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AZ CORP COMMISSION
DOCUMENT CONTROL

Arizona Corporation Commission

DOCKETED

AUG 24 2006

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION)
 OF JOHNSON UTILITIES COMPANY FOR)
 AN EXTENSION OF ITS CERTIFICATE OF)
 CONVENIENCE AND NECESSITY FOR)
 WASTEWATER SERVICE.)

DOCKET NO. WS-02987A-04-0889

NOTICE OF FILING TESTIMONY

Johnson Utilities Company ("Johnson" or the "Company") by and through undersigned
 counsel, hereby provides Notice of Filing of the Revised Direct Testimony Larry Davis in the
 subject docket.

The Bank's in-house attorney has requested that certain of the responses contained in Mr.
 Davis' Prefiled Testimony dated August 21, 2006, be expanded on in an attempt to clarify for the
 matters addressed therein. Attached is a clean copy of the Testimony which will be offered as an
 exhibit at the hearing. Also attached for your easy reference is a red-lined version of the changes.

RESPECTFULLY submitted this 24th day of August 2006.

SALLQUIST, DRUMMOND & O'CONNOR, P.C.

By: *Richard L. Sallquist*
 Richard L. Sallquist
 4500 South Lakeshore Drive, Suite 339
 Tempe, Arizona 85282
 Phone: (480) 839-5202
 Fax: (480) 345-0412

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Original and fifteen copies of the foregoing filed this 24 day of August 2006:

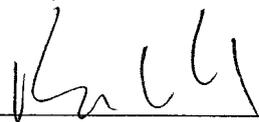
Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

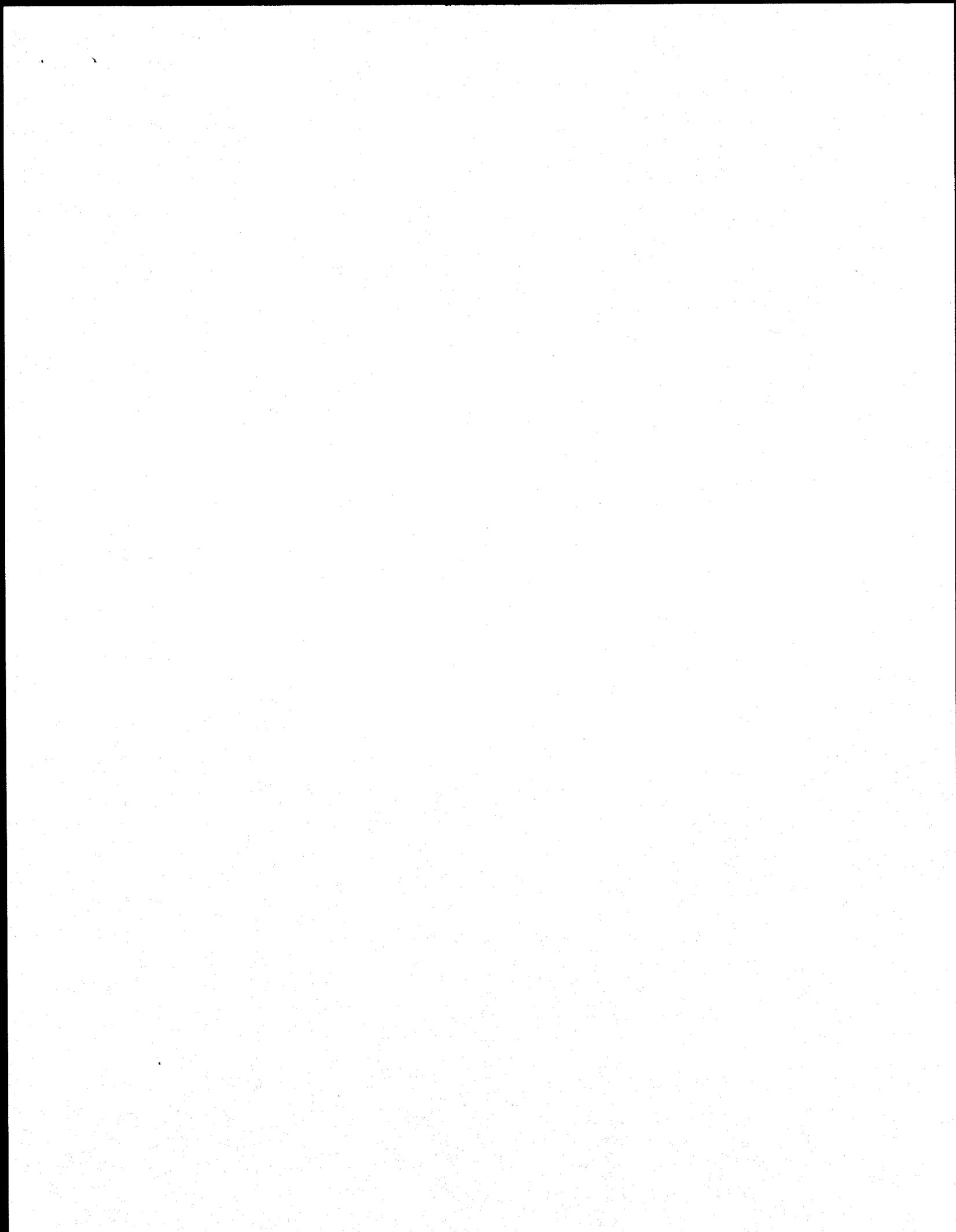
A copy of the foregoing mailed/hand delivered this 24 day of August 2006, to:

Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007





1 6. How long has National Bank of Arizona had a banking relationship with Mr. Johnson and
2 his companies?

3 A. **We have been working with Mr. Johnson since the mid 1990's.**

4 7. Were you approached by the Company regarding a Performance Bond or Letter of Credit
5 in the amount of \$500,000?

6 A. **Yes, we were.**

7 8. What could the Bank offer in that regard?

8 A. **We are a bank, not an insurance company, so we could only provide a Letter
9 of Credit.**

10 9. I show you what is the marked is Exhibit A-1. Is that a copy of the Letter of Credit the
11 Bank issued to Johnson Utility Company in favor of the Arizona Corporation Commission?

12 A. **Yes, it is.**

13 10. Does this Letter of Credit contain the specific terms requested by the Company and as
14 mandated by the Commission?

15 A. **Yes, we were informed that the Commission required substantially that
16 language in the instrument. Though the language required by the Commission is more
17 applicable to bonds than to letters of credit, we believe that it does not change the
18 obligations or procedure under the Letter of Credit, and that the Commission could draw
19 on the Letter of Credit by submitting its sight draft to the Bank accompanied by the
20 original Letter of Credit.**

21 11. For the record, will you briefly explain what a Letter of Credit is?

22 A. **A letter of credit is a direct obligation from the issuing bank to the
23 beneficiary, by which the issuing bank promises to honor one or more draw requests (i.e.,**

1 make payment) if the beneficiary submits certain defined documents to the issuing bank.
2 In this case, NBA would be the issuing bank and the Commission would be the beneficiary.
3 While the letter of credit is requested by an "account party", in this case Johnson Utility
4 Company (the "Company"), the account party is not a party to the letter of credit contract.
5 A letter of credit is designed to be easy to interpret, exercise and enforce. It does not
6 require, or even allow, that the issuing bank investigate whether the draw request is
7 appropriate or not—if the draw request is made in accordance with the requirements set
8 forth in the letter of credit (i.e., if the proper documents are submitted), the issuing bank
9 pays with no more questions asked. If the draw request is not exactly in conformance, then
10 the issuing bank cannot pay. However, the advantage of a letter of credit is that it is short
11 and concise, usually one or two pages, and it should clearly spell out exactly what the
12 beneficiary needs to do to draw on the letter of credit. Letters of credit are widely accepted
13 by county and municipal governments throughout the United States as an alternative to
14 performance bonds for construction and development projects.

15 12. So that I get the right terminology, we please identify the names of the parties to the
16 Letter of Credit for the Bank, the Company, and the Commission?

