

ARIZONA REGULATORY REPORTS

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IN THIS ISSUE

Commentary

- Not With a Bang, But with a Whimper, the End of the Water Workshops (page 2)
- To Settle, or not to Settle? (page 3)
- The ACC Gets Serious About Fixing Regulatory Lag (page 5)

Year in Review, 2011 (page 5)

Open Meeting Update

- ACC recognizes value of professional management (page 7)
- Two and a half years to approve WIFA loan? (page 8)
- ACC allows loan for arsenic removal costs; Rejects proposal to force capital investment (page 9)
- ACC approves interim tariff without considering revenue impact (page 9)

Cost of Capital Special Section

- The Best ROE You Can Get (page 10)
- The RUCO Index: Evaluating the ROEs earned by RUCO's "Comparable Companies" (page 11)
- Operating Margins – The Good, the Bad, and the Ugly (page 13)

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Commentary

Not With a Bang, But a Whimper – the end of the Water Workshops

After one full year, the ACC ended its Water Workshops in November – all told the industry made about 20 presentations to the Commission on issues ranging from DSICs, to ROEs, to acquisition costs and consolidation. Companies wrote letters in support of positions, responded to Staff questions, and addressed some of the most vexing challenges facing investment in Arizona.

If you're waiting for something to come out of it, don't hold your breath. The workshops are over and there is no big report coming, no reform package, no Special Open Meeting – nothing is coming next.

If you're looking for reasons, start by searching through Docket 06-0149. You will find there is something absent – there was never *a single letter from any Commissioner on any issue*. **Don't blame the Commissioners** – they are very active on issues that interest them; from renewable energy, demand side management, line extension costs, to integrated resource planning, the electric and gas industries receive a great deal of well-earned attention.

The fault lies not in the Commissioners, but in **our** efforts. After a year of effort, the water industry failed to attract an audience or an interest in reform. That's sobering.

For those of us who believe that the private sector has a role to play in managing and providing essential services, Arizona remains a conundrum: This isn't a left-wing state, but when it comes to water there is no desire to inject efficiency, market forces, or economies of scale into the water sector.

There is no willingness to invest in regional plants to increase efficient water use, wastewater reclamation, or water reuse. There is no desire to use price signals to encourage conservation of a resource that we simply cannot live without. And there is no interest in consolidating the sector to achieve economies of scale that would make it possible to fix the numerous small, remote, broken water systems in Arizona.

Each of those realities stands in stark contrast to the policies Arizona adopts and incents for electricity and gas companies. Those industries have adjustor mechanisms for transmission, power, distribution, conservation, and renewable energy. Hundreds of millions of dollars flow from ratepayer pockets to the solar industry's subsidies. And electric utilities get higher ROEs so investors provide billions of dollars to provide better and better service to more and more

people. Their cases get settled, so bond rating agencies improve the ratings and provide lower cost debt.

Arizona's water industry is like the guy at the dance who suddenly realizes that the last song is over, and every girl he asked to dance that night has turned him down.

This isn't the first time this has happened, and the usual response of our industry is to keep dancing by ourselves... We are witnessing an interesting experiment in democracy: *if we hold enough lunches, can we reform an industry?*

But while we dance alone, take a look around: APS just settled its rate case (again) and it will likely get a 10 ROE and a stack of adjustors (including a move toward decoupling and an increase in the tariff rate for water pumping). Southwest Gas settled well and got decoupling and a solid ROE. The electric and gas industries have adjustor mechanisms, robust ROEs, massive support from Commissioners on issues of importance – and the water industry can't generate a single letter from a Commissioner after a year of workshops.

We didn't even get anyone interested in DSICs which would ease "rate shock" while simultaneously improving infrastructure. (To continue our 'lonely guy at the dance' analogy, it's as if we opened a bottle of Moet and poured out five glasses, and nobody picked one up...)

What will happen next explains what just happened: each of us will go back to our work, on our narrow issues, on our next rate case, and hope that somebody, somewhere, fixes something.

In other words, we will keep dancing by ourselves and hope that at some point, the pretty girl will notice us and come over to dance with us. Bad news for dreamers: that isn't how it really ends.

We're not sure what the industry should do next; but we are sure of one thing – we can't expect change if we don't change.

To settle, or not to settle?

Commissioners debate settlement policy.

In an extended Staff meeting in December, the Commissioners debated the appropriateness of rate case settlements. Commissioners expressed concerns about their ability to have input into settlement terms, as well as less information being available when a case is settled. Chairman Pierce also expressed concerns that settlements are treated like a big pot of money where everyone gets something – except for those not in the room. Chairman Pierce also expressed

concern about what happens if the Commission wants to reject a settlement in its entirety; the whole process has then been set back by months.

Executive Director Ernest Johnson commented that settlements can be very challenging and that he sometimes asks himself “Frankly,... why am I doing this.” However, he urged the Commissioners to keep an open mind about proposed settlements, saying “I urge you to consider that settlements are a useful tool in the regulatory toolbox.” He emphasized the importance of Commissioners letting the parties know what their concerns and key issues are in advance, through letters, so the parties can take those matters into account in developing a settlement.

