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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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OCT 18 2013

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IN THE MATTER OF THE APPLICATION OF
VALENCIA WATER COMPANY – TOWN DIVISION
FOR THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES FOR UTILITY
SERVICE DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF ITS
PROPERTY THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. W-01212A-12-0309

IN THE MATTER OF THE APPLICATION OF
GLOBAL WATER – PALO VERDE UTILITIES
COMPANY FOR THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES FOR UTILITY
SERVICE DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF ITS
PROPERTY THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. SW-20445A-12-0310

IN THE MATTER OF THE APPLICATION OF WATER
UTILITY OF NORTHERN SCOTTSDALE, INC. FOR A
RATE INCREASE

DOCKET NO. W-03720A-12-0311

IN THE MATTER OF THE APPLICATION OF
WATER UTILITY OF GREATER TONOPAH FOR
THE ESTABLISHMENT OF JUST AND REASONABLE
RATES AND CHARGES FOR UTILITY SERVICE
DESIGNED TO REALIZE A REASONABLE RATE OF
RETURN ON THE FAIR VALUE OF ITS PROPERTY
THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. W-02450A-12-0312

IN THE MATTER OF THE APPLICATION OF
VALENCIA WATER COMPANY – GREATER
BUCKEYE DIVISION FOR THE ESTABLISHMENT OF
JUST AND REASONABLE RATES AND CHARGES FOR
UTILITY SERVICE DESIGNED TO REALIZE A
REASONABLE RATE OF RETURN ON THE FAIR
VALUE OF ITS PROPERTY THROUGHOUT THE
STATE OF ARIZONA

DOCKET NO. W-02451A-12-0313

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IN THE MATTER OF THE APPLICATION OF
GLOBAL WATER – SANTA CRUZ WATER COMPANY
FOR THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES FOR UTILITY
SERVICE DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF ITS
PROPERTY THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. W-20446A-12-0314

IN THE MATTER OF THE APPLICATION OF
WILLOW VALLEY WATER COMPANY FOR THE
ESTABLISHMENT OF JUST AND REASONABLE
RATES AND CHARGES FOR UTILITY SERVICE
DESIGNED TO REALIZE A REASONABLE RATE OF
RETURN ON THE FAIR VALUE OF ITS PROPERTY
THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. W-01732A-12-0315

CLOSING BRIEF

The Residential Utility Consumer Office (“RUCO”) files its Closing Brief in the above referenced matter. RUCO will address the Settlement Agreement (“Settlement”) first and then the remaining issue of the System Improvement Benefit mechanism for Global Water Utilities Willow Valley System (“SIB”).

1) INTRODUCTION

First and foremost, RUCO would like to reiterate that RUCO supports the Settlement. RUCO apologizes for any confusion that may have occurred during the hearing of this matter. RUCO signed the Settlement, agrees with the Settlement and will not withdraw from the Settlement should the Commission decide the SIB issue adverse to RUCO’s position.

The SIB issue is more complicated from RUCO’s perspective but not new to the Commission. RUCO’s position on the SIB in this case is no different than its position in the pending Arizona Water (Eastern and Northern Division) cases. Moreover, the reasons why RUCO opposes the SIB in this case are for the most part the same as in the other cases. In the interests of

1 brevity, RUCO will highlight those reasons but would refer the Commission to the Eastern and
2 Northern Group¹ for the complete analysis.

3 **2) THE SETTLEMENT IS IN THE PUBLIC INTEREST AND SHOULD BE**
4 **APPROVED**

5 The Settlement is in the public interest. It is a fair and reasonable resolution to a case that
6 had many difficult and contentious issues. The negotiations were also conducted in a fair and
7 reasonable way that allowed all of the parties to participate. R-5 at 2².