17 A. Yes, the Bank is known as the issuer or issuing bank, and the Company is
18 known as the account party. The Commission would be the beneficiary under this
19 instrument. The language required by the Commission also calls the Bank a "Surety", the
20 Company a "Principal" and the Commission a "Trustee" for the "Users of the Principal".
21 However, we believe that this language does not affect the operation of the Letter of Credit,
22 that the Bank would pay the Letter of Credit proceeds directly to the Commission upon
23 receipt of a conforming draw request.

1 13. How is the Bank, and for that matter the Commission, secured under this instrument?

2 A. It is up to the issuing bank to determine whether it needs collateral security
3 and/or guarantees, or whether it is comfortable issuing a letter of credit on an unsecured or
4 unguaranteed basis. The beneficiary is not affected by whether or not the issuing bank has
5 collateral or guarantees, because the letter of credit is an independent obligation of the
6 bank, and the bank will have to honor any conforming draw requests, whether or not the
7 bank has recourse to the account party, a guarantor, or any of their assets. The
8 Commission is "secured" by the fact that the letter of credit is a direct obligation of the
9 Bank.

10 14. In the event of the Company's failure to perform its obligations, how would the
11 Commission make a claim or execute on the Letter of Credit?

12 A. Once the Commission, as beneficiary, determines that the conditions exist
13 that justify a draw on the Letter of Credit, the Commission would submit a draw request ,
14 consisting of a sight draft accompanied by the original Letter of Credit, to the Bank. Upon
15 presentation of that documentation to our Documentation Department at 6001 N. 24th St
16 Phoenix, AZ 85016, the Bank would provide the proceeds of the Letter of Credit.

17 15. So the documentation required would merely be the Commission's determination
18 that the Company had not performed?

19 A. No. The required documentation consists of a sight draft and the original of
20 the Letter of Credit. The Letter of Credit could have been written so that the Commission
21 would also have to provide a signed certification that the Company had not performed, but
22 that was not required in the current version of the Letter of Credit. However, it stands to
23

1 reason that the Commission would make the appropriate determination before requesting
2 a draw on the Letter of Credit.

3 16. How long would it be from the Commission's request for funds until the Letter of Credit
4 was funded?

5 A. Technically the Bank has seven days to pay under the Letter of Credit to
6 honor a draw request, however, we typically fund within 48 hours of receiving a
7 conforming draw request.

8 17. What will the Bank do upon satisfying the Commission's draw request?

9 A. The Bank has an agreement with the Company that will obligate the
10 Company to reimburse the Bank, and that agreement may be secured by certain assets of
11 the Company or of Mr. Johnson. The Bank will take appropriate action to seek
12 reimbursement.

13 18. In your opinion is there any risk to the Commission under this arrangement?

14 A. I believe the only significant risk is failure of the Bank, which risk would
15 exist as well with a performance bond, i.e., failure of the issuing insurance company.

16 19. Are there costs to the Company for the Bank issuing a Letter of Credit?

17 A. They are typically 1-3% of the face amount.

18 20. How would the Letter of Credit be impacted in the unlikely event that the Company
19 should declare bankruptcy?

20 A. Because the Letter of Credit is a contract between the Bank and the
21 Commission and is not an obligation of the Company, I am not sure that the bankruptcy of
22 the Company would affect the Bank's obligation to honor draw requests by the
23 Commission. However, I am no bankruptcy expert, and it may be possible that the

1 **bankruptcy court could issue an order staying any action on the Letter of Credit, but I**
2 **assume that the Commission could move for and receive relief from any such stay.**

3 21. What would be the impact if the Bank were to have financial difficulties or declare
4 bankruptcy?

5 A. I believe that the Commission would be an unsecured creditor of the Bank.
6 However, it is very unlikely that the Bank will fail. National Bank of Arizona is a \$42
7 billion dollar company that has been operating in Arizona since 1982. Our parent is Zions
8 Bancorporation, a publicly traded company.

9 22. Mr. Davis, are you familiar with Performance Bonds?

10 A. I am not an expert, but I am generally familiar with those documents.

11 23. Are the terms contained in your Letter of Credit typical to a Performance Bond?

12 A. I do not believe so. My understanding is that Performance Bonds are
13 typically tied to a narrowly defined event or specific contract that has defined terms of
14 default. The Bond is basically an insurance contract, and I believe that they can be several
15 pages in length. They may not be as clear and concise as a letter of credit, and may contain
16 provisions or fine print that can make their exercise subject to other preconditions.

