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IN THE MATTER OF THE APPLICATION  
OF JOHNSON UTILITIES, LLC, DBA  
JOHNSON UTILITIES COMPANY FOR AN  
INCREASE IN ITS WATER AND  
WASTEWATER RATES FOR CUSTOMERS  
WITHIN PINAL COUNTY, ARIZONA

DOCKET NO. WS-02987A-08-0180

**JOHNSON UTILITIES LLC'S  
REPLY BRIEF**

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**I. INTRODUCTION.**

Johnson Utilities, LLC, dba Johnson Utilities Company (“Johnson Utilities” or the “Company”) hereby files its Reply Brief in response to (i) Staff’s Initial Post Hearing Brief (Staff’s Brief”); (ii) RUCO’s Opening Brief (“RUCO’s Brief”); and (iii) the Post Hearing Brief of Swing First Golf (“SFG’s Brief”).

As set forth in Johnson Utilities’ Closing Brief (Closing Brief”), for its Water Division, the Company is requesting a decrease in revenues of \$2,879,022, or a decrease of 21.86%, for a total revenue requirement of \$10,293,877 (Exhibit A-4, Volume II at 3), and an adjusted rate base of \$3,539,562. (Exhibit A-4, Volume II at 3; *see also* Johnson Utilities Notice of Filing Closing Schedules [“Final Schedules”] Water Division, Schedule C-1). For its Wastewater Division, Johnson Utilities is requesting an increase in revenues of \$2,326,532, or an increase of 20.49%, for a total revenue requirement of \$13,680,546. (Exhibit A-4, Volume III at 3) and an adjusted rate base of \$17,479,735. (Exhibit A-2, Volume III, page 4; *see also* Johnson Utilities’ Final Schedules, Wastewater Division, Schedule B-1).

1     **II.     RATE BASE.**

2             There are a number of contested issues among the parties regarding rate base  
3 adjustments and Johnson Utilities will not repeat the arguments raised in the Company's  
4 Closing Brief. Rather, the Company will address herein only those issues raised in the  
5 parties' respective closing briefs.

6             **A.     Plant Not Used and Useful.**

7             In their respective closing briefs, Staff and RUCO continue to propose the removal  
8 of plant from rate base that they alleged is not "used and useful" in the amount of  
9 \$4,127,019 for the Water Division and \$4,595,298 for the Wastewater Division.

10            For the Water Division, although Johnson Utilities agreed with the removal of  
11 \$3,395,894 as plant that is not used and useful (Exhibit A-2, Volume II at 11), the  
12 Company disagrees with the removal of \$731,125 for 331-Transmission and Distribution  
13 Mains (Rickey Water plant 4 miles of 12-inch mains). (*Id.*; see also Exhibit A-4, Volume  
14 II at 7). Although the water transmission main is not currently serving customers, the  
15 testimony and evidence in the case was uncontroverted that the Company was required to  
16 build this plant in order to serve a new development. (*Id.*). It is undisputed that Johnson  
17 Utilities received a *bona fide* request for water service from the developer, which  
18 obligated the Company to serve under its certificate of convenience and necessity  
19 ("CC&N"). (Exhibit A-7 at 14). In addition, Johnson Utilities entered into the Silverado  
20 Ranch Master Utility Agreement ("Silverado Agreement") in good faith, which  
21 contractually obligated the Company to construct the water main. (*Id.*). The Staff  
22 accounting witness seemed unaware that the Silverado Agreement was even provided to  
23 Staff, and the Staff witness admitted that he did not even read it:

24            Q.     Did you review a copy of the master utility agreement for Silverado  
25                    Ranch?

26            A.     No.

1 Q. Are you aware that a copy of that master utility agreement was  
2 attached as Exhibit A to Mr. Tompsett's rebuttal testimony in this  
3 case?

4 A. It might have been.

5 (Tr. Vol. X at 1570 [Mitchlik]). Johnson Utilities provided uncontroverted evidence and  
6 testimony that the decision to construct the water main was prudent and thus, it would be  
7 inappropriate and inequitable to remove the \$731,125 cost of the water main from rate  
8 base. (Exhibit A-2, Volume II at 11).

9 For the Wastewater Division, although Johnson Utilities agreed to remove  
10 \$2,209,026 of plant not used and useful (Exhibit A-2, Volume III at 11), the Company  
11 disagrees with the removal of \$690,186 for 360-Collections Sewer Force (Magma  
12 approx. 4 miles of 8-inch). (*Id.*). Although this plant is not currently serving customers,  
13 the testimony and evidence in the case was uncontroverted that the Company was  
14 required to build this plant in order to serve a new development. (*Id.*).

15 In addition, Johnson Utilities disagrees with the removal of \$1,695,816 for the cost  
16 of the Precision WRP-Marwood Plant which consists of (i) 354-Structures and  
17 Improvements for \$14,491; (ii) 381-Plant Sewers for \$5,749; and (iii) 381-Plant Sewers  
18 for \$1,675,846, because the plant was required by the Arizona Department of  
19 Environmental Quality ("ADEQ") before the department would issue new subdivision  
20 approvals, thereby making construction of the plant unavoidable. (Exhibit A-2, Volume  
21 III at 12). In addition, the Precision Wastewater Treatment Plant ("Precision WWTP")  
22 was necessary to serve the 2007 test-year level of customers. Staff acknowledged that it  
23 had no reason to dispute the Company's contention that it had no choice but to construct  
24 the Precision WWTP. (Tr. Vol. X at 1504-1505 [Scott]). Because construction of the  
25 Precision WWTP was a necessary prerequisite to the issuance of additional subdivision  
26 approvals in Johnson Ranch, and the plant was needed to serve the 2007 test-year level of

1 customers, the Precision WWTP should not be excluded from plant-in-service. (Exhibit  
2 A-5 at 36-37). Likewise, the construction of the 8-inch sewer force main to serve  
3 approximately 1,834 new homes planned for the Silverado Ranch development was  
4 necessary and prudent. (Exhibit A-5 at 37). Johnson Utilities holds the CC&N to  
5 provide wastewater service to Silverado Ranch and the Company received a *bona fide*  
6 request for wastewater service from the developer.

7 **B. Excess Capacity.**

8 In their respective closing briefs, Staff and RUCO continue to propose the removal  
9 of plant from rate base that they allege is "excess capacity" in the amount of \$1,127,065  
10 for the Water Division and \$5,443,062 for the Wastewater Division.

11 For the Water Division, the basis for Staff's disallowance is that the Rancho  
12 Sendero Well #1 and the 0.5 million gallon storage tank adjacent to the Rancho Sendero  
13 wells are not needed to serve Staff's growth projection of 1,780 customers at the end of  
14 2012. (Exhibit S-38 at 9; Exhibit S-36, Exhibit MSJ at 12.). However, Staff's assertion that  
15 the third well and storage tank is not needed in the 5-year planning period is not  
16 supported by the record. (Staff Brief at 6). As explained in Johnson Utilities' Closing  
17 Brief, the evidence shows that all three wells and both storage tanks are necessary and  
18 integral to the operation of the Anthem at Merrill Ranch water system in order to provide  
19 safe and reliable water service. (Exhibit A-5 at 6).

20 Notwithstanding its proposed disallowance, the Staff witness testified that nothing  
21 would prevent Johnson Utilities from operating all three wells and both storage tanks  
22 then requesting inclusion of the Rancho Sendero Well #1 and the 0.5 million gallon  
23 storage tank in a subsequent rate base. (Staff Brief at 6). In other words, if Staff's growth  
24 projections are too low (which the record clearly shows they are), then Rancho Well #1  
25 and the 0.5 million gallon storage tank are available if needed, but the Company may not  
26

1 earn a return on these assets at this time. This is simply unfair. The evidence in this case  
2 shows that both storage tanks and all three wells are necessary to serve the estimated  
3 number of 2,687 customers projected at the end of 2012. (Exhibit A-5 at 9; *see also*  
4 *Johnson Utilities' Closing Brief at 10-11*).

5 For the Wastewater Division, although Johnson Utilities provided evidence that  
6 the 1.0 million gallon per day ("MGD") Phase II ("Phase II") of the Santan Wastewater  
7 Treatment Plant ("Santan WWTP") will be put to use by late 2009 to treat wastewater  
8 flow that will be redirected from the Company's Pecan Wastewater Treatment Plant  
9 ("Pecan WWTP"), Staff argues in the Staff Brief that because the redirection occurred  
10 after the test year, the plant should be treated as excess capacity and removed from rate  
11 base. (Exhibit A-5 at 38; Staff Brief at 7). As discussed in its Closing Brief, Johnson  
12 Utilities decided to use the available Santan WWTP capacity rather than prematurely  
13 constructing expensive new additional capacity at the Pecan WWTP. This prudent way  
14 of operating gives the Company greater operational flexibility in treating wastewater  
15 flows in its service area, and it allows Johnson Utilities to obtain the maximum benefit  
16 from its combined wastewater treatment capacity. (Exhibit A-5 at 38). In fact, Staff  
17 testified at the hearing that if, during the test year, the Pecan WWTP had 3 million  
18 gallons per day of capacity, then Staff probably would not have recommended any  
19 disallowance at that plant. (Tr. Vol. X at 1513 [Scott]). Staff also agreed that a utility  
20 would not want to build plant capacity today if it can adequately address the capacity  
21 issues by moving flow to another plant. (Tr. Vol. X at 1517-1518 [Scott]). Johnson  
22 Utilities' decision to redirect wastewater flows to the Santan WWTP was prudent, and the  
23 Company should not be penalized by removing Phase II as excess capacity.

