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**BEFORE THE ARIZONA CORPORATION COMMISSION**

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

**ORIGINAL**

**ARIZONA WATER COMPANY'S  
EXCEPTIONS TO RECOMMENDED OPINION AND ORDER  
(SEPARATE PHASE 3 PROCEEDINGS)<sup>1</sup>**

Pursuant to A.A.C. R14-3-110(B), Arizona Water Company (also "Company") respectfully submits the following Exceptions to the Recommended Opinion and Order ("ROO") issued on March 24, 2014. Arizona Water Company requests that the Commission reject the ROO's recommended reduction in the Eastern Group's return on equity ("ROE") because RUCO did not meet its statutory burden of proof on rehearing. As in Phase 2 of this docket, Arizona Water Company takes specific exception to the ROO's imposition of a punitive, unsupported, and improper reduction of Arizona Water Company's

<sup>1</sup> Arizona Water Company refers to the November 25 and 26, 2013 rehearing proceedings as "Phase 3" of this docket, while the proceedings that led to issuance of Decision No. 73938 are referred to as "Phase 2" and the proceedings that led to the issuance of Decision No. 73736 are referred to as "Phase 1."

1 authorized ROE from 10.55 percent, which the Commission authorized in Decision No.  
2 73736 dated February 20, 2013 and reaffirmed in Decision No. 73938 dated June 27, 2013,  
3 to 10.00 percent. The evidence RUCO presented at the rehearing does not support such a  
4 reduction. Further, the reduction is far too steep of a price for this utility to pay for the  
5 adoption of a System Improvement Benefits (“SIB”) mechanism and is a material departure  
6 from the Phase 2 Settlement Agreement.

7 **I. Introduction.**

8 On July 17, 2013, RUCO filed an application for rehearing of Decision No. 73938  
9 pursuant to A.R.S. § 40-253. In its application, RUCO argued that the Commission’s  
10 “failure” to decrease the ROE it already authorized for the Company’s Eastern Group when  
11 it approved the SIB mechanism in Decision No. 73938 was both “unlawful” and  
12 “unreasonable,” and that the SIB mechanism is illegal under Arizona law. On August 15,  
13 2013, the Commission granted RUCO’s application and also reopened Decision No. 73736  
14 for the limited purpose of “consideration of modifying the Decision [73736] concerning the  
15 determination made related to the return on equity. . . .” [Procedural Order dated August 26,  
16 2013 at p. 2, ll. 10-11]. The rehearing is known as Phase 3 of these proceedings.

17 As the applicant, RUCO has the burden of proof in this Phase 3 rehearing. *See*  
18 A.A.C. R14-3-109(G); *Arizona Corp Comm’n v. Tucson Ins. & Bonding Agency*, 3 Ariz.  
19 App. 458, 463, 415 P.2d 472, 477 (1966) (addressing the burden under A.R.S. § 40-252, the  
20 procedural path under which Decision No. 73736 is being reviewed). A.R.S. § 40-253(E)  
21 provides as follows:

22 If, after a rehearing and a consideration of all the facts, including those  
23 arising since the making of the order or decision, the commission finds that  
24 the original order or decision or any part thereof is *in any respect unjust or*  
25 *unwarranted, or should be changed*, the commission may abrogate, change or  
26 modify the order or decision, and such order or decision has the same force  
and effect as an original order or decision, . . .

27 (emphasis supplied). The evidence in the record does not support making any change to the  
28 10.55 percent ROE the Commission authorized twice already. RUCO failed to prove that a

Bryan Cave LLP  
Two North Central Avenue, Suite 2200  
Phoenix, Arizona 85004-4406  
(602) 364-7000

1 10.55 percent authorized ROE was unjust or unwarranted or should be changed. Therefore,  
2 the Commission should reaffirm the 10.55 percent ROE.

3 **II. RUCO Failed to Meet Its Burden of Proving That the ROE Is Unjust or**  
4 **Unwarranted or Should Be Changed.**

5 **A. RUCO's New Cost of Equity Analysis Invites the Commission to Engage**  
6 **in Improper Single Issue Ratemaking.**

7 **1. The Commission Should Reject RUCO Witness Parcell's**  
8 **"Updated" Cost of Equity.**

9 The Commission should reject RUCO's request that the Commission reduce Arizona  
10 Water Company's authorized ROE because it invites the Commission to engage in improper  
11 single-issue ratemaking. The ROO is incorrect when it states that RUCO's witnesses on  
12 rehearing provided "persuasive" evidence with respect to its requested reduction of the  
13 Commission's previously authorized ROE. ROO at 43. RUCO witness Mr. David Parcell  
14 purported to provide an "updated" analysis of the current cost of equity to the entire water  
15 utility industry. However, Mr. Parcell's testimony improperly invites the Commission to  
16 engage in single issue ratemaking. The Commission appropriately determined the cost of  
17 equity for Arizona Water Company's Eastern Group in Phase 1 of this proceeding *at the*  
18 *same time* it determined all other elements of the Company's cost of service based on the  
19 Company's 2010 test year. In contrast to the Commission's proper ratemaking process in  
20 Phase 1, Mr. Parcell admitted in his Phase 3 testimony that he ignored every element of the  
21 Company's cost of service, other than the cost of equity, that the Commission considered  
22 when it issued Decision No. 73736. [See Phase 3 ("P-3") Transcript ("Tr.") at 132, l. 18 –  
23 133, l. 20; 137, l. 23 – 138, l. 8; *see also* P-3 AWC RH-2 (Reiker Prefiled Rebuttal) at 3, l.  
24 10 – 4, l. 13].