17 24. Other than that, how are Performance Bonds different than Letters of Credit?

18 A. A Performance Bond is basically an insurance policy. With a bond, the
19 Commission would be looking to the assets of the insurance company, instead of to the
20 assets of a bank. A bond may allow a "process" whereby the insurance company
21 investigates the claim made under that bond. A Letter of Credit, on the other hand, is
22 designed to be more "ministerial" in nature, requiring the Bank to honor a draw request
23

1 upon the Commission's satisfaction of a few clearly defined steps, i.e., submission of a sight
2 draft and the original Letter of Credit, as spelled out in the Letter of Credit.

3 25. Are the Bond premiums more than Letter of Credit fees?

4 A. Yes, I understand those annual premiums can run from 2 to 10 % of the
5 Bond, depending on the event secured and the financial strength of the secured party.

6 26. How does one make the claim on a Performance Bond?

7 A. I believe that the Commission would make a claim, not unlike the claim
8 under any insurance policy, and then the insurance company and its underwriters could
9 scrutinize the claim to see if it was within the terms of the bond. My understanding is that
10 this typically takes a number of weeks, if not months.

11 27. What proof would the Commission need to present?

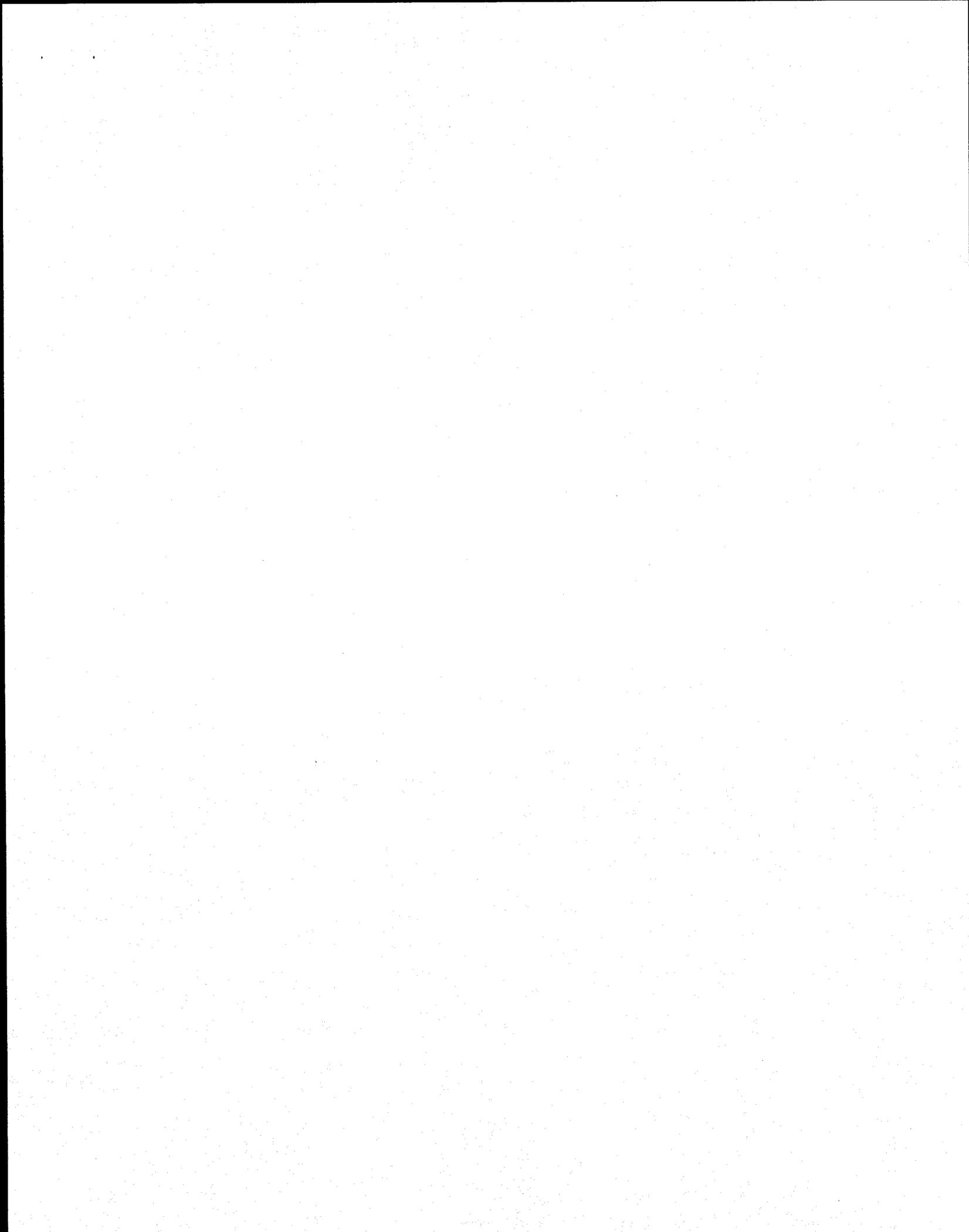
12 A. That depends on the exact language in the bond contract. The claim
13 procedure could vary from insurance company to insurance company.