24 **C. Inadequately Supported Plant.**

25 Rather than identifying and removing specific plant costs which were found to be  
26 unsupported or inadequately supported, Staff instead proposed an arbitrary 10% across-

1 the-board disallowance applied to all plant. (Staff Brief at 7). In its Closing Brief,  
2 Johnson Utilities provided a summary of the plant costs and the supporting  
3 documentation that were provided to Staff for both its water and wastewater plant.  
4 (Johnson Utilities' Closing Brief at 5 and 18). Staff's arbitrary deduction is nearly  
5 impossible to reconcile given Staff's oral testimony that line extension agreements,  
6 construction agreements, invoices, receipts and other supporting documentation are the  
7 types of documentation that a utility would traditionally submit to substantiate plant  
8 costs. (Tr. Vol. XI at 1643 [Michlik]). These types of documentation are exactly the  
9 types of documentation that Johnson Utilities provided to Staff in this case. The Staff  
10 witness admitted on cross-examination that he did not identify any specific item of plant  
11 that was inadequately documented or unsupported by Johnson Utilities. (Tr. Vol. XI at  
12 1660-1661 [Michlik]). Thus, even though there may have been some plant which Staff  
13 determined was fully supported, 10% of those costs were also disallowed based on this  
14 "shotgun" approach. (Exhibit A-2, Volume II at 9).

15 While the Staff witness testified that "only a minimal 10 percent disallowance is  
16 warranted in this case," that was small consolation to Johnson Utilities which suffered a  
17 \$20,000,000 reduction to its rate case for this "minimal" disallowance:

18 Q. And starting at the bottom of page 13 there is a question that says,  
19 "Is Staff recommending disallowance of all substantiated plant?"  
20 Your answer starting at line 25 is, "No. Rather than disallowing the  
21 entire plant cost, Staff decreased plant cost by 10 percent." And then  
22 continuing on the page 14, the question you are asking is: "How did  
23 Staff arrive at 10 percent disallowance?" And your answer is, "Staff's  
24 typical range of unsubstantiated plant ranges from 10 to 100 percent.  
25 Staff determined that only a minimal 10 percent disallowance is  
26 warranted in this case." Is that your testimony?

A. Yes.

Q. And in your opinion is a disallowance of \$19,855,342 in plant a  
minimal disallowance?

A. Well, correct for the double counting, but, yes, because we  
recommended 80 or 90 percent or even 100 percent except for the

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very few plant invoices that were provided to Staff on the wastewater side.

(Transcript Vol. XI at 1633-1634 [Michlik]).

In this case, Johnson Utilities continually sought to provide plant documentation that would satisfy Staff, but Staff's requirements kept changing. To illustrate this point, Staff witness Michlik testified as follows:

Q. What constitutes "complete and authentic" information?

A. For independent third party transactions, complete and authentic information is source documentation that includes but is not limited to vendor invoices for materials, supplies, and labor, contracts, canceled checks, time sheets, and reliable accounting records. This information would allow Staff to identify what was purchased and whether the item is allowable. Further, this documentation would allow Staff to identify the amount of the purchase and to determine whether the amount was reasonable.

In the case of transactions with affiliates, Staff would request source document in addition to fair competitive bids. The competitive bids should be such that the public perceives the bidding process as fair and therefore is willing to go through the cost of putting in a bid. Further, for Class A companies, the Commission affiliate interest rules require that the affiliate provide all source documentation.

(Exhibit S-38 at 11 [Michlik]). Although the Staff witness identified a variety of documentation that would constitute "complete and authentic information," later in his testimony he inexplicably narrows the scope of documents that would constitute such documentation:

Q. What costs should be included in plant and subsequently in rate base values?

A. Only the actual cost of materials, labor and overhead of the affiliate (exclusive of any profit) should be recognized in rate base. Johnson Water should be required to provide invoices as evidence to support the actual costs of the affiliate.

(Exhibit S-38 at 15 [Michlik]). Throughout its surrebuttal testimony, Staff continued to maintain that the only appropriate source documentation would be invoices:

1 Q. Are there any adjustments to plant in service that Staff did not make  
2 in direct testimony, but would like to make now for the water  
3 division?

4 A. Yes, for the plant that Staff determined to be: 1) not used and useful,  
5 or 2) having excess capacity. Staff had not made a corresponding  
6 adjustment to Advances-in-Aid of Construction ("AIAC") or  
7 Contributions-in-Aid of Construction ("CIAC") for these plant  
8 adjustments. These amounts are temporary adjustments to the  
9 Company's rate base, as the Company will receive a return on the  
10 plant investments in the next rate case **if it can provide Staff with**  
11 **adequate supporting source documentation (i.e., invoices)** to  
12 substantiate these plant amounts, as well as providing evidence that  
13 the plant is then used and useful or no longer excess capacity.

14 (Exhibit S-39 at 3) (emphasis added).

15 Staff throughout its Closing Brief complains that one of the reasons that plant was  
16 disallowed was because the Company failed to timely provide the requested  
17 documentation. (Staff Brief at 7-8). Yet the record supports the fact that throughout the  
18 case, Johnson Utilities made herculean efforts to supplement the documents request by  
19 Staff. As set forth in Exhibit A-69, responses to JMM 1-43 and JMM 1-44 were provided  
20 to Staff on September 22, 2008. Staff had requested documentation for Plant Additions  
21 for both the Water Division (JMM 1-43) and the Wastewater Division (JMM1-44). In  
22 response, the Company provided four volumes of documents by year as requested. In  
23 addition, Johnson Utilities provided the following response to each data request as  
24 follows:

25 Response to JMM 1-43:

26 Attached, by year, are copies of line extension agreements, construction  
agreements, invoices, receipts and other supporting documentation for the  
water plant additions listed in this data request. Johnson Utilities has not  
attached complete copies of the line extension agreements and construction  
agreements due to the volume of paper that would create. Rather, the  
company has attached the first page of the agreement and the attachments  
which describe the water plant constructed and the costs. If the Utilities  
Division Staff requires a complete copy of any agreement, Johnson Utilities  
will provide a copy upon request. Also, please note that the plant costs for  
fire hydrants are, in some cases, included in line extension and/or  
construction agreements. Where the company has separate invoices or other  
documentation for fire hydrants, it is tabbed separately from the other water

1 plant. Johnson Utilities has a small number of additional invoices to  
2 provide in response to this data request. These invoices will be provided  
shortly.

3 Response to JMM 1-44:

4 Attached, by year, are copies of line extension agreements, invoices,  
5 receipts and other supporting documentation for the sewer plant additions  
6 listed in this data request. Johnson Utilities has not attached complete copies  
7 of the line extension agreements due to the volume of paper that would  
8 create. Rather, the company has attached the first page of the agreement and  
9 the attachments which describe the sewer plant constructed and the costs. If  
the Utilities Division Staff requires a complete copy of any agreement,  
Johnson Utilities will provide a copy upon request. Johnson Utilities has a  
small number of additional invoices to provide in response to this data  
request. These invoices will be provided shortly.

10 (Exhibit A-69).

11 Thereafter, as set forth in Johnson's Closing Brief, in response to Staff Data  
12 Requests JMM 4-1, JMM 4-2, JMM 4-3, JMM 7-1, JMM 7-2, JMM 9-1, and JMM 9-2,  
13 the Company provided additional contracts, invoices, cancelled checks, and/or line  
14 extension agreements, accounting records, bank statements, plant schedules,  
15 reconciliations and other information supporting plant costs to supplement Staff's  
16 request. (Exhibit A-2, Volume II at 7-8).<sup>1</sup> In fact, Staff admitted under cross-  
17 examination that not only did it thank the Company for its supplemental responses; at no  
18 time did Staff raise any objection as to the form of the submitted documentation in a  
19 supplemental data request:

20 Q. (BY MR. CROCKETT) Mr. Michlik, I just asked you if you would  
21 read the data request JMM 7-1.

22 A. Sure. This is a follow-up to JMM 14-3 and JMM 1-44. "Thank you  
23 for the plant costs documentation provided. However, the cost of the  
24 plant per documentation provided does not equal the plant" -- it  
should be plant additions -- "i.e., the cost shown on the  
documentation sums to more and sometimes less than your reported

25 <sup>1</sup> In its Closing Brief, Johnson Utilities provided a summary of all the documentation  
26 provided to Staff to support plant costs for its Water and Wastewater Divisions.  
(Johnson's Closing Brief at 6 and 18).

1 cost of the plant addition. For example, in documentation provided  
2 for the sewer division's 1999 plant additions for account No. 361 was  
3 approximately \$949,000 less than the actual cost reported  
4 \$3,771,477. Please reconcile the differences by providing additional  
5 information where needed and indicated on each advance agreement  
6 the account numbers to which the costs were recorded."

