Meghan H. Grabel (021362)
OSBORN MALEDON, P.A.
2929 North Central Avenue, Suite 2100
Phoenix, Arizona 85012-2793
(602) 640-9000
mgrabel@omlaw.com

Attorney for Arizona Water Company

SUPREME COURT OF ARIZONA

SUN CITY HOME OWNERS ASSOCIATION, Petitioner/Appellant, v. THE ARIZONA CORPORATION COMMISSION, Respondent/Appellees EPCOR WATER ARIZONA, INC. and VERRADO COMMUNITY ASSOCIATION, INC., Intervenors.	Arizona Supreme Court No. CV-20-0047-PR Court of Appeals Division No. 1 CA-CC 17-0002 Arizona Corporation Commission Docket No. WS-01303A-16-0145 Decision No. 76162 **AMICUS CURIAE BRIEF OF ARIZONA WATER COMPANY**

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Constitutional Provisions

Statutes

Other Authorities

INTRODUCTION

On the issues accepted for review, this Court should (1) recognize, consistent with *Johnson Utilities, L.L.C. v. Arizona Corp. Commission*, 249 Ariz. 215 (2020), that approving consolidated rates is within the Arizona Corporation Commission's ("Commission") plenary ratemaking authority; (2) affirm that consolidated rates are neither discriminatory generally nor as applied here; and (3) confirm the existence of an appropriately deferential standard of review for Commission ratemaking decisions as established by the Arizona Constitution, Arizona statutes, and this Court's and other Arizona courts' well-established caselaw.

First, as reaffirmed and clarified by *Johnson Utilities*, the Commission's plenary authority to set "just and reasonable classifications" based on customers who receive "like and contemporaneous service" as part of its ratemaking authority must include the authority to both (1) consolidate customers into classes and (2) differentiate between classes of customers. Ariz. Const. art. XV, § 3; § 12. Any grouping of more than one customer together into a single ratemaking class is inherently an act of consolidation. Any creation of new class of customers, such as residential or commercial, is inherently an act of differentiation. Both acts are

common, long-used ratemaking tools in Arizona that are clearly well-within the Commission's plenary, exclusive, and self-executing ratemaking authority.

Second, only when consolidation or differentiation are "unjust" or "unreasonable" uses of the Commission's classification authority do they violate the Arizona Constitution and Arizona statutes. On such matters, the Commission necessarily holds discretion, subject to review by the Courts. In this case, the Commission's approval of consolidated wastewater rates for EPCOR customers was not unjust, unreasonable, or an abuse of its discretion.

Third, regardless of how the Court views the phrase "extreme deference," it should recognize the existence of an appropriately deferential standard of review for Commission approval of consolidated ratemaking consistent with the Arizona Constitution, Arizona statutes, and this Court's and other Arizona courts' well-established caselaw. Under any appropriate standard of review, the Commission's use of consolidation generally, and approval of EPCOR's consolidated wastewater rates specifically, should stand.

INTERESTS OF *AMICUS CURIAE*

Amicus Curiae Arizona Water is the second largest Commission-regulated water utility in Arizona. Arizona Water, whose corporate headquarters is in Phoenix, Arizona, operates 21 water systems that provide water service to over 250,000 people in more than thirty communities in eight counties throughout the State.

Arizona Water has an interest in this matter because it is a public service corporation regulated by the Commission and the scope of the Commission's ratemaking authority has a direct effect on its operations. The Commission's decision to approve consolidated rates for EPCOR is neither novel nor a departure from past Commission practice. The Commission has authorized Arizona Water to consolidate rates in most of its water systems; in fact, Arizona Water's 21 water systems are consolidated into three groups for ratemaking purposes: the Western Group, the Eastern Group, and the Northern Group. Some of these consolidated rates are almost twenty years old. Arizona Water plans to continue seeking the Commission's approval to consolidate customer rates in its three ratemaking groups in the future because rate consolidation

benefits customers and the Company, and is just and reasonable ratemaking policy and good public policy.