Southwest Gas settlement narrowly approved.

During the Commission’s (extremely lengthy) December open meeting, the Commission narrowly approved the settlement in the Southwest Gas rate case. RUCO and AARP opposed the settlement, leading to lengthy deliberations by the Commissioners. RUCO and AARP strongly objected to the “decoupling” rate design included in the settlement, which would allow Southwest Gas to recover its fixed costs while its use per customer decreases. Ultimately, the Commission approved the settlement 3-2, with Chairman Pierce, and Commissioners Newman and Kennedy voting in favor.

APS and Arizona-American.

In December, settlements to the APS and Arizona-American rate cases were also reached, subject to Commission approval. The Arizona-American settlement allows the highly controversial White Tanks regional surface water treatment plant to be included in rate base (\$78.9 million). It also provides for a 10.6% return on equity, but requires a three year phase in of the new rates, with no recovery of the foregone revenue.

Why aren’t there more water company settlements?

While it is not unusual to see rate case settlements for large energy utilities, like APS or Southwest Gas, the Arizona-American settlement is a positive sign. A regulatory environment that supports settlements can result in much lower rate cases expense, reduced regulatory risk, increase certainty, and reduced regulatory lag – all critical needs for Arizona water utilities. But rate case settlements are rare for water companies, and they are almost unheard of for small water companies. It seems like settlements happen only when vast armies of lawyers get involved in a case – and small water companies often can’t afford any lawyer at all. Staff, RUCO

and water companies of all sizes should consider settlements. As a New Year's Resolution for 2012, we should all look for ways to promote reasonable settlements. And let's find a pathway to settle rate cases for small water companies, without the need for lawyers.

The ACC Gets Serious About Fixing Regulatory Lag

During the WUAA annual luncheon on November 18, 2011, Chairman Gary Pierce emphasized the Commission's budget proposal, which includes adding a second hearing room in Phoenix, as well as two new ALJs to hear cases. Attached is a fact sheet from the ACC regarding their proposed FY 2013 budget.

The fact sheet notes that the plan "specifically equates to ***increased timeliness and efficiency in regard to multiple and overlapping scheduled Commission proceedings***. The centerpiece of this effort is our Hearings Division and the need for a second full-scale Hearing Room...." The fact sheet explains that they anticipate the plan "will reduce the time it takes for a Large Utility Rate case from a current average of 20 months to 9 months."

Recently, scheduling hearings has been very difficult because the main hearing room is frequently booked far in advance, as are the ALJs. The ACC's budget plan eliminates these key bottlenecks that slow down rate cases. Unnecessarily lengthy proceedings hurt everyone – Commissioners, Staff, customers, and certainly utilities, who suffer increased regulatory lag. The Commission should be commended for this innovative plan. We encourage everyone to support the Commission's FY 2013 proposed budget -- contact your state senator and representatives to let them know how important this is.

Year in Review - 2011

Some Positive Developments on the Water Front

While it's true that we are often critical of the Commission's decisions, we do believe in giving credit where credit is due, and there were positive developments with respect to the water industry in 2011. From our vantage point, in 2011 the Commission approved two major policy shifts for water companies.

Hook-up Fees

Most significantly, the Commission in several cases agreed that unexpended hook-up fees should not be deducted from rate base as CIAC. This makes a lot of sense; plant built with hook-up fees shouldn't be included in rate base. But rate base shouldn't be reduced just because the utility collected hook-up fees that are sitting in a bank account waiting to be spent.

Many utilities collected significant hook-up fees during the real estate boom; when the market tanked, the utilities sensibly cut back on capital expenditures, especially to serve new areas. They shouldn't be penalized for that by reductions to rate base. If and when the hook-up fees are spent on plant, the plant should be excluded from rate base. Notably, the Commission adopted this approach over RUCO's vociferous objections.

The first decision under this new approach involved Bella Vista Water Co.,¹ and the Commission subsequently followed the same path in a recent rate order for Litchfield Park Service Company.² Chairman Gary Pierce and Utilities Director Steve Olea are to be commended for spearheading this change.

BMPs

Second, in a number of orders, the Commission rejected attempts to impose "Best Management Practices" or "BMPs" for water conservation beyond those required by ADWR. In 2010, the Commission issued a number of orders imposing additional BMP requirements on water companies. While we at *Arizona Regulatory Reports* are big fans of water conservation, top-down regulatory mandates from the ACC are not the way to get there. Instead, as an economic regulator, the Commission should look to economic incentives (such as ROE adders) and cost recovery options (such as DSM or BMP adjustors) to give both water companies and customers incentives to pursue conservation – and to remove disincentives such as poor rate designs that encourage utilities to sell more water.

The Commission also issued two significant orders on rehearing, resolving highly contested, long-running rate disputes. The Commission reversed an \$18 million rate base reduction to Johnson Utilities³, and it allowed shareholders of Chaparral City Water Company to share in some of the settlement proceeds from a damaged well.⁴

¹ See *Arizona Regulatory Reports*, Issue 11-1, page 5.

