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BEFORE THE ARIZONA CORPORATION COMMISSION

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

Docket No. W-01445A-12-0348

Arizona Corporation Commission  
**DOCKETED**

OCT 11 2013

DOCKETED BY	<i>EAL</i>
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**APPLICATION FOR REHEARING OF DECISION NO. 74081**

21 Pursuant to A.R.S. § 40-253, the Residential Utility Consumer Office ("RUCO") hereby  
 22 applies for rehearing of Decision No. 74081, docketed on September 23, 2013 (the "Decision"  
 23 or "Order").

**I. BACKGROUND**

24 On August 1, 2012, Arizona Water Company ("AWC" or "Company") filed with the  
 Arizona Corporation Commission ("Commission") an application requesting adjustments to its  
 rates and charges for utility service provided by its Northern Group water systems. AWC also  
 requested several other authorizations in the application.

1 On September 23, 2013, the Commission issued Decision No. 74081, granting AWC a  
2 rate increase for its Northern Group systems. Testimony was filed by the parties and  
3 Settlement Discussions were held regarding the case. On April 12, 2013 the Company filed a  
4 Settlement Agreement with the Commission that was executed by Staff and the Company but  
5 not RUCO. Among other things, the Settlement adopted a System Improvement Benefits  
6 ("SIB") mechanism, a 10% return on equity ("ROE") and a declining usage adjustment. RUCO  
7 opposed the Settlement primarily on these three issues.

8 On May 8, 2013, the Administrative Law Judge granted RUCO's Motion to incorporate  
9 the entire record of Phase 2 of the Company's recent Eastern Group case (Docket No. W-  
10 01445A-11-0310) and that portion of the Phase 1 record pertaining to the Company's  
11 requested Distribution System Improvement Charge ("DSIC").

12 The hearing in this matter took place on May 13 and 14, 2013. On August 27, 2013, the  
13 ALJ issued her Recommended Opinion and Order ("ROO"). The ROO recommended approval  
14 of the Settlement Agreement. RUCO filed Exceptions and the case was heard at Open  
15 Meeting on September 10, 2013. At the Open Meeting several amendments were proposed.  
16 One amendment, which was approved, addressed the declining usage adjustment. Ultimately,  
17 the Commission approved the ROO as amended by a 5-0 vote.

#### 18 The Eastern Group Case

19 During the proceeding of this case, the Company's Eastern Group Case was still under  
20 consideration by the Commission. The Eastern Group Case was decided by the Commission  
21 in two phases – Phase 1 – Decision No. 73736 (February 20, 2013) and Phase 2 – Decision  
22 No. 73938 (June 27, 2013). In summary, the Commission in that docket approved a 10.55%  
23 ROE and a modified SIB mechanism. There was no issue concerning a declining usage  
24 adjustment before the Commission at Open Meeting. On July 17, 2013, RUCO filed an

1 Application for Rehearing of Decision No. 73938, pursuant to A.R.S. Section 40-253. On  
2 August 15, 2013, the Commission granted RUCO's Application for Rehearing and reopened  
3 the Phase 2 Decision and the Phase 1 Decision as to ROE. That matter has been scheduled  
4 for the filing of testimony and a hearing on November 25 and 26, 2013.

5 RUCO asks for rehearing of Decision No. 74081 specifically as to the ROE and the SIB  
6 issues. RUCO is not seeking rehearing on the declining usage adjustment resolution.

7  
8 **II. THE SIB DOES NOT QUALIFY AS AN ADJUSTOR MECHANISM**

9 The Decision cites to the legal conclusion reached in the Eastern Group case to support  
10 the same legal conclusion regarding the SIB in this case. In the Eastern Group case, the  
11 Commission determined that the SIB qualifies, under the standard set forth in *Scates v. Ariz.*  
12 *Corp. Comm'n*, 118 Ariz. 531, 578 P.2d 612 (App. 1978), as an adjustor mechanism and thus  
13 an exception to the Fair Value requirement. Decision No. 73938 at 52. However, the SIB does  
14 not satisfy the criteria for a permissible adjustor mechanism.

15 Permissible adjustor mechanisms allow rates to adjust for the variation in particular  
16 *operating expenses*. *Scates*, at 535, 578 P.2d at 616. Further, adjustor mechanisms are  
17 appropriate for expenses that routinely fluctuate widely. (Decision No. 56450 at 6 (“[t]he  
18 principal justification for a fuel adjustor is volatility in fuel prices”); Decision No. 68487 at 14-15  
19 (costs of pipeline integrity management program recovered through an adjustor due to annual  
20 fluctuations in the costs). Here, the costs to be recovered through the SIB mechanism are  
21 neither operating expenses, nor are they expected to be volatile. Moreover, the SIB  
22 mechanism only permits rates to adjust up, not down. Rather than recovering the costs of  
23 infrastructure replacements through an adjustor mechanism, the costs to be recovered through  
24 the SIB should be recovered through the standard rate adjustment process of a rate case.