14 28. In your opinion which document or instrument better secures the Commission and the
15 Company's customers in the event a claim would need to be made in this matter?

16 A. I believe it is well accepted in the financial industry that a Letter of Credit is
17 substantially more secure than a Performance Bond, in the sense that it is more sure in its
18 operation and it provides funds directly to the Commission for the Commission to use as it
19 sees fit to provide the necessary services to the customers.

20 29. Does that conclude your testimony?

21 A. Yes, it does.
22
23



1 **Johnson Utilities Company**
2 **Certificate of the Convenience and Necessity Applications**
3 **in Docket Nos.**

4 **WS-02987A-04-0288**

5 **WS-02987A-04-0889**

6 **WS-02987A-05-0088**

7 **Direct Testimony of**

8 **Larry Davis**

9 **Filed August 24, 2006,**

10 **Superseding Prefiled Document of August 21, 2006**

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11 **EXHIBITS**

12 A-1 Letter of Credit, dated January 23, 2006

13 A-2 Letter to Brian Bozzo, dated January 26, 2006

14 1. Please state your name and business address.

15 A. My name is Larry Davis, and my business address is 6001 N. 24th Street,
16 Phoenix, Arizona 85016.

17 2. By whom are you employed and in what capacity?

18 A. I am employed by National Bank of Arizona as the Chief Credit Officer of
19 the Company.

20 3. How long have you been so employed?

21 A. I have been with the Bank for approximately 10 years.

22 4. Please give a brief resume' of your education and experience as it relates to the utility
23 business.

 A. I have been in the banking business in Arizona for over 35 years. That
 includes 18 years with Arizona Bank, 5 years with Caliber Bank, and 10 with National
 Bank.

 5. Are you familiar with George Johnson and the Johnson Utilities Company?

 A. Yes, I am.

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1 6. How long has National Bank of Arizona had a banking relationship with Mr. Johnson and
2 his companies?

3 A. We have been working with Mr. Johnson since the mid 1990's.

4 7. Were you approached by the Company regarding a Performance Bond or Letter of Credit
5 in the amount of \$500,000?

6 A. Yes, we were.

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19 on the Letter of Credit by submitting its sight draft to the Bank accompanied by the
20 original Letter of Credit.

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22 A. A letter of credit is a direct obligation from the issuing bank to the
23 beneficiary, by which the issuing bank promises to honor one or more draw requests (i.e.,

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Deleted: There are many types of Letters of Credit. The one provided in this instance is referred to as a Stand-By Letter of Credit and is designed to guarantee an action or certain performance. If that contracted for performance is not completed, then the beneficiary under the Letter of Credit realizes the proceeds.

