PERFORMANCE AUDIT

RESIDENTIAL UTILITY CONSUMER OFFICE

RESIDENTIAL UTILITY CONSUMER BOARD

Report to the Arizona Legislature
By the Auditor General
October 1989
89-6

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October 11, 1989

Members of the Arizona Legislature
The Honorable Rose Mofford, Governor
Mr. Douglas M. Brooks, Director
Residential Utility Consumer Office
Mr. Mel Hannah, Chairman
Residential Utility Consumer Board

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Residential Utility Consumer Office and the Residential Utility Consumer Board. This report is in response to a June 2, 1987, resolution of the Joint Legislative Oversight Committee.

The report addresses the Office's effectiveness in rate case proceedings before the Arizona Corporation Commission. We found that RUCO plays an important role in the rate-making process and has effectively represented residential ratepayers in some cases we reviewed. In addition, RUCO has taken steps to improve its effectiveness since our previous audit. However, RUCO's effectiveness was still hindered due to inadequate preparation and presentation of evidence and poor use of consultants. In addition, the report addresses the need for statutory changes to strengthen RUCO's ability to represent residential utility consumers in proceedings before the Arizona Corporation Commission.

The report also addressed the Sunset Factors for the Residential Utility Consumer Board. We found that elimination of the Board would not harm the public health, safety or welfare. However, the RUCO director and staff have indicated that Board members provide valuable input and are an important link between the community of residential consumers and RUCO.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

Douglas R. Norton

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Auditor General

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SUMMARY

RESIDENTIAL UTILITY CONSUMER OFFICE

The Office of the Auditor General has conducted a performance audit of the Residential Utility Consumer Office (RUCO) in response to a June 2, 1987, resolution of the Joint Legislative Oversight Committee. This performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes (A.R.S.) §§41-2351 through 41-2379.

RUCO was established by the Legislature in 1983 (A.R.S. §40-462) to represent the interests of residential utility consumers in regulatory proceedings before the Arizona Corporation Commission (ACC). To accomplish this, RUCO analyzes proposals made by public service corporations to the ACC, and then develops and presents recommendations to the commission regarding the proposals. RUCO is funded by monies received from an assessment against large public service corporations. RUCO expended $880,803 during fiscal year 1988-89. This is our second report on RUCO. In 1986, the Auditor General completed a performance audit of RUCO: Report 86-6, Residential Utility Consumer Office - Residential Utility Consumer Board.

Although RUCO Has Taken Steps To Increase Its Effectiveness, Additional Efforts Are Needed To Improve Its Representation Of Residential Utility Consumers (see pages 5 through 13)

Although RUCO has taken steps to improve its effectiveness in representing residential utility consumers in rate case proceedings since our 1986 performance audit, further efforts are needed. RUCO continues to play an important role in the rate-making process and has effectively represented residential ratepayers in some cases we reviewed. For example, RUCO's intervention has resulted in smaller revenue increases and service charges to residential consumers than originally requested by the utilities involved. In one of those cases, RUCO negotiated an additional $825,000 reduction for the residential consumers.

However, in other cases we reviewed, RUCO's effectiveness was hindered due to inadequate preparation and presentation of evidence and poor use of consultants. In several cases, RUCO did not present supporting evidence or provide information on how ideas presented could be implemented by the utility. In other instances, RUCO's arguments lacked depth or contained judgment errors. RUCO's effectiveness has also suffered because it has not selected appropriate consultants and has not always managed its consultants well. In one case for instance, RUCO did not adequately review a consultant's testimony prior to hearing. This resulted in the consultant making recommendations contrary to applicable State statutes as well as ACC historical precedents. In addition, the consultant also recommended that the ACC use, for purposes of this case, a proposed but unpassed new tax law.

Some parties involved in the rate-making process expect recent changes to improve RUCO's effectiveness. A new director began work at RUCO in October 1988. Based on RUCO's performance in cases since his appointment, some ACC commissioners and staff, and utility representatives indicated that changes are being made which are resulting in increased effectiveness.

Statutory Changes Are Required To Ensure RUCO's Ability To Adequately Represent Residential Ratepayers **(see pages 15 through 21)**

Statutory changes are needed to strengthen RUCO's ability to represent residential utility consumers in proceedings before the ACC. According to a 1987 Attorney General opinion, current statutes appear to limit RUCO to intervening only in cases related to rate making or rate design. However, other types of cases, for example those involving mergers, could also ultimately impact residential rates. Although the ACC has historically granted RUCO permission to intervene in such cases, the right to intervene is not guaranteed. In some cases, public utilities have challenged RUCO's authority to intervene in cases which were not strictly rate making or rate design. Residential utility consumer advocacy groups in other states we contacted have broader authority than RUCO and can intervene in most any type of case that could potentially impact residential utility consumers.

RUCO is also limited in that it lacks the statutory authority to initiate cases before the commission. Currently, another party, as defined by statute, must initiate a case before RUCO can become involved. However, with similar authority, RUCO could improve its ability to represent consumer interests in two ways. First, it would enable RUCO, as the initiator, to help the ACC define the scope of the case, ensuring that issues important to residential utility consumers would be considered. Second, it would also allow RUCO to bring important cases to the commission in a timely manner, rather than relying on another party or the ACC to initiate the case. For example, RUCO's director cited overearning by utilities as the kind of case RUCO would like the ability to initiate. Both our research and that of RUCO's director indicates that in at least 28 other states, groups similar to RUCO have this authority.

RESIDENTIAL UTILITY CONSUMER BOARD

The Office of the Auditor General has also conducted a limited review of the Residential Utility Consumer Board in response to a June 2, 1987, resolution of the Joint Legislative Oversight Committee. This review was conducted as part of the Sunset Review set forth in A.R.S. §§41-2351 through §41-2379. An introduction, sunset factor evaluation, and board response are included in this report.

The board was established in conjunction with RUCO in 1983, and consists of five members appointed by the Governor. A.R.S. §40-463 provides that the board shall advise the RUCO office on all matters relating to rate making or rate design and involving public service corporations. During monthly meetings, the board discusses RUCO's actions on specific cases and gives advice to RUCO staff regarding the necessity of further action. In addition, the board serves an important role in that it provides RUCO with input regarding the concerns and problems of residential utility consumers throughout the State.

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RESIDENTIAL UTILITY CONSUMER OFFICE

INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Residential Utility Consumer Office (RUCO) in response to a June 2, 1987, resolution of the Joint Legislative Oversight Committee. This performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes (A.R.S.) §§41-2351 through 41-2379. This is the second performance audit of RUCO. In 1986, the Auditor General completed the first performance audit of RUCO: Report 86-6, Residential Utility Consumer Office - Residential Utility Consumer Board.

The Legislature established RUCO in 1983 (A.R.S. §40-462) to represent the interests of residential utility consumers in regulatory proceedings involving public service corporations before the Arizona Corporation Commission. A.R.S. §40-464 defines the powers and duties of the RUCO director. The statute states that the director may:

> "Research, study and analyze residential utility consumer interests...Prepare and present briefs, arguments, proposed rates or orders and intervene or appear on behalf of residential utility consumers before hearing officers and the corporation commission as a party in interest and also participate as a party in interest pursuant to §40-254 in proceedings relating to rate making or rate design and involving public service corporations."

Staffing and Organization

For fiscal year 1988-89, RUCO was authorized 12.25 full-time equivalent (FTE) positions. RUCO staff positions include a director, three attorneys, an engineer, three rate analysts, an administrative services officer, a program/project specialist, two secretaries, and part-time legal interns. RUCO's office is located in central Phoenix.

Budget

RUCO operates using revenues it receives from an assessment against public service corporations. A rate determined by the ACC is applied against the gross operating revenues of the corporations' intrastate

operations serving residential customers to determine the assessment amount. Assessments are limited to two-tenths of one percent of gross operating revenues exceeding $250,000 (of the preceding year). The Legislature appropriates RUCO's share of the monies received through this assessment, and places it into the Residential Utility Consumer Office Revolving Fund. Revolving Fund monies do not revert to the General Fund. RUCO revenues and expenditures for fiscal years 1986-87 through 1988-89 are shown in Table 1.

