IN THE
ARIZONA COURT OF APPEALS
DIVISION ONE

ARIZONA SCHOOL BOARDS ASSOCIATION and ARIZONA ASSOCIATION OF SCHOOL BUSINESS OFFICIALS, *Appellants*,

v.

ARIZONA CORPORATION COMMISSION, *Appellee*,

ARIZONA PUBLIC SERVICE COMPANY, *Intervenor*.

No. 1 CA-CC 15-0001
FILED 9-26-2017

Arizona Corporation Commission
Nos. 74876, 74948

AFFIRMED

COUNSEL

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Counsel for Appellants

Arizona Corporation Commission, Phoenix
By Maureen A. Scott, Janet F. Wagner, and Charles H. Hains
Counsel for Appellee

Pinnacle West Capital Corporation, Phoenix
By Thomas A. Loquvam, Thomas L. Mumaw, and Melissa M. Krueger
Counsel for Intervenor

MEMORANDUM DECISION

Acting Presiding Judge Donn Kessler[1] delivered the decision of the Court, in which Judges Michael J. Brown and Randall M. Howe joined.

K E S S L E R, Judge:

¶1 The Arizona School Board Association and the Arizona Association of School Business Officials (collectively, the "Association") appeal the decision of the Arizona Corporation Commission (the "Commission") approving an interim rate increase requested by Arizona Public Service ("APS"). The Association argues the increase violates the Commission's mandate to set just and reasonable rates by ascertaining the fair value of APS's property at the time the Commission sets the rate. The Association contends the increase was based solely on APS's cost of acquiring additional power plants without considering other changes to the fair value of APS's property since 2010, thus failing to meet the requirements for interim rate increases set forth in *Residential Utility Consumer Office v. Arizona Corp. Commission*, 240 Ariz. 108 (2016) ("*RUCO*"). For the reasons stated below, we affirm.

FACTUAL AND PROCEDURAL HISTORY

I. The 2012 Rate Increase

¶2 In November 2010, APS sought Commission approval to purchase Southern California Edison's interest in Four Corners Units 4 and 5, and "to defer for possible later recovery through rates of all non-fuel costs . . . of owning, operating, and maintaining . . . Units 4 and 5 and associated facilities, as well as unrecovered costs associated with . . . [its existing] Units 1-3 and additional costs incurred in connection with the closure of . . . Units 1-3." The Commission approved the acquisition of Four Corners Unit 4 and 5 and the deferral in Decision 73130. APS acquired the units on December 30, 2013 for $182 million (the "Acquisition").

[1] The Honorable Donn Kessler, Retired Judge of the Court of Appeals, Division One, has been authorized to sit in this matter pursuant to Article VI, Section 3 of the Arizona Constitution.

¶3 In June 2011, during this approval process, APS filed a general rate case. APS sought an adjustment of 3.3% ($95.5 million) net increase in base rates to become effective July 2012. The Association and other parties intervened. Eventually a settlement agreement was entered into by a majority of the parties, but not the Association ("2011 Settlement"). After hearings, in May 2012 the Commission approved the 2011 Settlement in Decision 73183. The Commission's order also provided, in accordance with the 2011 Settlement, that the rate case "shall remain open for the sole purpose to allow [APS] to file by December 31, 2013, an application for approval to adjust its rate to reflect the acquisition of Four Corners Units 4 and 5" ("Four Corners Rate Rider").

¶4 Decision 73183 also required APS to provide updated financial information including: (1) the most recent balance sheet; (2) the most current income statement at the time of filing; (3) an earning schedule that demonstrates the operating income resulting from the rate adjustment does not result in a return on rate base in excess of that authorized by the 2011 Settlement in the period after the adjustment becomes effective; (4) a revenue requirement calculation; (5) an adjustment rider that recovers the rate base and non-fuel related expenses associated with the Acquisition; (6) an adjusted rate base schedule; and (7) a typical bill analysis under present and filed rates.

II. The 2015 Four Corners Rate Rider

¶5 In December 2013, noting the consummation of the Acquisition, APS filed an application to approve the Four Corners Rate Rider per the Commission's instruction in Decision 73183. APS submitted updated financial information required by Decision 73183, including rate base schedules through the end of March 2012 that incorporated the Acquisition, financial statements setting forth incremental adjustments for acquisition of Units 4 and 5 and retirement of Units 1 through 3, and the assumed six-month cost of deferral.