25 Indeed, Mr. Parcell admitted under cross-examination that not only would the cost of  
26 equity already reflect the effect of a SIB mechanism on risk, but that his analysis was not  
27 specific to Arizona Water Company's Eastern Group. [P-3 Tr. at 132, l. 18 – 133, l. 20].  
28 Instead, Mr. Parcell conducted a limited discounted cash flow study and relied on a survey  
of ROEs recently authorized by various regulatory commissions around the country to

1 stretch to a conclusory opinion that any ROE exceeding 10.0 percent for any water utility at  
2 this time (*i.e.*, three years after the end of the test year in this proceeding) would be  
3 unreasonable. [*Id.* at 132, l. 18 – 133, l. 11; 137, ll. 13-22]. In other words, through Mr.  
4 Parcell’s testimony in Phase 3, RUCO appears to have abandoned the argument it made in  
5 Phase 2 and its application for rehearing that the Commission acted “unreasonably” and  
6 “unlawfully” by not lowering Arizona Water Company’s authorized ROE based on RUCO’s  
7 argument that the SIB mechanism “reduces risk.” Instead, RUCO argues for a complete  
8 update of a single element of Arizona Water Company’s revenue requirement – the cost of  
9 equity – without factoring in any other element of that revenue requirement as required by  
10 Arizona law.

11 **2. Lowering the ROE as Provided in the ROO Constitutes Single**  
12 **Issue Ratemaking in Violation of the Arizona Constitution.**

13 As RUCO has repeatedly pointed out in this proceeding, *see* ROO at 25, the “Arizona  
14 Constitution ... generally require[es] that the Commission only change a utility’s rates in  
15 conjunction with making a finding of the fair value of the utility’s property.” [*See also*  
16 RUCO’s Closing Brief – Phase II (April 29, 2013) at 4]. Arizona courts have held that the  
17 state Constitution requires that the Commission consider all relevant ratemaking elements,  
18 subject to exceptions for exigencies such as the SIB mechanism or adjustor mechanisms,  
19 and to avoid single issue and piecemeal approaches to setting a utility’s rates. *See* Arizona  
20 Constitution. Art. XV, § 14; *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 151,  
21 294 P.2d 378, 382 (1956).

22 Consistent with this constitutional mandate, in this case the Commission is required  
23 to fully examine and determine the fair value of the Company’s property in order to set “just  
24 and reasonable” rates and charges and to provide the Company with a “reasonable return  
25 upon the fair value of its properties at the time the rate is fixed.” *Simms*, 80 Ariz. at 153,  
26 294 P.2d at 383. When changes to a utility’s rates are undertaken outside the context of a  
27 rate case, those changes must still generally consider the relevant ratemaking elements and  
28 account for the impact of the changes on the utility’s authorized rate of return. *Scates v.*

1 *Arizona Corp. Comm'n*, 118 Ariz. 531, 537, 578 P.2d 612, 618 (App. 1978) (recognizing  
2 that full rate case consideration may not always be required, but holding that the  
3 Commission “was without authority to increase the rate without any consideration of the  
4 overall impact of that rate increase upon” the utility’s authorized rate of return).

5 RUCO did not introduce any evidence in Phase 3 that would allow this Commission  
6 to consider any of the other ratemaking elements that may have changed since the 2010 test  
7 year, such as expenses, reduced demand or changes in capital structure, as required by the  
8 Arizona Constitution, the *Simms* case or the *Scates* case. Instead, RUCO presented single-  
9 issue evidence in the form of Mr. Parcell’s new analysis and other evidence that ignored the  
10 current conditions the Company faces in its Eastern Group.

11 The ROO erroneously adopts this unconstitutional approach. It reduces the ROE the  
12 Commission has authorized twice to date without any consideration of the impact of that  
13 change or whether it will still allow Arizona Water Company to earn a reasonable rate of  
14 return. *See Scates* 118 Ariz. at 534, 578 P.2d at 615 (noting that a utility is entitled to earn  
15 “reasonable rate of return” based on “just and reasonable rates”). As a result, the ROO’s  
16 recommended adoption of a new ROE at this late date constitutes single issue ratemaking  
17 prohibited by the Arizona Constitution and Arizona law, and the Commission should reject  
18 the ROO’s reduction in ROE on this basis alone.

19 In summary, Decision No. 73736 is a general rate case order based on a 2010 test  
20 year and a hearing that took place in May, 2012. However, in March, 2014, the ROO now  
21 considers, out of the context of an entire rate case, subsequent evidence proffered by RUCO  
22 on a single issue—the cost of equity applicable to the entire Eastern Group’s test year rate  
23 base—without any consideration of other ratemaking elements that changed since the 2010  
24 test year. This portion of the ROO cannot stand for this reason.

