (1) promote
12 safe and reliable water service by fostering timely replacement of critical infrastructure,
13 (2) improve the financial health of utilities by reducing the detrimental impacts of
14 regulatory lag, and (3) protecting customers by promoting rate gradualism. Liberty and
15 Global Water joined in crafting the SIB Settlement and both are signatories to the
16 agreement. As the joint Liberty/Global closing brief reflects, the SIB furthers all of these
17 important regulatory goals and complies with Arizona law.

18 Liberty and Global Water are thankful for the significant efforts of Staff, Arizona
19 Water, and the other parties in developing the SIB mechanism and coming to a settlement
20 agreement. In addition, Liberty and Global Water greatly appreciate the efforts of the
21 Administrative Law Judge in conducting the hearing and preparing the detailed ROO on
22

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

26 ² Global Water – Palo Verde Utilities Company, Global Water – Santa Cruz Water 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 an accelerated schedule. Unfortunately, the ROO rejects the parties' settlement by
2 recommending material modifications to the SIB, putting significant benefits of a SIB at
3 risk.

4 Specifically, the ROO reduces AWC's authorized return on equity ("ROE") by 55
5 basis points as the apparent price of having a DSIC-like mechanism. This
6 recommendation flies directly in the face of the understanding of all parties—even
7 RUCO—that Arizona Water's return was not on the table in Phase 2. The
8 recommendation to reduce AWC's ROE materially alters the SIB Settlement and the
9 settling parties' expectations. Global Water and Liberty can unequivocally state that
10 neither will be a party to a modified settlement that forces a trade off between a SIB and a
11 just and reasonable rate of return, a reduction that has never been adopted in any other
12 state with a DSIC.³

13 The ROO also recommends an earnings test, another material modification of the
14 SIB Settlement. Liberty and Global Water, however, will accept this change in the SIB
15 upon clarification from the Commission that the earnings test will not prohibit
16 implementation of a SIB unless implementation of the SIB is shown to result in over-
17 earning by the utility.

18 Finally, Global Water and Liberty ask that the Commission clarify in its order that
19 Arizona law does not mandate a finding of exceptional circumstances before it can
20 approve an adjuster mechanism like the SIB in a general rate case. For the convenience of
21 the Commission, Global Water and Liberty have included suggested amendments on the
22 earnings test and exceptional circumstances issues in their joint Exceptions.

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24
25 ³ Tr. at 318:10-20 (Olea)(noting that the SIB is the only DSIC like mechanism with *any*
26 type of financial credit to customers).

1 **II. EXCEPTIONS AND REQUESTS FOR CLARIFICATION.**

2 **A. Requested Clarification Regarding Recommended Earnings Test.**

3 As stated, the ROO modifies the SIB Settlement by adding an “earnings test.”⁴
4 The purpose of this test appears to be to determine whether the utility seeking to
5 implement a SIB is over-earning. Although not part of the SIB Settlement, Global Water
6 and Liberty do not necessarily oppose the addition of an earnings test. AWC submitted a
7 proposed earnings test as part of its DSIC request in Phase 1, and Global Water submitted
8 a White Paper in Phase 2 that was prepared by Arizonans for Responsible Water Policy
9 (“Responsible Water”) and included discussion of, and a proposed schedule for, an
10 earnings test.⁵ The problem here is that the ROO says nothing about how the earnings test
11 will be used or how it will be evaluated in future SIB filings. Obviously, how money is
12 counted matters and it is imperative that all parties have a clear understanding as to how
13 an earnings test will be evaluated and used in future SIB filings. That is critical in order
14 for utilities such as Liberty or Global Water to continue to support the SIB Settlement and
15 use SIB mechanisms in the future.

16 The earnings test should be used to determine if the Company is earning its
17 authorized return and the impact of the SIB on earnings. If implementation of the SIB is
18 shown to result in over-earning by the utility, then the SIB surcharge for that year may not
19 be allowed to go into effect. For example, if the utility is not earning its return, but
20 implementation of the SIB would result in the utility over-earning, then the amount of the
21 SIB Surcharge should be capped to ensure that the utility does not over-earn its authorized
22 return. Thus, the earnings test should be used only to evaluate whether implementation of
23 a SIB will result in over-earning by the utility. In that situation, the SIB surcharge for that
24 year may be denied or it may be capped to prevent over-earning in that year. In either

25 _____
26 ⁴ ROO at 51:5-14.

⁵ Direct Testimony of Paul Walker, Phase 2 Exhibit Global-2, at Attachment 2, pages 9 and 13.