TABLE 1

RESIDENTIAL UTILITY CONSUMER OFFICE
STATEMENT OF FTEs AND ACTUAL REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
FISCAL YEARS 1986-87, 1987-88, AND 1988-89
(unaudited)

	1986-87	1987-88	1988-89
FTEs	10.00	10.00	12.25
Revenue:			
Intrastate Utility Assessment	$839,826	$ 884,439	$ 913,414
Expenditures:			
Personal services	355,448	324,980	335,936
Employee-related	60,775	53,795	65,470
Prof. & outside services	276,354	161,264	346,742
Travel, in-state	10,001	8,179	10,437
out-of-state	5,336	3,078	6,132
Other operating	82,896	82,448	104,948
Equipment	9,174	25,830	11,138
Total Expenditures	799,984	659,574	880,803
Excess of revenues over expenditures	39,842	224,865	32,611
Transfer out to State General Fund			310,500[a]
Fund balance, July 1	824,274	864,116	1,088,981
Fund balance, June 30	$864,116	$1,088,981	$ 811,092

(a) House Bill 2269, which was passed during the 1989 legislative session, resulted in an operating transfer out of RUCO's fund balance to the State General Fund in March 1989 in the amount of $310,500.

Source: Arizona Financial Information Systems and the State of Arizona, Appropriations Report for the Fiscal Year Ended June 30, 1989

Audit Scope and Purpose

This performance audit was conducted to evaluate RUCO's operations, focusing on these two objectives:

- To assess RUCO's effectiveness in residential rate case intervention.

- To determine whether RUCO should be given additional authority to initiate actions before the Corporation Commission and be involved in non-rate cases which may have the potential to affect future residential rates.

In addition to these two objectives, we reviewed RUCO's efforts at implementing the recommendations made in the 1986 performance audit. The results of this review are contained in the RUCO Sunset Factors (pages 27 through 30) and Finding I (pages 5 through 12).

This report also contains Other Pertinent Information regarding staff turnover and the impact of such turnover at RUCO.

This audit was conducted in accordance with generally accepted government auditing standards.

The Auditor General and staff express appreciation to RUCO's Director and employees for their cooperation and assistance during the audit.

FINDING I

ALTHOUGH RUCO HAS TAKEN STEPS TO INCREASE ITS EFFECTIVENESS, ADDITIONAL EFFORTS ARE NEEDED TO IMPROVE ITS REPRESENTATION OF RESIDENTIAL UTILITY CONSUMERS

The Residential Utility Consumer Office continues to play an important role in rate case proceedings but could attain a greater degree of effectiveness. To determine RUCO's effectiveness, we reviewed ACC opinions and orders, transcripts, and other legal documents, as well as interviewed ACC commissioners, hearing officers and staff, RUCO's director and staff, and others involved with the cases.[1] Our review found that while RUCO has implemented some of the recommendations made in our 1986 performance audit, inadequate evidence and poor use of consultants have hindered RUCO's effectiveness in some cases. However, other parties to the rate-making process anticipate that recent changes at RUCO will improve RUCO's effectiveness.

RUCO Has an Important Role and Has Improved Its Effectiveness

RUCO plays an important role in rate case proceedings and has improved its effectiveness in the past three years. The office has implemented several recommendations made in the previous performance audit and has demonstrated effectiveness in some important cases.

RUCO function important - RUCO continues to play an important role in rate case proceedings. The Legislature established RUCO in 1983 to represent utility consumers' interests in regulatory proceedings, to analyze proposals made by public service corporations, and to present recommendations to the Arizona Corporation Commission (ACC). Our 1986

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(1) See Appendix for a discussion of the methodology used to evaluate RUCO's effectiveness.

audit report indicated the need for an agency with such a mandate. Most commissioners, ACC staff, and utility representatives we contacted during the current audit reaffirmed the need. Generally, those interviewed stated that RUCO's role is necessary for two reasons. First, RUCO serves an important function in that it represents residential ratepayers. Commercial ratepayers and utility companies hire lawyers and lobbyists to represent their interests. RUCO provides similar services to represent the interests of residential ratepayers.

Second, an institutionalized consumer advocate serves an important function in the rate-making process. The existence of a consumer advocacy agency like RUCO lends credibility to the rate-making process by ensuring residential ratepayer interests are represented, thus enhancing public acceptance of the process as fair to all parties involved.

RUCO has implemented recommendations - RUCO has taken steps to improve its effectiveness by implementing some of the recommendations made in the 1986 audit report. During the 1986 audit, we made some recommendations that would enhance RUCO's effectiveness in representing residential ratepayers in rate cases. First, we recommended that RUCO develop a more accurate method of evaluating its effectiveness. RUCO previously claimed credit for the entire difference between the ACC staff's recommendation and the commission's final decision, thereby ignoring the effectiveness of other intervenors in the case and other factors which affect commission decisions. Second, we recommended RUCO evaluate its effectiveness by individual issue. RUCO presumed it had an impact on each issue leading to the decision. Third, because of RUCO's limited resources we recommended that RUCO develop a method to determine the necessity of intervention. During the 1986 audit, we found that RUCO did not adequately prioritize cases and thus could not direct its limited resources to the most important cases.

In response to the first and second recommendations, RUCO's new director recently developed a policy requiring the staff assigned to each case to prepare a case summary. The summary should include RUCO's positions on issues and the impact of these positions on the final case outcome.

Impact may be classified as direct monetary (adoption of an issue only RUCO presented), shared monetary (adoption of an issue RUCO and other parties presented), or nonmonetary (adoption of an issue having no, or no foreseeable, monetary impact).

In response to the third recommendation, RUCO's director stated that it is office policy to intervene in cases involving the large utility companies. For those cases involving smaller companies, RUCO considers the size of the rate increase request, the number of customer complaints, the importance of the case issues, and the availability of office resources in making an intervention decision. ACC officials affirm that RUCO now prioritizes better, stating RUCO always intervenes in the "big" cases and is not as involved in cases concerning only a few customers.

Effective in some cases - RUCO effectively represented residential ratepayers in several cases we reviewed. The following case examples illustrate RUCO's effectiveness.

- **Southwest Gas** - Southwest Gas requested a 9.2 percent revenue increase in its Apache Division and a 25.9 percent revenue increase in its Papago Division. In 1987, RUCO participated in negotiations which resulted in increases of only 6.61 percent and 21 percent, respectively. According to hearing transcripts, a Southwest Gas senior vice president noted that during the negotiations "RUCO received an additional $825,000 reduction for the residential class, which quite frankly came out of the stockholders' pocket."

- **Sulphur Springs Valley Electric Cooperative, Inc.** - Sulphur Springs' service territory covers most of Cochise and parts of Santa Cruz, Graham, and Pima Counties. The company requested an 8.82 percent revenue increase in this 1988 rate case. RUCO influenced the case outcome in three ways. First, the utility proposed disproportionately high rate increases for residential and large power classes and no increase for the irrigation class. RUCO and ACC staff proposed that the irrigation class share some of the total rate increase; the commission adopted the recommendation.

  Second, the utility charged $7.50 for basic monthly service and sought to increase this figure to $12.50. The ACC staff proposed an increase to $9.00, but RUCO recommended maintaining the $7.50 charge. The commission adopted RUCO's recommendation.

  Finally, RUCO recommended that ACC require the utility to provide current data and to perform certain studies for use during future rate proceedings. The commission also adopted these RUCO recommendations.

- **Citizens Utilities Company** - Several ACC officials noted that RUCO provided the impetus behind ACC ordering Citizens Utilities to justify its rates in certain Arizona locations. Citizens is a Delaware corporation with several operating divisions and subsidiaries in Arizona. The hearings resulted in revenue decreases of up to 23.4 percent.

In addition, ACC staff stated that RUCO has introduced new ideas into the rate-making process. For example, RUCO first recommended eliminating Arizona Public Service's (APS) Purchased Power and Fuel Adjustment Clause (PPFAC) several years ago.[1] At that time, the ACC did not adopt RUCO's position. Over the years RUCO continued to intervene in cases concerning fuel adjuster clauses. In a recent case the commission eliminated the APS PPFAC. RUCO's introduction of the idea several years ago and its continued intervention in PPFAC cases proved effective in the long term.

Some Factors Which Hinder RUCO's Effectiveness Were Still Apparent

Although RUCO has taken steps to improve its effectiveness in representing residential ratepayers since the 1986 performance audit, we noted some factors which hindered RUCO's effectiveness. These factors include inadequate evidence and poor use of consultants.

Inadequate evidence - RUCO did not prepare and present adequate evidence for some cases, and this adversely impacted its effectiveness.