25 **B. The Commission Should Reject the ROO Because it Ignores Evidence**  
26 **That the Company’s Cost of Equity Is Increasing.**

27 In the alternative, if the Commission is inclined to consider Mr. Parcell’s single-issue  
28 testimony, the Commission should still reject the ROO because it ignores evidence that the

1 Company's cost of equity has increased since the 2010 test year. Both Ms. Ahern and Mr.  
2 Reiker testified that the cost of capital, including the Company's cost of equity, has  
3 increased since the Commission issued Decision No. 73736. Ms. Ahern, the Company's  
4 cost of capital expert (whose testimony the ROO totally ignores), confirmed that real world  
5 interest rates are *increasing*. [P-3 Tr. at 201, l. 17 – 204, l. 6]. As a result, the cost of  
6 capital facing the Company is *increasing*, not decreasing. [*Id.*; see also P-3 AWC RH-3  
7 (Ahern Prefiled Rebuttal) at 3, l. 21 – 5, l. 10]. Based on the events that have transpired  
8 since the Commission set the ROE for the Eastern Group, Ms. Ahern opined that the  
9 Commission's grant of a 10.55 ROE was well within the bounds of reason. [*Id.*; P-3 Tr. at  
10 203, ll. 4-24; see also P-3 Tr. at 222, ll. 6-20 (Mr. Sorenson also opining that 10.55 is  
11 appropriate based on all the evidence in the record)].

12 None of RUCO's witnesses challenged Ms. Ahern and Mr. Reiker's testimony that  
13 the cost of capital for the Company is rising. Mr. Parcell's new analysis does not refute Ms.  
14 Ahern and Mr. Reiker's testimony because when he performed his new analysis, Mr. Parcell  
15 ignored the *increases* in the cost of capital, including the Company's cost of equity, that  
16 have occurred since the Commission issued Decision No. 73736. [P-3 Tr. at 137, l. 23 –  
17 138, l. 8]. Thus, not only did RUCO fail to provide evidence to show the 10.55 percent  
18 ROE was "unjust or unwarranted" in light of the Commission's approval of a SIB  
19 mechanism, the evidence in the rehearing record buttresses the strength of the  
20 Commission's two prior findings that 10.55 percent is a reasonable ROE for Arizona Water  
21 Company's Eastern Group of systems. The ROO's reduction of the Company's ROE  
22 should not stand in the face of this evidence.

23 **C. The Company's Northern Group and Western Group's ROEs Are**  
24 **Irrelevant.**

25 The Commission should ignore testimony from RUCO's witness Ralph Smith  
26 because the basis for his recommendation that the Commission reduce the Eastern Group's  
27 authorized ROE is fatally flawed. Mr. Smith did not conduct any analysis or study of the  
28 effect of a SIB mechanism on the Company's cost of equity or the Commission's authorized

1 ROE, effectively ignoring the Commission’s primary purpose for this rehearing. [P-3 Tr. at  
2 89, l. 22 – 92, l. 15]. Mr. Smith also did not conduct any study to address or quantify the  
3 differences in risk between the Eastern Group systems and the Company’s other systems.  
4 [P-3 Tr. at 96, ll. 11-15]. Rather, Mr. Smith simply looked at the compromise 10.00 percent  
5 ROEs the Company agreed to in the Western Group and Northern Group rate cases and  
6 leapt to the unsupported conclusion that the Eastern Group’s authorized ROE should be  
7 reduced by 55 basis points [*Id.* at 91, l. 7 – 92, l. 8].

8 Mr. Smith’s testimony is also flawed because, as he admitted, the Commission  
9 authorized a SIB for the Northern Group, but not for the Western Group, despite setting the  
10 same ROE for the two groups. [P-3 Tr. at 108, ll. 11-20]. As a result, Mr. Smith’s  
11 testimony fails to support RUCO’s burden of proof to show that the Commission’s decision  
12 not to decrease the ROE in Decision No. 73938 for the Company’s Eastern Group when it  
13 approved the SIB mechanism was “unjust or unwarranted, or should be changed.” As the  
14 record shows, the compromise ROEs in the Northern Group and Western Group rate cases  
15 are based on materially different circumstances, revenues, expenses, customers, service  
16 conditions and risk factors than those in the Eastern Group. Indeed, other than Mr. Smith’s  
17 conclusory statements, RUCO failed to introduce any evidence that the compromise ROEs  
18 for the Western and Northern Groups may be used to determine the cost of equity for the  
19 Eastern Group. To the contrary, as the evidence shows and as the Commission has  
20 concluded, the Eastern Group has a “somewhat higher” cost of equity “due to the age of  
21 some of its systems and the resulting increased need for infrastructure replacement and  
22 improvement.” *See* Decision No. 73736 at 61, lines 14 – 17.

23 **D. RUCO Failed to Prove That SIB and ROE are Related.**

24 **1. There is Extensive Evidence in the Record That ROE and the SIB**  
25 **Address Different Issues.**

26 The Commission should also reject the ROO’s reduction of the Eastern Group’s  
27 authorized ROE because RUCO has presented no evidence linking ROE and the SIB  
28 mechanism. The Commission has already expressly determined that “the existence or lack

Bryan Cave LLP  
Two North Central Avenue, Suite 2200  
Phoenix, Arizona 85004-4406  
(602) 364-7000

1 of a DSIC does not change the risk of the utility, and therefore the existence or lack of a  
2 DSIC should not change the utility's ROE....” Decision No. 73938 at 55, ll. 6-13. Despite  
3 the Commission's prior, express rejection of RUCO's position and RUCO's failure to  
4 provide any evidence to the contrary, the ROO adopts RUCO's arguments as a basis for  
5 lowering Arizona Water Company's authorized ROE. ROO at 43, ll. 11-24.