7 Q. And would you read the response to your request?

8 A. See the schedules attached to this data request which contain  
9 accounting details for the years 1998 through 2007."

10 Q. I notice that you thank the company for providing the plant cost  
11 documentation. I don't see in there where you indicated that the  
12 material was submitted to you in a form that wasn't acceptable. How  
13 was that communicated to the company?

14 A. Again, I think we had two separate meetings with the company on  
15 that issue.

16 Q. So you don't have a data request that specifically references that  
17 issue?

18 A. No.

19 (Tr. Vol. XI at 1654-1655 [Michlik]). In fact, Staff did not specifically request invoices  
20 pertaining to the previously provided main extension agreements until the meetings  
21 between Staff and the Company that are referenced above.

22 At hearing, Staff again testified that the only proper documentation to support  
23 plant were the underlying construction invoices:

24 Q. Mr. Michlik, in the context of evaluating a rate application and  
25 conducting an audit on a utility, what sort of documents does Staff  
26 need to conduct a proper evaluation?

27 A. First we look at the application. In this case we sent out data  
28 requests. We wanted plant additions by year and by line item. They  
29 should match to the company's general ledger, and supporting  
30 documentation, we are looking under those for actual invoices.

31 (Tr. Vol. X at 1529-1530 [Michlik]). Mr. Michlik continued:

32 Q. Why did Staff recommend a 10 percent disallowance of plant in this  
33 case?

34 A. Based on the lack of underlying supporting documentations. What I  
35 mean by that is actual invoices.

1 (Tr. Vol. X at 1534 [Michlik]).

2 On cross-examination related to affiliate plant numbers, Staff first testified that  
3 Johnson Utilities did not provide necessary supporting documentation. However, when  
4 pressed, the Staff witness testified that although the documentation may have been  
5 provided, it was not verifiable:

6 Q. And do you have any sense for whether these numbers that you see  
7 on this spreadsheet are in line with what other utilities might allocate  
for overhead?

8 A. No, we don't, because you never gave us the underlying supporting  
9 documentation. So for the automotive expense of \$79.04, the data  
10 request clearly asks for your underlying supporting documentation  
11 for that. Legal and accounting expense of \$2,292.08, you should  
12 have been able to provide us with some documentation for that.  
Insurance -- I can go on and on. Basically we asked for it; you  
didn't give it to us; all you did was give us a spreadsheet. I don't  
know how you created this spreadsheet.

13 Q. Well, I guess I'm just asking, you acknowledge, though, the  
company did provide this spreadsheet to you?

14 A. Right, and we can't verify any of the numbers or evaluate any of the  
15 numbers that are presented in this spreadsheet.

16 Q. Does that mean that you didn't do anything to try to evaluate these  
numbers?

17 A. Well, we asked the company. They didn't supply us with the  
18 underlying supporting documentation.

19 (Tr. Vol. XI at 1626-1627 [Michlik]). This, however, was not true. On cross-  
20 examination, the Staff witness conceded that the information, including supporting  
21 invoices, was in fact provided, but argued that the information was not provided  
22 specifically by year or by account number:

23 Q. But if you had the underlying support for this construction, you  
24 could have compared that to the stated overhead and profit rate of 5  
percent for the contract to determine whether these numbers are  
accurate; is that correct?

25 A. Right, and we would also need the contract piece, too.  
26

1 Q. And you are saying that you didn't receive that piece of it? Is that  
2 your testimony?

3 A. The Company may have provided it in a big box full of -- a shoebox  
4 full of invoices at that point but didn't adequately identify it.

5 Q. Well --

6 A. It actually should be on here. So, Johnson Ranch, you should have  
7 an extra column here; here is the contract amount. And you should  
8 have highlighted that to Staff so we could actually see where that  
9 contract was.

10 Q. So now your testimony is, I think, that we -- the company may have  
11 provided it but it was provided in a shoebox; is that correct?

12 A. I believe it was a -- not a shoebox, a Xerox box with just a cover  
13 sheet, nothing to indicate where each of these projects lined up to  
14 plant additions by year and by account number.

15 Q. Well, we will go through that with a couple of shoeboxes and see if  
16 we can corroborate that.

17 (Tr. Vol. XI at 1629-1630 [Michlik]). Finally, when confronted with the fact that  
18 Johnson Utilities did provide the requested information by account number and project,  
19 the Staff witness then proceeded to argue that while a spreadsheet and the underlying  
20 information was provided, a lead sheet was not provided so Staff could not trace the  
21 spreadsheet to the underlying documentation:

22 Q. Mr. Michlik, one more question before I move on from A-63. If you  
23 would turn to the back of that exhibit and if you would look at  
24 Attachment 13-1b that starts on the page at the bottom that is  
25 identified as JU-8023. Do you see that?

26 A. Yes.

Q. And has the company provided in this spreadsheet overhead by plant  
account number and project?

A. Yes, but they still haven't provided -- they should have provided this  
as a lead sheet and not actually underlying documentation so we  
could trace it back to this.

(Tr. Vol. XI at 1630 [Michlik]).

However, one more time, when pressed on the sufficiency of the documentation,

1 the Staff witness had to again admit that the appropriate documentation was in fact  
2 provided:

3 Q. Would you turn with me to the attachment 7.1. Would you identify  
4 for me what this is?

5 A. That is a spreadsheet.

6 Q. And what does it do?

7 A. It separates Johnson projects by date and account number.

8 Q. And you testified a moment ago that the information that was  
9 provided in 1-43 and 1-44 by the company wasn't completely helpful  
10 to you because there was nothing to tie that data back to account  
11 numbers, and you testified that the company didn't provide anything  
12 to you to help you do that. Did this documentation here not address  
13 that concern that you had raised?

14 A. Again, it is a spreadsheet, but the underlying supporting  
15 documentation was not there.

16 Q. Isn't that the underlying supporting documentation that was provided  
17 to you in response to 1-43 and 1-44?

18 A. Well, that is all the company had. I assume they gave it to us.

19 (Transcript Vol. XI at 1656 [Michlik]). The Staff witness further testified that one of the  
20 reasons the documentation was not accepted was because it did not correlate to the  
21 spreadsheets that were provided to explain the documentation. Yet, under cross-  
22 examination, the Staff witness admitted that he could not currently identify any instance  
23 when such documentation did not correlate to the spreadsheets; he confirmed that Staff  
24 never identified any such instances in its written testimony; and he admitted that Staff  
25 just made a blanket disallowance:  
26

Q. Can you tell me what is wrong with the documentation that we did  
supply in the four volumes that comprise response to 1-43 and 1-44  
when read with the spreadsheet that was provided as attachment to  
JMM 7-1?

A. This again -- I mean, I have to go back through and -- I didn't do the  
analysis of the actual invoice and what matched to the spreadsheet  
and what did not.

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THE WITNESS: Would you read that back?

(Requested portion was read.)

THE WITNESS: Again, I think there was some difficulties with what the company had previously supplied us as supporting documentation that may have not correlated to the number on the spreadsheet.

Q. (BY MR. CROCKETT) Now, you said may have not correlated.

Did or didn't it correlate?

A. In some cases I believe it did not.

Q. Can you identify a case where it did not?

A. Not here and now.

Q. Can you -- have you identified in your testimony a case where it did or did not?

A. No.

Q. Mr. Michlik, have you identified in your testimony anywhere any item of plant that was specifically not documented by the company?

A. No.

Q. You just made a blanket disallowance?

A. Yes.

(Tr. Vol. XI at 1660-1661 [Michlik]). Thus, the uncontroverted evidence in this case is that Staff did not identify one single item of plant that was specifically not documented by Johnson Utilities. Staff just made its "minimal" \$20,000,000 disallowance.

Finally, when questioned about the invoices that were provided to Staff by Johnson Utilities, the Staff witness found those unacceptable as well:

Q. Did you not testify -- well, you have been critical of the company for not providing invoices in certain instances; is that correct?

A. Correct.

Q. And here they have provided an invoice and yet this is deficient in your mind; is that correct?

1 A. We are skeptical at this point, yes.

2 (Tr. Vol. X at 1596-1597 [Michlik]). Staff did not deny that invoices were provided by  
3 Johnson Utilities:

4 Q. Okay. If you turn to the next page, JU-2154, what is that document?

5 A. An invoice.

6 Q. And that is from Clear Creek Associates?

7 A. Yes.

8 Q. Is this sufficient documentation to support plant costs in your mind?

9 A. I don't know. I would have to total the amounts up.

10 Q. But the question is: You indicated that invoices are adequate  
11 documentation to support plant costs, have you not?

12 A. Yes.

13 Q. And you agree with me that these are invoices?

14 A. Yes.

15 (Tr. Vol. XI. At 1649-1650 [Michlik]).

