



**ARIZONA SUPREME COURT  
ORAL ARGUMENT CASE SUMMARY**



**RESIDENTIAL UTILITY CONSUMER OFFICE v.  
AZ. CORP. COMMISSION/AZ. WATER CO.  
CV-15-0281-PR**

**PARTIES:**

*Petitioners:* Arizona Corporation Commission and Arizona Water Company

*Respondent:* Residential Utility Consumer Office

*Amici Curiae in support of petitioners:* Southwest Gas Corporation; Arizona Public Service Company; EPCOR Water Arizona Inc. and Chaparral City Water Company; Tucson Electric Power Company, UNS Electric, Inc. and UNS Gas, Inc.; Water Utilities Association of Arizona; Arizona Investment Council; Grand Canyon State Electric Cooperative Association, Inc.; and Global Water Resources, Inc.

*Amici Curiae in support of respondent:* The League of Arizona Cities and Towns; Arizona Center for Law in the Public Interest; and Energy Freedom Coalition of America

**FACTS:**

The Arizona Corporation Commission regulates rates charged by public service corporations, including Arizona Water Company (“AWC”), a utility that provides water service to nineteen systems in Arizona. Residential Utility Consumer Office (“RUCO”) is a state agency established to represent the interests of residential utility consumers in Commission proceedings.

Ariz. Const. Article XV, § 14 provides that the Commission “shall, to aid it in the proper discharge of its duties, ascertain the fair value of the property within the State of every public service corporation doing business therein . . . “

Water utilities like AWC are entitled to recover their costs of providing service in Arizona. The Commission generally determines costs during rate cases processed pursuant to the Commission’s Rule 103. Those proceedings are procedurally complex, and typically take more than a year to process.

Currently, AWC is undertaking extensive capital improvements due to the age of its systems. AWC’s capital improvements are estimated to cost approximately \$67 million in one division alone over the next ten years. Beginning in 2011, AWC applied to the Commission for rate increases for two of its water system divisions. In an attempt to avoid a series of rate cases, AWC proposed a step increase mechanism, modeled after a step mechanism employed in Pennsylvania, to accelerate its recovery of the costs of its capital improvements. The requested

mechanism, called a distribution system improvements charge or “DSIC,” permitted AWC to recover certain capital costs for improvement projects related to its distribution system and aging infrastructure. DSIC provided for relatively automatic rate increases between rate cases. RUCO intervened in the Commission proceedings.

The Commission’s Staff and RUCO both opposed the DSIC proposal in a hearing before an administrative law judge. The Staff argued that “allowing recovery of capital improvement costs between regular rate cases results in less scrutiny of plant investments both as to the prudence and the use and usefulness of the plant.” The Commission rejected the DSIC proposal based on the recommendation of the administrative law judge. However, due to the magnitude of AWC’s construction project, the Commission remanded the issue to allow the parties to attempt to agree upon a satisfactory step mechanism. The Staff and AWC entered into a settlement agreement that included a modified version of DSIC, called a “SIB” (for “system improvement benefits”).

The SIB is a tariff, like a DSIC, that allows AWC, with Commission approval, to add surcharges to customers’ water bills for up to five years to recoup certain capital costs (depreciation expenses and pre-tax return on investment) of defined infrastructure replacement projects completed by AWC before its next rate case.

RUCO opposed the SIB proposal, arguing that AWC’s filing must include all of the rate case elements in order to satisfy the Arizona Constitution’s requirement of a fair value determination. In response, the Commission added a number of elements to the SIB filing requirements.

After a hearing and further evidentiary proceedings, an administrative law judge recommended approval of the settlement including the modified SIB mechanism. In its final decision, the Commission approved the modified SIB mechanism.

RUCO filed a timely notice of appeal, arguing that the SIB mechanism was an impermissible attempt to adjust rates outside of a full rate case. The court of appeals agreed, and vacated the Commission’s approval of the SIB proposal on the ground that it failed to provide the functional equivalent of a fair value determination as required by the Arizona Constitution. The Arizona Supreme Court granted review, specifying that the parties should address the issue set forth below.

**ISSUE:**

Whether the system improvements benefits (“SIB”) mechanism approved by the Arizona Corporation Commission complies with the Arizona Constitution’s mandate that the Commission determine a public service corporation’s fair value when setting rates.

*This Summary was prepared by the Arizona Supreme Court Staff Attorneys’ Office solely for educational purposes. It should not be considered official commentary by the Court or any member thereof or part of any brief, memorandum, or other pleading filed in this case.*