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BEFORE THE ARIZONA CORPORATION COMMISSION

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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 EASTERN GROUP
AND FOR CERTAIN RELATED
APPROVALS.

Docket No. W-01445A-11-0310

Arizona Corporation Commission

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RUCO'S REPLY BRIEF – APPLICATION FOR REHEARING

RUCO replies to the arguments raised by the Company, Staff and other parties in their Closing and responsive Briefs as follows.

1) THE SIB AND THE 10.55% COE ARE DUPLICATIVE IN PURPOSE

Both the Company and Staff argue that the SIB and the 10.55% are not duplicative. Company Brief at 6-8, Staff Brief at 4-5. The Phase 1 Decision (Decision No. 73736) states that due to the age of the Company's systems and the resulting increased need for infrastructure replacement and improvement, there is a necessity for a somewhat higher COE. It is not a coincidence, that part of the Commission Decision is prefaced by a reference to the Western

1 Group Case which adopted a COE of 10%. There is no dispute that the whole point of the SIB
2 is to address the Company's aging infrastructure and the need for its replacement and
3 improvement – not even the Company would argue that. Based on the plain meaning of the
4 words, there is clearly a duality of purpose. There is no confusion, the words speak for
5 themselves.

6 As the following replies will show, every response that RUCO has to every argument that
7 the Company and Staff has made in their Briefs, with the exception of the legal arguments, is
8 tied to this fact.

9 The Company complains that it needs the higher COE in order to fund up-front
10 construction costs. Company Brief at 7. This argument misses the point. How is this Company
11 any different from any other water Company that needs to fund up-front construction costs? All
12 Companies need to fund up-front construction costs which are necessary to provide service.
13 Nearly all of the other utilities in AZ have an authorized COE of 10.0% or less and they have
14 needs for construction/capital (e.g., APS is 10%). RUCO RH-4 at 15-16, Exhibit DCP-9, RUCO
15 RH-5 at 6

16 But for the sake of argument, let's assume that the Company's argument has merit. The
17 Company's argument would result in the award of a higher cost of equity where the Commission
18 awards a SIB. Anything less, would "impair" the Company's ability to raise funds for up-front
19 construction. It necessarily follows then that the SIB and the COE are "expressly" related. This
20 obvious relationship debunks both the Company and Staff's arguments that the two are not
21 related. Staff RH-1 at 3, Company Brief at 5. The Company's argument suggests that the
22 Company is even more at risk with the SIB than without a SIB. RUCO believes that the COE
23 and the SIB are related, but for the reasons explained by Mr. Smith and Mr. Parcell, RUCO
24 believes the SIB reduces the risk.

1 **2) THE SIB REDUCES RISK**

2 Mr. Smith concludes that the SIB reduces risk and that the reduction to risk cannot be
3 quantified precisely. RUCO RH-2 at 6-7. Both the Company and Staff suggest that RUCO's
4 inability to quantify the impact somehow justifies the higher return on equity. Staff Brief at 2-3,
5 Company Brief at 11-12. Staff goes as far as saying that since a reduction cannot be quantified
6 there can be no corresponding reduction to the Company's 10.55% COE. Staff Brief at 3.
7 Staff's conclusion is misguided. RUCO maintains that it is not necessary to measure the impact
8 of the SIB. Nowhere in Decision No. 73736 does it show how the 10.55% COE was derived
9 from any evidence or quantitative analysis. So why must there now be a "quantitative analysis"
10 to ascertain a reduction of 55 basis points? It was the Commission's decision in Phase I that
11 cited the infrastructure improvements as reason to go from 10.0% to 10.55%. RUCO-RH-5 at 4.
12 The subsequent approval of a SIB to address the infrastructure needs again created a mis-
13 match. RUCO requests the Commission correct its mistake.