16 The role of Staff in a rate case is to analyze and otherwise audit the rate case  
17 application submitted by the utility, to request additional information necessary to  
18 augment such information and/or resolve discrepancies, and then provide a  
19 recommendation to the Commission based upon its analysis. It is very clear from  
20 reviewing the transcript of the hearing that the Johnson Utilities did, in fact, provide Staff  
21 with all of the requested information for Staff to be able to perform the analysis that it  
22 performs in every rate case. However, it is equally clear that many of Staff's  
23 recommendations and conclusions cannot be substantiated because Staff failed to  
24 properly examine the information provided by the Company in this case. In fact, it  
25 appears that this Staff witness felt that such analysis was not his responsibility:

26 Q. These eight binders that were provided or given -- again, I don't  
know if they were binders -- but the information that is contained in

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these eight binders that we have been talking about that was provided to Staff back in January, would you agree with me that that is source documentation to back up the main extension agreements that have been provided earlier to Staff?

A. They may or may not be because we can't trace these into the plant account by year -- plant additions by year and by plant account. They simply don't trace in. The burden is on the company -- it is not Staff -- to kind of figure out the pieces to the company's puzzle on where all of these volumes go back into the company's spreadsheets. They probably shouldn't have -- they should have provided a crosswalk or some type of reconciliation sheet that -- as I went over before -- reconcile where these invoices tie back into the company's spreadsheets.

Q. Isn't that the job of the auditor of the case?

A. No.

(Transcript Vol. XI at 1683-1684 [Michlik]). The evidence in this case supports the fact that Johnson Utilities submitted all of the necessary and required source documentation to support its rate application. There is absolutely no basis for imposing what amounts to a \$20,000,000 penalty based upon Staff's 10% across-the-board reduction in plant.

**D. Post Test Year Plant.**

In its Closing Brief, Staff continues to recommend that \$3,222,495 of the Wastewater Division plant be excluded as post test-year plant. (Staff Brief at 9). Staff admits that the Commission has in other cases allowed post test-year plant in rate base in certain scenarios. (Staff Brief at 10). Other than Mr. Michlik's unsupported testimony, Staff has not provided any evidentiary support for the proposition that:

Staff has traditionally recognized two such scenarios: (1) when the magnitude of the investment relative to the utility's total investment is such that not including the post-test-year plant in the cost of service would jeopardize the utility's financial health, and (2) when conditions such as the following exist: (a) the cost of the post-test-year plant is significant and substantial, (b) the net impact on revenue and expenses for the post-test-year plant is known and insignificant or is revenue-neutral, and (c) the post-test-year plant is prudent and necessary for the provision of services and reflects appropriate, efficient, effective, and timely decision-making. It is the Company's burden to show that the post-test year plant is revenue neutral.

(*Id.*).

1 In contrast, Johnson Utilities provided specific Commission decisions in which  
2 post test-year plant was allowed when the plant was revenue neutral (*i.e.*, necessary for  
3 the provision of service to customers at the end of the test year) and completed and  
4 placed in service a reasonable time before the hearing so that it can be inspected  
5 and audited.<sup>2</sup> (Exhibit A-2, Volume III at 18). Both the Parks Lift Station and the Queen  
6 Creek Leach Field are revenue neutral (providing service to test year customers) and  
7 were completed and placed in service a reasonable time before the hearing, allowing for  
8 audit and inspection. (Exhibit A-2, Volume III at 19).

9 In addition, despite the fact that Johnson Utilities provided voluminous amounts of  
10 documentation to support plant costs, Staff again tried to salvage its position by arguing  
11 that such documentation was not reliable, and therefore such disallowances are justified.  
12 (Staff's Brief at 10-11).

13 As explained in its Closing Brief, Johnson Utilities discovered during this  
14 proceeding that \$2,201,386 of plant originally classified at post test-year plant and  
15 booked to plant in 2008 was actually placed in service in 2007. (Exhibit A-2, Volume III  
16 at 14; *see also* Johnson Utilities' Final Schedules, Wastewater Division, Schedule B-2 at  
17 3.4). Despite the fact that the Company had identified these projects in its rebuttal  
18 testimony, Staff failed to evaluate whether these projects were in fact placed in service in  
19 test-year 2007. At hearing, the Staff engineering witness admitted that he had not looked  
20 at or analyzed the plant the Company had identified as test-year plant. Rather, he  
21 testified that that analysis was done by the Commission's accounting section:

22 <sup>2</sup> *See, e.g., Rio Rico Utilities, Inc.*, Commission Decision No. 67279 (October 5, 2004); *Arizona*  
23 *Water Company—Eastern Group*, Commission decision No. 66489 March 19, 2004); *Bella Vista*  
24 *Water Company*, Commission Decision No. 65350 (Nov. 1, 2002); *Arizona Water Company—*  
25 *Northern Group*, Commission Decision No. 64282 December 28, 2001); *Paradise Valley Water*  
26 *Company*, Commission Decision No. 61831 (July 20, 1999); *Far West Water Company*,  
Commission Decision No. 60437 (September 29, 1997); *Chaparral City Water Company*,  
Commission Decision No. 68176 (September 30, 2005).

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Q. You understood that that was the company's position, that this plant was not, in fact, post-test-year plant, but was actually plant-in-service in the test year?

A. I'm getting a little confused here because what the company filed, a \$3.3 million post-test-year plant item, and there was some discussion between Staff and the company that it was actually -- was not post-test-year plant, that it was built during the test year. So I didn't follow that discussion with the company or Staff accounting section. So I'm not clear on these -- all of these lift stations, so I would have to defer that question to our Staff accountant.

Q. To Mr. Michlik?

A. Yes.

Q. Wouldn't Mr. Michlik come to you and say, Mr. Scott, the company asserts that this plant on line 6 through 19 was actually in place during the test year? Wouldn't he come to you to corroborate that?

A. He could, but I don't remember him doing that. All we talked about was my concern was the other three main post-test-year plant items on this sheet.

Q. We will get to that in a minute. But in terms of the plant that the company alleges was in place in 2007, I'm trying to understand, when you saw this exhibit -- and you testified that you did see this exhibit -- did you understand that the company was asserting that that plant was, in fact, in place during the test year?

A. Yes.

Q. And understanding that, then what steps did you take after that to either confirm or disapprove that this plant was, in fact, in place during the test year?

A. I did not further evaluate this listing on these lift stations.

Q. Is there a reason you didn't further evaluate it?

A. My understanding was there was discussion between the company and Staff on post-test-year plants, should it be post-test-year plant or was it built at the end of the test year. I just left it up to our accounting section to figure that out and let me just resolve or work on these other three main post-test-year plant items.

(Tr. Vol. X at 1495-1497 [Michlik]).

1           However, the Staff accounting witness testified that the basis of the disallowance  
2 of the post test-year plant was the Staff engineer's conclusion that he was not able to  
3 determine when the plant was in fact put in service:

4           Q.    I'm going to shift gears here for a minute. Mr. Michlik, do you have  
5 in front of you a copy of Exhibit A-53 or can you put your hands on  
6 that?

7           A.    I have it.

8           Q.    You have that. Okay. Were you here earlier today when I discussed  
9 this exhibit with Mr. Scott?

10          A.    Yes.

11          Q.    And have you seen this exhibit before?

12          A.    Yes.

13          Q.    Did you look at this exhibit in the process of reviewing the  
14 company's rate case filing?

15          A.    Yes.

16          Q.    Now, do you understand the company's position that line items 6  
17 through 19 were plant that was actually constructed and placed in  
18 service in the year 2007?

19          A.    I believe the company originally had all this amount as post-test-year  
20 plant, and then they looked back and there was some type of error in  
21 their accounting records. And so the time between their direct and  
22 surrebuttal -- or rebuttal and rejoinder testimony you changed or  
23 moved some of the post-test-year plant into current test year, is my  
24 understanding.

25          Q.    And I think that is correct. Did you hear Mr. Scott testify that he did  
26 not try to ascertain whether -- or did you hear him testify that he did  
not address this adjustment to rate base?

          A.    I think he testified that he was unable to tell when this plant went  
into service.

          Q.    Well, that wasn't my recollection of his testimony. I recall that he  
said that he had spoken to you about this; is that correct? Do you  
recall him saying that you were dealing with the company on this  
adjustment?

          A.    That I was?

- 1 Q. Yes. Do you recall that?
- 2 A. No.
- 3 Q. Is that a true statement?
- 4 A. We talked about this, and I think he said he didn't know when the  
5 plant was placed in service and he hadn't -- he had been out to look,  
6 but he didn't know whether it was in service or not.
- 7 Q. Okay. Well, he did not -- he testified, I believe, and the record will  
8 speak for itself, that he did not address this adjustment that the  
9 company had proposed and that you had addressed it. Is that not  
10 accurate?
- 11 A. Yeah, I think we addressed this one.
- 12 Q. We being -- who are you referring to?
- 13 A. Staff. Staff.
- 14 Q. Does that include Mr. Scott?
- 15 A. It may have. I believe at one point it did.
- 16 Q. Okay. What did you do to address this adjustment?
- 17 A. Well, we asked the company for supporting documentation for post-  
18 test-year plant, and they provided us with invoices from an affiliate.  
19 And then we wanted to actually look at the affiliates' general ledger  
20 and supporting documentations and the company confused [sic] to.
- 21 Q. That wasn't my question. My question was with respect to the plant  
22 that was moved into the test year, not post-test-year plant. How did  
23 you deal with the company's statement in this exhibit that the plant  
24 identified in lines 6 through 19 was actually plant that was completed  
25 and booked -- or was completed and placed into service in 2007?
- 26 A. We -- it was just the company's presentation. We didn't do an  
adjustment for it or anything. Is that your question?
- Q. Yeah. Did you analyze this exhibit?
- A. Did I analyze it, yeah. We analyzed it, and the company first wanted  
it as post-test-year plant and now it's -- two-thirds of it is in test-year  
plant. Our engineer was unable to determine when it was placed in  
service.
- Q. And was that --
- A. That was his testimony.