¶6 In the Four Corners Rate Rider application, APS requested a rate increase of 2% ($62.53 million) to reflect costs of acquiring the new units, retiring the old units, and the deferred cost authorized by Decision 73130. APS calculated the incremental addition to the rate base associated with the Four Corners transactions at $217.63 million and the resulting revenue requirement using that single rate based addition at $62.53 million. Apart from the Acquisition, APS did not propose other changes or adjustments to the rate base found in Decision 73183 that had occurred since the end of the 2010 test year.

¶7 In post-hearing briefing the Association objected to the requested increase because it only considered the additional base rate attributable to the Acquisition. The Association maintained there was no effort to update the fair value rate base ("FVRB") except for the Acquisition, but "[t]here have undoubtedly been numerous changes to the rate base on the last four years." The Association argued that "fair value" means the value at the time of inquiry or as close as possible to it. It asserted that the Commission cannot single out one item of expense for rate treatment while excluding other elements of revenues and expenses that had changed since the test year. The Association claimed that there was no evidence that the return determined appropriate in the Commission's 2012 order continued to be appropriate two-and-a-half years later and that there had been no evaluation of current revenues and expenses. The Association maintained that "[s]imply keeping an old rate case open to use its fair value determination without an examination of all current revenues and expenses does not satisfy Arizona's constitutional requirements."

¶8 In December 2014, the Commission approved the Four Corners Rate Rider through a 2.03% rate increase to be applied equally to all customer bills, resulting in an annual revenue requirement of $57.05 million in Decision 74876. The Commission determined APS provided the information required by Decision 73183, that it had the necessary factual record to adjust rates set therein, and that it was just and reasonable to approve the adjustment rates set by Decision 73183 to recover the rate base and expense effects of the Acquisition.

¶9 The Association moved for rehearing, again arguing the Commission did not find fair value. The Association claimed that the decision was unlawful for two reasons: (1) it approved a revenue increase without a finding of fair value as required by the constitution and, even assuming fair value from the 2012 proceedings is included, there is no finding of fair value of all APS's property at the time the rate was set, but rather only for those properties from the 2010 test year; and (2) the Four Corners Rate Rider only focuses on one element of the company's costs — the Acquisition — and is therefore single issue rate making which is generally prohibited. Thus, the rates are not just and reasonable as required by the Arizona Constitution. The Association maintained that the updated financial analysis promised in 2012 "is totally lacking" and that there is no discussion about the financial information submitted by APS or impact of the rate increase on APS's earnings.

¶10 The Commission granted rehearing and on February 9, 2015, in Decision 74948, it amended its decision by identifying the incremental

rate base associated with the Acquisition over two years earlier in Decision 73183: "The [FVRB] in Decision No. 73183 is $8,167,126,000. The Four Corners acquisition resulted in a $225,933,911 addition to the FVRB found in [that decision]. Thus, the total FVRB including the [A]cquisition is $8,393,059,911." The Commission also added that:

> Contrary to the School Associations' argument at page 3 of its request for rehearing, APS filed updated financial information related to the Company's earnings and return. This Commission and Staff carefully considered that updated information in this matter. No party, including the School Associations, challenged APS's updated numbers or offered any alternative calculations for the Commission to consider.

See Ariz. Rev. Stat. ("A.R.S.") § 40-254.01(B) (2017) (providing amended order replaces original order).[2]

¶11 The Association filed a timely notice of direct appeal from the Four Corners Rate Rider approval pursuant to A.R.S. § 40-254.01.[3] We have jurisdiction pursuant to A.R.S. § 40-254.01(A).

DISCUSSION

¶12 While this appeal was pending, the Arizona Supreme Court issued *RUCO*. We ordered, and the parties filed, supplemental briefs on the effect of *RUCO* on this appeal. Since the parties agree and we concur that the reasoning in *RUCO* should dictate the result here, we focus on the arguments in the supplemental briefs and *RUCO*.