² Docket No. SW-01428A-09-0103.

³ See *Arizona Regulatory Reports*, Issue 11-5, page 20.

⁴ See *Arizona Regulatory Reports*, Issue 11-1, page 4.

Perhaps most importantly, the Commission stopped issuing radically low ROEs, such as the 8.01% imposed on Litchfield Park Water Company in 2010.⁵

Lastly, the Commission approved EPCOR Water USA's acquisitions of Arizona-American Water Company and Chaparral City Water Company. It is notable that the Commission approved these purchases without imposing onerous conditions (e.g., a rate case "stay-out" requirement.) Those of us who remember the conditions the Commission imposed upon the sale of some of the same water systems when they belonged to Citizens understand the downside and long-term negative effects such conditions can have. While such conditions may seem attractive to the Commission at the time the transaction is approved, they have highly problematic consequences down the road.

Open Meeting Updates

ACC recognizes value of professional management

Mirabell Water Co.

Docket No. W-02368A-11-0185

Mirabell is a small, Class D water company with 57 customers. Its owner, Morton Friedman, has owned it for at least 30 years. He told the ACC that he's never taken a salary or a dime in profit from the company. Like a lot of small, older companies, Mirabell was challenged with aging infrastructure, limited finances and no professional staff. In a previous interim rate case, the Commission noted management and operational deficiencies. Facing a service outage and increased regulatory oversight, Mirabell retained Southwester Utility Management (SUM), an experienced operator of small water systems.

SUM went to work immediately. Unfortunately, the test year for the rate case was already over. Mirabell proposed including SUM's ongoing fees in rates, with a \$10 a month temporary surcharge to pay-off the remaining SUM fees. Staff recommended the surcharge be denied, arguing that these were non-recurring expenses out of the test year. The ALJ recommended 50% recovery with a \$5 fee.

However, Chairman Pierce proposed an amendment to allow the full \$10 surcharge. His amendment stated "We believe that it is in the public interest to authorize timely recovery of

⁵ See *Arizona Regulatory Reports*, Issue 11-1, page 2.

SUM's managerial expenses. Failure to authorize timely recovery of SUM's managerial expenses may result in companies like SUM being unwilling to rescue distressed water companies, including serving as interim managers, in the future." After the ALJ noted that hiring SUM was "an excellent move", Chairman Pierce explained that he wanted to make sure SUM was made whole and to make sure that Mirabell has enough cash flow to pay SUM. The ACC approved the amendment (see Decision No. 72675).

Two and a half years to approve a WIFA loan?

Sonoita Valley Water Services

Docket No. W-20435A-09-0296

Sonoita Valley Water Services (Sonoita) is a Class D water utility in Southeastern Arizona. Its current owner, Buck Lewis, was asked by the Commission to take it over as an interim manager and eventually he bought the system when its previous owner essentially abandoned it. Like many such systems, it was poorly designed and constructed and has been plagued by operational problems.

In June of 2009 Sonoita filed a rate case and financing applications. The financing application requested approval of a loan from WIFA to address its significant infrastructure deficiencies. On August 10, 2011 the Commission approved a rate increase (Decision No. 71830), however, the Commission indicated more information was necessary before approving the loan. Sonoita was required to file a detailed description and prioritization of construction projects allowing the Staff to prepare a Revised Staff Report.

The company provided a revised description of the necessary capital improvements and their costs to the Commission. In an effort to reduce the impact on its customers the company proposed a less extensive (and less expensive) capital improvement plan. The initial Revised Staff Report rejected the company's new capital improvement plan but, after discussions with Mr. Lewis, Staff filed a revised report recommending approval of the financing request.

The Commission approved the company's revised financing request at the November 8, 2011 Open Meeting which is a positive for the company and its customers. However, the fact that it took two and a half years for a Class D financing request to be approved is notable. Such delays not only delay the necessary system improvements, they also increase the legal and administrative costs of such filings. Given the essentially non-existent returns earned by owners of small systems like Sonoita, mitigating such delays (and their accompanying expenses) should be a priority for the Commission.

ACC allows loan to recover arsenic capital costs; Staff proposal to force capital investment rejected

**Little Park Water Co.
(Docket W-02192A-10-0395)**

Little Park Water Company, like many water companies in Arizona, faced significant expenses in complying with the EPA's arsenic requirements. Little Park incurred \$267,091 in capital expenditures for arsenic treatment plant. It collected \$85,835 in hook-up fees. Little Park obtained a loan from its parent company for the remainder, \$140,000. Little Park then sought a loan from Chase Bank for the \$140,000, to repay its parent company, Big Park Water Company.

Chase agreed to the loan, but the ACC Staff recommended that the loan be rejected, and that the \$140,000 loan from the parent be invalidated, and that the \$140,000 be considered paid-in capital from the parent. In the alternative, Staff recommended a \$118,000 loan. Little Park argued that its parent, Big Park, could not afford to make a \$140,000 investment in Little Park and that Big Park needs to be repaid. The ALJ agreed with Staff's \$118,000 alternative. The Commission, in an amendment proposed by Commissioner Kennedy, rejected the Staff and ALJ alternatives and approved the full \$140,000 loan.