14 Moreover, the calculation of the cost of capital is more of an art than a science. The
15 Commission has often deviated from DCF and CAPM calculations to ascertain the return on
16 equity. Many aspects of the cost of equity are not quantifiable – such as market factors, interest
17 rates and risk premiums which often factor into the final cost of equity number. Staff, who talks
18 of the Commission's "great discretion to adopt rate-making tools and set rates" cannot
19 legitimately argue the other side because it fits its position in perhaps the one area where the
20 Commission has its greatest discretion in setting rates – the cost of capital.

21 It is obvious that the Company and Staff look at RUCO's Application solely as an attempt
22 to reduce the cost of equity - and hence any reduction needs to be quantified by some sort of
23 calculation. RUCO's perspective is different – the Commission awarded the Company to high
24 of a COE in the first place – the Commission did it to address the same concern as the SIB

1 addresses. The Commission, not RUCO cited the Western Group case in its Decision (No.
2 73736) and the Western Group 10 percent return on equity when explaining why the Eastern
3 Group needs a "higher COE". Decision No. 73736. No matter how much the Company and
4 Staff want to explain it away the Commission was clear. For the Company to argue that
5 RUCO's reliance on the Western Group rate case is improper to support its position is without
6 merit since the Commission relies on it to explain why it was awarding the "higher" return on
7 equity. In the Western Group case, the Commission did not award a SIB - which by itself,
8 supports a finding why the Commission made a mistake by awarding a higher COE in this case.

9 **3) RUCO'S PHASE 3 TESTIMONY IS RELEVANT**

10 Staff, the Company and EPCOR complain that RUCO's testimony on rehearing is for the
11 most part irrelevant. The Company claims Mr. Parcell's and Mr. Smith's' testimony are
12 generalized statements and irrelevant information. Company Brief at 8-9. Staff claims that
13 RUCO's evidence showing a trend downward of COE's on a national level is only minimally
14 relevant. Staff Brief at 6. Nonetheless, the Company maintains that it is "undisputed" that costs
15 of equity have increased since the Phase I decision. Company Brief at 12-13. Apparently, the
16 Company believes it determines what evidence is relevant and when it is relevant, even if the
17 Company is mistaken.

18 It is not the Company, nor Staff or RUCO who determines relevancy – it is the Judge. It
19 is noteworthy that neither Staff, the Company, nor any of the complaining parties objected to the
20 admission of the testimony in question. Transcript at 76 and 125. RUCO used "updated" COE
21 numbers (AWC was criticized in Phase I for using stale data¹) and provided extensive data on
22 authorized COEs in Arizona and the nation. While neither the Company, Staff or the other
23 complaining parties may like the fact that COE's for water, electric and gas companies are

24 ¹ RUCO RH-4 at 3

1 trending downward - below 10% nationally in the midst of a Commission Decision increasing an
2 COE 55 basis points above 10%, it is relevant information in this case. RUCO RH-4 at 15,
3 RUCO RH-5 at 8. It is even more relevant, as Mr. Parcell has testified, that 18 out of 20
4 recently authorized returns on equity for Arizona Water Utilities have been 10% or less. Id. at
5 16, Exhibit DCP-9. AWC's Eastern group "specific and extraordinary" circumstances are
6 recognized in the implementation of the SIB. The relevant question becomes "does AWC
7 deserve both the SIB and 10.55% while nearly all of the other AZ utilities and US water utilities
8 get less than 10.0%?" The answer is no.

9 **CONCLUSION**

10 For all of the above reasons², RUCO requests the Commission reconsider Decision No.
11 73938 and RUCO would not oppose the approval of a 10 percent COE and SIB.

12
13 RESPECTFULLY SUBMITTED this 24th day of January, 2014.

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15 
16 Daniel Pozefsky
17 Chief Counsel

18 AN ORIGINAL AND THIRTEEN COPIES
19 of the foregoing filed this 24th day
20 of January, 2014 with:

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22 Arizona Corporation Commission
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² RUCO has nothing to add in reply to the legal arguments raised in the parties' briefs. RUCO's legal arguments are well documented in the underlying record and address everything raised by the parties. RUCO incorporates said arguments by reference.

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