¶13 As explained in *RUCO*, whether the Commission's rate setting mechanism complies with the Arizona Constitution is a question of law we review de novo. *RUCO*, 240 Ariz. at 111, ¶ 10 (citation omitted). However, we presume the Commission's actions are constitutional and uphold them unless they are arbitrary or an abuse of discretion. *Id.* at 111, ¶ 10, 112, ¶ 15 (citations omitted). On appeal, the Association "must make a clear and satisfactory showing that the [Commission's] order is unlawful or unreasonable." A.R.S. § 40-254.01(E); *see Consol. Water Utils., Ltd. v. Ariz. Corp. Comm'n*, 178 Ariz. 478, 481 (1993) (citation omitted) ("'Clear and satisfactory' evidence means the same as 'clear and convincing' evidence.");

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[2] We cite to the current version of statutes unless changes material to this decision have occurred.

[3] In August 2015, we permitted APS to intervene in the appeal.

Tucson Elec. Power Co. v. Ariz. Corp. Comm'n, 132 Ariz. 240, 243 (1982) (citation omitted) (explaining clear and satisfactory "is a standard of proof greater than 'by a preponderance of the evidence'").

¶14 The issue in this case is whether the Commission's approval of the Four Corners Rate Rider, like the systems improvement benefit ("SIB") used in *RUCO*, complies with Arizona Constitution Article 15, Section 14, which provides in pertinent part that the Commission "shall . . . ascertain the fair value of the property . . . of every public service corporation" in determining rates. Ariz. Const. art. 15, § 14. As *RUCO* explains, while the Commission has broad powers on how to set rates, *RUCO*, 240 Ariz. at 111, ¶ 12, the Commission must "base rates on the current fair value of the utility's property," *id*. at 112, ¶ 13.

¶15 The Association argues the Commission failed to fulfill its constitutional mandate to find fair value at the time it set rates in 2014 and 2015 because, unlike *RUCO*, it relied on the data from 2012 and updated data relating only to the Acquisition. APS and the Commission argue that the data used in the Four Corners Rate Rider proceedings complies with the requirements of *RUCO*.[4]

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[4] The Commission and APS also argue that the Association did not object during the 2012 proceedings, which permitted updated information related to the Acquisition, nor did they seek rehearing or appeal that final order, and thus, this appeal is a collateral attack on the 2012 orders. We disagree. The premise for the collateral attack argument is that the 2012 decisions were a part of a separate proceeding. However, APS and the Commission contend that the mechanism used in the 2012 rate increase and the Four Corners Rate Rider should be viewed together to meet constitutional muster. They cannot have it both ways. Because we agree that the 2012, 2014, and 2015 decisions were two phases in a single rate case, we disagree that the Association's appeal is an impermissible collateral attack because it raises issues that depend upon, flow from, and implicate the 2012 proceedings.

Nor can we agree with the Commission's argument that the Association is estopped from raising the issues about updated information for the Four Corners Rate Rider because the Association did not raise this issue as part of the 2012 proceedings. As noted *supra* ¶ 4, in allowing APS to seek the later Four Corners Rate Rider, the Commission ordered APS to provide additional updated information about its rate base. An appeal

III. Determination of an FVRB After *RUCO*

¶16 As explained most recently in *RUCO*, the Commission is charged with constitutional and statutory duties to set "just and reasonable" rates for public service utilities. *Id.* at 111-12, ¶¶ 11-12 (quoting Ariz. Const. art. 15, §§ 3, 14). Moreover, for private, for-profit public service utilities, the Commission must determine fair value of the utilities property to calculate a reasonable return on investment and a proper rate. *Id*. at 112, ¶ 13 (citations omitted). With limited exceptions, fair value must be determined when the rates are set. *Id.* (citations omitted). The fair value requirement applies only to the rate base in traditional ratemaking. *Id*. at ¶ 14 (citations omitted).