1 Q. That was his testimony today?

2 A. I think so.

3 Q. That he was unable to determine that?

4 A. Yes.

5 (Tr. Vol. X at 1592-1595 [Michlik]).

6 In addition, even though the Staff engineer testified that there was no question in  
7 his mind that the Hunt Highway force main was placed in service in the test year, Staff still  
8 disallowed the plant as post test-year plant:

9 Q. Now, Mr. Scott, the line 19, do you see what Mr. -- do you see what  
10 Mr. Bourassa's note or comment says on that item, the Hunt  
Highway force main?

11 A. Yes.

12 Q. And does it say that that force main connects the Section 11 and  
13 Anthem Wastewater Treatment Plant?

14 A. Yes.

15 Q. And it says there year in service was 2007. Do you see that?

16 A. Yes.

17 Q. Do you have any reason -- let me back up. Did you actually confirm  
18 that there is a force main that connects to the Section 11 and Anthem  
plant?

19 A. Yes.

20 Q. Do you know what year that force main was placed in service?

21 A. During the test year.

22 Q. During the test year?

23 A. Yes.

24 Q. Is there any question in your mind about that?

25 A. No.

26 Q. Then this would not be an item of post-test-year plant, would it?

1 A. Well, there is also that accounting side as how to show it on the  
2 books and records. I'm not going to get into that or how it was  
reported. I will leave it at that.

3 Q. That is an accounting issue for Mr. Michlik. But as far as your  
4 engineering analysis goes you confirmed that that force main  
connecting Section 11 and Anthem Treatment Plant was in place and  
in service in 2007?

5 A. Yes.

6 (Tr. Vol. X at 1498-1499 [Scott]).

7 Staff also asserts that Johnson Utilities failed to present evidence that such plant  
8 was necessary to provide service to existing customers (Staff Brief at 10-11). To the  
9 contrary, the Company provided uncontroverted evidence that the Parks lift station was  
10 constructed for use initially by a Fry's shopping center that was started in 2007. (Exhibit  
11 A-5 at 34). Further, the evidence is uncontroverted that without the completion of the  
12 Parks lift station, the Company would have been forced to pay for vaulting and hauling  
13 the wastewater generated by the shopping center. (*Id.*). It is also uncontroverted that the  
14 physical transportation of the wastewater by truck to the Pecan WWTP would have been  
15 very costly. (*Id.*).

16 The evidence is uncontroverted that all of the excess effluent flows from the Pecan  
17 WWTP during the test year which required disposal were being sent offsite to the Shea  
18 Homes' Trilogy Encanterra development during the construction of that project. (Exhibit  
19 A-5 at 35). The evidence is also uncontroverted that these wastewater flows were well in  
20 excess of the demands needed for the Encanterra golf course and that the Queen Creek  
21 Leach Field was constructed to dispose of the excess effluent that Shea Homes agreed to  
22 take during construction to alleviate the 2007 level of effluent disposal needs. (*Id.*).

23 Staff also argues that the Company has not substantiated its claim that the  
24 additions are revenue neutral. (Staff Brief at 11). Yet according to the uncontroverted  
25 testimony of Company expert accounting witness Thomas Bourassa, these two projects  
26

1 are revenue neutral and are necessary for reliability purposes, to serve the test year-end  
2 level of customers. (Exhibit A-2, Volume III at 15).

3 **E. Affiliate Profit.**

4 Johnson Utilities does not dispute Staff's contention or the supporting case law  
5 cited that indicates that the courts agree that affiliate transactions require greater scrutiny  
6 than non-affiliate transactions (Staff Brief at 14-15). However, Johnson Utilities does  
7 take issue with Staff's definition of what constitutes an "affiliate" under Arizona law.  
8 Staff proposes that certain entities with which the Company has done business should be  
9 treated as affiliates based solely upon the familial relationships of members of these  
10 entities and members of Johnson Utilities. It is Staff's position that "family  
11 relationships" make any transaction between the Company and these other entities related  
12 party transactions, and therefore, they should be treated the same as affiliate transactions.  
13 Yet family relations alone do not create affiliate transactions under either Arizona or  
14 federal law.

15 The Commission's own Affiliated Interest Rules provide as follows:

16 'Affiliate,' with respect to the public utility, shall mean any other entity  
17 directly or indirectly *controlling or controlled by, or under direct or*  
18 *indirect common control with*, the public utility. For purposes of this  
19 definition, the term 'control' (including the correlative meanings of the  
20 terms 'controlled by' and 'under common control with'), as used with  
21 respect to any entity, shall mean the power to direct the management  
22 policies of such entity, whether through ownership of voting securities, or  
23 by contract, or otherwise.

24 A.A.C. R14-2-801(1) (emphasis added).

25 Staff has not provided any evidence, other than alleged family relations, that  
26 Johnson Utilities has any control over these separate entities within the meaning of  
A.A.C. R14-2-801(1). The Commission's definition equates "affiliate" with the power to  
direct management policies. Only an entity which can be directed is deemed to be an  
affiliate. Absent sufficient ownership of voting securities, contract or some other right to

1 direct management policies, the other entity is not an "affiliate." In addition, Courts  
2 examining whether control can be imputed through family attribution have consistently  
3 ruled no. *Propstra v. U.S.*, 680 F. 2d 1248 (9th Cir 1981); *Bright v. U.S.*, 658 F.2d 1248  
4 (5th Cir 1981). The Ninth Circuit stated as follows in *Propstra v. U.S.*:

5 Not only would these inquiries require highly subjective assessments but  
6 they might well be boundless. In order to determine whom the legatee or  
7 heir might collaborate with when selling his or her property interest, one  
8 would have to consider all other owners. The unity of ownership inquiry  
9 could not end with a consideration of whether the beneficiary's family  
10 members own an interest; it would have to consider friends, business,  
11 partners, investments partners and others who might be owners of the  
12 remaining interest in the property.

13 Next, although Staff again raises its inadequate documentation argument in the  
14 Staff Brief to try to justify removing affiliate profit of 7.5% of all plant constructed, the  
15 Company has provided uncontroverted evidence that 7.5% is grossly overstated. For  
16 example, the affiliate contracts and the responses provided to Staff by the Company in its  
17 data responses (Staff data requests JMM 1-43 and JMM 4-2) clearly show that the  
18 affiliate contracts included a mark-up of 5-10% for affiliate profit and overhead—not just  
19 affiliate profit. (Exhibit A-2, Volume II at 5-6). Further, as explained by the Company in  
20 its response to Staff Data Request JMM 9-2, the Company's affiliates added 10% to the  
21 base contract cost to cover overhead and profit, and the affiliate profit represented only  
22 2% of the base contract cost. (Exhibit A-2, Volume II at 6).

23 The Company does not dispute the Commission's authority to exclude affiliate  
24 profit from plant-in-service. To this end, the Company provided uncontroverted evidence  
25 that for the Water Division, an adjustment of \$469,832 was made to plant-in-service to  
26 remove affiliate profit on affiliate-constructed water plant totaling \$26,847,516 (Exhibit  
A-2, Volume II at 4); and for the Wastewater Division, an adjustment of \$800,179 was  
made to plant-in-service to remove affiliate profit on affiliate-constructed sewer plant  
totaling \$45,724,508. (Exhibit A-2, Volume III at 5). The Company has also provided

1 uncontroverted evidence that the appropriate affiliate profit percentage on affiliate  
2 contracts is 1.75% not 7.5%. (Exhibit A-2, Volume II at 4-5).

3 There is a lack of consistency between Staff's pre-filed testimony and its testimony  
4 at hearing regarding what percentage of plant was constructed by affiliates:

5 Q. Based on all of the documentation that the Company provided, what  
6 are Staff's conclusions?

7 A. The Company used affiliates to construct approximately all plant  
8 after 1998.

9 (Exhibit S-41 at 10). Yet at the hearing, the Staff witness testified as follows:

10 Q. So the company -- is it your testimony, Mr. Michlik, that 100 percent  
11 of Johnson Utilities' plant was constructed by affiliates.

12 A. No. But we can't put a valuation on what was -- what the IACC  
13 amount was by developers.

14 (Tr. Vol. X at 1576 [Michlik]).

15 On the issue of allocation of overhead, although Staff once again raised the same  
16 refrain that Johnson Utilities failed to provide documentation as to how the Company  
17 allocates overhead to its affiliate contracts, when pressed on cross-examination, the Staff  
18 witness again had to admit that such documentation was in fact provided:

19 Q. Okay. And I'm sorry. I keep going back to A-63, but one more thing.  
20 Since this references it, 13-1d, you ask for the company to explain  
21 how they allocate their overhead. And would you agree that the  
22 company provided a response under 13-1d regarding how it  
23 applies—how it allocates overhead? Mr. Michlik, I'm asking you if  
24 you acknowledge that the company has provided the expense.