8 RUCO supports the Agreement primarily because of the following benefits.

- 9 • Rate increases for authorized expenses phased in over three years with no increase in
10 the first year
- 11 • Rate increases for resolution of ICFA's phased in over eight years with no increase in
12 the first year
- 13 • Revenue requirement that was less than 50 percent of what the Company requested
- 14 • Resolution of all issues concerning ICFA's
- 15 • Stay out provision until at least May 31, 2016 for filing a rate case
- 16 • Future investment must be funded with debt, equity, hookup fees and main extension
17 agreements
- 18 • Code of Conduct to be developed to define how certain transactions between Global
19 and other entities would operate in the future
- 20
- 21

22 R-5 at 5.

23 RUCO further believes that the Settlement is in the public interest because it provides
24 favorable terms and protections for residential customers as set forth above and it is a fair and
25

26 ¹ Eastern Group – W-01445A-11-0310; Northern Group – W-01445A-12-0348

27 ² For ease of reference, trial exhibits will be identified similar to their identification in the Transcript of Proceedings.
The transcript volume number will identify references to the transcript

1 balanced approach to addressing the Company's concerns raised in its Application and testimony.
2 RUCO recommends that the Commission approve the Settlement.

3 **3) THE COMMISSION SHOULD REJECT THE SIB**

4 The issue of the SIB, from RUCO's perspective, is not just specific to this case. Nor, are
5 there circumstances in this case that cause RUCO to deviate from its position in other cases where
6 the SIB is in contention. RUCO opposes the SIB for both policy and legal reasons.

7 **A) THE SIB SHIFTS RISK FROM THE COMPANY TO THE**
8 **RATEPAYER WITHOUT ADEQUATE FINANCIAL**
9 **CONSIDERATION TO THE RATEPAYER**

10 The SIB mechanism reduces regulatory lag in the favor of Global Water Utilities Willow
11 Valley System because the Company will not have to wait until new rates go into effect to recover
12 a return on SIB eligible plant or the depreciation expense associated with it. R-4 at 6-9. However,
13 any actual cost savings, such as lower operating and maintenance expenses, attributable to the new
14 plant are not captured by the mechanism and are not flowed through to ratepayers. Id. The reason
15 for the mismatch is the SIB filings will consider eligible plant placed in service after the time
16 period considered in the rate case. Hence, the operating expenses associated with the SIB plant
17 as well as all of the other rate case elements normally considered in a rate case will not be
18 considered. Id. This mismatch works against the ratepayer's interests and assures that ratepayers
19 will not pay their actual cost of service and will more than likely pay more over time.

21 Ratepayers will be paying for the recovery of and return on routine plant placed into
22 ratebase in between rate cases that the ratepayer would not otherwise pay until the next rate case.
23 To the extent the ratepayer receives a benefit through the efficiency credit on the increased
24 revenues associated with the SIB related plant that paltry benefit is only available until the next
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1 rate case filing. At that time the relevant plant is rolled into the ratebase and subject to the ROR
2 awarded in the next rate case.

3 Another argument advanced in support of the SIB that is linked to the financial benefit is
4 that the SIB will promote rate gradualism. Transcript at 881, 899. Even if one were to buy into
5 this argument, it comes at a cost. Ratepayers are likely to pay higher rates over time because of
6 the failure to consider all of the rate case elements at each SIB filing. Gradualism will also come
7 at the expense of rate stability. Ratepayer's rates will change yearly as the result of each SIB
8 filing.
9

10 Each filing will also result in a rate increase. For reasons which will be addressed below,
11 the SIB is not an adjustor. Ratepayers will see no actual cost savings that might be realized and
12 will no longer benefit from the rate stability that exists under the present ratemaking procedure.
13 The Commission should reject the SIB.

14 **B) THE SIB IS ILLEGAL IN ARIZONA**

15 RUCO incorporates the legal arguments it made on this subject in the AWC Eastern Group
16 Case. The SIB is a DSIC type mechanism, and the same arguments apply³. In all fairness to Staff
17 in the Eastern Group case, Staff did not foreclose the possibility that a DSIC mechanism could be
18 constitutional. According to Staff, "...where exceptional circumstances exist, and a mechanism
19 for a future rate adjustment is adopted in the context of a rate case as part of a utility's rate
20 structure and if that mechanism meets the constitutional requirements that rate base is determined
21 and the overall impact on the rate of return prescribed, that mechanism will not violate the Arizona
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26 ³³ See W-01445A-11-0310 - RUCO Opening Brief at 11-14 (Phase I), RUCO Reply Brief at 2-5, (Phase I). RUCO
27 also incorporates the legal arguments made by Staff in its Opening Brief (pps. 25-28, Phase I) and Reply Brief (pps.
19-23, Phase I) to the extent they are consistent with RUCO's legal arguments.