ACC approves interim tariff without considering revenue impact

**Truxton Canyon Water Company, Inc.
W-02168A-10-0247**

At the December 14, 2011 Open Meeting the Commission addressed the issue of what rates the Valle Vista Property Owners Association (the Association) should pay to Truxton Canyon Water Company, Inc. (Truxton.) The Association's water consumption is driven by a golf course, park and swimming pool it owns and operates. Previous to this decision the Association did not take water from Truxton Canyon, rather it paid a fixed monthly amount under a contract with the Claude K. Neil Family Trust (Trust.) The Trust is affiliated with Truxton and subsidizes Truxton's operations.

As a result of previous Commission action, the Association became a direct customer of Truxton and Truxton filed a proposed interim tariff for the Association to be effective from January 1, 2012 through the resolution of Truxton's current rate case. The interim tariff was subject to a true up to the rates that ultimately will be approved in the rate case. The interim tariff filed by

Truxton was designed to maintain the status quo in that it generated the same revenue as the contract with the Trust.

The Association opposed the interim tariff and advocated for substantially lower rates. Truxton maintained that those rates were far too low to cover its cost of operations. The Commission ultimately approved an interim tariff with rates slightly above those advocated by the Association and well below those filed by Truxton. The rates approved by the Commission are also significantly below what the Association would pay under Truxton's existing tariff.

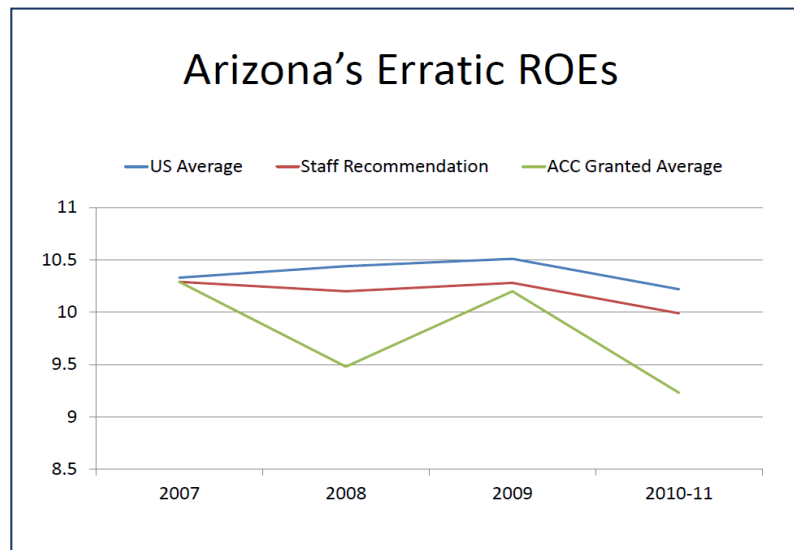
Truxton maintained that the approved rates would result in severe financial strain on the company. The Staff indicated that Truxton had not filed any supporting "cost of service" information in spite of the fact that a full rate case was filed by Truxton in September. It seems odd that the Commission would approve rates without considering the revenue impact on the company.

Cost of Capital – Special Section

The Best ROE You Can Get

We have been tracking Arizona ROEs for all Class A companies (water, gas, and electric) since 2004 and comparing them to the U.S. average ROEs as reported in Public Utilities Fortnightly.

Here's what you already know: the ACC fares poorly – usually lagging the U.S. average by *over 100bp* (in a world where investment decisions can turn on 10bp differentials.) This is a major reason why S&P, Moody's, and Janney Montgomery Scott rate Arizona in the bottom of their surveys of states for utility investment.



Here's what you don't already know: All of that can be solved with one simple solution: *Adopt the ACC Staff's ROE.*

In 2011, there were only two rate decisions affecting large water companies and the ACC granted an average ROE of 8.875%. The U.S. average (compiled using data from Public Utilities Fortnightly) was 10.11% (based on 100 cases across the U.S.)

In 2011, the ACC Staff's ROE recommendation was 9.3% - still lower than the U.S. average, but because of the tiny number of cases, we think the better way to look at the issue is by combining Arizona's 2010 and 2011 decisions. In 2010 and 2011, the ACC granted ROE average was 9.23% while the U.S. average during that period was 10.22% - consistent with Arizona's norm of being 100bp lower than average.

But if the ACC had adopted the ROE recommendations of its own Staff, the average ROE in 2010 and 2011 would have been 9.99% - still lower than the U.S. average of 10.22%, but close enough to be within the range of reasonableness.

This month, the ACC Staff reached a Settlement with Arizona Public Service for its pending rate case – with an agreed-upon ROE of 10%.

If the ACC and the water industry want to do something simple, transparent, and positive for the long term investment needs in Arizona, we recommend one thing: Adopt Staff's ROE recommendations. And the best way to do that is to follow the Florida Model, have the Staff build one ROE model per year, and let water and wastewater companies opt-in to that ROE.