1 make payment) if the beneficiary submits certain defined documents to the issuing bank.
2 In this case, NBA would be the issuing bank and the Commission would be the beneficiary.
3 While the letter of credit is requested by an “account party”, in this case Johnson Utility
4 Company (the “Company”), the account party is not a party to the letter of credit contract.
5 A letter of credit is designed to be easy to interpret, exercise and enforce. It does not
6 require, or even allow, that the issuing bank investigate whether the draw request is
7 appropriate or not—if the draw request is made in accordance with the requirements set
8 forth in the letter of credit (i.e., if the proper documents are submitted), the issuing bank
9 pays with no more questions asked. If the draw request is not exactly in conformance, then
10 the issuing bank cannot pay. However, the advantage of a letter of credit is that it is short
11 and concise, usually one or two pages, and it should clearly spell out exactly what the
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13 by county and municipal governments throughout the United States as an alternative to
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15 12. So that I get the right terminology, we please identify the names of the parties to the
16 Letter of Credit for the Bank, the Company, and the Commission?

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18 known as the account party. The Commission would be the beneficiary under this
19 instrument. The language required by the Commission also calls the Bank a “Surety”, the
20 Company a “Principal” and the Commission a “Trustee” for the “Users of the Principal”.
21 However, we believe that this language does not affect the operation of the Letter of Credit,
22 that the Bank would pay the Letter of Credit proceeds directly to the Commission upon
23 receipt of a conforming draw request.

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Deleted: "Surety"
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Deleted: "Trustee"

1 13. How is the Bank, and for that matter the Commission, secured under this instrument?
2 A. It is up to the issuing bank to determine whether it needs collateral security
3 and/or guarantees, or whether it is comfortable issuing a letter of credit on an unsecured or
4 unguaranteed basis. The beneficiary is not affected by whether or not the issuing bank has
5 collateral or guarantees, because the letter of credit is an independent obligation of the
6 bank, and the bank will have to honor any conforming draw requests, whether or not the
7 bank has recourse to the account party, a guarantor, or any of their assets. The
8 Commission is "secured" by the fact that the letter of credit is a direct obligation of the
9 Bank.

Deleted: Due to the long-term and ongoing relationship between the Bank and Mr. Johnson's entities, how we are quite familiar with his financial statements, including his fixed and liquid assets. The Bank enters into other documentation with Mr. Johnson that places a lien on his assets sufficient to secure the Letter of Credit. In this instance the Letter is secured by cash.

10 14. In the event of the Company's failure to perform its obligations, how would the
11 Commission make a claim or execute on the Letter of Credit?

Deleted: Principal
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12 A. Once the Commission, as beneficiary, determines that the conditions exist
13 that justify a draw on the Letter of Credit, the Commission would submit a draw request ,
14 consisting of a sight draft accompanied by the original Letter of Credit, to the Bank. Upon
15 presentation of that documentation to our Documentation Department at 6001 N. 24th St
16 Phoenix, AZ 85016, the Bank would provide the proceeds of the Letter of Credit.

Deleted: Presumably the Commission will take some official action to determine that the Company has, in fact, failed to perform as contemplated.
Deleted: document
Deleted: along with a request for the funds,
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17 15. So the documentation required would merely be the Commission's determination
18 that the Company had not performed?

Deleted: Yes.

19 A. No, The required documentation consists of a sight draft and the original of
20 the Letter of Credit. The Letter of Credit could have been written so that the Commission
21 would also have to provide a signed certification that the Company had not performed, but
22 that was not required in the current version of the Letter of Credit. However, it stands to

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1 reason that the Commission would make the appropriate determination before requesting
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3 16. How long would it be from the Commission's request for funds until the Letter of Credit
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5 A. Technically the Bank has seven days to pay under the Letter of Credit to
6 honor a draw request, however, we typically fund within 48 hours of receiving a
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8 17. What will the Bank do upon satisfying the Commission's draw request?

9 A. The Bank has an agreement with the Company that will obligate the
10 Company to reimburse the Bank, and that agreement may be secured by certain assets of
11 the Company or of Mr. Johnson. The Bank will take appropriate action to seek
12 reimbursement.

Deleted: has fully secured this amount with other assets of Mr. Johnson, and we would then be forced to execute under those documents in the amount of the Letter of Credit.

13 18. In your opinion is there any risk to the Commission under this arrangement?

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Deleted: None whatsoever.¶

14 A. I believe the only significant risk is failure of the Bank, which risk would
15 exist as well with a performance bond, i.e., failure of the issuing insurance company.