6 The clear and convincing evidence in the record shows that the SIB mechanism does  
7 not affect ROE. The Company, Commission Staff, and the other utility intervenors have  
8 produced extensive evidence and testimony that the 10.55 percent ROE and the SIB address  
9 separate and distinct issues. In the Phase 3 hearing, Mr. Reiker provided additional  
10 testimony that the SIB only provides partial recovery of the recurring capital costs (i.e.,  
11 return and depreciation) that arise when a limited set of infrastructure is placed in service for  
12 the benefit of customers between rate cases. In other words, the SIB mechanism addresses  
13 the chronic under-earnings associated with regulatory lag on a limited subset of post-test  
14 year infrastructure improvements. [P-3 Tr. at 162, l. 20 – 163, l. 16]

15 The ROO ignores the fact, as does RUCO, that the SIB mechanism in no way funds  
16 the \$67 million (i.e., the “up-front” capital cost) the Company needs to invest to replace  
17 what the Commission acknowledges is Arizona Water Company's increased need for  
18 infrastructure replacement and improvement. [See P-3 Tr. at 161, l. 4 - 163, l. 16; see also  
19 206, ll. 1-17 (Ms. Ahern confirming Mr. Reiker's explanation)]. By adopting an adequate  
20 ROE for the Company's Eastern Group, the Commission already recognized Arizona Water  
21 Company's urgent need to raise prodigious amounts of capital to pay for replacing aging  
22 and failing water infrastructure. [See P-1 Ex. A-34 at p. 29, ll. 17-20 (Ms. Ahern testifying  
23 as to the importance of adequate ROE in conjunction with DSIC-like mechanism); see also  
24 P-3 Tr. at 232, l. 4 – 233, l. 2 (Mr. Walker noting that ROE in Decision No. 73736  
25 addressed significant challenges found in Eastern Group, but did not replace a SIB)].

26 Stated differently, the Commission should not grant Arizona Water Company a SIB  
27 mechanism – which already includes an efficiency credit equivalent to an 87 basis point  
28 reduction to the ROE applicable to all SIB-eligible projects – then hinder the Company's

1 ability to raise the capital necessary to pay for all of its utility plant additions, including  
2 replacing aging and failing infrastructure, by imposing an authorized ROE that is below the  
3 Company's true cost of equity. The 87 basis point hit for the efficiency credit on top of the  
4 55 basis point reduction in ROE as proposed in the ROO amounts to punishing Arizona  
5 Water Company twice for the "offense" of acting in the public interest to replace aging and  
6 failing infrastructure.

7 Utilities Division Director Steve Olea confirmed in Phase 3 that the Company's ROE  
8 should not be linked to implementation of the SIB. [P-3 Staff RH-1 (Olea Pre-filed Direct)  
9 at 2, l. 13 – 5, l. 12 (stating, among other things, that "Staff believes that the granting of a  
10 SIB does not have a direct effect on the utility's ability to recover or not recover its cost of  
11 service related to its test year rate base")]. Mr. Olea testified:

12 I believe that the SIB is not germane to the ROE that's granted by the  
13 Commission for, for test year purposes, because it is, the SIB is related to  
14 future plant and future changes in plant, not what was your normal test year,  
you know, setting of rates.

15 [P-3 Tr. at 256, ll. 11-15]. Staff properly considers ROE to be an independent determination  
16 that must be analyzed on a case-by-case basis. [see P-3 Tr. at 260, ll. 14-18 (emphasizing  
17 that ROE and SIB "are not related"); 264, ll. 10-15; 268, ll. 6-14]. As a result, Staff  
18 continues to staunchly support the Commission's authorized 10.55 percent ROE even with  
19 the adoption of the SIB mechanism in Phase 2 of this proceeding. [P-3 Staff RH-1 at 2, ll.  
20 5-11]. The Commission here authorized a 10.55 percent ROE based on its determination of  
21 the overall cost of capital to support Arizona Water Company's entire existing Eastern  
22 Group rate base following a fully litigated rate case. Decision No. 73736. The  
23 Commission properly decided that ROE should not be affected by its approval of the SIB.  
24 RUCO presented no evidence on rehearing that rebuts any of these points.

25 Finally, there are only three systems in Arizona Water Company's Eastern Group to  
26 which a SIB mechanism applies: Superstition, Falcon Valley and Cochise. Applying a 55  
27 basis point ROE reduction to the Eastern Group's *entire* rate base of \$63 million, which  
28 includes other systems that are not even subject to the SIB mechanism, is punitive,

Bryan Cave LLP  
Two North Central Avenue, Suite 2200  
Phoenix, Arizona 85004-4406  
(602) 364-7000

1 confiscatory and without justification. Moreover, the twice-approved 10.55 percent ROE  
2 helps the Company raise crucial capital to fund necessary projects beyond those slated for  
3 the SIB mechanism, and a reduction in ROE hurts not only the SIB-related projects, but the  
4 Company's ability to fund an even wider list of needed replacement and repair projects in  
5 all of its Eastern Group systems.