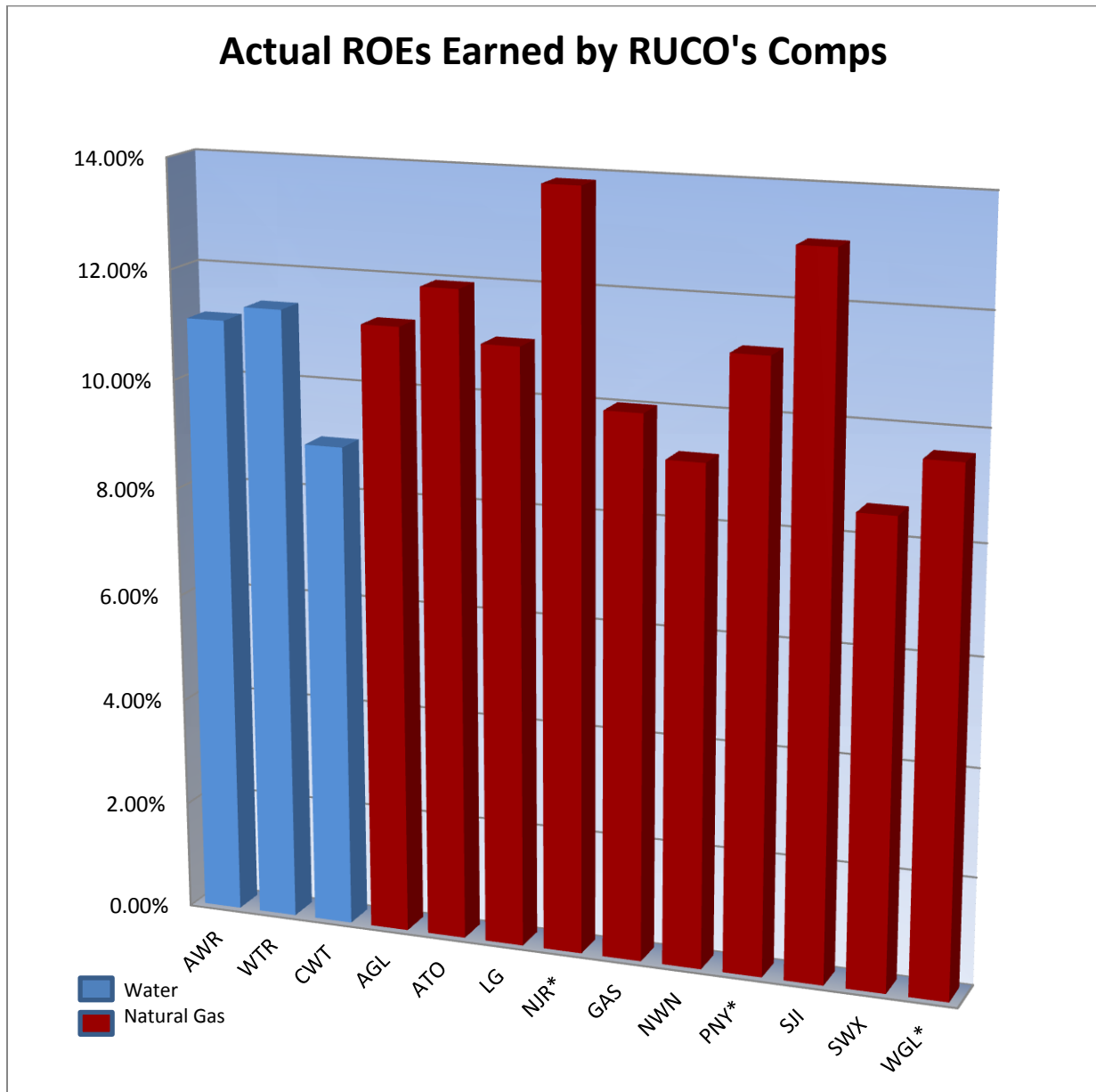
The results would be an instantaneous savings of hundreds of thousands of dollars of rate case expense per year (which is borne by customers), an increase in regulatory certainty in Arizona (which improves our investment profile), and a decrease in hearing days (which saves the ACC time and money.)

The RUCO Index

Evaluating the ROEs earned by RUCO's "Comparable Companies"

In our first issue we took a look at the actual returns on equity (ROE) earned by the companies RUCO uses to develop its cost of capital estimates. It turned out that the actual ROEs earned by these companies were well above what that ROE estimation process implies. We thought it was time for an update so we took a look at the ROEs actually earned by the RUCO sample through the third quarter's end.

The returns have come down some since year end (due to seasonality in the gas industry) but are still relatively very healthy. **The average earned ROE of the RUCO companies is 10.85% - well above what we've experienced in Arizona.**



*Through end of second quarter.