1           Additionally, the implementation of rate mechanisms by which rates are increased  
2 without full rate case submissions requires exceptional situations. *Scates*, at 537, 578 P.2d at  
3 618. No such exceptional circumstances exist here. In the Eastern Group case, Staff  
4 asserted that the Commission's direction to discuss a DSIC created an "extraordinary  
5 circumstance" sufficient to justify the use of adjustment SIB mechanism. There is no new  
6 evidence on this issue in this case. The Commission's direction in that case does not  
7 constitute an extraordinary circumstance in that case nor this case. The courts have previously  
8 rejected such an "*ipse dixit* approach" by the Commission to finding extraordinary  
9 circumstances to circumvent the constitutional mandate that rates be established in the context  
10 of a full rate case. See, *Resid. Utility Consumer Office v. Ariz. Corp. Comm'n (Rio Verde)*, 199  
11 *Ariz. 588, 593, ¶ 21, 20 P.3d 1169 1174 (App. 2001).*

12  
13           **III. THE PROPOSED COST OF EQUITY IN THIS CASE IS TOO HIGH UNDER THE**  
14           **CIRCUMSTANCES OF THIS CASE**

15           In this case the Commission has approved a SIB mechanism and the declining usage  
16 adjustment – both of which will have the effect of reducing the Company's risk. The Company  
17 will now recover routine plant expenditures in between rate cases and will be made whole for  
18 declines in the projected water consumption. Nonetheless, the Commission has awarded a  
19 10% ROE which it has done for similar company's which do not have the same risk-reducing  
20 accounting mechanisms.

21           The Commission need look no farther than the recent AWC Western Group case,  
22 Docket No. W-01445A-10-0517. There, Staff, in justifying its support for that Settlement noted  
23 that the Settlement was fair because it adopted a 10 percent cost of equity which Staff had  
24 recommended in its direct case and did not implement a DSIC. Decision No. 73144 at 38-39.

1 The Settlement also did not contain a declining usage adjustment. RUCO has compiled a list  
2 of recent ROE's awarded to water utilities in Arizona by the Commission (See attached  
3 spreadsheet). While every utility is different, it is worthwhile to look at what the Commission  
4 has authorized in other rate cases. Clearly, with the SIB, and now the declining usage  
5 adjustment – the trend is less risk and lower ROEs. Thus, adoption of a 10% ROE in this  
6 matter is unreasonable.

7

8 **CONCLUSION**

9 The SIB mechanism does not comport with the requirement that rates be set only  
10 upon a finding of fair value, as it does not qualify as a true adjustor mechanism. The ROE  
11 is too high in view of the approval of the SIB and the adoption of a declining usage  
12 adjustment. The Commission should rehear Decision No. 74081 to reject the SIB and  
13 adopt a lower ROE.

14 DATED this 11<sup>th</sup> day of October, 2013.

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16 \_\_\_\_\_  
17 Daniel W. Pozefsky  
18 Chief Counsel

19 AN ORIGINAL AND THIRTEEN COPIES  
20 of the foregoing filed this 11th day  
21 of October, 2013 with:

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**Water Utility Decision Matrix  
2010 -- 2013**

Utility	Decision	Date	ROR	Return on Equity	Debt	Approved OCRB/FVRB
<b>Far West Water &amp; Sewer, Inc.</b>	ROO only	8/29/2013	7.29%	9.50%	Short-Term Long-Term	7.51% 6.66% \$ 19,989,045
<b>Arizona Water Company -- Northern Group</b> (2 systems)	Settlement Agreement	8/27/2013	8.44%	10.00%		6.82% \$ 36,045,296
<b>Rio Rico Utilities, Inc.</b>	73996	7/30/2013				
Water			8.50%	9.20%		5.70% \$ 7,731,209
Waste Water			8.50%	9.20%		5.70% 4,790,738
<b>Arizona Water Company -- Eastern Group</b> (6 systems)	73736	2/20/2013	8.72%	10.55%		6.82% \$ 63,253,911
<b>Pima Utility Company</b>	73573	11/21/2012	7.63%	9.49%		4.25% \$ 19,017,780
<b>AZ-American Water Co.</b> (3 systems)	73145	5/2/2012	7.10%	10.60%	Short-Term Long-Term	0.41% 5.66% \$ 152,421,781
<b>Arizona Water Company -- Western Group</b> (3 systems)	73144 approved settlement	5/1/2012	8.44%	10.00%		6.82% \$ 53,234,209
<b>GoodmanWater Company</b>	72897	2/21/2012	9.68%	NA		NA \$ 1,755,118
<b>Rio Rico Utilities, Inc.</b>	72059	1/6/2011				
Water			8.74%	9.50%		5.70% \$ 7,808,837
Waste Water			8.74%	9.50%		5.70% \$ 3,226,898
<b>Litchfield Park Service Co.</b>	72026	12/10/2010				
Water			7.72%	8.01%		6.39% \$ 37,468,339
Waste Water			7.72%	8.01%		6.39% 27,895,231
<b>Global Utilities</b>	71878	9/14/2010				
Palo Verde			7.80%	9.00%		6.34% \$ 53,314,083
Valencal/Gr. Buckeye			7.68%	9.00%		6.60% 929,057
WUGT			7.82%	N/A		(4,186,150)
Willow			7.60%	9.00%		5.50% 2,251,164
Santa Cruz			7.93%	9.00%		6.57% 39,155,692
Valencal/Town			8.08%	9.00%		6.70% 4,240,018
<b>Arizona Water Company</b> (17 systems)	71845	8/25/2010	7.87%	9.50%	Short-Term Long-Term	3.00% 6.83% \$ 144,460,816