1 case, the utility would still retain the SIB and could file for a SIB surcharge the following
2 year (when another earnings test will be conducted).⁶ Absent such protections, Liberty
3 and Global Water cannot support the addition of an earnings test.

4 **B. Requested Clarification Regarding Commission Authority to Approve**
5 **Adjustment Mechanisms in a General Rate Case.**

6 The ROO correctly states that the SIB is an adjuster mechanism and that Arizona
7 law allows for the approval of such a mechanism in a general rate case.⁷ The ROO also
8 recognizes that the decision in *Scates* affirmed the Commission's authority to approve
9 rates outside the general framework of a general rate case if exigent circumstances are
10 present.⁸ As the ROO clearly reflects, AWC's need for infrastructure replacement is
11 exceptional.⁹ In fact, the statewide need for infrastructure replacement could be deemed
12 an exceptional circumstance.¹⁰ This does not mean, however, that exigent circumstances
13 must be present for the Commission to approve an adjuster mechanism like the SIB.
14 Rather, as the ROO clearly finds, the SIB allows for consideration of all costs at the time
15 approved, is attended by fair value findings, and is limited to "readily identifiable and
16 narrowly defined plant."¹¹ Thus, approval of the SIB is clearly within the Commission's
17 constitutional authority, a fact Liberty and Global Water respectfully suggest be clarified
18 in the Conclusions of Law with the addition of the following language to paragraph 4 of
19 the Conclusions of Law beginning on page 60 of the ROO.

20 The Commission has the constitutional ratemaking authority
21 to approve adjustment mechanisms in a general rate case; or

22
23 ⁶ See Global Water/Liberty Proposed Amendment No. 1 attached hereto at Attachment 1.

⁷ ROO at 43:26 – 44:6; 51:21-22.

⁸ ROO at 44:7-21; 51: n. 39.

⁹ See ROO at 8:14 – 9:12; 22:1-12; 22:22 – 23:4; 34:10-13; and 51:n.39.

¹⁰ Direct Testimony of Gary Yaquinto, Phase 2 Exhibit AIC-1, at 2:21 – 3:17; Direct Testimony
25 of Paul Walker, Phase 2, Exhibit Global-2, at Attachment 2, pages 5-6.

¹¹ ROO at 51:15-22; 52:23 – 53:23.

1 to approve rates outside the general framework of a rate case
2 where exigent circumstances are found.¹²

3 **C. Exception to Recommended Reduction in the ROE.**

4 Liberty and Global Water intervened in this case and went into the settlement
5 negotiations believing that the ROE decided in Phase 1 was final. At the February 12,
6 2013 Open Meeting, when Decision No. 73736 was approved, the Commission adopted
7 an amendment that set Phase 2 into motion.¹³ The underlying record is clear that ROE is
8 not contingent on the SIB and those two issues are not linked together. As the proponent
9 of that amendment most eloquently put it at the time - "One final comment I will say, I do
10 believe that the issue of COE and DSIC are two separate issues."¹⁴

11 Commissioner Bitter Smith, in explaining her Amendment to establish Phase 2,
12 said: "The purpose of my amendment however, though, is in doing so [establishing a
13 DSIC conversation/process] is giving some sense of certainty to this particular water
14 company about what the end result, in concept, will look like so that they're not floating
15 in limbo."¹⁵ RUCO then further clarified the intent of Commissioner Bitter Smith's
16 amendment by asking:

17 But I did wanna pose a question with that: If you're willing to
18 go there, if that's what you wanna do so that now we would
19 be considering a DSIC in this case, in light of the 10.55.
20 Does your amendment or do you also want to consider the
21 10.55 cost of equity? Because, remember, the reason we're
22 raising that cost of equity, as I understand it, is to address the
23 additional risk caused by the infrastructure... Now, if you're
24 opening it up to consider a DSIC, don't you think it would be
25 appropriate to also then re-consider the 10.55? Because if
26 you do pass a DSIC and eventually apply it retroactively to

23 ¹² See Global Water/Liberty Proposed Amendment No. 2 attached hereto at Attachment 2.

24 ¹³ Commissioner Bitter Smith Proposed Amendment No. 1, filed February 12, 2013, as adopted
25 by the Commission and reflected in Decision No. 73736 (Feb. 20, 2013) at pages 104 – 105 and
26 110.

¹⁴ ACC Video Archive Recording, April 9, 2013 Open Meeting, at 2:25:41.

¹⁵ ACC Video Archive Recording, February 12, 2013 Open Meeting, at 1:55:43.