Operating Margins – The Good, the Bad, and the Ugly

At a recent ACC hearing Staff provided testimony that we found very surprising. On the subject of how to set rates for utilities with negative or very low rate bases the Staff witness testified that:

We don't really use operating margin. Operating margin just doesn't mean anything. To use operating margin for rate of return is like allocating general expenses based on how much revenue one division gets over another. It provides no basis whatsoever. Operating margin doesn't provide any good measure to quantify whether the rates are adequate. As long as the cash flow is there, then that's the basis.⁶

A REGULATORY REPORTS DIALOGUE

ROWELL

I found this very surprising because Staff's standard practice has been to set rates based on operating margins when the rate base is negative or close to zero. There are a multitude of ACC orders that adopt the operating margin as the method for setting the revenue requirement when the rate base is inadequate.

WALKER

To me, the interesting element is that the Staffer did something we don't see often enough: just flat out told the truth about a policy. OM's are completely artificial, and the operating margin approach covers a multitude of investment sins – God bless him for saying that there is nothing rational about running utilities with an operating margin.

ROWELL

In a perfect world that's true, operating margins aren't rational. In a perfect world all utilities would have rate bases large enough to use rate of return regulation. But we all know that in the real world many water utilities don't have the rate base for that. In the real world we have to think about "second-best" solutions. The operating margin is recognized nationally as the appropriate "second-best" ratemaking method to use when the rate base is too small.

The National Regulatory Research Institute's research on small water companies indicates that the Operating Margin is the appropriate ratemaking method to use in these instances.⁷ Public utility Commissions across the country employ the operating margin for ratemaking. For example, the California Public Utilities Commission has an explicit policy of calculating both the return on rate base and an operating margin and using whichever one produces the higher

⁶ Testimony of Gordon Fox, Docket No. W-02031A-10-0168 et. al., 10/19/2011, Transcript Volume II at 253.

⁷ See the NRRRI publication: *Small Water Systems: Challenges and Recommendations*, Melissa J. Stanford, February 7, 2008

revenue to set the revenue requirement for small water utilities.⁸ It is also the stated policy of the Florida Public Service Commission to use the operating margin when rate base is too low to use the rate of return method.⁹

To my knowledge it is the norm across the country to use the operating margin when the rate base isn't an option.

WALKER

Once upon a time, my church, the Catholic Church, got caught up in a mess because it was selling 'indulgences' to provide forgiveness for sins in exchange for money. That indulgences were widespread was not a justification. The U.S. relies on original cost rate base – and so does Arizona even though we are technically a fair value state; so when assets get depreciated, unless there is growth driving more and more investment, the rate base just disappears. When that happens, you have utility companies with no assets – so at that point they can't grow at all unless they have a lot of retained earnings because banks simply won't lend to them.

ROWELL

That's right, but to get retained earnings companies need cash flow; and what sort of cash flow does the Staff believe is appropriate for small water companies? At the same hearing Staff's witness testified that:

“spare cash flow that should be made available should be fairly nominal.”¹⁰

So the Staff believes that only a “nominal” amount of cash should be made available to cover both contingencies (such as equipment breakdowns) and to provide a return to the owners of small water companies.

WALKER

So, in my work for Wall Street firms and for utilities, I look at the whole of regulatory policy and try to figure out the overarching goal. And there are some states where we look at that and conclude, 'this state is trying to get investment in sustainability', or 'this state is trying to flatten the forward price curve.' But you look at Arizona's approach to water and it's 'keep water cheap.' And that fits, really, with Arizona's entire water history: at first it was - keep water cheap so we can farm, then it became - keep water cheap for new housing and growth, and now our policy is - keep water cheap because our economy sucks.

⁸ See, CPUC RESOLUTION NO. W-4524, March 17, 2005.

⁹ See Florida PSC *Order Nos. PSC-96-0357-FOF-WS and PSC-97-0130-FOF-WU*.

¹⁰ Testimony of Gordon Fox, Docket No. W-02031A-10-0168 et. al., 10/19/2011, Transcript Volume II at 199.

ROWELL

So the message to owners and potential owners of small water companies is clear: Arizona believes that the only compensation you should receive for the significant liability you incur *and* the only cash available for contingencies is a “nominal” amount of cash flow. This attitude towards the industry is not conducive either to encouraging current owners to invest in their utilities or to encouraging consolidation in the industry.

WALKER

That’s right, so we have 280-something water companies around the state, and most of them have little to no rate base, so they can’t finance and grow; and bigger companies can’t buy them because you add customers and costs but not rate base. So it’s just a matter of time before something breaks, the well runs dry, a new EPA rule comes down, and the company goes to WIFA and gets emergency financing and the ACC gives them just barely enough money to pay the WIFA loan back but because it was thru rates it doesn’t change rate base and we stay, forever and ever, in this position where half the water companies, and their customers, live under the sword of Damocles.

Did we miss an important issue or case? Let us know. Working on a case we should follow? Let us know and we will track it. Have a question or a regulatory issue? Let us know, that’s what we do.

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Arizona Regulatory Reports Staff

Matt Rowell served on the ACC Staff from 1996 to 2007. For the last five of those years Matt served as the ACC Utilities Division’s Chief Economist where he supervised several Staff members and was deeply involved in a wide variety of rate cases and other matters before the ACC. Since 2007 Matt has worked for Desert Mountain Analytical Services, providing expert analysis and testimony in multiple cases. He has advised clients on regulatory strategies for acquisitions, general rate cases, and litigated disputes. Matt recently passed the Certified Rate of Return Analyst (CRRRA) exam administered by the Society of Utility and Regulatory Rate of Return Analysts.