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(1) Purchased Power and Fuel Adjustment Clauses (PPFACs) are semiautomatic mechanisms which allow utilities to maintain consistent rates of return in times of fluctuating fuel and purchased power costs. Fuel adjuster clauses were developed in the 1970s, a period of greatly fluctuating fuel prices. The clauses allowed electric utilities to charge customers a surcharge to cover increased fuel costs. Thus, the utilities did not have to initiate and defend full rate cases to recoup the increased fuel costs. RUCO advocates that PPFACs be eliminated for two reasons. First, fuel costs have decreased and stabilized, thereby eliminating the need for the clauses. Second, some utility companies have allegedly abused the clauses by including other charges in the surcharge. For example, in a Citizens Mohave and Santa Cruz Electric case, the utility requested that the capital costs of gas turbine generating units be passed along to ratepayers through the PPFAC.

Several ACC opinions and orders we reviewed dismissed RUCO's positions because RUCO did not present supporting evidence. The ACC can only adopt positions that are supported by evidence and that can be implemented by utility companies. Thus, arguments must be based on factual information relevant to the specific utility in the case. In addition, the commission must be able to predict the effect of adopting a recommendation. In some cases RUCO presented general, theoretical ideas, without providing practical information on how the utility could implement the ideas. In other instances, RUCO investigated only the aspects of an analysis or law which would benefit residential ratepayers, without determining the total effect of adopting the analysis or law. In other cases RUCO's arguments lacked depth or contained judgment errors.

The following case examples illustrate where RUCO did not develop adequate evidence.

- **APS Palo Verde 2** - RUCO raised 12 issues in this case, however 9 had no impact on the ACC's final decision (RUCO was solely responsible for the ACC adoption of one issue, and partially responsibly for the adoption of two others). Even in the issue where RUCO had sole impact, the final impact was much less than RUCO sought because RUCO did not base its position on relevant factual information. RUCO proposed an $11.4 million reduction in operation and maintenance expenses because of reduced reliance on fossil fuel plants and increased reliance on Palo Verde Units 1 and 2. In the decision, the commission agreed that "some adjustment should be made." However, the commission could not adopt the RUCO recommendation because the RUCO witness "provided nothing more than an unsupported allegation." Although the commission rejected the $11.4 million adjustment, it did adopt a $1.85 million adjustment based on RUCO's testimony.

  In another issue, one in which RUCO had no impact, RUCO again did not provide adequate supporting evidence for its position although its position differed significantly from the other parties involved in the case. This issue involved estimating future monies needed to decommission the Palo Verde Unit 2 nuclear plant. Both Arizona Public Service (APS) and ACC staff agreed on an estimated cost figure. RUCO's estimate, however, was four time greater. In the opinion and order the commission commented, "Instead of supporting a reasonable estimate based on what is now known about decommissioning, RUCO takes the position that in light of the uncertainties the future holds, we should start with a high estimate and review it every three years." The commission did not adopt the RUCO position because RUCO failed to provide supporting evidence for its position. The commission further responded, "Current ratepayers should not be unnecessarily burdened with the additional cost imposed by (the RUCO witness') unsupported contingency factor."

- **Citizens Utilities Company** - RUCO advanced several positions without providing complete information on the results of the adoption of the positions. For example, RUCO did not present research stating the full effect of its recommendation of changing an allocation methodology. RUCO proposed eliminating one component of the "Four Factor" formula for allocating administrative office expenses. However, this formula is an accepted methodology in all ten states where Citizens provides utility services. RUCO wanted to eliminate the factor which allocated costs to consumers. According to one of the hearing officers involved in the case, the formula is called the "Four Factor" model because each factor is important. The commission concluded:

  > "RUCO's proposed elimination of one of the factors would, no doubt, be beneficial to some entities and harmful to others. Any change in the allocation methodology would, of necessity, produce different results. However, without some compelling reason to change, we will continue to approve the Four Factor method."

- **Los Cerros Water Company** - RUCO lacked adequate research and made judgment errors in several issues it proposed in this case. In one issue, RUCO attempted to depart from the "groundrules" established for the case. A utility company's rate increase application must be based on an actual 12-month period of operation. The period from which this information is drawn is called the "test year." The test year is approved by the ACC at the beginning of the rate case. Although the test year was already decided, the RUCO witness recommended that a revenue-generating event which occurred after the test year be added to test year revenues. The ACC rejected RUCO's position.

  Further RUCO did not perform some basic research for this case. First, RUCO contacted a Phoenix company to obtain information on charges for water management but did not tell the company the information was for the Tucson area. As a result, because Los Cerros is located in Tucson, geographic differences made this an invalid comparison. In a second issue, RUCO failed to ask company officials why two company checks were written to different accounting firms for the same purpose. Therefore, RUCO made an erroneous assumption and recommended a reduction to outside services expenses. However, testimony of company representatives during the hearing showed that Los Cerros had legitimately sought a second opinion about a complicated new tax law. Here again, the ACC rejected RUCO's positions on both of these issues.

Poor use of consultants - RUCO's effectiveness has also suffered because it has made poor consultant selection decisions and has not managed its consultants well. In some instances RUCO has hired consultants who have hindered its effectiveness in rate proceedings. For example, RUCO has hired consultants whose arguments had been rejected by the commission in previous cases or upon whose testimony the commission cannot rely, as indicated in the following cases.

- **APS PPFAC** - At least two problems were evident with RUCO's involvement in the 1987 APS PPFAC case - RUCO raised an argument in the wrong type of case, and RUCO lacked adequate support for its position. In a 1986 APS PPFAC case, RUCO's consultant made a recommendation that the ACC either eliminate the PPFAC or utilize a new approach in determining PPFAC charges. The ACC rejected RUCO's argument, but indicated they would be willing to consider these reforms in future rate cases. RUCO again raised this issue in the 1987 APS PPFAC case. However, the purpose of the 1987 APS PPFAC case was to review actual 1986 fuel and purchased power costs and to establish a new PPFAC cost. Thus it was an inappropriate time to raise the issue as it was not within the hearing scope. Further, RUCO used the same consulting firm in this case as it had used in the 1986 APS PPFAC case. The consultants presented testimony in 1987 which resembled the testimony presented, and rejected by the commission, in the 1986 case. The consultants did not provide any additional evidence as to why the ACC should adopt the argument. In fact, in the 1987 opinion and order the commission quoted the 1986 opinion and order in dismissing RUCO's arguments.

- **APS Palo Verde 2** - In the APS Palo Verde 2 rate case RUCO used a consultant who was not credible. The consultant had testified before the Federal Energy Regulatory Commission (FERC) five years before the Palo Verde 2 case. In his testimony before the FERC, he indicated that APS should "continue to construct and retain its ownership share in (Palo Verde) units 1 and 2." However, in the Palo Verde 2 case, the consultant testified that APS should have stopped construction or sold its ownership share in Palo Verde 2 in 1981. Thus, the RUCO consultant testified that APS should have known back in 1981-82 what he himself did not know then. Further, the FERC judge had made unfavorable statements concerning the testimony of this witness, and during cross-examination, these statements were presented. The commission noted in the opinion and order:

  > "APS presented extensive rebuttal evidence by a number of witnesses concerning (the RUCO witness') presentation.... However, we do not need to repeat all of their criticisms or even summarize their conclusions. (The RUCO witness') opinion is not sufficient support for a finding that construction of and retaining the ownership interest in Palo Verde 2 was imprudent."

RUCO's effectiveness also suffers in the management of its consultants. This was evidenced in several of the cases we reviewed. For example, it appears that RUCO staff did not always adequately review testimony compiled by their consultants prior to ACC filing deadlines. This has resulted, for example, in RUCO's presenting testimony that does not conform to Arizona law or ACC precedence, or that cannot be implemented. The case below illustrates poor consultant management.

- Citizens Utilities Company - In this case, RUCO's attorneys did not adequately review a consultant's testimony for compliance with Arizona law. One consultant made recommendations contrary to applicable Arizona statutes. In this case, RUCO lost credibility because RUCO's attorneys did not provide guidance regarding Arizona laws to an out-of-state witness.

  Finally, RUCO's consultant recommended the use of the 1986 Tax Reform Act in calculating Citizens' test year tax expense. At the time of the hearing, the tax law was imminent but had not yet passed. Further, the effect of the new tax law on Arizona taxes was unknown. Thus, the ACC could not use the 1986 tax law at the time.

Other Parties Anticipate That Recent Changes at RUCO Will Improve Its Effectiveness

Recent changes at RUCO are expected to improve RUCO's effectiveness. RUCO's new director assumed his position in October 1988. As of the time of the audit, the commission had not issued opinions and orders on any of the cases in which the new director provided guidance. However, commissioners, ACC hearing officers and staff, and utility representatives asserted in interviews that the new director is making changes which are resulting in increased effectiveness. For example, comments regarding RUCO's effort in the Tucson Electric Power (TEP) case illustrate the new director's influence. Some ACC commissioners, hearing officers and staff noted that RUCO performed well in the TEP case. Specifically, RUCO proposed well-supported arguments and hired credible consultants to use as witnesses.