¶17 One way to determine rates is to have a full rate case. However, that is not constitutionally required. *Id*. at ¶ 15. The Commission can have interim proceedings. *Id*. Thus, in *RUCO*, the Commission approved an SIB method allowing it to adjust rates between full rate cases to help the utility recoup the cost of newly-completed infrastructure. *Id*. at 109, ¶ 1. Under that process, the utility was undertaking capital improvements to its pipelines and filed two rate increase applications with a step-increase mechanism that would allow the Commission to adjust rates between full rate cases as the new infrastructure projects became active. *Id.* at 110, ¶¶ 2-3. As approved by the Commission, the SIB required the utility to file a full rate case at least every five years and, within the rate case, the Commission had to evaluate and preapprove all SIB-eligible infrastructure replacement projects. *Id.* at ¶ 7. During interim years, the utility could file for only one SIB surcharge per year. *Id.* As part of that process, the utility had to "submit current financial documents, including a balance sheet reflecting the value of its property — both older infrastructure and newly-constructed SIB projects that are in use." *Id.* at ¶ 8. Tax multipliers, depreciation rates and authorized rates of return for the SIB had to be the same as those approved in the most recent rate case. *Id*. at 110-11, ¶ 8.

¶18 The supreme court approved the SIB interim rate mechanism subject to certain conditions. To ensure the rate adjustments were based on a current finding of fair value of utility property, the Commission must use

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from the 2012 proceedings would have been premature and speculative until the Association could determine if the additional filings for the Four Corners Rate Rider updated the value of APS's property generally. The Association challenges the Four Corners Rate Rider proceedings, arguing that not all the financial information and analysis promised in 2012 actually occurred in the proceedings approving the Four Corners Rate Rider.

supplemental and updated fair value from the previous rate case. *Id.* at 113, ¶ 18. The court held that this requirement was met because:

> The mechanism uses the fair value determination made in the previous rate case and adds the value of the infrastructure improvements once they are made. [The utility] must submit up-to-date financial statements with each SIB surcharge application, including an adjusted rate base schedule in which the value of operational SIB projects is added to the underlying rate base from the previous rate case. Using these financial statements, the Commission will also update the [FVRB] and other elements of the formula from the most recent rate case to "recognize changes in plant, accumulated depreciation, contributions in aid of construction, advances in aid of construction, and accumulated deferred income taxes . . . ." Although the Commission will not re-calculate anew every input into the fair value determination, this updated measurement satisfies the constitutional requirement that the Commission "ascertain the fair value" of a public utility's property "to aid it in the proper discharge of its duties."

Id. at 112-13, ¶ 16 (citations omitted).

¶19 Thus, to see if the Four Corners Rate Rider procedure complied with the constitution, we must see if, when it approved the rider, the Commission had before it not only the 2010 test year data from the 2012 proceedings,[5] but also the value of the new property (improvements or acquisitions) and updated financial statements from the utility, including the addition of the new property to the values of the property from the earlier rate case. Moreover, the Commission must then recognize changes in plant, accumulated depreciation, contributions in aid of construction, advances in aid of construction, and accumulated deferred income taxes. However, the Commission does not have to recalculate anew every input into the fair value determination.

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[5] As a practical matter, in determining an appropriate FVRB the Commission generally "adopts a test year from which to project the future capital expenditures and income needs of the utility." *Tucson Elec. Power Co.*, 132 Ariz. at 246; *see Ariz. Corp. Comm'n v. Ariz. Pub. Serv. Co.*, 113 Ariz. 368, 370 (1976) (rejecting argument that fair value based on the use of a historic test year is prospectively confiscatory because use of test year allegedly produces rate that is obsolete before it is set).

IV. APS and the Commission Complied with *RUCO*

¶20 The Association attacks the approval of the Four Corners Rate Rider on two grounds. First, the Association argues that while — as it conceded at oral argument — APS submitted to the Commission updates or adjustments reflecting most other additions or reductions based on retirements, new investments, depreciation or changes in plant, accumulated depreciation, contributions in aid of construction, advances in aid of construction, or accumulated deferred income taxes, the Commission did not comply with *RUCO*. The Association argues that the Commission did not consider those submissions as part of a "new" fair value determination after the Acquisition, but merely added the increased value associated with the Acquisition to the fair value determined in May 2012. At oral argument, the Association argued that the Commission is required to update other factors even if they are unrelated to the Acquisition. Second, contending that the Commission's approval of the Four Corners Rate Rider was not current under *RUCO*, the Association asserts the approval violated *Scates v. Arizona Corp. Commission*, 118 Ariz. 531 (App. 1978), because no one can tell if the increase affected APS's rate of return. Of course, if APS and the Commission complied with *RUCO*, then *Scates* has no bearing on our analysis because the supreme court rejected *Scates* to the extent that the determination of fair market value was current when the rate increase was approved. *RUCO*, 240 Ariz. at 113, ¶ 19.