Tim Sabo has a decade of experience practicing before the ACC, including serving as an ACC staff attorney from 2001 to 2005. Tim has over 70 ACC hearings under his belt, including many rate cases. Tim represents utilities

before the ACC in rate cases, CC&N extensions, and formal complaint proceedings. He also represents utilities in civil litigation and arbitration cases.

Paul Walker served as Chairman Marc Spitzer's advisor from 2001 to 2004. Since 2004 Paul has worked with energy and water utilities and investment firms on regulatory analysis, lobbying, and consulting in multiple states and has worked extensively on rate cases, acquisitions, growth strategies, and regulatory issues. Paul is on the national board of directors of ConservAmerica – a 6,000 member organization working to improve the environment through market-based policies at the national level, and is Chairman of Arizonans for Responsible Water Policy – a trade group comprised of large water companies advocating for long-term water policy changes. Paul serves on the Arizona Power Plant and Line Siting Committee, a statutory board comprised of elected and appointed officials that determines the environmental compatibility of power plant and electric transmission line and grants approval for the building of those projects – the Line Siting Committee's decisions are reviewed by the ACC which approves, modifies, or denies the final Certificate of Environmental Compatibility. His firm co-sponsors quarterly water seminars with Fenmore Craig and Liberty Water and he is a frequent presenter at energy and water forums throughout the United States.

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ARIZONA CORPORATION COMMISSION

FY 2013 Budget Submission Request

On September 1, 2011, the AZ Corporation Commission submitted its FY 2013 Budget to Governor Jan K. Brewer. For your consideration, the following provides insight and support for the particular budget requests and the timing for these requests.

The Commissions' goal in the FY 2013 Budget Submission is to *continue its current efforts to streamline Arizona Corporation Commission processes*. This specifically equates to *increased timeliness and efficiency in regard to multiple and overlapping scheduled Commission proceedings*. The centerpiece of this effort is our Hearings Division and the need for a second full-scale Hearing Room to take the burden off our one existing Main Hearing Room currently in use for all Class A Utility rate cases, Commission Open Meetings and other large scale Public Comment Forums. The requested appropriation and associated staffing will reduce the time it takes for a Large Utility Rate case from a current average of 20 months to 9 months. Our second request for funding statewide video-conferencing capabilities will *improve public access for remote public comment and live interaction at Commission meetings and hearings throughout the state*. Finally, funding for the upgraded microfilm reader and printer system will provide us with the *necessary updated technology required for Commission record keeping and document storage*.

Our Budget Request specifically consists of the following three elements:

1. **One Additional Hearing Room** – Sized and outfitted to complement the current main Hearing Room with full hearing capabilities. These include technological capabilities, as well as strategically placed personnel necessary to achieving reduced hearing times.
2. **Statewide Video-Conferencing Capabilities** – To-date the Commission has added the hardware to broadcast hearings from the main Hearing Room. This budget item would allow:
 - A. Installation of permanent hardware, software and wiring in the Hearing Room located at 400 W. Congress, to be able to broadcast hearings from Tucson as we are currently doing in Phoenix through Granicus.
 - B. Additional capabilities for live interactive video and audio teleconferencing hardware in and from Phoenix and Tucson and;
 - C. Add two additional transportable teleconferencing units to remotely broadcast and allow for direct live interaction between the public and the Commissioners throughout the state.
3. **Microfilm Reader and Printer System Upgrade** - Maintain compliance with state statute and conformity with document storage requirements *required* by the Secretary of State and the Division of Library and Archives, Records Retention Center.

During preliminary budget conversations, we have encountered several Frequently Asked Questions. They are included below for your convenience:

General Questions:

- 1) Does the Corporation Commission have authority to tax, charge fees, or otherwise raise revenue? Or is your revenue generating ability controlled entirely by the Legislative process? The Commission's authority to generate/raise revenue is statutory. Applicable statutes provide specific fees to be collected, i.e., Corporations filings, Securities filings, a formula based annual assessment for public utilities, and other minor allowable fees and charges. The ACC does have authority to establish the fee for SDND (Same Day Next Day) service.
- 2) Of the 308.3 Authorized FTE, how many are currently funded/filled? We currently have approximately 255 filled FTEs, with (calculated) funding for approximately 265 FTEs. We anticipate filling vacancies through strategic hiring that would bring us closer to the 265 FTEs. This follows the Governor's request for voluntary compliance (in agencies with elected officials) with a 15% reduction in FTEs and related appropriations during the ongoing budget crisis.

