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State watchdog agency sues Corporation Commission over water charges



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A state consumer watchdog agency is suing the Arizona Corporation Commission over its decision to allow water companies to charge customers for incremental system improvements without formal rate cases.

The Residential Utility Consumer Office in a lawsuit filed in the Arizona Court of Appeals says the policy violates the state utility rate-making process prescribed in the state Constitution.

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"While it might seem obvious — it still needs to be said — ratepayers should not pay twice for the same infrastructure."

Patrick Quinn, RUCO director

The dispute centers on Arizona Water Co., which serves about 84,000 customers through 19 water systems statewide, including systems serving Oracle, Bisbee and parts of Sierra Vista.

But the policy sets a precedent for some 400 small water systems across Arizona, RUCO Director **Patrick Quinn** said.

"It's a test case — whether we win or lose will set the tone," Quinn said.

The issue began bubbling up in 2011, when Arizona Water filed for a rate adjustment for its so-called Eastern Group water systems. Those systems serve about 24,000 customers in the Apache Junction, Miami and Superior areas as well as about 1,500 customers in Oracle, 1,500 customers in San Manuel, 6,400 customers in Bisbee and Sierra Vista, 90 customers in SaddleBrooke Ranch and about 160 customers in Winkelman.

In February 2013, the Corporation Commission awarded Arizona Water a rate increase for its Eastern systems that allowed a 10.55 percent return on equity — essentially a measure of profit — under the state's cost-of-service regulatory process, partly to help pay for system improvements.

In the same proceeding, the commission directed the parties to come up with a special "distribution system improvement charge" as a way to charge ratepayers for system improvements between formal rate cases, which are costly and can take 18 months to conclude.

Other states have adopted similar measures to allow small utilities to upgrade aging equipment while avoiding the high legal costs and delays of full rate cases.

In June 2013 the Commission approved a system improvement surcharge, called the System Improvement Benefits mechanism — along with the higher return on equity — despite a hearing judge's recommendation that Arizona Water's return on equity be reduced to 10 percent to avoid double recovery of system improvement costs.

RUCO requested a rehearing of the matter, and in May 2013 the same judge reached the same conclusion that both the extra return on equity and the improvements surcharge would amount to double counting.

Arizona Water, in opposing RUCO's request for a rehearing, said there was no legal basis for linking the system improvement charge to return on equity. The company argued that the issue was fully vetted by the Corporation Commission and that reducing the company's return on equity would be an improper partial rescission of the commission's earlier rate decision.

In April, the Corporation Commission approved an amendment offered by Commissioner **Gary Pierce** that allowed both the system improvement surcharge and the higher return on equity.

Quinn said the ruling violates the state Constitution and results in "double recovery" of system improvement costs.

"While it might seem obvious — it still needs to be said — ratepayers should not pay twice for the same infrastructure," Quinn said.

Arizona Water has filed for a system-improvement charge that would cost the typical ratepayer about 82 cents per month, but with allowed annual requests that amount could grow to \$3 monthly by 2017, Quinn said. The Corporation Commission is expected to consider the amount of the improvement charge in July.

RUCO wants the appellate court to rule the system improvement benefit is unconstitutional or alternatively, rule that the extra return on equity is improper. The Corporation Commission has generally approved returns on equity of 9 to 10 percent for water companies, Quinn said.

The Court of Appeals Division One is expected to hear arguments on RUCO's case by sometime this fall.

Meanwhile, several other water companies have filed for system improvement benefits charges, and RUCO plans to challenge each one, Quinn said.

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