RECOMMENDATIONS

1. RUCO should continue to improve the quality of evidence presented in rate case proceedings by:

   a. Conducting sufficient research to present well-supported arguments which contain sufficient depth and presenting adequate supporting evidence for its recommendations.

   b. Determining and presenting to the ACC the effect of its recommendations.

2. RUCO should continue to improve its selection and management of consultants in order to enhance its effectiveness in rate case proceedings by:

   a. Evaluating a consultant's effectiveness following a rate case in order to determine any shortcomings in his or her presentation, and any actions needed if the consultant is used again in the future. RUCO should also review the consultant's effectiveness in other federal or state presentations to determine possible shortcomings in his or her approach.

   b. Requiring consultants to submit testimony far enough in advance of the case hearing to allow RUCO attorneys and staff sufficient time to review the testimony, clarify any uncertainties with the testimony, and correct any errors.

FINDING II

STATUTORY CHANGES ARE REQUIRED TO ENSURE RUCO'S ABILITY TO ADEQUATELY REPRESENT RESIDENTIAL RATEPAYERS

Broadening RUCO's statutory authority would enhance its ability to represent the interests of residential utility consumers. Currently, RUCO's statutes appear to limit RUCO to intervening in only those cases which directly affect residential rates. In addition, RUCO lacks the statutory authority to initiate cases.

RUCO's Statutory Authority Should Be Expanded

The statutes should be amended to provide RUCO with the authority to intervene in any case which could ultimately impact residential utility rates. RUCO's enabling legislation could be interpreted as limiting RUCO to intervening only in cases involving rate making and rate design. However, there are a variety of cases which fall outside of that scope which could ultimately impact residential utility rates. RUCO's authority to intervene in these types of cases has been challenged by public utilities.

Statutory limitations - Although the Arizona Corporation Commission has allowed RUCO to intervene in a variety of cases, RUCO's enabling statutes could be interpreted as limiting RUCO's intervention authority only to cases related to rate making and rate design. Arizona Revised Statutes (A.R.S.) §40-462 A. provides RUCO with global authority to represent ratepayers before the commission, but A.R.S. §40-464.A.2. could be interpreted as restricting the type of cases in which RUCO may intervene. Specifically, the statute states, in part, that RUCO's director may:

> "Prepare and present briefs, arguments, proposed rates or orders and intervene or appear on behalf of residential utility consumers before hearing officers and the corporation commission as a party in interest and also participate as a party in interest pursuant to 40-254 in proceedings relating to rate making or rate design and involving public service corporations." (emphasis added)

A 1987 Attorney General Opinion (I87-053) concluded that "RUCO is authorized only to participate in proceedings which both relate to rate making or design and also involve public service corporations." Stating that "relating to" embraces more than "directly connected to," the Attorney General Opinion interpreted the statutes as allowing RUCO to participate in proceedings which have a reasonable relationship to rate making or rate design (emphasis added). In addition, a Legislative Council representative also stated that RUCO's statutes do appear to limit RUCO's intervention authority.

Authority should be expanded - Although RUCO's authority appears to be limited to rate cases, other types of cases also impact residential rates. In order to more fully protect consumers' interests, RUCO should be allowed to participate in any case that has the potential to affect a utility's cost of providing service or how those costs might be distributed among the utility's various classes of customers. There are a variety of cases which, strictly defined, are not "rate making or rate design," but which could ultimately impact residential utility rates. Examples of such cases, which could be interpreted as being beyond the scope of RUCO's authority to intervene, include the following:

- Least cost electric utility planning,[1]
- Limiting regulation or deregulating telecommunications services,
- Opening monopoly services to competition,
- Mergers,
- Changing the nature of how a utility industry is regulated, and
- Determining whether a utility is obtaining supplies at the lowest possible price.

Many of these cases could lead to rate increases. RUCO should be allowed to influence the case itself, rather than waiting until the resulting

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(1) The ACC recently required electric utilities to file with the commission every three years their plans for meeting demand for electricity over the next decade. Following the filings, the commission will set hearing dates designed to allow interested parties to review and critique the plans. These are referred to as least cost planning reviews for electric utilities.

rate increase is inevitable. By becoming involved in cases at the outset, RUCO would be in a better position to represent residential ratepayers' long-term interests.

RUCO's authority has been challenged - Although the ACC has historically granted RUCO permission to intervene in these types of cases, public utilities have challenged RUCO's authority. Two recent examples of utilities challenging RUCO's authority to intervene in cases which are not strictly rate making or rate design are the Arizona Public Service case on dividend payment policies, and the Tucson Electric Power merger case.

CASE 1:

Arizona Public Service objected to RUCO intervening in its current case on dividend payment policies to its financially troubled holding company. APS argued that the case is not a rate-making or rate design case, and therefore, RUCO had no statutory authority to intervene. RUCO argued that allowing APS to subsidize losses by other non-utility subsidiaries of the holding company will ultimately result in higher rates for APS consumers. According to RUCO, the case is "related to rate making and rate design", and the impact of the decision made in this case could ultimately affect residential consumer rates. In addition, RUCO has historically been allowed to intervene in cases which were not strictly rate making or rate design.

CASE 2:

Tucson Electric Power objected to RUCO's motion to intervene in its merger with San Diego Gas and Electric. They claimed that RUCO did not have the statutory authority to intervene in the merger because it was not a rate-making or rate design case. RUCO argued that the merger would have a long-term impact on the cost of utility service in Tucson.

Although the commission granted RUCO's petition to intervene in these and in other cases in the past, RUCO's right to intervene is not guaranteed. The commission is an elected body whose membership and orientation could change completely with the next election. A different commission could more narrowly define RUCO's role and restrict its intervention to cases which specifically address rate making or rate design. Further, if the commission's decision to allow RUCO to intervene were challenged in court, based on current statutes, the court could deny RUCO the authority to intervene.

In other states, the authority to intervene in non-rate cases is commonly granted to agencies similar to RUCO. All seven of the residential utility consumer advocacy groups in other states which we contacted (Colorado, Florida, Michigan, Missouri, New Mexico, Ohio, and Pennsylvania) have the statutory authority to intervene in non-rate cases. We surveyed these particular states because they were identified as having superior utility consumer advocacy agencies by the administrative director of the National Association of State Utility Consumer Advocacy Agencies or the director of RUCO.

According to a Legislative Council representative, a statutory change would be required to ensure RUCO's authority to intervene. He indicated that deleting the words "relating to rate making or rate design" from A.R.S. §40-464.A.2. should be sufficient to ensure RUCO's authority to intervene in the types of cases identified above. It is this phrase which could be interpreted as limiting RUCO's intervention to only rate cases.

RUCO Should Be Allowed to Initiate Cases

In addition to potentially restricting the types of cases in which RUCO may intervene, statutes further limit RUCO's effectiveness by not providing RUCO with the authority to initiate rate cases before the ACC. The authority to initiate cases includes the power to define the scope of the case and to identify the issues which will be addressed. Other states have awarded their utility advocacy programs the power to initiate cases.

RUCO lacks statutory authority - Currently, neither RUCO nor ACC statutes empower RUCO to initiate rate cases before the commission.[1] RUCO's statutes provide that RUCO may intervene in

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(1) RUCO is also not empowered to initiate non-rate cases. However, such authority may not be necessary. According to an ACC official, either the ACC itself or the public utilities are required to initiate a case before the commission prior to taking various significant actions, such as mergers, or the sale of stocks or bonds. Therefore, enabling RUCO to intervene in such cases should be sufficient.

rate-making and rate design cases before the ACC, but the statutes do not permit RUCO to initiate cases. Further, ACC statutes do not include RUCO in the list of parties which may initiate cases before the ACC as to the reasonableness of public utility rates and charges. According to A.R.S. §40-246 A., only the following parties may do so:

- The commission itself
- The mayor or the majority of the legislative body of the city or town where the utility service is in question
- Not less than 25 consumers or prospective consumers of the service.[1]

Advantages of power to initiate cases - Providing RUCO with the statutory authority to initiate cases before the commission would enhance its ability to represent residential ratepayers. First, the initiator significantly influences the scope of the case. The concerns which they identify and the issues which they define are the foundation upon which the hearing is based. While the commission is ultimately responsible for setting the scope of the case, it is the initiator who frames the debate. Intervenors, on the other hand, are allowed only limited input into the scoping of the case.

