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BEFORE THE 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 EASTERN GROUP
 19 AND FOR CERTAIN RELATED
 20 APPROVALS.

Docket No. W-01445A-11-0310

Arizona Corporation Commission
DOCKETED

DEC 20 2013

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RUCO'S CLOSING BRIEF – APPLICATION FOR REHEARING

21 RUCO's reason for filing its Application was not because it supports the SIB or a 10
 22 percent ROE for that matter. In fact, RUCO believes that the approval of a SIB and a 10
 23 percent ROE is unwarranted under the circumstances of this case. RUCO, however, believes
 24 that a SIB and a 10 percent ROE award is a better result for the ratepayer than a SIB and a
 10.55 percent award. Given the alternatives, RUCO would not oppose a 10 percent ROE and
 SIB under the circumstances of this case.

Looking beyond the decline in the ROE awards around the countries, the studies of the
 growing infrastructure replacement needs of utilities around the country, the different
 interpretations of the Phase 1 order and the Phase II ROO, what the Commission did in this

1 case was to look at its decision in the Company's 2012 Western Group case where it adopted
2 a 10 percent ROE, and no DSIC. The Commission then awarded a higher ROE in this case -
3 10.55 percent, to address the Company's "increased need for infrastructure replacement and
4 improvement." Decision No. 73736 at 61. The purpose of the SIB, which no one disputes is to
5 do exactly the same thing – address the "Company's need for infrastructure replacement and
6 improvement." RUCO believes that both were done to achieve the same goal and the
7 Commission made a mistake at the ratepayers' expense.

8
9 **THE 10.55 PERCENT ROE AWARD IS UNREASONABLE, EXCESSIVE AND ILLEGAL. IN
10 ADDITION, THE SIB IS ILLEGAL.**

11 The purpose of a § 40-253 rehearing is to afford the Commission an opportunity to
12 correct its own mistakes before the matter is brought to the court. *Cogent Public Service, Inc.,
13 v. Arizona Corp. Commission* (App. Div.1 1984) 142 Ari. 52, 688 P.2d 698. RUCO has at
14 length explained why it feels the Commission has made mistakes in awarding a higher ROE
15 and why the SIB is illegal. RUCO incorporates the arguments made in the following filings in
16 support of its arguments:

17 Application for Rehearing – pages 3-6 (ROE and SIB)

18 Phase II Closing Brief – pages 4-11 (Illegality of the SIB), pages 13-19 (other reasons
19 why the SIB should not be adopted)

20 RUCO Opening Brief at 11-14 (Phase I similar legal arguments concerning the
21 proposed DSIC), RUCO Reply Brief at 2-5, (Phase I).

22 In addition, RUCO agrees with the logic of that portion of the Phase II ROO which
23 states:

1 In adopting a higher ROE for AWC in Phase 1 than would
2 otherwise have been authorized, we believe the Company's
3 infrastructure replacement needs were recognized, at least in
4 part. Our approval of the proposed SIB mechanism in this
5 Phase 2 proceeding is also intended to enable AWC to pursue
6 its replacement and improvement needs in a more timely
7 manner and, therefore, at least partially achieves the same goal
8 that was contemplated in awarding the Company a higher ROE
9 in Phase 1. (See Tr. 274-275.)

10 We therefore find that the 10.55 percent ROE authorized in
11 Phase 1 should be adjusted downward to 10.0 percent to
12 reflect that commonality of purpose. We believe that a 10.0
13 percent ROE is reasonable under the circumstances of this
14 case, especially given the authorized Western Group ROE of
15 10.0 percent (with no SIB mechanism) in Decision No. 73144,
16 and AWC's recent settlement in the pending Northern Group
17 case (Docket No. W-O1445A-12-0348) reflecting a 10.0
18 percent ROE (which includes a nearly identical SIB mechanism
19 to the one approved herein).

20 RUCO understands that the Commission did not adopt this reasoning in its Decision nor
21 is bound by it. RUCO references it solely for the purpose of noting that RUCO agrees with the
22 reasoning that the two achieve the same end.

23 Both Staff and the Company seem to suggest that the Commission's authority and
24 discretion is without bounds. Mr. Olea testified "This Commission has the authority and
discretion, based on the evidence presented to it, to make whatever decision is just and
reasonable for the utility at that time." Staff RH-1 at 6. When asked by Staff's attorney, Mr.
Reiker testified:

Q. And, finally, you discussed briefly the breadth of the
Commission's discretion. Is it your understanding that that
discretion is without limit or without tie to any kind of authority?

A. It is my general understanding, yeah, it is pretty
broad.

1 Transcript at 199. RUCO does not take issue with the fact that the Commission has great
2 authority and discretion. But RUCO does not believe that the Commission's authority and
3 discretion is without bounds – legal or otherwise. As even Mr. Olea notes – rates need to be
4 just and reasonable. A higher ROE award whose purpose is duplicative does not result in just
5 or reasonable rates.

