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BEFORE THE ARIZONA CORPORATION COMMISSION

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ARIZONA CORPORATION COMMISSION
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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

REPLY BRIEF

RUCO has addressed most of the arguments raised by the Company and Staff in support of the SIB in its Opening Brief. To that extent, RUCO would incorporate by reference those arguments raised in its Opening Brief. RUCO Brief at 4-11. RUCO replies to the following points raised in the Company and Staff's Opening Briefs.

1) The benefits of the SIB to ratepayers.

The Company and Staff claim that the SIB would provide significant benefits to ratepayers at a minimal cost. Company Brief at 24. The SIB, according to the Company, would permit the Company to replace and upgrade its aging infrastructure in a timely and efficient manner, while providing more gradual and smaller rate impacts on those customers. Id. Moreover, the SIB will reduce regulatory lag on the SIB related investments. Id.

These benefits do not outweigh the costs to the ratepayer. The Company is obligated to provide safe and reliable drinking water. That is part of the regulatory compact – the Company

1 provides safe and reliable drinking water in exchange for the ability to operate in a defined service
2 territory where there is no competition (i.e. captive ratepayers). The Company is further provided
3 the opportunity to earn its authorized rate of return and may seek rate relief if it is unable to do so.
4 The Company benefits under this system – it does not have to compete to sell its service and at
5 any time if it believes it is necessary it can apply to the Commission for a revenue increase. The
6 Company should not have to be incentivized by regulatory gimmicks to do what it has agreed to
7 do. Ratepayers should also not have to pay extra in order for the Company to fulfill its obligation
8 to serve.
9

10 The Company has had this infrastructure for a long time - 50 years. Company Brief at 23.
11 Why, all of a sudden is the Company facing an infrastructure crisis that needs to be solved
12 immediately and by extraordinary ratemaking? And why should all of the financial risk now be
13 shifted onto the backs of ratepayers? If there really is a financial crisis, the Company put itself in
14 that situation by waiting as long as it has to make the necessary repairs and the distribution system
15 does not have to be repaired in its entirety right now. The Company even admits so – the
16 Company has come up with a 20 year plan to replace most of its distribution system. Transcript at
17 811, Company Brief at 23. The Company can make the repairs and recover the costs by
18 traditional ratemaking and over time.
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20 The Company would rather focus on its perceived benefits rather than the costs to
21 ratepayers. In truth, the benefits of the SIB are far greater to the Company than the ratepayer. The
22 Company will now be allowed to recover and earn a return on plant placed into ratebase in
23 between rate cases. Moreover, this plant will be considered alone outside of a rate case and not
24 along with all the other rate case elements. The plant being considered is routine infrastructure.
25 That is not to say that RUCO does not recognize a possible benefit to the ratepayer of more
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1 frequent and smaller, incremental rate increases. It is easier to accommodate small increases than
2 larger ones. But all things are not equal. The use of the SIB will result in greater costs to the
3 ratepayers than traditional ratemaking. As discussed in RUCO's Opening Brief, the SIB removes
4 the utility's inherent incentive to effectively manage its costs in between rate cases. Furthermore,
5 5 percent efficiency credit is a paltry quid pro quo to the ratepayer. The SIB results in inflated
6 rates since it does not recognize the true operational efficiencies associated with the replacement
7 of old plant with new plant. The cost of the SIB to ratepayers far outweighs the benefits to
8 ratepayers which explains, at least in part, why so many states have not adopted a SIB or a DSIC
9 type
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11 The Company refers to the similarity of the policy and the legal arguments in the Arizona
12 Water decision. The whole genesis of the DSIC discussion goes back to Arizona Water's multi-
13 district case several years ago. In Decision No 71845, the Commission followed Staff's
14 recommendation for a process which would reduce the non-account water for each system below
15 ten percent. Decision No. 71845 at 76. The Commission's Decision was directed at AWC, not
16 the whole water industry. The Commission's directive was not meant to be absolute - the
17 Commission did not make it a requirement that the AWC achieve a water loss of less than 10
18 percent at any cost. In fact, the Decision required AWC to submit a detailed cost analysis if AWC
19 contended that reaching the Commission's objective would not be cost effective. Id. The
20 Commission's Decision No. 71845 placed cost as a major consideration. Finally, the relevant
21 provisions that the Commission adopted were recommended by the Staff. Staff did not
22 recommend then nor is it recommending now the adoption of a SIB in order for the Company to
23 comply with Decision No. 71845.
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1 The purpose of the SIB has morphed to something beyond the Commission's concerns
2 expressed in Decision No. 71845. No longer is actual water loss even a consideration. Now it
3 seems to be a subjective determination that a water utilities plant is old and needs to be replaced –
4 routine plant at that. The cost consideration has also morphed somehow. There is no question that
5 the Commission meant in Decision 71845 that AWC was to achieve the objective of less than 10
6 percent water loss in a cost effective manner. RUCO, in its Opening brief, explained in detail why
7 the SIB is not cost effective. Among other things, the SIB will result in inflated rates – the exact
8 opposite of cost effective rates. The Commission should reject the SIB.
9