ARGUMENT

I. The Commission's power to approve consolidated rates is well-within its plenary ratemaking authority.

Article XV, section 3 of the Arizona Constitution states:

> The corporation commission shall have full power to, and shall, prescribe just and reasonable classifications to be used and just and reasonable rates and charges to be made and collected, by public service corporations within the state for service rendered therein; . . . Provided further, that classifications, rates, charges, rules, regulations, orders, and forms or systems prescribed or made by said corporation commission may from time to time be amended or repealed by such commission.

As explained by this Court in *Johnson Utilities*, "[t]he first clause of section 3, which describes the Commission's authority to 'prescribe just and reasonable *classifications* . . . rates and charges' for [public service corporations], is referred to as the Commission's 'ratemaking authority.'" *Johnson Utilities*, 249 Ariz. at 220, ¶ 19.

There are at least three aspects of the scope of the Commission's ratemaking authority recognized by this Court that are relevant to the question of whether the Commission has authority to approve consolidated rates.

First, the Commission's plenary ratemaking authority necessarily includes plenary authority to classify, consolidate, and differentiate customers and classes of customers. As this Court has made clear: "[t]he Commission's ratemaking authority under article 15, section 3 is plenary. The ratemaking clause states that the Commission has '*full power*' to prescribe rules, regulations, and orders governing [public service corporation] rates, charges, and *classifications*." *Id.* at 221, ¶ 21. (second emphasis added). In the seminal case on the Commission's ratemaking authority, *State v. Tucson Gas, Electric Light & Power Co.*, with nearly every reference to the Commission's ratemaking authority, the Court discusses the Commission's "full power to prescribe just and reasonable classifications." 15 Ariz. 294, 297 (1914).

Second, the self-executing nature of section 3 extends to the Commission's classification, consolidation, and differentiation authority. "The Commission's ratemaking authority is also self-executing.

Specifically, because section 3 grants the Commission authority to make rules, regulations and orders, no legislative action is necessary to enable the Commission to exercise its ratemaking powers." *Johnson Utilities*, 249 Ariz. at 221, ¶ 22. Like the provision in section 3 granting the Commission self-executing authority to set rates, the provision giving the Commission's authority to set classifications "grants a right which can be put into operation without further legislative action." *Miller v. Wilson*, 59 Ariz. 403, 408 (1942).

Third, the exclusive nature of the Commission's ratemaking authority extends to its ratemaking classification, consolidation, and differentiation authority. "[T]he Arizona Constitution, by its terms, makes ratemaking the exclusive responsibility of the Commission; it cannot delegate this authority to another agency or branch of government. . . . The drafters stressed the mandatory nature of the term 'shall' in the ratemaking clause by using the permissive term 'may' in the second clause of section 3 to describe the Commission's authority over public health and safety." *Johnson Utilities*, 249 Ariz. at 221, ¶ 23. For more than a century, this Court has held that "[t]o *prescribe classifications*, rates, and charges of public service corporations is the duty, and the exclusive duty, of the Corporation

Commission." *Ariz. E. R.R. Co. v. State*, 19 Ariz. 409, 413–14 (1918) (emphasis added).

The power to approve consolidated rates is thus well-within with the long-recognized scope of the Commission's ratemaking and classification authority. As the Court in *Johnson Utilities* described, the Commission's power under section 3 to prescribe rules, regulations, and orders regarding rate classifications is full, exclusive, and self-executing. Inherent in the power to classify customers for ratemaking purposes is the power to group them according to "like and contemporaneous services" (consolidate) and decide when to create separate classes if services are unlike or asynchronous (differentiate). As explained below, neither consolidation nor differentiation is inherently discriminatory.

II. Consolidated rates are not inherently discriminatory, nor was the consolidated rate approved by the Commission for EPCOR in this case discriminatory.

Article XV, section 12 of the Arizona Constitution distinguishes charges that are "just and reasonable" from those that are discriminatory:

> All charges made for service rendered, or to be rendered, by public service corporations within this state shall be just and reasonable, and no discrimination in charges, service, or

> facilities shall be made between persons or places for rendering a like and contemporaneous service.

A.R.S. § 40-334 likewise prohibits public service corporations from discriminating against customers and emphasizes that discrimination is found only when the utility applies preferential or prejudicial treatment to a "person" or maintains "unreasonable" differences in rates and charges between localities or classes of service. *See* A.R.S. § 40-334(A)-(B).