6 The unfairness of the 10.55 ROE under the circumstances of this case is further
7 highlighted by several factors. In the rehearing, Mr. Parcell updated the COE for AWC as
8 being in the range of 8.5 percent to 10 percent with a mid-point estimate of 9.25 percent.
9 RUCO RH-4 at 14-15. By comparison, average authorized return on equity for water utilities in
10 other states in the country over the past four years has been trending downward, and within
11 the last two years the trend has been below 10 percent. Id. at 16, DCP-7. In Arizona, 18 of 20
12 of the recently authorized returns on equity for Arizona Water Utilities has been 10 percent or
13 less. Id., DCP-9.

14 What makes this case unusual is this is the first case to implement a SIB – so awarding
15 a significantly higher ROE than almost all of the other water utilities makes no sense. The SIB
16 will increase the Company's cash flow in between rate cases and reduce regulatory lag related
17 to cost recovery of the subject infrastructure. RUCO RH-2 at 6. The SIB provides for a
18 quicker recovery of capital costs on the infrastructure than would typically occur. Id. These
19 facts are undisputed. If the SIB reduces risk - it is a mistake for the Commission to increase
20 the ROE¹.

21
22
23 ¹ RUCO believes that the efficiency credit is paltry and is not a quid pro quo to the ratepayer in terms of
24 benefit.

1 The logic disconnect is further supported by Staff's position on the ROE in the
2 underlying case. Staff in its Direct case in Phase I recommended a 9.1 percent ROE.
3 Decision 73736 at 58. In surrebuttal Staff updated its recommendation to 9.4 percent. Id. at 60.
4 Staff opposed the Company's original DSIC proposal. Staff further opposed the Company's 90
5 basis point risk premium recommendation because Staff believes that the Commission has
6 previously determined that the utility size does not warrant recognition of a risk premium for
7 regulated utilities and because investors are able to eliminate firm specific risks by holding
8 diversified portfolios. Id. at 59-60. Yet Staff ultimately came up 115 basis points on the ROE
9 to support the 10.55 and agreed to a SIB. Even Mr. Olea, when asked admitted that a 115
10 basis risk premium was unwarranted on its face:

11 Q. So assuming, subject to check, that that's correct, that Staff
12 did reject it, if a 90 basis point risk premium is not warranted,
13 would it also be logical to conclude that a higher risk premium
14 such as 115 basis points is similarly not warranted?

15 A. I would say yes, but I don't know how that's related to what
16 we are talking about, but yes, just on its face.

17 Q. On its face you would agree, correct?

18 A. Yes

19 Transcript at 266. Perhaps Mr. Olea was confused by the question, but his answer is
20 indicative of the point that a 10.55 percent ROE is unreasonable in this case.

21 Setting reason aside, there are legal mistakes that the Commission should correct. The
22 Commission was not only free to modify the ROE in the Phase 2 proceeding, it was required to
23 consider whether modification was necessary at the time it considered the ROO. For reasons
24 set forth in RUCO's Application for Rehearing, the Commission is not allowed to consider the
SIB in the absence of the consideration of the ROE in the same rate case. See RUCO's
Application for Rehearing at 3-4. Clearly, such a tactic raises the concern associated with

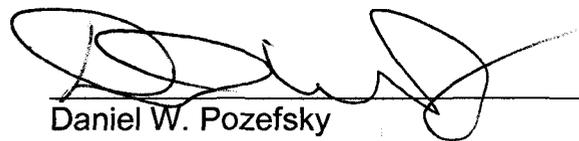
1 piecemeal ratemaking and is not only objectionable from a legal perspective but clearly is bad
2 public policy.

3 Finally, the SIB is not an Adjustor Mechanism. See RUCO Closing Brief Phase II at 4-
4 6. The purpose of the SIB is not to address narrowly defined operating expenses that permit
5 rates to fluctuate up and down – it is to address routine infrastructure replacement. *Scates v.*
6 *Arizona Corp. Comm'n*, 118 Ariz. 531, 535, 578 P.2d 612, 616; *Residential Util. Consumer*
7 *Office v. Arizona Corp. Comm'n ("Rio Verde")*, 199 Ariz. 588, 591 ¶ 11, 20 P.3d 1169, 1172.
8 Further, the SIB is a mechanism that allows the Company to recover the costs of routine plant
9 in between rate cases without a new fair value rate base finding and there are no exceptional
10 circumstances which require it. The SIB is illegal in Arizona.

11
12 **CONCLUSION**

13 For the above reasons, RUCO requests the Commission reconsider Decision No.
14 73938 and RUCO would not oppose the approval of a 10 percent COE and the SIB.

15 RESPECTFULLY SUBMITTED this 20th day of December, 2013.

16
17 
18 Daniel W. Pozefsky
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