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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 NORTHERN GROUP AND FOR CERTAIN RELATED APPROVALS.	Docket No. W-01445A-12-0348

Arizona Corporation Commission
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RUCO'S EXCEPTIONS

The Residential Utility Consumer Office ("RUCO") submits the following exceptions to the Recommended Opinion and Order ("ROO") in the above matter. RUCO takes exception to the ROO in the above matter because RUCO does not believe that the proposed Settlement is in the best interests of ratepayers. In the Company's recent Western Group case (Docket No. W-01445A-10-0517), the Commission approved a Settlement which adopted a 10 percent cost of equity and did not include a declining use adjustment for residential ratepayers or a DSIC[1]. See Decision No. 73144 at 38-39, Docketed May 1, 2012). Here, the ROO recommends the

[1] The Company proposed a DSIC but withdrew its proposal.

Commission approve a declining usage adjustment, a SIB and a 10 percent cost of equity – from RUCO's perspective the Settlement comes at too high a cost to ratepayers.

Moreover, RUCO questions how the Commission can approve the present Settlement Agreement based in part, on what the Commission decided in the Eastern Group case (Decision Nos. 73938 and 73736) when the Commission has opened up those Decisions for further consideration. Specifically, the Commission has opened up those Decisions to reconsider whether the SIB qualifies as an adjustor mechanism under Arizona law and whether the ROE should be adjusted because of the SIB. There currently is a tentative hearing date scheduled in that matter for November 25 and 26, 2013. These issues are not resolved as stated in the ROO (ROO at 59, 65) and the Commission should not rely on those Decisions to approve the Agreement at this time.

RUCO's opposition to the Settlement does not mean that RUCO opposes all aspects of the Settlement. RUCO participated in the Settlement negotiations which were fair and open and RUCO's input was considered and even adopted in some instances. RUCO's area of concern is limited to the issues of the declining usage adjustment, the SIB and the ROE. In regard to those three issues, RUCO is sensitive to the parties concerns and the policy issues. In fact, based on the ROOs recommendations, RUCO proposes, if the Commission is considering approval of the Settlement, that the Commission balances the interests by allowing the ratepayer's a refund should usage increase.

THE COMMISSION SHOULD CONSIDER THE IMPLICATIONS OF CHANGING THE POLICY ON DECLINING USAGE IN THIS CASE

The ROO, if adopted, would set a precedent for changing the Commission's policy on declining usage in rate cases. Clearly, a change in policy that would allow for the recovery of forecasted shortfalls of revenue through rate design would favor the shareholder should there be no shortfall and/or declining use. RUCO recognizes that there has been declining use in the past. This Commission has made it clear that it is concerned with the Company's earnings and a continued pattern of declining usage would negatively affect those earnings. This appears to be the reasoning underlying the decision in the ROO.

Overlooked, however, is the policy issue from the ratepayer's perspective. The declining use, as Steve Olea testified, and the ROO recognized, is caused by "... more efficient water use caused by not only the tiered rates but also the BMPs."[2] In other words, for the ratepayer, who now conserves, and adjusts his/her use downward, they will see at the very least no change and even possibly an increase in their bill to make up for the loss of revenues to the Company caused by their conservation. Such a framework would be inapposite to the tiered rate design whose purpose is to encourage conservation.

The Commission is familiar with this dynamic and the effect it has on the ratepayer in other regulatory realms. In the area of renewable energy, the Commission has seen first-hand the pushback from ratepayers when there is little to no cost benefit from conservation oriented alternatives.

If the customer no longer has the incentive to conserve because he/she is not saving, then their usage is likely to go up. An increase in usage or even a leveling off in usage will result in over-recovery which is the risk inherent in forecasting. RUCO has made the calculation of what the cost to the ratepayer would be if use does not decline as projected – the Northern Group will receive an additional $419,644, or 11.31 percent in operating revenue.[3]

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[2] ROO at 63, Transcript at 95

[3] ROO at 44, See Attachment A

The Company's same calculation is $383,000 or 10.32 percent.[4] Either way, on an overall proposed revenue increase of $2,240,329, a wrong forecast would have a significant overall impact on ratepayers.

THE BASIS FOR CHANGING THE COMMISSION'S CURRENT POLICY IS MISPLACED

The Company has unsuccessfully proposed several times a declining usage adjustment for residential ratepayers. See Decision Nos. 71845 (Company's district wide case), Decision No. 73144 (Western Group), Decision No. 73736 (Eastern Group). Staff and RUCO have always opposed the Company's declining usage adjustment for the residential ratepayers. Seven months ago, in the Company's Eastern Group case (Decision No. 73736 docketed February 20, 2016) the Commission rejected the same type of adjustment that the ROO is recommending in this case.