These anti-discrimination provisions related to ratemaking in the Arizona Constitution and related statutes must therefore be read in harmony with the constitutional provisions requiring the Commission to set "just and reasonable rates" and "just and reasonable classifications" based on customers who receive "like and contemporaneous service." Ariz. Const. art. XV, § 3; § 12.

Taken together, these provisions mean that only when rate classification, consolidation, or differentiation become unjust or unreasonable do they discriminate and violate the Constitution and related statutes. Specific to this case, consolidation is nothing more or less than the Commission classifying customers into groups based on "like and contemporaneous services." It is no more inherently discriminatory than

any other act the Commission may take to classify or differentiate customers.

In one of the few cases to address arguments of discrimination related to consolidation, the United States Court of Appeals for the District of Columbia Circuit agreed that the act of consolidation is not inherently discriminatory. *See Ala. Elect. Co-op., Inc. v. F.E.R.C.*, 684 F.2d 20 (D.C. Cir. 1982). In *Alabama Electric*, the agency, the Federal Energy Regulatory Commission ("FERC") approved a uniform rate for two classes of customers creating a 0.45 difference in rate of return. When one class of customers raised this issue, FERC determined the challenge was time-barred and refused to address it. On appeal, the court held that the challenge was timely brought and remanded to FERC to determine whether the uniform rate was unlawfully discriminatory. In providing direction to FERC on remand, the court noted that a single uniform rate applied to more than one class of customers may "be unlawfully discriminatory" if it "creates an *undue disparity* between the rates of return on sales to different groups of customers." *Id.* at 27 (emphasis added). The court noted, however, several reasons why a uniform rate may not be unlawfully discriminatory, including (1) "even under a purely cost-based

rate scheme, absolute equivalence of overall rates of return among similar customer groups is little more than an ideal;" and (2) it would "be impossible . . . to formulate a rate scheme with such precision that each customer-or even customer group-is made to bear the exact cost of the service [s]he received." *Id.* at 28. Further, similar to the Arizona constitutional and statutory restrictions on discrimination, the federal anti-discrimination statute at issue in *Alabama Electric* "proscribe[d] only 'any unreasonable difference in rates' and 'any undue preference or advantage.'" *Id.* (quoting 16 U.S.C. 824d(b)).

On remand, FERC correctly determined the uniform rate was not unlawfully discriminatory. *Ala. Power Co.*, 23 FERC ¶ 61392 (F.E.R.C. 1983), *corrected*, 24 FERC ¶ 61396 (F.E.R.C. 1983). First, FERC noted the universal truth in ratemaking that "[w]henever customers with similar characteristics are placed in a rate class, differences in earned return will result" because "[n]o two customers have identical cost-of-service features." *Id.* ¶ 61832. Next, FERC recognized that "[w]hen there is sufficient similarity to place customers in one rate class, it is difficult to see how the disparities in earned returns amounts to 'undue' discrimination." *Id.* Ultimately, FERC determined that the disparity in costs between the two classes of customers

was (1) "inherent when two or more customers are placed in a single class," (2) "not an insignificant disparity but [not] so significant that it would work undue discrimination," (3) "foreseeable," and (4) something that "must be tolerated in order to preserve the Commission's orderly and reasonable system of customer classes and rate design." *Id.* ¶ 61833.

Consistent with the ultimate resolution of the *Alabama Electric* matter, this Court should reject any argument that difference in costs of service between customers are discriminatory either inherently or as applied to this case. As both the court in *Alabama Electric* and FERC recognized, even within largely homogeneous classes of customers with "like and contemporaneous service," each individual customer has differences in their cost of service when considering the multitude of factors at play. Those factors include but are not limited to distances from the source of service, equipment required to provide service to various locations, energy and water supply required to provide service to various locations, use of service by the ratepayer, and maintenance costs associated with all of the above. For this reason, the Court of Appeals below correctly declined to "interpret the constitutional prohibition on 'discrimination in charges, services, or facilities . . . between persons or places' as mandating different

charges based on location." *Sun City Home Owners Ass'n v. Ariz. Corp. Comm'n*, 248 Ariz. 291, 298, ¶ 20 (App. 2020).