25 A. Yes.

26 (Tr. Vol. XI at 1631 [Michlik]).

**F. Unexpended Contributions in Aid of Construction ("CIAC").**

Staff and RUCO continue to propose to include \$6,931,078 of unexpended hook-  
up fees ("HUFs") (*i.e.*, CIAC) in Water Division rate base, and \$16,505 of unexpended  
HUFs (CIAC) in Wastewater Division rate base. As explained in Johnson Utilities'

1 Closing Brief, including unexpended HUFs in rate base not only creates a mismatch in  
2 rate base, but existing ratepayers receive a windfall because existing rate payers get credit  
3 for HUFs paid on behalf of future customers who have not yet connected to the system.  
4 (Exhibit A-2, Volume II at 15-16). The capacity to serve those future customers has not  
5 been constructed, nor has cost of the future capacity been reflected in rate base. (Exhibit  
6 A-2, Volume II at 16). The Company's collection of HUFs ensures that funds are  
7 available for new and needed capacity when construction begins, not after-the-fact. (*Id.*).  
8 The evidence in this case is uncontroverted that these funds are restricted and can only be  
9 spent on new capacity. (Exhibit A-2, Volume II at 17). The evidence in this case is also  
10 uncontroverted that the Company does not benefit from excluding unexpended CIAC  
11 from rate base, and that existing rate payers are not harmed in any way. (*Id.*).

12 In addition, according to the NARUC Uniform System of Accounts, Section 271-  
13 Contributions in Aid of Construction, the CIAC account includes the following:

- 14 A. This account shall include:
- 15 1. Any amount or item of money, services or property received  
16 by a utility, from any person or governmental agency, any  
17 portion of which is provided at no cost to the utility, which  
18 represents an addition or transfer to the capital of the utility,  
and which is utilized to offset the acquisition, improvement or  
construction costs of the utility's property, facilities, or  
equipment used to provide utility service to the public.

19 NARUC Section 271A, Uniform System of Accounts for Class A Water Utilities  
20 (1996). Thus, CIAC isn't CIAC until it offsets used and useful plant. There is a  
21 transition period from the time a utility receives contributed money and the time the  
22 contributed money has been spent and is reflected as an offset to used and useful plant.  
23 Unexpended dollars and associated construction work in progress ("CWIP") are not used  
24 and useful plant and therefore the associated CIAC is technically in transition to  
25 becoming CIAC offsetting used and useful plant - particularly in rate base. Thus,  
26 unexpended CIAC should be excluded from rate base.

1 **III. REVENUE REQUIREMENT.**

2 **A. Income Taxes.**

3 Johnson Utilities spent considerable time setting forth its arguments for including  
4 income tax expense in the Company's expenses, and those arguments will not be repeated  
5 here at length. (See Johnson Utilities' Closing Brief at 31-36). In short, however, it is  
6 undisputed that the Commission has the authority to allow the recovery of income tax  
7 expense on a case-by-case basis. Staff and RUCO continue to argue that as an L.L.C,  
8 taxes are passed through to the members and, therefore, recovery of income tax expense  
9 is not warranted. (Staff Brief at 19; RUCO Brief at 7). Yet, neither Staff nor RUCO can  
10 deny that in the case of a subsidiary C-Corporation utility in a parent holding company  
11 structure whose tax returns are consolidated with the parent (and the subsidiary C-  
12 Corporation utility does not file a separate tax return), this Commission has traditionally  
13 allowed income taxes of the utility to be computed on a stand-alone basis and included in  
14 the revenue requirement. (Exhibit A-2, Volume II at 24). The reasoning is that if the C-  
15 Corporation subsidiary were a stand-alone entity, it would file tax returns and pay income  
16 taxes (See Staff Brief at 19). In the case of an S-Corporation, pure form over substance  
17 produces a result that is inequitable, and the customers of the S-Corporation utility reap a  
18 windfall in the form of a lower revenue requirement and operating income when income  
19 taxes are excluded. (*Id.*). Rate making should always be applied in a manner which  
20 produces reasonable, realistic and non-discriminatory results, regardless of the legal form  
21 of the utility. Inclusion or exclusion of income taxes in company expenses should not be  
22 affected by technical distinctions; rather the appropriate inquiry should consider whether  
23 the outcome is fair and non-discriminatory. The income taxes required to be paid by  
24 shareholders of an S-Corporation on a utility's income are inescapable business outlays  
25 that are directly attributed to the utility and are directly comparable with similar taxes  
26

1 paid by C-Corporations.

2 **IV. COST OF CAPITAL.**

3 RUCO argues in the RUCO Brief that the Commission should reject Johnson  
4 Utilities' use of its actual capital structure and instead adopt RUCO's hypothetical capital  
5 structure of 40% long-term debt and 60% common equity. (RUCO Brief at 15).  
6 Although the Company will not repeat its arguments set forth in its Closing Brief, if the  
7 Company's cost of equity estimate of 14.1% was used in RUCO's proposed hypothetical  
8 capital structure, the resulting weighted cost of capital would be 11.66%, as opposed to  
9 RUCO's 8.18%. (Exhibit A-2, Volume I at 21).

10 Next RUCO argues that the use of a historic market risk premium to determine its  
11 CAPM cost of equity was appropriate. (RUCO Brief at 16). However, RUCO  
12 conveniently ignores the fact that this Commission has consistently approved the use of a  
13 current market risk premium in implementing the CAPM in water and wastewater utility  
14 rate cases. (Exhibit A-2, Volume I at 11). As referenced in Johnson Utilities' Closing  
15 Brief, in Decision No. 68176 (September 30, 2005) in the Chaparral City case, the  
16 Commission-adopted cost of capital used an historic market risk premium and a current  
17 market risk premium in its CAPM estimates.<sup>3</sup> (*Id.*).

18 In addition, changes in the current market risk premium have been a significant  
19 factor in the cost of equity authorized by the Commission for water and wastewater  
20 utilities. (*Id.*). In Arizona Water Company's Eastern Group case filed in 2002, Staff  
21 computed a current market risk premium of 13.1 percent in its CAPM estimate, and relied  
22 on that market risk premium in estimating a cost of equity of 9.2 percent, using the same  
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24 \_\_\_\_\_  
25 <sup>3</sup> See Direct Testimony of Alejandro Ramirez, Docket No. W-02113A-04-0616 (March 22,  
26 2005); Surrebuttal Testimony of Alejandro Ramirez, Docket No. W-02113A-04-0616 (May 5,  
2005).

1 six sample water utilities.<sup>4</sup> (*Id.*) At that time, the country was in the midst of a  
2 recession, and, according to Staff, interest rates had fallen to the lowest levels since the  
3 1950s.<sup>5</sup> (*Id.*) Moreover, the average beta of Staff's water utility sample group was only  
4 0.59 at that time, indicating that investment risk for the water utility industry was low  
5 relative to the market.<sup>6</sup> (Exhibit A-2, Volume I at 11-12).

6 Two years later, Arizona Water Company filed a rate case for its Western Group  
7 systems. (Exhibit A-2, Volume I at 12). Interest rates had increased from the levels in  
8 2002, and the average beta of the Staff's sample utilities had increased as well, indicating  
9 greater investment risk.<sup>7</sup> (*Id.*) However, Staff's cost of equity estimate was virtually  
10 identical to the Eastern Group case, 9.1 percent.<sup>8</sup> (*Id.*) The primary reason was that  
11 Staff's current market risk premium had dropped from 13.1 percent to 7.8 percent. (*Id.*)  
12 The Commission, in adopting Staff's CAPM estimate, relied on this change, explaining  
13 that "while interest rates have gone up, the cost of equity for the market as a whole as  
14 decreased, while the cost of equity for utilities has remained relatively stable."<sup>9</sup> (*Id.*)

15 Even more recently, in Black Mountain Sewer Corporation's rate case, the  
16 Commission relied on a further decline in the current market risk premium to support  
17 Staff's recommended 9.6 percent cost of equity.<sup>10</sup> (*Id.*) In that case, interest rates and  
18 the average beta of the sample group were even higher than 2003 levels, and while the  
19 result produced by Staff's models was higher, the increase was not as large as would be  
20 expected.<sup>11</sup> (*Id.*) The reason was that the current market risk premium had decreased to

21 <sup>4</sup> Direct Testimony of Joel M. Reiker, Docket No. W-01445A-02-0619, 24, 25 (July 8,  
22 2003) at 25.

23 <sup>5</sup> *Id.* at 5.

24 <sup>6</sup> *Id.* at 23.

25 <sup>7</sup> Surrebuttal Testimony of Alejandro Ramirez, Docket No. W-01445A-04-0650, Sch.  
26 AXR-8 (May 25, 2005).

<sup>8</sup> *Id.*

<sup>9</sup> *Arizona Water Co. (Western Group)*, Decision No. 68302 at 38 (Nov. 14, 2005).