Decision Package Questions

- 3) Setting aside the mandate in the Administrative Code, how critical are time-clock rules for the actual well being of businesses? Are businesses held up if the deadlines aren't met or are they able to manage? How do we know? What kind of feedback have you gotten from the business community regarding their need to meet the deadlines these rules impose? The public utility companies report that time clock rules are extremely critical for their operations in order to provide safe and reasonable services. In rate case proceedings, failure on the part of the ACC to timely address these matters could result in a diminution of utility services. The public utility companies share with the ACC our shortcomings which impact their operations, and are strongly in favor of expediting cases. The larger utilities have shared that delays in hearings can also lead to lost revenues.
- 4) Will you provide an estimate of how much faster would cases would be heard/processed if the "hearing case efficiencies issue" were funded? The ACC's initial expectation will be to meet existing identified timeframes, and then to seek additional efficiencies to further reduce those timeframes. How many more filings would be processed in a year? (you can compare the difference between if the issue is not funded versus if issue is funded). If you can also direct me to any comparisons with other states as far as how quickly we hear and process cases in a year, that could also be helpful for my analysis. We hope to have further comparisons available to share at a later date.
- 5) *Is there a less expensive option for the hearing room? For example, can you hold the meetings at another public venue?* If not, please explain. There is *no identified less costly option*. We have contacted other agencies to inquire about their available spaces, but this isn't a feasible solution for many reasons, *not the least of which is the necessity to have Commissioners and staff available at the Commission offices for other concurrent duties and obligations*. In addition, the ACC must schedule the use of the Tucson Hearing room through the ADOA facilities manager as that facility is a shared state facility. Most Class A case hearings must be held in the main hearing room in Phoenix, in order to allow the listening public the opportunity to follow the case via existing technologies.
- 6) *Why are the two issues tied together (new hearing room and new staff)? Are these items dependent on each other or could one be funded without the other?* The two issues are *inextricably linked and inter-dependent*. The Hearing Room is the much-needed Infrastructure and Technology. The staff component is the critical Support component, without which the Hearing Room is meaningless. The Commission's priority with the creation of the new Hearing Room is to move more case hearings along the process. In order to be effective with a new hearing room, we need to strategically fill vacancies to more efficiently address the various components of rate case analysis, hearings and adjudication.
- 7) What is the ongoing cost of the "hearing case efficiencies" issue? It says 350K is for "initial" renovation/construction. What is ongoing cost of the rest of the issue (personnel etc.). (i.e. how much

of the funding needs to continue into FY14 and cannot be “backed out”). The initial estimate for construction has not yet been validated through ADOA Building and Planning Services. Our figures include replacing the functional components of the existing hearing room and incorporating newer technological advances. Ongoing costs are roughly \$1.6MM URRF, to cover related personnel and ERE costs.

- 8) How much will be saved in travel expenses if the “statewide teleconferencing” issue is funded? How many staff days/hours saved? Please explain your methodology. The purpose of acquiring the teleconferencing equipment is to provide the public greater access to official proceedings. Presently, we have experienced 15-20 ACC commissioners and staff attending public comment sessions statewide and hearings (Tucson) for a single day or many days as the case may dictate. Depending on the driver, staff may lose out on being able to function while traveling to an event.
- 9) Could you train current staff to operate the teleconference equipment instead of hiring a new FTE? Why or why not? It isn't a "training issue", however, it is an issue of not having sufficient staff to perform the duties. We are currently staffing a position with a double fill assignment to meet the needs of the elected officials. This has resulted in a critical shortage of duties being completed in an office from which the staff member was originally located.
- 10) How much less does it cost if we just install hardware in Tucson and Phoenix? A critical component for greater public access is a transportable unit which will still require a human operator. Installing in one location doesn't alleviate the issue when the Commission meets in outlying parts of the state.
- 11) For the “microfilming equipment” issue, are any savings incurred from lower service charges if this issue is funded? We are required by the Secretary of State, Division of Library and Archives to utilize microfilming for long-term storage of public documents, and the upgrade will meet or exceed current technology standards.

Revenues:	<u>FY2007-08</u>	<u>FY2008-09</u>	<u>FY2009-10</u>	<u>FY2011-12</u>	<u>FY2012-13</u>
ACC Generated					
Funds Total:	\$51,787,164	\$69,995,819	\$47,065,700	\$57,529,298	\$51,385,800(est.)
Spending Authority					
(Appropriation):	\$28,930,700	\$27,926,800	\$25,906,700	\$24,768,900	\$24,593,100
Amt ACC sent to GF:	\$38,674,406	\$40,094,900	\$30,659,496	\$30,095,972	\$ n/a

The FY 2013 Budget request is for **an additional \$2,225,400.00** above the FY2012-2013 appropriation.

Assuming approval of our budget submission, the ACC will book ADOA by February 2012, so that construction can begin July 2012, and the new Hearing Room can be operational by October 2012 (start of FY2013 Q2). Space is currently being identified and blocked for an expected quote from ADOA. The Commission is not at liberty to bid this project out.

Any of the Commissioners or the ACC Executive Director are happy to respond to any additional questions or points not covered in this memo, as am I. We appreciate your continued support of the AZ Corporation Commission's ongoing efforts to *ensure that rates, terms and conditions of (utility) services are fair, just and reasonable.*

Thank You!

Lori J. Lustig
Legislative Liaison