6 **2. ROE Should Not Be Reduced Because of the SIB Mechanism.**

7 RUCO's own experts on rehearing repeatedly admitted that the impact of a SIB  
8 mechanism on the cost of equity, and ultimately, the ROE authorized by the Commission, is  
9 already reflected in the sample group of utilities used to estimate the cost of equity and  
10 cannot be quantified. [P-3 RUCO RH-2 (Smith Prefiled Direct) at 7, ll. 1-2 (can't be  
11 precisely quantified); P-3 Tr. at 140, ll. 19-23; 144, ll. 3-8 (Parcell - no one can quantify risk  
12 reduction impact of SIB)]. Mr. Parcell testified that Arizona Water Company's ROE should  
13 not be reduced to reflect the SIB Mechanism: "Now, am I proposing a reduction in AWC's  
14 cost of equity to reflect the SIB? The answer [is] no." <sup>2/</sup> [*Id.* at 127, ll. 17-18]. "I am not  
15 proposing an adjustment here from the market cost of equity." [*Id.* at 143, ll. 19-20]. [*Id.* at  
16 134, ll. 5-10]. Thus, RUCO's own witnesses in the Phase 3 rehearing confirmed what the  
17 Commission has already determined: that any marginal risk reduction related to the SIB  
18 mechanism is already subsumed in the ROE analysis.

19 The Eastern Group's ROE should not be reduced because of the SIB mechanism  
20 because, as Mr. Reiker testified, Ms. Ahern confirmed, and RUCO's experts admitted, the  
21 companies in the proxy groups relied upon to estimate Arizona Water Company's cost of  
22 equity in Phase 1 already have DSIC-type mechanisms in place. The new companies that  
23 Mr. Parcell relied upon in his new Phase 3 analysis also have a DSIC-type mechanism in  
24 place. [P-3 at 167, l. 21 – 168, l. 12 (Mr. Reiker testifying that all of the proxy companies  
25 had DSIC-like mechanisms in place); 208, l. 2 – 209, l. 10 (Ms. Ahern); 144, l. 12 – 145, l. 2  
26

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27 <sup>2/</sup> This statement is further evidence that RUCO is asking the Commission to engage in  
28 unlawful single-issue ratemaking, as discussed above.

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Two North Central Avenue, Suite 2200  
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1 (Mr. Parcell)]. Any analysis using data from those companies inherently accounts for any  
2 impact such a mechanism has on the cost of equity. *See* Decision No. 73938 at 55, ll. 11-20  
3 (recognizing that “to the extent (if any) that a DSIC impacts risk, the reduced risk would be  
4 reflected in the sample companies used to set the ROE...”). Therefore, the ROO’s proposed  
5 55 basis point reduction to the ROE applicable to *all* existing utility plant in the adopted test  
6 year Eastern Group rate base has no support in the record and is inappropriate.

7 **III. The ROO’s Proposed ROE Reduction Would Be A Material Change In the**  
8 **Settlement Agreement, Triggering Arizona Water Company’s Withdrawal.**

9 A centerpiece of the settlement agreement the parties entered into in Phase 2 was the  
10 agreement that “[n]othing herein is intended to amend or supersede Decision No. 73736,  
11 which Decision is final in every respect.” [Settlement Agreement, ROO Attachment A, at §  
12 11.1]. The Signatory Parties expressly agreed as follows:

13 If the Commission fails to issue an order adopting all material terms of  
14 this Agreement or adds new or different material terms to this Agreement, *any*  
15 *or all of the Signatory parties may withdraw from this Agreement*, and such  
16 Signatory party or Parties may pursue without prejudice their respective  
17 remedies at law. For the purposes of this Agreement, *whether a term is*  
*material shall be left to the discretion of the Signatory Party choosing to*  
*withdraw from the Agreement.*

18 [*Id.* at § 11.6 (emphasis supplied)].

19 By this filing, Arizona Water Company confirms that it considers the monetary  
20 impact of the unsupported 55 basis point reduction to the ROE (applicable to the entire  
21 Eastern Group rate base) the Commission already authorized in Decision No. 73736 to be a  
22 material change in the terms of the Settlement Agreement. The monetary impact of the  
23 ROO’s proposed reduction exceeds \$1.1 million<sup>3</sup>, which would have a profound adverse

24 \_\_\_\_\_  
25 <sup>3</sup> Based on a 55-basis point reduction in ROE, the assumption that rates in the Eastern  
26 Group’s next general rate case would go into effect in August 2017 (based on the Settlement  
27 Agreement’s requirement to file a general rate case by August 31, 2016), and the following  
28 ratemaking elements approved in Decision No. 73736: total Eastern Group rate base of  
\$63,253,911; an equity ratio of 50.97%, and; a gross revenue conversion factor of 1.6576:

28 [(((\$63,253,911 x 50.97%) x 0.55%) x 1.6576) x 4 years] = \$1,175,721

1 effect on the Company’s ability to attract the capital necessary to make the urgently needed  
2 utility plant additions and infrastructure upgrades and replacements throughout its Eastern  
3 Group of systems (and not just SIB-eligible projects). Such a cut would not only entirely  
4 negate the benefits of the SIB mechanism that the Signatory Parties carefully negotiated and  
5 adopted in the settlement agreement, it would cut far deeper.