The Commission noted in the Eastern Group case:

> It is possible that, with more complete and transparent information as to the normalization adjustment methodology and its impacts, the Commission might find such an adjustment to be appropriate in the future. The Commission understands that a consistent pattern of declining usage, and the diminished revenues that follow, could jeopardize AWC's ability to recover its cost of service, which is contrary to the best interests of AWC, AWC's customers, and the Commission. **However, the Commission will not approve such an adjustment without first being confident that the changes in usage are known and measurable, that any corresponding**

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[4] ROO at 51, See Attachment A

> **changes in costs have been factored into the normalization calculation so as to avoid mismatches and over-recovery, and that the Commission is aware of the actual impacts of the adjustment on proposed rates.**[5]

In the Eastern Group case, Staff opposed the adjustment as it found Mr. Reiker's "... estimates of change in use per customer to be unstable, to vary with the time frame for analysis, and thus not to be known and measurable.[6] In the present case, Staff in its direct case recommended that the Commission reject the Company's declining usage proposal. Staff's witness, Mr. Michlik noted that the "normalization" adjustments "... can result in higher rates because revenue requirement targets will be spread over fewer billing determinants." [7] At the same time, Mr. Michlik recommended rejection of all of the Company's

> "...normalization adjustments based on the Company's estimates of trends in use per customer. The adjustments are based on slope coefficients determined by statistical regression analysis. The coefficients vary significantly when the analysis is conducted over varying time frames (e.g., ten vs. five years). Consequently the adjustment cannot be known and measurable." [8]

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[5] Decision No. 73736 at 70-71 (Emphasis added).

[6] Staff did accept a declining usage adjustment for the commercial customers in the Superstition Division. Id. at 68 -69. (Ex. S-7 at 5 (0130)).

[7] S-1 at 4.

[8] S-1 at 4.

Mr. Olea confirmed that the Settlement proposal had not addressed Mr. Michlik's concerns and that it could result in higher rates because of revenue requirement targets will be spread over fewer billing determinants[9].

There is a Settlement in this case because Staff and the Company reached an agreement which included the approval of a declining usage adjustment. As even the ROO notes, Staff, via Mr. Olea, transformed its opinion on Mr. Olea's explanation that he felt it is time to make the adjustments as there is now more efficient water use caused by not only the tiered rates but also the BMP's. When questioned about Staff's new position on this issue, Mr. Olea was asked if there are situations where Staff would favor one group over the other; Mr. Olea admitted there are circumstances. Mr. Olea explained that an example would be the situation where it looks like Staff's position will not get adopted by the Commission.[10]

The ROO dismisses the concerns raised by the Commission in the Eastern Division case by noting Mr. Olea's assertions that this type of adjustment will never be known and measurable, that the risk that water use per customer will remain the same or increase in the future is "very small" and that there will be a relatively minimal impact on the monthly bill caused by the declining usage adjustments.

RUCO is not at ease with a dramatic shift in an important Commission policy based on the underlying facts of this case. In explaining its rationale, the ROO notes one thing is certain, and RUCO agrees, that no party in this case or the Commission can tell the future. So why change the Commission's long standing policy and give the Company the benefit of the doubt based on Staff's Director's personal change of position in the middle of a case? RUCO

[9] Transcript at 278.

[10] Transcript at 287

is not saying that the Commission cannot change its position from the Eastern Division case – RUCO is saying that the Commission should not change its position based on the "new evidence" in this case. At the very least, the Commission should give this issue further consideration.

THE DECLINING USAGE ADJUSTMENT SHOULD PROVIDE REFUNDS TO THE RATEPAYERS IF USAGE DOES NOT DECLINE

RUCO understands that the declining usage adjustment is one component of a settlement which RUCO has no doubt that the Commission will approve. The best RUCO can hope for under the circumstances is to seek consideration of a declining usage adjustment that works both ways – it adjusts for the Company when use declines and provides refunds when use increases.

The ROO recommends that the Company provide, for each customer class and each division, data regarding monthly per class usage. The data will allow Staff to determine monthly actual use and compare to the forecasted use. The numbers can be trued-up and a refund credited if warranted or a surcharge added if warranted. RUCO believes that if the Commission is going to approve the declining use adjustment, it should go both ways – not one way as recommended in the ROO. RUCO has attached a proposed Amendment.

THE SIB IS NOT IN THE RATEPAYER'S BEST INTERESTS

The Commission and the parties are aware of RUCO's opposition to the SIB. The ROO discusses RUCO's position at length and RUCO's filings in the Eastern Division case also set forth the basis for RUCO's opposition. RUCO would refer the Commission to those documents should there be any question.

UNDER THE CIRCUMSTANCES OF THIS CASE, A ROE OF 10 PERCENT IS TOO HIGH

RUCO's reason for opposing a higher ROE where there are risk adverse accounting measures is also well known. With the addition of the declining usage adjustment, the Company will be able to not only recover its infrastructure costs in between rate cases without the scrutiny of a full rate case, it will also now be able to recover revenues without the worry of declining use. It is not a stretch to believe that the Company faces less operational and financial risk under the terms of the Settlement than a similar company awarded a 10 percent ROE without a DSIC and/or a declining usage adjustment. RUCO recommends a cost of equity of 8.75 percent which is slightly below Staff's original 9.1 percent recommendation which Staff recommended without the declining usage adjustment.

RESPECTFULLY SUBMITTED this 5th day of September, 2013.

Daniel W. Pozefsky
Chief Counsel

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