Secondly, some issues of interest to residential utility consumers may not be addressed at all, or may not be addressed in as timely a fashion, unless RUCO is given the authority to initiate cases. RUCO's director cited overearning by utilities as an example of the kind of case RUCO would like the power to initiate. In the past, public utilities have overearned due to changes in tax laws resulting in savings which the company did not pass on to ratepayers. Under these circumstances the company is unlikely to file for a rate increase which would bring it before the commission. Therefore, unless one of the parties identified above as having the authority to initiate a case files a complaint with

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(1) According to RUCO's director, even if 25 citizens do file a petition to initiate a hearing, RUCO does not have the statutory authority to represent the group.

the commission, RUCO cannot take action regarding the utility's rates. RUCO would like the authority to require the company to justify its rates in these instances.

Other states' advocacy agencies have authority to initiate cases - RUCO's director recently surveyed 38 other states' utility advocacy programs and found that of the 29 that responded to the survey, all have the authority to initiate cases.[1] In addition, we contacted seven agencies in states with this authority.[2] These states cited the following examples of the types of cases they initiate: reducing utility rates when companies were overearning due to tax windfalls, removing a nuclear power plant from the rate base, and, challenging charges for telephone directory assistance. One director stated that the authority to initiate cases before the commission enhanced his agency's ability to negotiate with utility companies.

Although most agencies similar to RUCO have the authority to initiate cases, they appear to use this authority sparingly. The burden of proof is on the party initiating the proceedings, and developing adequate evidence is time-consuming and costly. Therefore, none of the agencies we surveyed have initiated more than one or two cases per year.

Statutory changes are needed - According to a Legislative Council representative, statutory changes would be necessary to provide RUCO with the authority to initiate rate cases before the commission. A.R.S. §40-246 A. (the list of parties who may initiate rate cases before the ACC) would need to be expanded to include the director of RUCO. In addition, A.R.S. §40-464 A. (duties of RUCO's director) would need to be expanded to include the responsibility for initiating rate cases before the commission. RUCO has attempted to have such legislation enacted in the past, but has been unsuccessful.

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(1) According to RUCO's director, 39 states (including Arizona and the District of Columbia) have utility advocacy programs or agencies.

(2) Colorado, Florida, Michigan, Missouri, New Mexico, Ohio, and Pennsylvania

RECOMMENDATION

The Legislature should consider amending:

- A.R.S. §40-464 A. 2. to expand RUCO's authority to participate in any case before the Arizona Corporation Commission which could ultimately impact residential utility rates.

- A.R.S. §§ 40-246 A. and 40-464 A. to grant RUCO the authority to initiate rate cases before the corporation commission.

OTHER PERTINENT INFORMATION

During the course of the audit we obtained information regarding the level of staff turnover and the difficulty of attracting attorneys with adequate experience to fill vacancies at RUCO.

Staff Turnover

Turnover at RUCO has been high, particularly for attorneys and directors. The turnover of attorneys and directors is critical because these positions are major leadership roles at RUCO. The high level of turnover is largely attributable to changes in governors and directors.

Turnover at RUCO since July 1, 1986, has been excessive - During the last three fiscal years, RUCO has experienced a high level of turnover. Six of RUCO's ten positions turned over in fiscal year 1986-87, three of its ten positions turned over in fiscal year 1987-88, and four of the twelve positions turned over during fiscal year 1988-89. As of June 1989, only three of RUCO's employees had worked at RUCO for more than two years.

Turnover has been particularly high for RUCO's director and attorneys. In the last three years, RUCO has served under three different directors and one acting director. Since July 1, 1986, RUCO's chief counsel and its junior attorney positions have each been held by three separate attorneys. Furthermore, during that same time period, RUCO's senior attorney position has turned over twice. This level of turnover seems particularly high when compared to that of similar positions in other organizations. For example, during the same time period only one of the seven attorneys at the Utility Division of the Arizona Corporation Commission left, and none of the rate regulation attorneys used by US West has left.

The director and attorney positions at RUCO are critical to its effective operation - Turnover of RUCO's director and attorneys strongly impacts the agency because of the critical role these positions play.

Both types of positions provide essential leadership roles in the RUCO organizational structure. RUCO's director sets the priorities for the agency. He or she is ultimately responsible for selecting the cases in which RUCO will intervene, for representing the agency before the Legislature and the public, and for selecting staff to serve RUCO. The attorneys are responsible for representing RUCO before the Arizona Corporation Commission. They help develop the strategy used in presenting RUCO's case, and they spearhead RUCO's efforts at hearings.

Change in governors and directors has led to most of RUCO's turnover - Instability in RUCO's director position has been caused by changes in governors. Since July 1, 1986, Arizona has had three different governors. As new governors took office, new directors were appointed with differing philosophies. The turnover in directors lead to staff turnover. We interviewed eight former RUCO employees to determine their reasons for leaving, and five stated that they quit for reasons directly related to a RUCO director. In addition, another was fired by a previous director.

Adequacy of Attorneys' Qualifications

RUCO has had difficulty attracting and keeping qualified attorneys. As a result, RUCO has had to operate without experienced legal leadership. The high level of expertise required, salary levels which are not competitive with those offered by the private sector, and RUCO's history of instability all contributed to its difficulty in attracting qualified attorneys.

RUCO has had difficulty attracting and keeping qualified attorneys - RUCO's directors, past and present, have had difficulty attracting qualified applicants for the attorney positions. Because only attorneys who have passed the Arizona Bar may appear before the ACC, RUCO requires that all three of its attorneys be licensed to practice law in the State. Additionally, because of the nature and complexity of the issues dealt with, RUCO requires that its chief counsel and senior attorney have five years of experience in the practice of public utility law, a subsection of administrative law. RUCO's current director had difficulty

in his recent attempt to fill the chief counsel position. For example, none of the original applicants for the position had any public utility rate regulation experience. The position was ultimately filled by a former RUCO attorney who was not in the original pool of applicants.

As a result, RUCO has lacked experienced legal leadership - Because RUCO has difficulty attracting experienced attorneys, the director is sometimes forced to hire someone who does not have sufficient experience to effectively perform the job. A former RUCO director stated that he hired the highest qualified applicants for the positions of chief counsel and senior attorney. However, the chief counsel whom he hired had not practiced law during the five years immediately preceding his appointment at RUCO and had no utility rate regulation experience. The senior attorney whom he hired also had no experience in utility rate regulation.

Another impact of the difficulty in recruiting and maintaining experienced attorneys is that RUCO has been forced to operate without experienced legal leadership. For example, the current entry level attorney position at RUCO is intended to be a support position under the supervision of an experienced attorney. However, due to vacancies in the chief counsel and senior attorney positions, the entry level attorney received little or no supervision for two and a half months. This attorney, a recent law school graduate, prepared motions to be presented before the Arizona Supreme Court and the Superior Court, and represented RUCO before the Arizona Corporation Commission. However, he lacked the expertise and experience for such a high level of responsibility.

Causes of difficulty in attracting and keeping qualified attorneys - According to both the current director and a prior RUCO director, several RUCO and ACC staff, and one utility respresentative we spoke with, several factors impede RUCO's attempts to attract and keep qualified attorneys. First, the pool of qualified attorneys is limited. Public utilities rate regulation is a highly technical, specialized area, for which a high level of expertise is needed. Second, like other State agencies, RUCO is unable to offer attorney salaries which are competitive

with the private sector. Third, RUCO's history of instability has reduced its attractiveness as an employer. Lack of job security may deter experienced attorneys from applying for positions at RUCO. The attorney positions are exempt, which means that they serve at the pleasure of the director who serves at the pleasure of the Governor. Finally, according to RUCO's director, a position with the ACC or the Attorney General's office is seen as more prestigious.

Officials from advocacy agencies in other states reported similar problems in attracting attorneys with appropriate backgrounds. As a result, they tend to hire inexperienced attorneys and train them. However, because RUCO has been unable to retain a core of experienced attorneys, it lacks the means to provide training to new staff. Furthermore, many of RUCO's attorneys have served too short a tenure to develop a high level of expertise in public utilities rate regulation.

SUNSET FACTORS

In accordance with Arizona Revised Statutes §41-2354, the Legislature should consider the following 12 factors in determining whether the Residential Utility Consumer Office should be continued or terminated.

1. **The objective and purpose in establishing RUCO**

   RUCO was established in 1983 (A.R.S. §40-462) to represent the interests of residential utility consumers of regulated utilities in proceedings before the Arizona Corporation Commission (ACC). According to the act establishing RUCO, the agency is intended to represent the interests of residential consumers, critically analyze proposals made by public service corporations to the ACC, and formulate and present recommendations to the commission.