6 Following a full general rate case hearing and briefing, the Commission filed  
7 Decision No. 73736 on February 20, 2013. It became final on March 13, 2013. As the  
8 Commission directed them to do, the parties proceeded into settlement discussions on a  
9 DSIC-like mechanism for future infrastructure replacements. A detailed settlement  
10 agreement was executed and docketed on April 1, 2013. That contract was in the nature of  
11 an executory accord: it addressed the Signatory Parties’ contractual duties and obligations,  
12 but was conditioned on Commission approval and implementation of its terms.<sup>4</sup> If the  
13 Commission failed to adopt all of the agreement’s material terms, it provided that any or all  
14 of the Signatory Parties may withdraw. In that event, the terms of the compromise  
15 evaporate and the provisions of the agreement cannot be enforced. *See Aritex Land Co. v.*  
16 *Baker*, 14 Ariz. App. 266, 273-274, 482 P.2d 875, 882-883 (1971) (affirming a return to  
17 litigation once the conditions of an executory settlement agreement were not fulfilled); *see*  
18 *also Pacheco v. Delgado*, 46 Ariz. 401, 407, 52 P.2d 479, 481 (1935) (“Where an  
19 agreement of compromise has been breached by what is in effect a failure or refusal to  
20 perform, the other party may elect to regard the compromise as rescinded and proceed on  
21 the original cause of action.”).

22 For the reasons stated above and in its prior briefing in this docket, the Commission  
23 should amend the ROO to affirm the Commission’s previously-authorized 10.55 percent  
24 ROE and to confirm the terms of the Phase 2 Settlement Agreement, including the SIB

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26 <sup>4</sup> “If the Commission issues an order adopting all material terms of this Agreement,  
27 such action shall constitute Commission approval of the Agreement. Thereafter, the  
28 Signatory Parties shall abide by the terms of this Agreement, as approved by the  
Commission.” [Settlement Agreement, paragraph 11.4].

Bryan Cave LLP  
Two North Central Avenue, Suite 2200  
Phoenix, Arizona 85004-4406  
(602) 364-7000

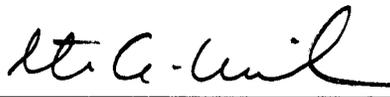
1 mechanism, based upon RUCO's failure to meet its burden of proof. If the Commission is  
2 inclined to adopt the portions of the ROO reducing Arizona Water Company's authorized  
3 ROE to 10.0 percent, the Company hereby withdraws from the settlement agreement under  
4 paragraph 11.6, withdraws its application for a DISC/SIB, and seeks an Order that: (1)  
5 rejects the ROO, (2) vacates Decision No. 73938 based on the nullified settlement  
6 agreement, and (3) restores the parties to their position *status quo ante* as of March 13,  
7 2013, when Decision No. 73736 became final and unappealable.

8 **IV. Conclusion.**

9 RUCO did not meet its burden of proof to show that Arizona Water Company's  
10 authorized 10.55 percent ROE "is in any respect unjust or unwarranted, or should be  
11 changed." On the contrary, RUCO's own witnesses provided testimony that supports this  
12 Commission reaffirming the Company's twice-authorized 10.55 percent ROE. Accordingly  
13 the Commission should adopt the Company's proposed amendment, which is attached for  
14 its convenience. However, if the Commission is inclined to adopt the ROO as written and  
15 reduce the Company's ROE to 10.00 percent, the Company hereby withdraws from the  
16 settlement agreement under paragraph 11.6, withdraws its application for a DISC/SIB, and  
17 seeks an Order that: (1) rejects the ROO, (2) vacates Decision No. 73938 based on the  
18 nullified settlement agreement, and (3) restores the parties to their position *status quo ante*  
19 as of March 13, 2013, when Decision No. 73736 became final and unappealable.

20 RESPECTFULLY SUBMITTED this 2nd day of April, 2014.

21 BRYAN CAVE LLP

22  
23 By   
24 Steven A. Hirsch, #006360  
25 Stanley B. Lutz, #021195  
26 Two N. Central Avenue, Suite 2200  
27 Phoenix, AZ 85004-4406  
28 Attorneys for Arizona Water Company

1 **ORIGINAL** and 13 copies of the foregoing  
2 filed this 2nd day of April, 2014, with:

3 Docket Control Division  
4 Arizona Corporation Commission  
5 1200 W. Washington Street  
6 Phoenix, AZ 85007

7 **COPIES** of the foregoing hand-delivered  
8 this 2nd day of April, 2014, to:

9 Lyn A. Farmer  
10 Chief Administrative Law Judge  
11 Hearing Division  
12 Arizona Corporation Commission  
13 1200 W. Washington Street  
14 Phoenix, AZ 85007

15 Janice Alward, Chief Counsel  
16 Wes Van Cleve  
17 Bridget Humphrey  
18 Legal Division  
19 Arizona Corporation Commission  
20 1200 W. Washington Street  
21 Phoenix, AZ 85007