16 19. Are there costs to the Company for the Bank issuing a Letter of Credit?

17 A. They are typically 1-3% of the face amount.

18 20. How would the Letter of Credit be impacted in the unlikely event that the Company
19 should declare bankruptcy?

20 A. Because the Letter of Credit is a contract between the Bank and the
21 Commission and is not an obligation of the Company, I am not sure that the bankruptcy of
22 the Company would affect the Bank's obligation to honor draw requests by the
23 Commission. However, I am no bankruptcy expert, and it may be possible that the

Deleted: We would be subject to any Bankruptcy Court ruling, just like everyone else. However, I am certain that if the Commission would request the lift of the Court's Stay on fund disbursement, it would be granted to permit continuing utility service.¶

1 bankruptcy court could issue an order staying any action on the Letter of Credit, but I
2 assume that the Commission could move for and receive relief from any such stay.

3 21. What would be the impact if the Bank were to have financial difficulties or declare
4 bankruptcy?

5 A. I believe that the Commission would be an unsecured creditor of the Bank.
6 However, it is very unlikely that the Bank will fail. National Bank of Arizona is a \$42
7 billion dollar company that has been operating in Arizona since 1982. Our parent is Zions
8 Bancorporation, a publicly traded company. .

9 22. Mr. Davis, are you familiar with Performance Bonds?

10 A. I am not an expert, but I am generally familiar with those documents.

11 23. Are the terms contained in your Letter of Credit typical to a Performance Bond?

12 A. I do not believe so. My understanding is that Performance Bonds are
13 typically tied to a narrowly defined event or specific contract that has defined terms of
14 default. The Bond is basically an insurance contract, and I believe that they can be several
15 pages in length. They may not be as clear and concise as a letter of credit, and may contain
16 provisions or fine print that can make their exercise subject to other preconditions.

17 24. Other than that, how are Performance Bonds different than Letters of Credit?

18 A. A Performance Bond is basically an insurance policy. With a bond, the
19 Commission would be looking to the assets of the insurance company, instead of to the
20 assets of a bank. A bond may allow, a "process" whereby, the insurance company
21 investigates the claim made under that bond. A Letter of Credit, on the other hand, is
22 designed to be more "ministerial" in nature, requiring the Bank to honor a draw request

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Deleted: We would not speculate on that event.

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Deleted: Additionally, the cash collateral is subject to FDIC \$100,000 insurance.

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Deleted: y typically would not reference a rather ambiguous "failure to provide competitive water and wastewater services" as the operative language.

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Deleted: With a Letter of Credit, the Commission is relying upon the fact that the Bank has the cash under its control to perform under the Letter of Credit.

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1 upon the Commission's satisfaction of a few clearly defined steps, i.e., submission of a sight
2 draft and the original Letter of Credit, as spelled out in the Letter of Credit.

Deleted: an "event" under which the Trustee in this instance merely presents the request for funding

3 25. Are the Bond premiums more than Letter of Credit fees?

4 A. Yes, I understand those annual premiums can run from 2 to 10 % of the
5 Bond, depending on the event secured and the financial strength of the secured party.

6 26. How does one make the claim on a Performance Bond?

7 A. I believe that the Commission would make a claim, not unlike the claim
8 under any insurance policy, and then the insurance company and its underwriters could
9 scrutinize the claim to see if it was within the terms of the bond. My understanding is that
10 this typically takes a number of weeks, if not months.

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11 27. What proof would the Commission need to present?

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12 A. That depends on the exact language in the bond contract, The claim
13 procedure could vary from insurance company to insurance company.

Deleted: Again, bonds are typical insurance policies and may contain substantial fine print.

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14 28. In your opinion which document or instrument better secures the Commission and the
15 Company's customers in the event a claim would need to be made in this matter?

16 A. I believe it is well accepted in the financial industry that a Letter of Credit is
17 substantially more secure than a Performance Bond, in the sense that it is more sure in its
18 operation and it provides funds directly to the Commission for the Commission to use as it
19 sees fit to provide the necessary services to the customers.

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20 29. Does that conclude your testimony?

21 A. Yes, it does.
22
23