10 **2) The Legal Issues**

11 Again, the legal arguments raised by the Company and Staff are the same. The parties can
12 all agree at least that the “adjustor mechanism” is one of the very limited exceptions to Arizona’s
13 fair value requirement. *See Scates v. Arizona Corp. Comm’n*, 118 Ariz. 531, 535, 578 P.2d 612,
14 616; *Residential Util. Consumer Office v. Arizona Corp. Comm’n (“Rio Verde”)*, 199 Ariz. 588,
15 591 ¶ 11, 20 P.3d 1169, 1172. RUCO differs with the Company and Staff on whether the SIB is
16 an adjustor as defined in *Scates*. The Company refers to the Arsenic Cost Recovery Mechanism
17 (“ACRM”) for legal support. Company Brief at 25. But the ACRM’s legality has not been called
18 into question or reviewed by an Arizona court. Given the very narrow interpretation the Arizona
19 courts have given adjustor mechanisms and what qualifies as an adjustor mechanism, whether the
20 ACRM meets the adjustor criteria is questionable and should not be presumed. Hence, the ACRM
21 should not be the legal standard used to judge the legality of the SIB. The legality of the ACRM is
22 not in question in this case – the legality of the SIB is in question. In ascertaining whether the SIB
23 is legal, the legality of the ACRM is therefore irrelevant which explains why RUCO did not
24 include it in its legal analysis in RUCO’s Opening Brief.
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1 a) **Staff's legal analysis is misplaced.**

2 Staff essentially concludes that the SIB does not violate Arizona's Constitution based on
3 the argument that the Commission has wide discretion when it comes to ratemaking. Staff Brief at
4 34-37. RUCO does not take issue with the Company that the Commission has wide discretion
5 when it comes to ratemaking. That wide discretion, however, is not without limits.

6 With regard to the specific and limited area of increasing rates outside of a rate case, which
7 is what the SIB does, the Commission's discretion is very limited. *See Scates, supra*. Arizona's
8 courts recognize that, "in limited circumstances," the Commission may engage in rate making
9 without ascertaining a utility's rate base. *Residential Utility Consumer Office v. Arizona*
10 *Corporation Commission*, 199 Ariz. 588, 591 ¶11, 20 P.3d 1169, 1172 (App. 2001). The SIB is
11 not "consistent" with those limited circumstances for all of the reasons stated in RUCO's Opening
12 Brief. See RUCO Opening Brief at 6-11. Arizona, unlike the other states with DSIC's or DSIC-
13 like mechanisms, has a constitutionally mandated fair value requirement. The SIB does not meet
14 Arizona's fair value requirement nor does it qualify as an exception.
15

16 Next, Staff argues that the SIB would require updated filings and these filings would
17 satisfy the Fair Value finding. Staff Brief at 34-35. According to Staff, to argue that the updates
18 to the rate base would not comply with the Constitution implies "... that the Commission will
19 ignore this information..." Staff Brief at 35. Staff's argument is absurd and its premise is
20 misguided. Staff's premise appears simple – all the Company has to do is update its ratebase
21 yearly to meet the fair value requirement. RUCO is unable to find any case in Arizona that that
22 supports Staff's premise. Why would the Company or any Company bother with a rate case if all
23 it had to do legally is update its rate base yearly? RUCO is not suggesting that the Commission
24 would not review the updates – that argument is a red herring and has no basis in fact. The review
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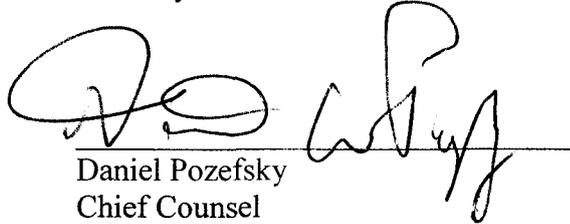
of the updates does not provide a meaningful fair value determination as Staff and the Company claims.

Finally, Staff raises the so called “third exception” to the fair value finding – the “exceptional situation” argument that is mentioned in *Scates*. Despite Staff’s argument to the contrary, *Scates* never defined exceptional situations as an exception to the Constitutional fair value requirement. Staff’s interpretation is a legal fiction. Besides, for the reasons stated in RUCO’s Opening Brief there are no exceptional situations that distinguish this case. RUCO Brief at 9. There is no legal basis for the SIB in Arizona.

3) Conclusion

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

RESPECTFULLY SUBMITTED this 31st day of October, 2013.


Daniel Pozefsky
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