22 Steven M. Olea  
23 Director, Utilities Division  
24 Arizona Corporation Commission  
25 1200 W. Washington Street  
26 Phoenix, AZ 85007

27 Daniel W. Pozefsky, Chief Counsel  
28 Residential Utility Consumer Office  
1110 W. Washington Street, Suite 220  
Phoenix, AZ 85007

**COPIES** e-mailed and mailed this 2nd day  
of April, 2014, to:

Scott S. Wakefield  
Ridenour, Hienton & Lewis, P.L.L.C  
201 N. Central Avenue, Suite 3300  
Phoenix, AZ 85004-1052  
Co-Counsel for Residential Utility Consumer Office

1 Jay L. Shapiro  
2 Fennemore Craig PC  
3 2394 E. Camelback Road, Suite 600  
4 Phoenix, AZ 85016-3429  
5 Attorneys for Intervenor Liberty Utilities

6 Christopher D. Krygier  
7 Liberty Utilities  
8 12725 W. Indian School Road, Suite D101  
9 Avondale, AZ 85392

10 Thomas M. Broderick  
11 EPCOR Water Arizona, Inc.  
12 2355 W. Pinnacle Peak Road, Suite 300  
13 Phoenix, AZ 85027

14 Michael M. Grant  
15 Gallagher & Kennedy  
16 2575 E. Camelback Road  
17 Phoenix, AZ 85016-9225  
18 Attorneys for Intervenor Arizona Investment Council

19 Gary Yaquinto  
20 Arizona Investment Council  
21 2100 N. Central Avenue, Suite 210  
22 Phoenix, AZ 85004

23 Michael W. Patten  
24 Timothy J. Sabo  
25 Roshka Dewulf & Patten, PLC  
26 One Arizona Center  
27 400 E. Van Buren, Suite 800  
28 Phoenix, AZ 85004-2262  
Attorneys for Intervenor Global Water

Ron Fleming  
Global Water Utilities  
2140 N. 19th Avenue, Suite 201  
Phoenix, AZ 85027

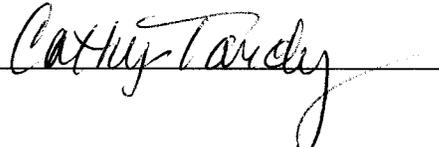
Garry D. Hays  
The Law Offices of Gary D. Hays  
1702 E. Highland Avenue, Suite 204  
Phoenix, AZ 85016  
Attorney for Intervenor City of Globe

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2  
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24  
25  
26  
27  
28

Greg Patterson  
916 W. Adams, Suite 3  
Phoenix, AZ 85007  
Attorney for Intervenor Water Utility  
Association of Arizona

Michael Hallam  
Lewis Roca Rothgerber LLP  
40 N. Central Avenue  
Phoenix, AZ 85004  
Attorneys for EPCOR Water Company

Kathie Wyatt (by mail only)  
1940 N. Monterey Drive  
Apache Junction, AZ 85120



# Proposed Amendment No. 1

**ARIZONA WATER COMPANY  
PROPOSED AMENDMENT NO. 1**

TIME/DATE PREPARED: April 2, 2014

COMPANY: Arizona Water Company

AGENDA ITEM NO. \_\_\_

DOCKET NO(S). W-01445A-11-0310

OPEN MEETING DATE: April 8, 2014

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**Page 41, Line 13:**

DELETE: second occurrence of "Northern"

INSERT: "Eastern"

**Page 41, Line 20 through Page 45, Line 4**

DELETE

**Page 45, Line 4**

INSERT:

RUCO asserts that the SIB mechanism we approved in Phase 2 decreases the risks faced by AWC and that the previously approved ROE for the Eastern Group, which RUCO asserts was granted specifically to address the Company's demonstrated infrastructure needs, should be adjusted downward to compensate for that alleged decrease in risk. As the party seeking reconsideration of our prior decisions, RUCO bears the burden of (1) demonstrating that the approval of a SIB mechanism substantively reduces the risks faced by AWC, (2) demonstrating that the ROE we previously approved in Decision No. 73736 was not reasonable in light of the cost of service factors considered in that Decision and the circumstances of this case, and (3) providing a supported quantification of the purported reduction in risk and its impact on the associated cost of capital.

After reviewing the entire record in this proceeding, we conclude that RUCO has failed to meet its burden and that the ROE approved in Decision No. 73736 should be affirmed. We have already determined that "the existence or lack of a DSIC does not change the risk of the utility, and therefore the existence or lack of a DSIC should not change the utility's ROE...." Decision No. 73938 at 55, ll. 6-13. A review of the evidence provided by RUCO reveals nothing to change that determination.