1 Constitution.”⁴ As was the case with the Eastern Group and the Northern Group before this case
2 there is nothing exceptional about this case, and the SIB does not meet the Constitution’s Fair
3 Value Requirement.

4 **C) THE SIB IS NOT AN ADJUSTOR MECHANISM**

5 At the risk of being repetitive it is important to establish what the SIB is and what it is not
6 when considering its constitutionality. The Arizona Constitution protects consumers by generally
7 requiring that the Commission only change a utility’s rates in conjunction with making a finding
8 of the fair value of the utility’s property.⁵ However, Arizona’s courts recognize that, “in limited
9 circumstances,” the Commission may engage in rate making without ascertaining a utility’s rate
10 base.⁶ One of those circumstances exists where the Commission has established an automatic
11 adjustor mechanism. *Scates v. Arizona Corp. Comm’n*, 118 Ariz. 531, 535, 578 P.2d 612, 616;
12 *Residential Util. Consumer Office v. Arizona Corp. Comm’n (“Rio Verde”)*, 199 Ariz. 588, 591 ¶
13 11, 20 P.3d 1169, 1172. An automatic adjustor mechanism permits rates to adjust up or down “in
14 relation to fluctuations in certain, narrowly defined, operating expenses.” *Scates* at 535, 578 P.2d
15 616. An automatic adjustor permits a utility’s rate of return to remain relatively constant despite
16 fluctuations in the relevant expense. An automatic adjustor clause can only be implemented as
17 part of a full rate hearing. *Rio Verde* at 592 ¶ 19, 20 P.3d 1173, *citing Scates* at 535, 578 P.2d 616.
18

19 The Commission has also defined adjustor mechanisms as applying to expenses that
20 routinely fluctuate widely. In a prior decision in which it eliminated APS’ fuel and power
21 adjustor, the Commission stated:
22
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24 ⁴ See W-01445A-11-0310 Staff’s Opening Brief (Phase 1) at 26 citing *Scates v. Ariz. Corp. Comm’n*, 118 Ariz. 531,
25 533, 578 P.2d 612, 614 (App. 1978).

26 ⁵ Arizona Constitution. Art. XV, § 14; *Simms v. Round Valley Light & Power Company*, 80 Ariz. 145, 151, 294 P.2d
27 378, 382 (1956); see also *State v. Tucson Gas*, 15 Ariz. 294, 308; 138 P.781, 786 (1914); *Arizona Corporation
Commission v. State ex rel. Woods*, 171 Ariz. 286, 295, 830 P.2d 807, 816 (1992).

⁶ *Residential Utility Consumer Office v. Arizona Corporation Commission*, 199 Ariz. 588, 591 ¶11, 20 P.3d 1169,
1172 (App. 2001).

1 The principle justification for a fuel adjustor is volatility in fuel
2 prices. A fuel adjustor allows the Commission to approve changes
3 in rates for a utility in response to volatile changes in fuel or
purchased power prices without having to conduct a rate case.
(Decision No. 56450, page 6, April 13, 1989).

4 The Commission went on to discuss the undesirability of such adjustors because they can cause
5 piecemeal regulation that is inefficient and undesirable. *Id.* at 8. *See also Scates* at 534, 578 P.2d
6 615.

7 In the subject case, the SIB clearly is not an adjustor mechanism – its purpose is not to
8 account for fluctuating operating expenses. Its purpose is to allow for recovery of plant costs
9 which increase rate base and thereby increase operating income. Unlike an adjustor, the SIB does
10 not allow for rates to adjust “in relation to fluctuations in certain, narrowly defined, operating
11 expenses.” Moreover, the SIB only permits rates to adjust up, not down as the result of allowing
12 for the SIB related plant recovery.
13

14 Even if one could set aside the argument that Arizona’s courts have only recognized
15 adjustors for very limited operating expenses and not for operating income, the SIB mechanism
16 still would not qualify as an adjustor because the justification for the mechanism is not the
17 volatility in the price of the plant. As explained, the concern here is the amount of the investment,
18 and no case law parities the need for an adjustor mechanism with the magnitude of investment in
19 plant. The SIB is not an adjustor mechanism nor should the exception be expanded in any manner
20 to treat it as such.
21

22 **D) THE COMPANY HAS NOT REQUESTED INTERIM RATES**
23

24 The only other circumstance where the Commission may engage in rate making without
25 ascertaining a utility’s rate base involves requests for interim rates.⁷ The Commission’s authority
26 to establish interim rates is limited to circumstances in which 1) an emergency exists; 2) a bond is

27 ⁷ *Scates v. Ariz. Corp. Comm’n*, 118 Ariz. 531, 533-35, 578 P.2d 612, 614-16 (App. 1978).