<sup>10</sup> *Black Mountain Sewer Corp.*, Decision No. 69164 at 26 (Dec. 5, 2006).

<sup>11</sup> In the *Black Mountain* case, the intermediate-term Treasury used by Staff in its CAPM

1 only 5.7 percent, reducing the result produced by the CAPM. (*Id.*). Thus, while interest  
2 rates increased and the investment risk of the water utility sample had increased, Staff  
3 explained that those increases were offset by a further decline in the current market risk  
4 premium, indicating that the overall risk of the market had declined.<sup>12</sup> (Exhibit A-2,  
5 Volume I at 13).

6 As these decisions show, not only has the Commission consistently considered the  
7 current market risk premium, but changes in the current market risk premium have had a  
8 major impact on the cost of equity, offsetting changes in interest rates and water utility  
9 betas in recent cases. (*Id.*). Further, RUCO's witness has acknowledged the importance  
10 of considering current market conditions in determining the cost of equity:

11 Consideration of the economic environment is necessary because trends in  
12 interest rates, present and projected levels of inflation, and the overall state  
13 of the U.S. economy determine the rate of return that investors earn on their  
14 invested funds. Each of these factors represent potential risks that must be  
weighed when estimating the cost of equity capital for a regulated utility  
and are, most often, the same factors considered by individuals who are  
also investing in non-regulated entities.<sup>13</sup>

15 In light of the current volatility in the financial markets, the failure to consider current  
16 market risk would grossly distort the CAPM result. (*Id.*). Consequently, RUCO's use of  
17 two historic market risk premiums while ignoring the impact of current market risk on  
18 investor expectations invalidates RUCO's cost of equity estimate. (*Id.*).

## 19 V. RESPONSE TO ARGUMENTS OF INTERVENOR SWING FIRST GOLF.

20 Swing First Golf's 53-page Post Hearing Brief continues the same bombastic  
21 diatribe that has characterized most of SFG's prior filings in this case. In its brief, SFG

22 was 4.8 percent, while the average beta of Staff's sample group was 0.74. Surrebuttal  
23 Testimony of Pedro M. Chaves, Docket No. SW-022361A-05-0657, Sch. PMC-2 (May 4,  
2006). In *Arizona Water's Eastern Group* case, in contrast, the intermediate-term  
24 Treasury used by Staff in its CAPM was 3.3 percent, while the average beta of Staff's  
sample group was 0.59. Direct Testimony of Joel M. Reiker, Docket No. W-01445A-02-  
0619, Sch. JMR-7 (July 8, 2003).

25 <sup>12</sup> *Black Mountain Sewer Corp.*, Decision No. 69164 at 25-26 (Dec. 5, 2006).

26 <sup>13</sup> R-8 at 36.

1 refers to the principal of Johnson Utilities as the "notorious George Johnson" who it  
2 simultaneously described as a "jilted lover" and a "white-collar thug." Johnson Utilities  
3 itself is described as "going rogue," stealing a now warn-out line from a current best-  
4 seller. As demonstrated by its conduct throughout this proceeding, SFG is a disgruntled  
5 customer with a complaint pending against Johnson Utilities in Docket WS-02987A-08-  
6 0049. Rather than pursuing its complaint in the proper docket, which was opened nearly  
7 two years ago in January 2008,<sup>14</sup> SFG opted to wage its fight against Johnson Utilities  
8 and George Johnson in this rate case docket, obviously in the hope of inflicting some  
9 harm upon the company and perhaps securing some advantage in the complaint case.  
10 Many of the arguments in SFG's Post Hearing Brief simply do not belong in a rate case,  
11 and Johnson Utilities will not waste additional time addressing them in this brief.  
12 However, Johnson Utilities is compelled to address certain of the allegations and  
13 assertions contained in SFG's Post Hearing Brief which arguably bear upon the quality of  
14 the Company's service, its compliance with applicable rules and laws, and its treatment of  
15 its customers.

16 At the outset, Johnson Utilities notes that SFG is the only customer that has  
17 intervened in this rate case. In addition, not a single customer attended any of the  
18 multiple hearing days to make public comment. This noticeable lack of opposition by  
19 the Company's customers belies the assertion of SFG that Johnson Utilities has shown a  
20 "blatant disregard for its customers." (SFG Post Hearing Brief at 45). Moreover, there is  
21 no evidence in this case that the Company's customer complaint history is below  
22 acceptable standards.

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25 <sup>14</sup> The last pleading filed by SFG in its complaint case was a motion to quash the  
26 deposition of SFG principal David Ashton and another potential witness on February 26,  
2009.

1 Johnson Utilities also notes that SFG witness Sonn Rowell lacks first-hand  
2 knowledge regarding the facts of this rate case and she has performed little analysis  
3 regarding the case. On February 3, 2009, SFG filed the Direct Testimony of David  
4 Ashton, and on February 19, 2009, Johnson Utilities filed a Motion to Strike Mr.  
5 Ashton's testimony in part because it was laden with statements and opinions that were  
6 not based upon Mr. Ashton's direct personal knowledge or any expertise that is relevant  
7 in a rate case. In an effort to salvage Mr. Ashton's testimony, SFG filed a Notice of  
8 Revised Direct Testimony on March 2, 2009, in which SFG had Ms. Rowell adopt  
9 substantial portions of Mr. Ashton's testimony. Notwithstanding, Ms. Rowell still admits  
10 that she does not have first-hand knowledge regarding any of the water and wastewater  
11 facilities of Johnson Utilities. (Tr. Vol. VIII at 1108). She admits that she did not ask  
12 any data requests of Johnson Utilities. (*Id.*). She testified that she did not audit the books  
13 of Johnson Utilities. (*Id.* at 1079). She testified that she did not review the bills from  
14 Johnson Utilities to SFG or any other utility customer. (*Id.* at 1132, 1138). She adopted  
15 wholesale the nine recommendations contained in Mr. Ashton's initial direct testimony.  
16 (*Id.* at 1128, 1130). Finally, she testified that she had already formed an opinion of  
17 George Johnson as a "menace to Arizona" long before she was engaged by SFG in this  
18 case. (*Id.* at 1105). For all of these reasons, her testimony should be given little or no  
19 weight whatsoever.

20 With regard to Mr. Ashton, it should be noted that he surreptitiously recorded a  
21 former employee of Johnson Utilities and lied to him on more than one occasion when  
22 asked whether he was recording the conversation. Thus, Mr. Ashton's testimony should  
23 be evaluated against the backdrop of this deception and accordingly given little or no  
24 weight.  
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1           **A.     Notices of Violation.**

2           SFG states that since 2003, Johnson Utilities has received 14 notices of violation  
3 ("NOVs") issued by the Arizona Department of Environmental Quality ("ADEQ"), and  
4 that six of those remain open and unresolved. (SFG Post Hearing Brief at 3). SFG  
5 claims that the number of NOVs issued over this seven-year period is "unprecedented,"  
6 but provides no comparative data for any other provider of wastewater service to  
7 corroborate its bald assertion. (*Id.*). Moreover, SFG's statement that six NOVs remain  
8 "open and unresolved" is misleading. The uncontroverted testimony in this case is that  
9 Johnson Utilities has fully and timely complied with all requirements of these six NOVs,  
10 has submitted all required documentation to ADEQ, and is waiting for ADEQ to close the  
11 NOVs.

12           ADEQ describes the purpose and use of an NOV as follows:

13           [An NOV] is an informal compliance assurance tool used by ADEQ to put a  
14 responsible party (such as a facility owner or operator) on notice that the  
15 Department believes a violation of an environmental requirement has  
16 occurred. It describes the facts known to ADEQ at the time of issuance and  
17 cites the requirement that ADEQ believes the party has violated.

18           Although ADEQ has the authority to issue appealable administrative orders  
19 compelling compliance, an NOV has no such force or effect. Rather, an  
20 NOV provides the responsible party an opportunity to do any of the  
21 following before ADEQ takes formal enforcement action: (1) meet with  
22 ADEQ and discuss the facts surrounding the violation, (2) demonstrate to  
23 ADEQ that no violation has occurred, or (3) document that the violation has  
24 been corrected.

25           (Exhibit A-38).

26           At the hearing, Mr. Tompsett discussed the status of each of the 14 NOVs issued  
since 2003, which is summarized in the following table:

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NOTICES OF VIOLATION <sup>15</sup>			
	NOV CASE ID	DATE	STATUS
1	32021	September 2, 2004	Closed with no further action by ADEQ
2	33138	January 3, 2005	Closed with no further action by ADEQ
3	34537	April 6, 2005	Closed with no further action by ADEQ
4	34567	April 28, 2005	Closed with no further action by ADEQ
5	35075	July 26, 2005	Closed with no further action by ADEQ
6	37416	December 15, 2005	Closed with no further action by ADEQ
7	84092	August 2, 2007	Closed with no further action by ADEQ
8	106347	March 9, 2009	Closed with no further action by ADEQ
9	92021	March 4, 2008	Awaiting closure
10	97512	June 5, 2008	Awaiting closure
11	99135	October 9, 2008	Awaiting closure
12	102722	October 20, 2008	Awaiting closure
13	103357	October 20, 2008	Awaiting closure
14	103956	March 11, 2009	Awaiting closure

For all NOV's that have been received by Johnson Utilities—whether closed or awaiting closure—Mr. Tompsett testified that the Company timely complied with all requirements of the NOV's. (Tr. Vol. VII at 1034). Mr. Tompsett testified that with respect to each of the closed NOV's, ADEQ took no formal action against Johnson Utilities. Mr. Tompsett further testified that at this time, Johnson Utilities is awaiting closure of the six other NOV's. (*Id.*). There is no evidence in the record presented by any party which refutes any of these statements by Mr. Tompsett.