1 this case, then it would only make sense that their risk would
2 decrease.¹⁶

3 In response, the Amendment's sponsor, Commissioner Bitter Smith, stated:

4 Mr. Pozefsky, I think you're asking the intention of my
5 amendment. And, as I started earlier in the conversation, I
6 think there are two separate issues. One is the COE which is
7 your 10.55 issue; and my amendment does not address that.
8 My amendment simply sets up the mechanism... [that] would
also give us the opportunity to set up a template that would
apply, potentially apply going forward, to other water cases
that are moving in this direction.¹⁷

9 RUCO clearly believed that the ROE decided in Phase 1 was final:

10 With hindsight, I think our fate was sealed when the
11 Commission back on February 12th made it clear that there
12 was no connection, at least in its view, between the ROE and
the SIB mechanism – or what's now become the SIB
mechanism.¹⁸

13 RUCO further stated:

14 ...I think, now again that we have this hindsight, by sort of
15 putting conditions on the debate. You said, 'go, come up
16 with a DSIC, but don't have any connection, don't discuss the
ROE'.¹⁹

17 Neither RUCO nor any other party sought rehearing of Decision No. 73736. Nor was a
18 request made under A.R.S. § 40-252 to modify that decision.

19 For its part, Staff was not sure whether the Commission had taken the ROE off the
20 table in Phase 2.²⁰ Mr. Olea was absolutely clear, however, that there was no need or
21 reason to further reduce the ROE. As he explained, the way the SIB is set up with an

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23 ¹⁶ ACC Video Archive Recording, February 12, 2013 Open Meeting, at 1:57:08.

24 ¹⁷ ACC Video Archive Recording, February 12, 2013 Open Meeting, at 1:58:02.

25 ¹⁸ ACC Video Archive Recording, April 9, 2013 Open Meeting, at 30:20.

26 ¹⁹ ACC Video Archive Recording, April 9, 2013 Open Meeting, at 32:37. *See also* Tr. 426:21 –
428:17; 458:9-11.

²⁰ Tr. at 267:12-13.

1 efficiency credit, you can keep the ROE entirely separate.²¹ Most importantly, as
2 Mr. Olea testified on cross-examination by RUCO, approval of a DSIC-like mechanism
3 does not change the utility's risk:

4 Q. Do you believe, to the extent that the 5 percent
5 efficiency credit is a benefit to ratepayer, that the
6 benefit is negated by the higher 10.55 percent ROE
awarded by the Commission.

7 A. No.

8 Q. Why not?

9 A. Because I think that the risk is what the risk is on that
10 company, and the fact that they now have a
11 mechanism or would have a mechanism to address part
of their infrastructure needs doesn't change that. The
risk still is what it is.²²

12 Had the parties known that the ROE decided in Phase 1 was back in play, it is
13 beyond dispute that the negotiations of the parties would have been different. The
14 reduced ROE is unquestionably a material change to the SIB Settlement. While the ROO
15 is careful to carve out this case as unique and **not** establishing a precedent that DSIC-like
16 mechanisms reduce risk,²³ such language will be of little comfort to AWC, which has to
17 bear the cost of losing the benefit of their bargain in real dollars.

18 Under these circumstances, the Commission should reject the proposed ROE
19 reduction set forth in the ROO as contrary to the underlying record and the terms of the
20 SIB Settlement. As Mr. Olea made clear, a reduction to AWC's overall ROE is neither
21 appropriate nor necessary. Additionally, even with the attempted qualifying language
22 contained in footnote 44 of the ROO, a decision approving the ROE reduction for AWC
23 will impose the risk on all utilities of a reduced ROE in future cases resulting from a SIB.

24
25 ²¹ Tr. at 272:9 – 273:2.

26 ²² Tr. at 275:23 – 276:8.

²³ ROO at 55, n. 44.

1 This, in turn, jeopardizes the use and clear benefit of the SIB mechanism to facilitate
2 replacement of critical infrastructure, reduce the detrimental impacts of regulatory lag,
3 and promote rate gradualism.

4 And at the end of the day, the SIB before the Commission includes the elements
5 that RUCO told the Commission were needed during the February 12, 2013 Open
6 Meeting:

7 There are ways that you can come up with a DSIC that I think
8 will address your concerns and won't shift the risk; I mean if
9 that's where the Commission wants to go we surely want to
10 be participating in that. There's, for example, you can set a
11 percentage amount if the parties, let's say, could come up
12 with an agreement you know, where we could credit the
13 DSIC mechanism a certain percentage to make up or to
14 account for the operational efficiencies. You can put a cap on
the DSIC, for example, to make sure that numbers aren't
gonna raise too high. We under, we're okay with that. I
mean, we're, we, I think if we can, actually agree on it with
the utilities, what would be fair to do that; that we can present
something to you that we can all live with, regardless of what
our feelings are on the legal implications.²⁴

15 In the SIB Settlement, there is a credit to make up "for the operational
16 efficiencies;" the 5 percent efficiency credit which equates to an 87 basis point reduction
17 in ROE based on AWC's capital structure. There is a cap on the DSIC of five percent per
18 year. Every SIB would have to be approved in a rate case; and every adjustment to rates
19 would be first subject to review by Staff.