1 posted guaranteeing a refund if interim rates are higher than final rates determined by the
2 Commission; and 3) the Commission undertakes to determine final rates after making a finding of
3 fair value.⁸ The Arizona Attorney General has opined that an emergency exists when “sudden
4 change brings hardship to a company, when a company is insolvent, or when the condition of the
5 company is such that its ability to maintain service pending a formal rate determination is in
6 serious doubt.”⁹

7
8 The Company has not asserted an emergency nor requested interim rates. Regardless, and
9 perhaps the reason why the Company has not asserted an emergency, is because the Company
10 would not meet the legal criteria – there is no evidence of a sudden change that has brought
11 hardship, no insolvency issue, or evidence that the Company has an inability to maintain service in
12 the interim or long term for that matter.

13 The provisions of Arizona’s Constitution should be liberally construed to carry out the
14 purposes for which they were adopted.¹⁰ Conversely, exceptions to a constitutional requirement
15 should be narrowly construed.¹¹ Essentially, the Commission should not use the “emergency”
16 exception or the adjustor mechanism exception liberally as an excuse to set aside the rule of
17 finding fair value when setting rates.¹²

19 **E) THE SIB WILL INCREASE THE COMPANY’S FAIR VALUE RATE**
20 **BASE WITHOUT ANY DETERMINATION OF FAIR VALUE**

21 Having established that the SIB does not meet any of the criteria required by Arizona’s
22 Courts to side-step the Constitution’s fair value requirement, the question then becomes whether
23 or not the SIB complies with the Constitution’s fair value requirement. First, it is important to

24 ⁸ 199 Ariz. at 591, ¶12, citing *Scates*.

25 ⁹ 71-17 Opinion Arizona Attorney General at 50. (1971).

26 ¹⁰ *Laos v. Arnold*, 141 Ariz. 46, 685 P.2d 111 (1984).

27 ¹¹ See *Spokane & I.E.R. Co. v. U.S.*, 241 U.S. 344, 350, 36 S.Ct. 668, 671 (1916) (an “elementary rule” that exceptions from a general policy embodied in the law should be strictly construed).

¹² Arizona case law and the Attorney General Opinion 71-17 set forth the legal parameters within which the Commission should act when considering emergency rate relief.

1 recognize what the SIB is – it is a mechanism, not an adjustor mechanism, which will allow for
2 the recovery of, and a return on routine plant in between rate cases, needed to address the
3 Company’s plant and improvement needs.

4 Next, there is a question of whether exceptional circumstances exist for the extraordinary
5 ratemaking being contemplated. The Commission has also determined that cost recovery
6 mechanisms designed to side-step the fair value requirement should only be allowed in
7 extraordinary circumstances. For example, see Decision No. 70351 at 36. There is nothing
8 extraordinary about this case. R-4 at 7. In the Eastern case, Staff’s Director, Steve Olea provided
9 insight on this important consideration. In that case, Staff concluded that the Company had not
10 demonstrated extraordinary circumstances in the underlying case to justify the Company’s
11 proposal.¹³ When asked in the Phase II hearing what has changed, Mr. Olea responded the
12 Commission’s request that the parties were all directed to talk about the DSIC¹⁴. In Staff’s view, a
13 Commission directive to look at the DSIC constitutes an extraordinary circumstance. Staff’s
14 definition of “extraordinary” was even more murky and inconsistent¹⁵ when one considers that the
15 Commission in the last Arizona Water Company wide rate case ordered the Company to do a
16 DSIC study and report on it in this case. Decision No. 73736 at 14-15. While it does not appear
17 that Arizona’s case law defines extraordinary or exceptional, it is doubtful that it would include
18 the Commission’s directive in the Eastern case. For example, *Scates* did define what was needed
19 for interim rates – an emergency which is far more tangible than a mere directive. *Scates v. Ariz.*
20 *Corp. Comm’n*, 118 Ariz. 531, 535, 578 P.2d 612, 616 (App. 1978). Likewise, there is nothing
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26 ¹³ W-01445A-11-0310 - S-3 at 35 (Phase I).