2. **The effectiveness with which RUCO has met its objective and purpose and the efficiency with which RUCO has operated**

   RUCO actively intervenes in matters involving residential utility consumers before the ACC, and has taken some steps to improve this intervention effort since the 1986 performance audit. However, RUCO could further improve its representation of residential ratepayers. Auditor General staff reviewed 12 final decisions issued by the ACC since 1986. The review showed that RUCO has been effective in impacting commission decisions in some cases. However, RUCO was not effective in some instances due to inadequate evidence. RUCO's poor selection and management of consultants have further hindered its effectiveness. Some commissioners and ACC hearing officers and staff indicated that RUCO's new director appears to be taking steps to improve RUCO's effectiveness (see Finding I, page 5).

   In addition, RUCO has taken some action toward strengthening its legal writing. During the 1986 audit, we found that RUCO could make its legal writing more effective and persuasive by improving the organization, clarity, and conciseness of its legal documents. According to RUCO's current director, it is now a policy that, when

time permits, RUCO's chief counsel and/or director review all written legal documents for editing purposes. Furthermore, to strengthen their skills, RUCO attorneys are sent to continuing legal education seminars. Although we did not conduct a formal evaluation of RUCO's legal writing due to time constraints, RUCO appears to have made some improvements in this area.

3. **The extent to which RUCO has operated within the public interest**

RUCO has operated within the public interest by representing residential consumers in rate cases before the ACC. The adoption of RUCO proposals by the ACC has the effect of reducing residential utility bills below what they would have been if RUCO had not intervened. In addition, RUCO's intervention can result in nonmonetary benefits. For example, in one case, RUCO monitored a utility company's compliance with energy conservation efforts.

4. **The extent to which rules and regulations promulgated by RUCO are consistent with the legislative mandate**

Although the director has the statutory authority to promulgate rules, RUCO has not done so. Our review did not reveal the need for RUCO to develop any rules.

5. **The extent to which RUCO has encouraged input from the public before promulgating its rules and regulations and the extent to which it has informed the public as to its actions and their expected impact on the public**

Since RUCO has chosen not to promulgate rules, input from the public has not been necessary. However, RUCO does attempt to keep residential utility consumers aware of its actions through the issuance of formal media releases and statements. Further, the director participates in forums and addresses citizens and community groups' meetings upon request. In addition, RUCO posts notices of monthly RUCO board meetings which are open to all members of the public. These activities provide residential consumers with an opportunity to learn more about the utility rate-making process and to voice their concerns and problems regarding utility services.

6. **The extent to which RUCO has been able to investigate and resolve complaints that are within its jurisdiction**

During the 1986 performance audit we found that RUCO was investigating consumer complaints against utilities. However, we found that RUCO did not have the statutory authority to investigate complaints and recommended that RUCO discontinue handling such complaints since it is not a regulatory agency. As a result, RUCO no longer investigates consumer complaints. Occasionally RUCO still receives complaints from residential consumers. When this occurs, RUCO refers these consumers to the ACC's Consumer Services Division.

7. **The extent to which the Attorney General or any other applicable agency of State government has the authority to prosecute actions under the enabling legislation**

This factor is not applicable since RUCO is not a regulatory agency. Legal representation of the office in proceedings before the ACC and the courts is provided by RUCO's own staff attorneys, pursuant to A.R.S. §41-192.

8. **The extent to which RUCO has addressed deficiencies in its enabling statutes which prevent it from fulfilling its statutory mandates**

RUCO's director noted RUCO's inability to initiate a case with the ACC concerning excessive utility rates as a major deficiency in its enabling statutes. RUCO unsuccessfully requested legislation in the 1988 and 1989 legislative sessions which would have enabled RUCO to file such complaints with the commission (see Finding II, page 15).

9. **The extent to which changes are necessary in the laws of RUCO to adequately comply with the factors listed in the Sunset Law**

Based on our audit work we recommend that the Legislature consider the following changes to RUCO's statutes.

- Amend A.R.S. §40-464 to expand and clarify RUCO's authority to participate in any case before the ACC that may have the potential to impact residential rates in the future (see Finding II, page 15).

- Amend A.R.S. §§40-246 and 40-464 to grant RUCO the authority to initiate cases before the ACC (see Finding 11, page 15).

10. **The extent to which the termination of RUCO would significantly harm the public health, safety or welfare**

Termination of RUCO could have an impact on the welfare of residential utility consumers. RUCO's role in the rate-making process is important. RUCO's intervention has had some impact in lowering residential utility bills. In addition, RUCO's presence in the process ensures that residential ratepayers' interests are presented and thus enhances public acceptance of the commission's final decisions. If RUCO did not exist, residential ratepayers would have limited representation. Although other consumer groups or the ACC staff could provide representation for residential ratepayers, many of the consumer groups may not have the financial resources or technical expertise to present arguments in complex cases. ACC staff must balance the interests of the utilities and all classes of ratepayers and thus cannot be as attentive to residential consumer needs as can RUCO.

11. **The extent to which the level of regulation exercised by RUCO is appropriate and whether less or more stringent levels of regulation would be appropriate**

This factor does not apply to RUCO since it is not a regulatory agency.

12. **The extent to which RUCO has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished**

RUCO has extensively used private contractors in its case intervention. RUCO contracts with experts to analyze and testify on issues because expertise in specific areas of utility regulation is necessary to adequately understand and investigate the issues. RUCO has also contracted with private attorneys for legal representation, although this has historically been done only when RUCO has experienced significant turnover of experienced staff counsel (see Other Pertinent Information, page 23).

RESIDENTIAL UTILITY CONSUMER BOARD

INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a limited review of the Residential Utility Consumer Board in response to a June 2, 1987, resolution of the Joint Legislative Oversight Committee. This performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes (A.R.S.) §§41-2351 through 41-2379.

The board was established in conjunction with the Residential Utility Consumer Office (RUCO) in 1983. A.R.S. §40-463 provides that the board shall advise RUCO on all matters relating to rate making or rate design and involving public service corporations. The board is statutorily empowered to instruct RUCO's director to withdraw any court action filed by RUCO, and to prepare, jointly with the director, RUCO's proposed annual budget request. In addition, the board may also advise the Governor and Legislature on matters relating to RUCO.

The board consists of five members appointed by the Governor, who serve staggered five-year terms. No more than two members may reside in the same county. In addition, no more than three members may be affiliated with the same political party. The board is required to meet at least monthly and, in order to facilitate input from residential consumers, has met in various parts of the State. Members are eligible to receive compensation for each day of actual service on the board, pursuant to A.R.S. §38-611. Board expenditures for fiscal year 1988-89 were approximately $6,480.

Scope of Audit

The scope of our audit included a limited review of the board's operations and functions. Our major audit objective was to respond to sunset factors set forth in A.R.S. §41-2354.D.

This audit was conducted in accordance with generally accepted government auditing standards.

The Auditor General and staff express appreciation to the Residential Utility Consumer Board members for their cooperation during the audit.

SUNSET FACTORS

In accordance with A.R.S. §41-2354, the Legislature should consider the following 12 factors in determining whether the Residential Utility Consumer Board should be continued or terminated.

1. **The objective and purpose in establishing the board**

   The Residential Utility Consumer Board was established to advise the Residential Utility Consumer Office on all matters relating to rate making or rate design and involving public service corporations. The board is statutorily empowered to instruct RUCO's director to withdraw any court action filed by RUCO, and is mandated to prepare jointly with the director the proposed annual budget request for RUCO. In addition, the board may advise the Legislature and the Governor on all matters relating to RUCO.

2. **The effectiveness with which the board has met its objective and purpose and the efficiency with which the board has operated**

   The board has generally met its objective and purpose. According to RUCO's board, RUCO's staff are sometimes required to make decisions regarding rate cases without board input due to time constraints. To keep members informed, RUCO staff maintain contact with the board throughout the month regarding significant issues. During monthly meetings, the staff updates the board as to actions taken on specific rate cases. At that time, the board is given the opportunity to discuss decisions and give advice as to further action needed.