20 **III. CONCLUSION.**

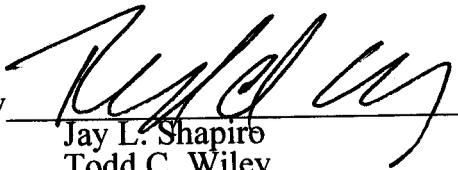
21 The SIB mechanism proposed in the settlement agreement is in the public interest
22 and should be approved. As the ROO demonstrates, the SIB mechanism is lawful and
23 within the Commission's authority. Customers will benefit from more gradual rate
24 changes, and from safe and reliable water service that the SIB will foster by enabling
25 significant and necessary infrastructure improvements needed in Arizona. Utilities will

26 ²⁴ ACC Video Archive Recording, February 12, 2013 Open Meeting, at 1:52:15.

1 benefit from a better opportunity to earn the authorized return on these investments.
2 Accordingly, Liberty and Global Water respectfully ask the Commission to approve the
3 amendments to the ROO included as Attachments 1, 2 and 3, and to approve the ROO as
4 amended.

5 DATED this 6th day of June, 2013.

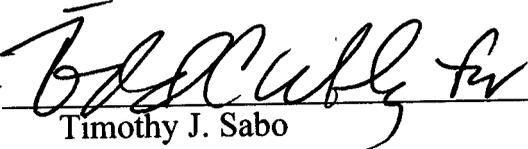
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Attachment 1

Suggested Amendment Language – Earnings Test Clarification

Page 51, Line 14, ADD the following additional language:

“The earnings test will operate in the following manner. If the earnings test calculation described herein shows that the Company will not exceed its authorized rate of return with the implementation of the SIB surcharge, the surcharge for that year shall go into effect upon issuance of the surcharge approval order and subject to the conditions described herein. But if the earnings test calculation described herein shows that the Company will exceed its authorized rate of return with the implementation of any part of the SIB surcharge, the surcharge for that year shall not go into effect. Lastly, if the earnings test calculation described herein shows that the Company will exceed its authorized rate of return with the implementation of the full surcharge, but a portion of the surcharge may be implemented without exceeding the authorized rate of return, then the surcharge will be authorized up to that amount, again upon issuance of the surcharge approval order and subject to the conditions described herein. In any event, the earnings test shall not impact the approval of the SIB mechanism or the possibility of SIB surcharges in future years where authorized in accordance with the SIB mechanism.”

MAKE ALL CONFORMING CHANGES

Attachment 2

Suggested Amendment Language – Adjustor Clarification

Page 60, line 16 ADD the following language to Conclusion of Law No. 4:

“The Commission has the constitutional ratemaking authority to approve adjustment mechanisms in a general rate case; or to approve rates outside the general framework of a rate case where exigent circumstances are found.”

MAKE ALL CONFORMING CHANGES

Attachment 3

Suggested Amendment Language – ROE

(1) DELETE Page 55, lines 2 to 23.5 and ADD at Page 55, line 2 the following:

“We disagree with RUCO. As Mr. Olea testified, the existence or lack of a DSIC does not change the risk of the utility, and therefore the existence or lack of a DSIC should not change the utility’s ROE. (Tr. at 275 to 276). As Mr. Olea explained, the efficiency credit is a more appropriate means to provide a financial benefit to the ratepayers. (Tr. at 276 to 277). Moreover, we find RUCO’s argument ironic; while today RUCO argues that adding a DSIC reduces risk, we do not recall RUCO ever arguing that the absence of a DSIC results in higher risk. In addition, RUCO’s witness Mr. Rigsby conceded that some of the “sample” group of companies used to determine ROE have DSICs. (Tr. at 485). Logically, to the extent (if any) that a DSIC impacts risk, the reduced risk would be reflected in the sample companies used to set the ROE, and we are not persuaded that any adjustment to the ROE is warranted.”

(2) DELETE Page 56, lines 1 to 4

(2) DELETE Page 60, lines 4 to 6 (Finding of Fact No. 26)

(3) DELETE Page 60, lines 19 to 24 (Conclusion of Law No. 6)

(4) DELETE Page 61, lines 5 to 15.

(5) DELETE Page 62, lines 1 to 4.