Petitioners and the dissenting opinion below take issue with the rate consolidation approved by the Commission in this case because Sun City was previously served by a different public service corporation that did not classify Sun City residents in the same class with other wastewater customers. Yet there is nothing discriminatory or unlawful about a public service corporation classifying its own customers into groups based on their type of service so long as there has been a reasonable determination that the services provided to all those customers are actually "like and contemporaneous." Indeed, the very fact that customers in these groups all now receive service from the same public service corporation is conclusive evidence that the service is contemporaneous. And, in this case, there was also strong evidence presented to the Commission that services across the EPCOR districts were "like." *Id.* ¶¶ 20-23. As noted by the Court of Appeals, the record before the Commission reflected that "all EPCOR customers receive the same exact service, the same customer service, the same billing systems, and the same operations teams and that the costs for

operation, maintenance, and administrative tasks are relatively the same across the districts." *Id.* ¶ 22 (internal quotations and alterations omitted).

While *Alabama Electric* and the subsequent FERC order are instructive on the issue of discrimination, they are inapplicable to the question of whether a remand to the Commission is necessary. As noted above, in *Alabama Electric*, FERC initially refused to address the discrimination argument after determining it was time-barred. There was therefore no agency decision in the record for the court to consider on this issue. In contrast, the Commission here grappled directly with the questions of whether EPCOR's districts were like and contemporaneous enough that allowing them to consolidate would not be unjust, unreasonable, or unlawfully discriminatory. As explained by the Court of Appeals, "[t]he Commission resolved conflicting evidence in favor of finding that the customers within the consolidated district receive like and contemporaneous wastewater services." *Id.*

Remanding to the Commission would result only in the conclusion it already reached: the EPCOR districts receive like and similar services, and differences in cost of service do not create unlawful discrimination. Indeed, in *Alabama Electric*, a case where remand was warranted, the agency

reached this exact conclusion: "[w]hen there is sufficient similarity to place customers in one rate class, it is difficult to see how the disparities in earned returns amounts to 'undue' discrimination." *Ala. Power Co.*, 23 FERC ¶ 61832. Different costs of service amongst customers with like and contemporaneous services "must be tolerated in order to preserve the Commission's orderly and reasonable system of customer classes and rate design." *Id.* ¶ 61833.

In addition to being legal, rate consolidation is good public policy because it allows substantial infrastructure costs to be spread over a larger group of similarly situated customers, thus keeping rates relatively low for all. For example, as earlier explained, Arizona Water combines its 21 water systems into three groups for ratemaking purposes, the Western Group, the Eastern Group, and the Northern Group. The Western Group is made up of five water systems: White Tank, Stanfield, Coolidge, Casa Grande, and Ajo.

In 2008, to comply with the Safe Drinking Water Act, Arizona Water constructed an arsenic removal facility in the small, rural town of Stanfield at a cost of $315,000. In 2008, Arizona Water had 200 customers in Stanfield, a small, low-income town located 13 miles from the larger town

of Casa Grande, in which Arizona Water served 23,000 customers in 2008. To mitigate the customer bill impact of that investment, Arizona Water applied and received the Commission's approval to consolidate Stanfield with Casa Grande for ratemaking purposes. The result was that the cost of the arsenic removal facility was spread across the Casa Grande and Stanfield combined total of 23,200 customers, resulting in a $4.00 per month rate increase to the consolidated class. Had the Commission not approved consolidation of these customer classes, Stanfield customers would have experienced a rate increase of $36.30 – a rate hike of 94.2%. Similar examples abound in Arizona Water's other ratemaking groups, where consolidation has saved many small and often times low-income communities from bearing a disproportionate portion of the cost of required and substantial infrastructure investments. Consolidation thus well serves public policy.

Taken to its extreme, Sun City Home Owner Association's argument would require the Commission to base every individual customer's rate on their specific cost of service. Such a result would arguably prevent not just consolidation of geographic service areas but also the classification of residential, commercial, and industrial customers. That outcome would be

unworkable for utilities and was clearly not intended by the framers of Arizona's Constitution. The Commission's reasonable decision to approve consolidated rates for EPCOR should thus be upheld.