3. **The extent to which the board has operated within the public interest**

   The board's principal role is advising RUCO on matters of rate making and rate design involving the regulated utilities of Arizona. To the extent that the board renders such advice, it functions within the public interest by promoting fair utility rates for residential consumers. It also provides RUCO with input regarding the concerns and problems of residential utility

consumers. In addition, the board has pursued issues beyond the scope of rate hearings that also impact residential consumers. For instance, according to the board, two of its members served on two task forces set up by and for a telephone company to survey services and rates. Another board member assisted in the development of Lifeline legislation designed to help the economically disadvantaged in paying for telephone and electrical service. On various occasions the board members, acting either individually or jointly as the board, have contacted the Legislature, the Governor, and the Arizona Corporation Commission on matters involving utility companies.

Our review of RUCO board meeting files for the period January 1988 through June 1989 indicated that the RUCO board complied with State open meeting laws, A.R.S. §38-431.

4. **The extent to which rules and regulations promulgated by the board are consistent with the legislative mandate**

The board's responsibilities do not include the promulgation of rules and regulations.

5. **The extent to which the board has encouraged input from the public before promulgating its rules and regulations and the extent to which it has informed the public as to its actions and their expected impact on the public**

The board has not promulgated rules and regulations.

6. **The extent to which the board has been able to investigate and resolve complaints that are within its jurisdiction**

The board has no authority to, and does not investigate residential consumers complaints.

7. **The extent to which the Attorney General or any other applicable agency of State government has the authority to prosecute actions under the enabling legislation**

The purpose of this board is to act as an advisor to RUCO. Therefore, it has no regulatory authority, and consequently, no enforcement powers.

8. **The extent to which the board has addressed deficiencies in its enabling statutes which prevent it from fulfilling its statutory mandates**

According to the board, its enabling statutes have not been changed since its creation in 1983. According to current board members, board statutes do not need modification.

9. **The extent to which changes are necessary in the laws of the board to adequately comply with the factors listed in Sunset Law**

Our review did not identify needed statutory changes.

10. **The extent to which the termination of the board would significantly harm the public health, safety or welfare**

Elimination of the board would not directly harm the public health, safety, or welfare. Essentially, the board has very limited power, its most significant power is that of instructing RUCO to withdraw filed court actions. Further, because RUCO and its director make decisions autonomously from the board, they could function without board oversight. However, RUCO's director and staff have indicated that board members provide valuable input and are an important link between the community of residential consumers and RUCO. In addition, because discussion of actions contemplated and taken by RUCO occur at monthly board meetings, these meetings have been a valuable forum for the dissemination of timely information to the media, public, and utility companies in attendance.

11. **The extent to which the level of regulation exercised by the board is appropriate and whether less or more stringent levels of regulation would be appropriate**

This factor does not apply to the board as it has no regulatory authority.

12. **The extent to which the board has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished**

The board has not used the services of private contractors.

RESIDENTIAL UTILITY CONSUMER OFFICE

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Rose Mofford
Governor

Douglas M. Brooks
Director

October 10, 1989

Douglas R. Norton
Auditor General
2700 North Central Ave.
Suite 700
Phoenix, AZ 85004

Dear Mr. Norton:

Attached are the respective responses of the Residential Utility Consumer Office (RUCO) and the Residential Utility Consumer Board (Board) to the Performance Audit conducted by your Office.

We are pleased by your finding that RUCO has an important role to play in the regulatory process and has been effective in fulfilling its mission of representing the interests of residential consumers in utility-related matters before the Corporation Commission. We are especially heartened by your finding that statutory changes are needed to enhance RUCO's ability to adequately represent ratepayers, a position advocated by the Board and all of the Directors that RUCO has had.

With regard to the specific recommendations presented in the Report, RUCO and the Board accept those made in conjunction with Finding I and endorse those made in conjunction with Finding II. RUCO has already implemented the recommendations made with regard to the quality of its presentations. RUCO and the Board believe that, with more attention paid to the quality of its presentations and the selection and management of its consultants, RUCO will be an even more effective advocate for Arizona's residential consumers.

Those items with which RUCO takes issue are discussed in the formal responses.

Thank you for the opportunity to respond to the Audit Report, and for the professional and objective manner in which the audit was performed.

Very truly yours,

Douglas M. Brooks
Director

attachments

RESPONSE OF THE RESIDENTIAL UTILITY CONSUMER OFFICE (RUCO)

FINDING I: ADDITIONAL EFFORTS ARE NEEDED TO IMPROVE RUCO'S REPRESENTATION OF RESIDENTIAL UTILITY CONSUMERS.

While it is true that in some cases the preparation and presentation of issues and recommendations by RUCO witnesses were not adequate, RUCO believes that its efforts have had a positive effect on utility regulation and the rates paid by utility customers. The Audit Report acknowledges the positive role RUCO has played and the contributions RUCO has made, and presents cases illustrative of RUCO's effectiveness. RUCO acknowledges however that the consistency of RUCO's work can be improved over what it has been in the past, and to this end has initiated better training and supervision of RUCO staff and has emphasized the hiring of experienced and better qualified individuals for staff positions.

While a majority of the specific examples of inadequate presentations or poor use of consultants are accurate, RUCO believes that two are not. The first is that the criticism of RUCO's presentation on the decommissioning cost issue fails to reflect the complexity and detail that went into the witness' recommendations. The Audit Report does not disclose that RUCO's witness levied substantive criticisms against the decommissioning cost estimates of APS, which the witness felt were unrealistically low. RUCO's witness brought forth examples of where the APS witness had in the past underestimated the costs of decommissioning and had to revise his estimates upward. This is important because the failure of an electric utility to collect sufficient funds over the life of a nuclear plant to pay for its decommissioning will result in the utility having to raise significant funds from the capital market at very high rates to pay the decommissioning bill. To the extent that the Commission's discussion of this issue in its Opinion and Order failed to reflect the extensive criticism levied by RUCO against APS' analysis, it did not accurately describe the sophistication of the RUCO witness' analysis.

Further, the criticized argument was an integral part of RUCO's overall analysis of the economics of Palo Verde. This analysis is centered on the finding that the current generation of

nuclear power plants, including Palo Verde, are uneconomic and will continue through their lives to be more costly to ratepayers than reasonable alternatives. RUCO has recommended that, as a result of these very high costs, as well as planning mistakes made by APS, significant amounts of the costs of Palo Verde should not be passed through to ratepayers through higher rates. The rapidly increasing estimates of the costs of decommissioning nuclear power plants is an important component of the calculations of the lifetime cost of Palo Verde and determining that those costs are excessive.

RUCO also disagrees with the criticism expressed regarding RUCO's presentation of the operation and maintenance (O & M) expense issue in APS' Palo Verde 2 rate case. RUCO believes that the ACC's decision oversimplified the analysis done by the witness in proposing his $11.4 million adjustment. The witness found that some of the figures reported by APS for O & M expense levels for particular kinds of generating stations were unusual when compared to industry averages. He sought to correct the aberrant numbers by using figures recommended in a technical guide published by the Electric Power Research Institute, a utility industry group. This adjustment was rejected by the Commission, which apparently felt that industry average figures was too far removed in this instance from the specifics of APS' experience. The Audit Report relies on the ACC's decision and its characterization of the witness' analysis for the criticism of RUCO for failing to develop adequate evidence. In so doing, however, the Audit Report accepts without question the Commission's opinion, which of course is not always the same as RUCO's. RUCO believes that its witness brought to the Commission's attention a very real discrepancy in APS's reported data and presented a well-supported methodology for recasting APS numbers in a "closer-to-average" light. In addition, RUCO feels that the Audit Report's discussion of this issue downplays the significance of the O & M adjustment that was accepted by the Commission. By this adjustment the witness saved APS ratepayers $1.85 million per year.

RUCO acknowledges that in some cases its oversight of the work of consultants has been less than thorough. We agree that the quality of RUCO's representation of residential utility consumers

suffers when this occurs. RUCO has therefore tightened up its contracts with outside experts to require that witnesses must provide preliminary drafts of their testimony in time for RUCO to review the drafts and correct errors before testimony is filed. RUCO is also more aggressive with regard to maintaining contact with its consultants during the course of their work to ensure that they will produce drafts of testimony in a timely fashion. In addition, RUCO now more extensively scrutinizes the backgrounds of bidders before awarding a contract for expert witness services through a careful review of bidders' past work for quality and potential incompatibility with RUCO positions. RUCO believes that these efforts will improve the quality of its performance, and is gratified that, according to the Audit Report, other parties have noticed an improvement.

The Audit Report discusses only three instances in which RUCO's selection and supervision of consultants were deficient. It is relevant to note that during the period covered by this audit (roughly FY's 87, 88 and 89) RUCO entered into and managed approximately 35 contracts for expert witness services. While the Auditor General was unable in the course of its audit to review each and every case in which RUCO used consultants, RUCO believes that it successfully utilized consultants in a significant number of cases.