¶21 In contrast, the Commission contends that those other updated factors unrelated to the Acquisition go to earnings and not fair value and that the record shows the Commission considered those unrelated factors not in determining value of APS property, but to ensure that any increased rates were fair and reasonable. APS argues the financial information it provided to the Commission to approve the Four Corners Rate Rider complied with *RUCO* because *RUCO* only requires the utility to submit an adjusted rate base schedule which reflects the value of additional property added to the underlying rate base from the previous case and up-to-date financial statements. APS also explains that any consideration of changes in plant, accumulated depreciation, contributions and advances in aid of construction, and accumulated deferred income taxes under *RUCO* are used solely to calculate the earnings test to put a cap on any surcharges rather than to determine fair value. APS and the Commission argue that the Commission used that data as part of an earnings test to ensure APS would not exceed the authorized rate of return from the 2012 order. APS and the Commission finally argue that the Commission did not violate *Scates* because updating the fair value avoided the error in *Scates* in which rates were approved without consideration of fair value.

¶22 We conclude that APS and the Commission complied with *RUCO*.[6] First, as the Association conceded at oral argument, APS submitted updated financial data for determination of FVRB reflecting the Acquisition and the retirement of Units 1-3 as well as other property owned by APS.

¶23 Second, the record does not support the crux of the Association's *RUCO* argument — as crystallized at oral argument — that the Commission did not consider financial updates unrelated to the Acquisition and thus the Commission failed to meet its constitutional rate-making mandate. As the Commission pointed out at oral argument, the record shows that one of its witnesses reviewed those factors to determine whether any increased rate would be fair and reasonable as it affected earnings for APS. That expert explained that while he did not study all the effects of that updated financial information, the assumptions underlying APS's data seemed to meet historical trends and that APS's earnings would not be better by adoption of the rate request.

¶24 Third, we fail to see how the Association's argument that the Commission was required to update and reanalyze all other changes to APS's financial position since the 2012 orders is consistent with *RUCO*. As the supreme court made clear, interim rate increases based on specific changes in rate base do not require a full-blown rate increase hearing with the Commission having to recalculate anew every input into the fair value determination. *RUCO* at 112-13, ¶¶ 15-17. Rather, the court explained that on each interim addition, a utility must submit "up-to-date financial statements . . . including an adjusted rate base schedule in which the value of the [addition] is added to the underlying rate base from the previous rate case" and the Commission "will then update the fair value rate base and other elements of the formula from the most recent rate case to 'recognize changes in plant, accumulated depreciation, contributions in aid of construction, advances in aid of construction, and accumulated deferred income taxes . . . .'" *Id.* at 112-13, ¶ 16. We understand this to mean that in determining FVRB, the Commission need only rely on updated information related to the Acquisition. Other factors, like those referenced in *RUCO*, relate only to the earnings test to ensure that any rate increase based on an interim event is still fair and reasonable. When the evidence shows, as it does here, that the Commission considered all the financial updates related

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[6] Given our holding, we need not discuss the alternative arguments raised by APS and the Commission regarding whether the rates approved by the Four Corners Rate Rider are just and reasonable or whether an immediate refund of amounts collected under the Four Corners Rate Rider was required.

to the Acquisition to determine FVRB, and then considered financial updates unrelated to the interim event to ensure any rate increase is fair and reasonable, the Commission complies with *RUCO* absent a conclusion the Commission failed to properly consider the financial updates unrelated to the interim event. The Commission did not err in approving the Four Corners Rate Rider.

V. Attorneys' Fees

¶25 Finally, the Association argues that it is entitled to attorneys' fees pursuant to the Private Attorney General Doctrine because it has vindicated important public interests. The Commission argues it has not met the criteria. Given that the Association has not prevailed, we decline to award attorneys' fees. *Arnold v. Ariz. Dep't of Health Servs.*, 160 Ariz. 593, 609 (App. 1989) (noting that attorneys' fees can be awarded under the private attorney general doctrine when plaintiffs have prevailed in vindicating important public interests).

CONCLUSION

¶26 For the reasons stated, we affirm.