III. The Court should recognize an appropriately deferential standard of review for Commission ratemaking decisions regarding consolidation.

Other than the Court of Appeal's decision below, Arizona Water has found no references to "extreme deference" to describe the standard of review for Commission ratemaking decisions. While this phrase is hyperbolic, as described below an appropriately deferential standard of review for Commission ratemaking decisions is well-established in Arizona law and not controversial.

Judicial review of Commission ratemaking decisions has always been available under the Arizona Constitution, with courts consistently applying a deferential standard of review when the issue is within the Commission's plenary ratemaking authority. Article XV, section 6 of the Arizona Constitution gives the Legislature the ability to enlarge the powers of the Commission and sets forth processes to govern the Commission's proceedings. Further, Article XV, section 17 of the Arizona Constitution

preserves "the right of appeal to the courts of the state from the rules, regulations, orders, or decrees fixed by the corporation commission . . . ."

Implementing these Constitutional provisions, the Legislature has enacted A.R.S. §§ 40-254.01(A) and (E), which establish the procedure for filing "a notice of appeal in the court of appeals to vacate, set aside, affirm in part, reverse in part or remand with instructions to the commission [its ratemaking] order if the court of appeals determines upon a clear and satisfactory showing that the order is unlawful or unreasonable." A.R.S. § 40-254.01(E) states that "[i]n all appeals that are taken pursuant to this section, the party adverse to the commission or seeking to vacate or set aside an order of the commission must make a clear and satisfactory showing that the order is unlawful or unreasonable."

Interpreting these Constitutional provisions and statutes, this Court has held that '"[c]lear and satisfactory" is the same as "clear and convincing" and is a standard of proof greater than "by a preponderance of the evidence."' *Tucson Elec. Power Co. v. Ariz. Corp. Comm'n*, 132 Ariz. 240, 243 (1982) (citations omitted). Further, "[b]ecause ratemaking is a function specifically entrusted to the Commission by the Arizona Constitution, a stringent standard of review applies." *Freeport Minerals Corp. v. Ariz. Corp.*

Comm'n, 244 Ariz. 409, 411, ¶ 6 (App. 2018), *review denied* (Oct. 31, 2018). Specifically, on ratemaking issues, this Court "generally presume[s] the Commission's actions are constitutional, and we uphold them unless they are arbitrary or an abuse of discretion." *Residential Util. Consumer Office v. Ariz. Corp. Comm'n*, 240 Ariz. 108, 111, ¶ 10.

Under well-established precedent, therefore, to overturn a ratemaking decision, an appellant must show "clearly and convincingly, that the Commission's decision is arbitrary, unlawful or unsupported by substantial evidence." *Litchfield Park Serv. Co. v. Ariz. Corp. Comm'n*, 178 Ariz. 431, 434 (App. 1994). Further, "it is the Commission's constitutional responsibility, when engaged in its ratemaking power, to view conflicting evidence and make determinations accordingly." *Sierra Club – Grand Canyon Chapter v. Ariz. Corp. Comm'n*, 237 Ariz. 568, 576, ¶ 26 (App. 2015); *see also DeGroot v. Ariz. Racing Comm'n*, 141 Ariz. 331, 336 (App. 1984) ("If two inconsistent factual conclusions could be supported by the record, then there is substantial evidence to support an administrative decision that elects either conclusion.").

Applying this deferential standard of review, the Court should affirm the Commission's approval of EPCOR's consolidated wastewater rates in

this case. Petitioners have shown only a difference in costs between customers subject to the same rate. This is far from carrying their burden of proving by clear and convincing evidence that the Commission's decision is arbitrary, unlawful or unsupported by substantial evidence.

CONCLUSION

This Court should apply an appropriately deferential standard of review and affirm the Court of Appeals' decision that the Commission acted within its constitutional ratemaking authority in setting consolidated rates for customers receiving "like and contemporaneous services."

RESPECTFULLY SUBMITTED this 6th day of April, 2021.

OSBORN MALEDON, P.A.

By /s/ Meghan H. Grabel
Meghan H. Grabel
2929 North Central Avenue, Ste. 2100
Phoenix, Arizona 85012

Attorneys for Arizona Water Company