With regard to the specific recommendations presented by the Audit Report in conjunction with this finding, RUCO accepts both sets of recommendations and has in fact begun their implementation.

FINDING II: STATUTORY CHANGES ARE REQUIRED TO ENSURE RUCO'S ABILITY TO ADEQUATELY REPRESENT RESIDENTIAL RATEPAYERS

RUCO agrees with the Audit Report's finding that the Office needs expanded statutory authority for it to adequately represent the interests of residential consumers. We believe that the

adoption by the Legislature of both of the recommendations made in conjunction with this finding will enable RUCO to more efficiently and effectively carry out its mission.

RUCO agrees with the Audit Report's recommendation that RUCO's authority to intervene in any case which could impact residential utility rates be made clear. Utility companies, particularly those in the electric industry, have been aggressive in attempting to keep RUCO from participating in non-rate change cases that had the potential to significantly affect residential rates. The most egregious examples are discussed in the Audit Report. RUCO and the consumers it represents have been fortunate in having a Commission that believes the current statute can be interpreted broadly enough to allow RUCO's intervention in those types of cases. Should the Commission change however, or should a utility appeal the granting of RUCO's intervention in a non-rate change case to the courts, RUCO runs the risk of having its statute interpreted and applied in a more restrictive way.

In the future many issues of great significance to the state's regulated utilities and their customers will be heard and decided by the ACC in non-rate case settings. The types of cases listed on page 16 of the Audit Report are just a sample of the new and different procedural settings in which important issues will be raised and resolved in the future. RUCO will need to be involved in each of them, and the statutes should make clear RUCO's ability to intervene in them.

RUCO is also concerned that its inability to bring to the Commission formal complaints regarding excessive utility rates is a severe constraint on its ability to fulfill its statutory mandate. RUCO was established to provide full-time, professional representation for residential consumers, but without the authority to initiate proceedings, RUCO must rely upon others to bring formal action against utilities who are overearning. Thus RUCO is reduced to waiting upon others whose agendas, priorities and interests could be different from its own.

Similarly, the inability to file excessive earnings complaints can render RUCO a mere spectator in settlement negotiations of excessive rate investigations. Every other party has the ability, either by itself or in concert with others, to bring to the bargaining table the club of filing their own

complaint regarding excessive rates. RUCO alone cannot do this. And, as the Audit Report reflects, a survey undertaken by RUCO was unable to identify any other utility consumer advocacy agency in another state that does not possess the power to initiate proceedings with its state utility commission.

RUCO urges the Legislature to take affirmative action with respect to the Audit Report's recommendations regarding RUCO's powers. The result will be seen in more effective representation of residential consumers.

OTHER PERTINENT INFORMATION: STAFF TURNOVER AND ADEQUACY OF ATTORNEYS' QUALIFICATIONS

RUCO appreciates the discussion found in this section of the Audit Report and believes it points to very real problems that RUCO has and will continue to experience. RUCO agrees that turnover of directors and attorneys can cause difficulty for the agency, but does not believe that it can be resolved in the context of a report such as this.

The discussion of the adequacy of attorneys' qualifications is important, in that RUCO's attorneys play such a vital role in presenting RUCO's positions to the ACC and the courts. RUCO agrees with the Audit Report's conclusions regarding the causes for RUCO's problems in attracting and retaining qualified attorneys, and hopes that current efforts at increasing the quality and professionalism of RUCO's work product will improve the image RUCO projects in the legal community. RUCO also agrees that the inability of the State to offer attorneys salaries that are competitive with the private sector has hurt its recruitment effort, and notes that RUCO itself appears to lack competitiveness with other state agencies, particularly the Attorney General's Office and the Corporation Commission, in the salaries it has actually been able to offer and pay.

Despite RUCO's agreement with this part of the Audit Report, it believes that two statements made in this section require clarification. The first of these statements is that an entry level attorney went without supervision for two and a half months due to difficulties encountered in hiring supervisory attorneys. While RUCO agrees that for a period of time the entry level attorney was the only attorney on staff, the period was only slightly more than one month (from April 4th to May 15th). In addition, the statement that an entry level attorney received little or no supervision for that period of time is not entirely correct. The attorney represented RUCO in two proceedings during the time in question with supervision and guidance from RUCO's Director, who, while not licensed to practice law in this State, is licensed in another jurisdiction and has been actively engaged in practicing law before a state utility commission for six years. Experienced staff personnel also assisted the new attorney in dealing with the technical issues raised in the cases. The time in which the attorney did not have direct supervision from a supervisory attorney was caused by the abrupt resignation of a staff attorney and the difficulty, documented by the Audit Report, that the Director encountered in finding and hiring an experienced Chief Counsel.

The report also states that RUCO lacks the means to provide training to new legal staff. While RUCO acknowledges that an experienced in-house legal staff is the best source of education and training for a new attorney, the Office ensures that new attorneys, as well as new technical staff employees, receive training through attendance at two educational conferences designed for new utility regulatory personnel. Education is an important part of the training of a new attorney, and RUCO's policy is to send new attorneys to these programs within their first year of employment.

RESPONSE OF THE RESIDENTIAL UTILITY CONSUMER BOARD

The Residential Utility Consumer Board (Board) agrees with the Audit Report's discussion of the Board. We believe the Board serves a valuable purpose and should be continued, along with the Residential Utility Consumer Office (RUCO). While we recognize that the Auditor General's review of the Board was limited in nature, we believe it accurately sets forth the role the Board plays in providing a link between RUCO and the community and functioning as a means of transmitting consumer concerns. In addition members of the Board, both as a group and individually, work on behalf of residential utility consumers as members of task forces and other groups involved in improving the provision of affordable utility services.

The Board has reviewed the findings and recommendations of the Auditor General with regard to RUCO, and concurs with the response provided by RUCO. We believe it should be emphasized that the examples of poor development of evidence and the use of consultants cited in the Audit Report took place before the current RUCO Director was hired. We are confident that RUCO will continue to make improvements in its work, as recognized in the Audit Report, and that RUCO will continue to be an effective representative of residential consumers' interests.

We heartily endorse the Auditor General's recommendation that RUCO's enabling statutes be amended to: (1) expand RUCO's authority to participate in any case which could ultimately impact residential utility rates; and, (2) grant RUCO the authority to initiate rate cases before the Corporation Commission. The need for these changes are ably documented in the Audit Report, and it should be naoted that the Board has endorsed and worked for the passage of legislation that would have granted RUCO the power to file complaints. We urge the Legislature to adopt the Auditor General's recommendations when extending the statutory mandate of RUCO.

APPENDIX

Case Evaluation Methodology

In determining RUCO's effectiveness, we reviewed a prior performance audit report and analyzed a sample of cases in which RUCO intervened. In 1986, Auditor General staff conducted a performance audit of RUCO. We found that, although RUCO had been effective in some cases, inadequate evidence and preparation resulted in RUCO's having little impact in many cases. Following the 1986 report, the Legislature continued RUCO for four years. During the current audit, we reviewed RUCO's work and operations since the previous audit to determine if further improvements are needed at RUCO. As a part of our review, we analyzed 12 opinions and orders for cases in which RUCO intervened to determine RUCO's level of effectiveness in rate cases and to identify areas for improvement.[1]

We defined our sample of cases by reviewing the cases in which RUCO intervened, and had been resolved, from January 1987 through May 1989. During this time, RUCO documents showed that RUCO was involved in 36 cases which resulted in 55 opinion and orders.[2] A listing of these cases and resulting orders was reviewed with Arizona Corporation Commission (ACC) members, hearing officers, and staff, utility company representatives, and RUCO staff. Specifically, we asked each party to identify cases in which RUCO had been very effective and cases in which RUCO had not been

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(1) At the conclusion of a hearing, the hearing officer writes a recommended opinion and order. The utility company, ACC staff, and intervenors may file exceptions to the hearing officer's recommended opinion and order. The commissioners decide whether to adopt the recommended opinion and order as written or to modify it. The document detailing the commissioners' final decision is called an opinion and order.

(2) However, RUCO may not have been involved in all of these cases and opinions and orders. Some may have been the result of stipulations in which RUCO may not have been involved. In addition, some opinion and orders were the result of ACC efforts to consolidate two or more cases.

effective. Most of the cases we analyzed were those which generated the greatest consensus among the parties interviewed.

Our analysis consisted of reviewing the opinions and orders, case legal filings, and hearing transcripts, and interviewing ACC hearing officers and staff, and representatives from other consumer groups involved with the cases.