27 ¹⁴ W-01445A-11-0310 -Transcript at 301- (Phase II). .

¹⁵ I.e. it was not extraordinary when Staff considered the Company’s proposed DSIC but was extraordinary in consideration of the Eastern Group’s Settlement’s proposed DSIC.

1 exceptional in this case which would constitute exceptional circumstances and warrant the
2 inclusion, recovery, and return on routine plant in between rate cases.

3 Finally, comes the question of exactly how the SIB works mechanically and whether it
4 meets the fair value requirement. In this case, based on the evidence that is a mystery. There was
5 no plan of administration filed. Mr. Walker initially talked about a DSIC and CSIC in his direct
6 testimony. A-13 at 20- 28. Mr. Walker discusses the DSIC in a general sense throughout his
7 testimony. Mr. Walker also explained how the “SIB Mechanism” works in his testimony in
8 support of the Settlement - but, he does not explain the mechanics of the mechanism. A-30 at 11-
9 12. Mr. Fleming likewise discusses the SIB but also does not explain the mechanics of it nor is it
10 explained in the Company’s September 4 revised engineering report filing. A-19. Staff’s witness,
11 Jian Liu also testified on the SIB but like the Company does not explain the mechanics. S-6.
12 Based on the evidence, or lack thereof, RUCO can only assume that the proposed SIB in this case
13 will follow the Eastern group “template”. R-8. The haphazard nature of the evidence surrounding
14 the mechanics of the SIB is symptomatic of a more arching concern that RUCO has with the SIB
15 proposed in this matter. The late timing of the Company’s SIB testimony, and the short period of
16 the Commission Staff’s review and turn around filings are hardly sufficient to have done an
17 adequate analysis of a SIB. R-8 at 7. The Company submitted its Revised Engineering report on
18 September 4, 2013 and Staff’s Engineer filed his testimony on September 6, 2013 recommending
19 approval of the SIB. Id. at 6-7.

22 One thing that is for sure is the SIB in this case will be established as part of the pending
23 rate case. Under the Eastern Group template, within 12 months of the date of the Commission’s
24 final decision, AWC will be able to file a request to implement the SIB surcharge¹⁶. The
25 Company will be able to file for the SIB surcharge no more than five times between rate case
26

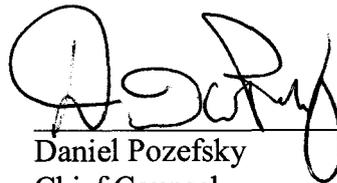
27 ¹⁶ W-01445A-11-0310 (Phase II) A-1 at 5, Section 4.2.

1 decisions.¹⁷ The Commission will ultimately consider and then may approve each surcharge
2 filing. The Commission, however, will not be making a new FVRB finding as part of each
3 surcharge filing in such a way as to make fair value meaningful. As Staff noted concerning the
4 DSIC in Phase I of the Eastern Group, the SIB will do far more than simply pass on increasing
5 costs to the Company - it will allow "...surcharges based on the cost of the new plant, effectively
6 increasing the fair value rate base without any determination by the Commission of what that fair
7 value is."¹⁸ The SIB suffers from the same constitutional deficiency effectively making it illegal
8 in Arizona.
9

10 **CONCLUSION**

11 For the reasons stated above, the Commission should not approve the SIB in this case.
12

13 RESPECTFULLY SUBMITTED this 18th day of October, 2013.
14

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16

17 Daniel Pozefsky
18 Chief Counsel
19

20
21 AN ORIGINAL AND THIRTEEN
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23 18th day of October, 2013 with:

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¹⁷ W-01445A-11-0310 (Phase II) A-1 at 5, Section 4.4.

¹⁸ W-01445A-11-0310 (Phase I) See Staff Opening Brief at page 26.

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