**\*\* Make all conforming changes**

<b>THIS AMENDMENT:</b>		
_____ Passed _____	Passed as amended by _____	
_____ Failed _____	Not Offered _____	Withdrawn _____

**ARIZONA WATER COMPANY  
PROPOSED AMENDMENT NO. 1**

TIME/DATE PREPARED: April 2, 2014

COMPANY: Arizona Water Company

AGENDA ITEM NO. \_\_

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OPEN MEETING DATE: April 8, 2014

---

Throughout these proceedings, RUCO has contended that the 10.55 percent ROE and the SIB are duplicative. (See RUCO's Application for Rehearing of Decision No. 73938 (July 17, 2013) at 4-5). Arizona Water Company, Commission Staff and the utility intervenors, however, persuasively demonstrated during the Rehearing that the SIB addresses separate and distinct issues and should not be linked to a utility's ROE. AWC's witness, Mr. Reiker, highlighted that the SIB only addresses the carrying costs of a limited set of infrastructure that is constructed between rate cases, but it does not address the initial capital costs of constructing that infrastructure. (Rehrg. Tr. at 161, l. 4-163, l. 16; see also 206, ll. 1-17). Those costs have to be addressed through an award of an adequate ROE. The SIB is only effective to the extent that the Company's awarded ROE is reflected in its final rates. (See Phase 1 Ex. A-34 at p. 29, ll. 17-20; see also Rehrg. Tr. at 232, l. 4 – 233, l. 2).

Utilities Division Director Steve Olea confirmed that the Company's ROE should not be linked to implementation of the SIB. (Rehrg. Staff Ex. RH-1 at 2, l. 13 – 5, l. 12 (stating, among other things, that "Staff believes that the granting of a SIB does not have a direct effect on the utility's ability to recover or not recover its cost of service related to its test year rate base")). As Mr. Olea testified:

I believe that the SIB is not germane to the ROE that's granted by the Commission for, for test year purposes, because it is, the SIB is related to future plant and future changes in plant, not what was your normal test year, you know, setting of rates.

(Rehrg. Tr. at 256, ll. 11-15). We concur with Staff's conclusion that ROE is an independent determination that must be analyzed on a case-by-case basis. (see Rehrg. Tr. at 260, ll. 14-18; 264, ll. 10-15; 268, ll. 6-14). We awarded a 10.55 ROE to the Company's Eastern Group based on our analysis of the required rate of return for the Eastern Group following a fully contested rate case. Decision No. 73736. That determination was independent of our later approval of the SIB and only partially addressed the significant infrastructure challenges facing the Eastern Group. Decision No. 73938 at 55.

**\*\* Make all conforming changes**

**THIS AMENDMENT:**

\_\_\_\_\_ Passed \_\_\_\_\_ Passed as amended by \_\_\_\_\_  
\_\_\_\_\_ Failed \_\_\_\_\_ Not Offered \_\_\_\_\_ Withdrawn

**ARIZONA WATER COMPANY  
PROPOSED AMENDMENT NO. 1**

TIME/DATE PREPARED: April 2, 2014

COMPANY: Arizona Water Company

AGENDA ITEM NO. \_\_\_

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OPEN MEETING DATE: April 8, 2014

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While our determination that a SIB mechanism and ROE address distinct issues is sufficient to end our inquiry, we further note that RUCO failed to demonstrate that the ROE approved in Decision No. 73736 was not reasonable in light of the circumstances of this case.<sup>1</sup> RUCO's evidence with respect to the ROE issue consisted of purported national trends in the ROEs approved by various regulatory bodies, a request that we apply the compromise ROEs from the Company's Northern and Western Group rate cases to the Eastern group and the conjecture of its witnesses as to the reduction in risk attributable to our approval of the SIB in Phase 2.

**Page 47, Line 8**

DELETE: Findings of Fact No. 19

INSERT New Findings of Fact:

The 10.55 percent ROE authorized in Phase 1, and affirmed in Phase 2, should be affirmed because RUCO has failed to meet its burden of demonstrating any basis for a downward adjustment of that ROE. We believe that a 10.55 percent ROE continues to be just and reasonable, and in the public interest, under the circumstances of this case.

---

<sup>1</sup> Ironically, RUCO seeks to have us engage in single issue and piecemeal rate making, a practice prohibited by the Arizona Constitution and decried by RUCO in its Application for Rehearing. Art. XV, § 14; *Simms v. Round Valley Light & Power Company*, 80 Ariz. 145, 151, 294 P.2d 378, 382 (1956); *see also Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 534, 578 P.2d 612, 615 (App. 1978). We decline to retroactively alter the Eastern Group ROE without consideration of all relevant rate making factors.

**\*\* Make all conforming changes**

<b>THIS AMENDMENT:</b>			
_____ Passed _____	Passed as amended by _____		
_____ Failed _____	_____ Not Offered _____	_____ Withdrawn _____	

**ARIZONA WATER COMPANY  
PROPOSED AMENDMENT NO. 1**

TIME/DATE PREPARED: April 2, 2014

COMPANY: Arizona Water Company

AGENDA ITEM NO. \_\_\_\_

DOCKET NO(S). W-01445A-11-0310

OPEN MEETING DATE: April 8, 2014

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**Page 47, Line 23**

DELETE: Conclusions of Law No. 5

INSERT New Conclusions of Law:

A 10.55 percent ROE is just and reasonable under the circumstances of this case, based on the entirety of the record.

**Page 48, Line 2**

DELETE: Ordering Paragraphs

INSERT New Ordering Paragraph:

IT IS THEREFORE ORDERED that the 10.55 percent ROE authorized in Decision No. 73736, and affirmed in Decision No. 73938, is affirmed.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

**\*\* Make all conforming changes**

<b>THIS AMENDMENT:</b>			
_____ Passed	_____ Passed as amended by _____		
_____ Failed	_____ Not Offered	_____ Withdrawn	