**B. Sewer System Overflows.**

SFG asserts in its Post Hearing Brief that Johnson Utilities tried to avoid making its number of sewer system overflows ("SSOs") a part of the record in this case. (SFG

<sup>15</sup> Tr. Vol. VII at 1025-1036; Exhibits A-35 and A-38.

1 Post Hearing Brief at 19). To the contrary, Johnson Utilities has a favorable record  
 2 regarding SSOs within its wastewater system, and makes no apologies regarding its  
 3 record on SSOs. At the hearing, SFG introduced Exhibit SF-12, which a copy of a March  
 4 30, 2009, letter from Johnson Utilities to the five commissioners in Docket WS-02987A-  
 5 07-0487. In that letter, Mr. Tompsett provided the following explanation regarding SSOs  
 6 generally:

7 SSOs within Johnson Utilities' service area have been few, but they do occur  
 8 on occasion despite the Company's best efforts to prevent them. They are  
 9 something that I, and the Company, take very seriously, but SSOs occur in  
 10 every wastewater system in the country. While sound engineering and  
 11 prudent operational practices can limit the number of SSOs, it is not  
 12 possible to completely prevent SSOs. By way of illustration, I have attached  
 13 as Attachment 1 a table depicting an Environmental Protection Agency  
 14 ("EPA") Region 9 survey showing sewer system spill rates per 100 miles of  
 15 sewer line per year for the calendar year 2000. The survey is based upon 33  
 16 collection systems in the Pacific Southwest United States, and shows an  
 17 average spill rate of 6.1 spills per 100 miles and a median spill rate of 4.0  
 18 spills per 100 miles.

19 Information from ADEQ regarding SSOs within the Pima County regional  
 20 wastewater reclamation system is also instructive. Based upon the  
 21 spreadsheet attached as Attachment 2 which the Company obtained from  
 22 ADEQ, the Pima County Regional Wastewater Reclamation Department  
 23 ("PCRWRD") reported 284 SSOs during the four years 2005 through 2008,  
 24 as follows:

SEWER SYSTEM OVERFLOWS—PIMA COUNTY WASTEWATER RECLAMATION DEPARTMENT		
YEAR	SSOs REPORTED	TOTAL GALLONS
2005	76	88,660
2006	98	81,251
2007	68	103,488
2008	42	76,387

1 The SSOs reported by PCRWRD in 2008 resulted from a variety of factors  
2 outlined in the ADEQ spreadsheet including vandalism, contractor error,  
3 grease, roots and broken pipes. The SSOs resulted in sewage discharges to  
4 natural washes, desert areas, streets, golf courses, a school building, parking lot  
5 and play area, residences and storm drains. Eleven of the SSOs exceeded 2,000  
6 gallons, and a number of the SSOs resulted in exposure to humans.

7 Data regarding SSOs for the City of Phoenix for the years 1997-2004 is  
8 attached as Attachment 3 (citation omitted). The City of Phoenix reported  
9 SSOs in every year caused by grease, roots, vandalism, lint, broken mains,  
10 debris and/or contractor damage. In almost all of the years reported, SSOs  
11 exceeded 50 per year. Based on the 2005 data, the City of Phoenix reported 1.4  
12 SSOs per 100 miles of sewer line.

13 Personnel at the City of Chandler have told Johnson Utilities that the City  
14 reported 12 SSOs since January 1, 2007, and has had an unspecified number  
15 of unreported SSOs. Johnson Utilities understands that other municipalities  
16 in the Phoenix metropolitan area also have periodic SSOs on their sewer  
17 systems and many of those go unreported.

18 (Exhibit SF-12 at 2-3). As part of its case, Johnson Utilities introduced Exhibit A-  
19 14, which is an April 13, 2009, letter from the Company to the five commissioners. In  
20 that letter, Mr. Tompsett reported that Johnson Utilities had 5,423 wastewater manholes  
21 and approximately 340 miles of wastewater lines in the Company's wastewater system at  
22 the end of calendar year 2008. (Exhibit A-14 at 2). Mr. Tompsett testified at the hearing  
23 that Johnson Utilities had a total of ten SSOs in the years 2007 and 2008, for an average  
24 of five SSOs per year for the two years. (Tr. Vol. 1 at 122). Using 340 miles of  
25 wastewater lines, Mr. Tompsett then calculated that Johnson Utilities had an SSO rate of  
26 between 1.4 and 1.5 SSOs per 100 miles of sewer line. (Tr. Vol. VII at 1017). The  
Company's rate of SSOs is very close to the City of Phoenix's reported rate of 1.4 SSOs  
per 100 miles in 2005, and it is well below the average rate of 6.1 SSOs per 100 miles  
reported by EPA Region 9 based upon year 2000 data from 33 collection systems in the  
Pacific Southwest United States. (*Id.*) This evidence and testimony is also uncontroverted  
in this case.

1           Moreover, the Arizona Department of Environmental Quality recognizes that it is  
2 not reasonable to expect that a wastewater system could be operated without SSOs. As  
3 recounted in Mr. Tompsett's April 13, 2009, letter admitted as Exhibit A-14:

4           During the April 1 [2009] Open Meeting, Joan Card, the Director of Water  
5 Quality for the Arizona Department of Environmental Quality ("ADEQ"),  
6 answered questions from the Commissioners regarding SSOs. Ms. Card  
7 advised the Commission that she was unaware of any wastewater provider  
8 that was able to operate without having periodic SSOs. In fact, Ms. Card  
9 stated that it would probably be unreasonable to expect a wastewater  
10 provider to operate without any SSOs.

11           (Exhibit A-14 at 2).

12           Rather than addressing the substance and merits of the evidence presented by  
13 Johnson Utilities regarding SSOs within the Company's wastewater system, SFG  
14 attempts to deflect the weakness of its position by instead devoting four pages of its Post  
15 Hearing Brief to criticizing the Company's objection to an SFG data request submitted  
16 shortly before the start of the hearing. Neither SFG nor any other party in this rate case  
17 has provided evidence with controverts the evidence presented by Johnson Utilities  
18 regarding its good record regarding SSOs.

19           SFG implies in its brief that Johnson Utilities intentionally withheld "damaging  
20 information" from the Commission in Docket WS-02987A-07-0487 regarding an SSO  
21 that occurred on February 22, 2009, in the Cambria subdivision within Johnson Utilities'  
22 CC&N. (SFG Post Hearing Brief at 7-8). Johnson Utilities submits that the record  
23 speaks for itself in Docket WS-02987A-07-0487, and that there is simply no evidence of  
24 any willful intent to withhold information from the Commission, damaging or otherwise.  
25 Johnson Utilities explained the circumstances surrounding the February 22, 2009, SSO in  
26 its March 30, 2009, letter to the commissioners which was admitted in this case as SFG's  
Exhibit SF-12:

          The Commission approved Decision 70849 [conditionally extending Johnson  
Utilities' sewer CC&N] at the Open Meeting on March 3, 2009. On March 13,  
2009, Johnson Utilities notified each of you and Utilities Division Staff via e-

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mail of a sewer system overflow ("SSO") that occurred on Sunday morning, February 22, 2009, in the Cambria subdivision, which is located within the Company's existing CC&N. This portion of the CC&N is the area formerly served by Arizona Utility Supply and Services, LLC ("AUSS"), and Johnson Utilities began serving this area at the request of the Commission when AUSS walked away from its sewer system. The purpose of this letter is to provide the Commission with additional information regarding the Cambria SSO, and to provide context regarding the SSO.

At the outset, it is important to understand that the Cambria SSO was not caused by any malfunction of equipment, lift-stations or the wastewater treatment plants of Johnson Utilities. Rather, the SSO occurred within the gravity flow portion of the sewer collection system in the subdivision as a result of grease and debris (such as mop heads) that were disposed of within the system. Wastewater came up through two manholes located immediately adjacent to retention basins on the perimeter of the Cambria community next to the Links Golf Course. The SSO was reported to Johnson Utilities by a customer at approximately 9:10 AM, and the Company had an emergency crew on-site immediately thereafter. Johnson Utilities reported the SSO to the Arizona Department of Environmental Quality ("ADEQ") via e-mail at 11:45 AM that morning. The Company submitted a subsequent report regarding the SSO to ADEQ via email on February 25, 2009. Copies of these e-mails were attached to the Company's e-mail to the Commission on March 13,2009, but for convenience, I have attached additional copies to this letter.

The wastewater which flowed into the retention basins was recaptured by Johnson Utilities and transported from the area using ADEQ-approved pumper trucks and the basins were disinfected pursuant to ADEQ protocol, all of this occurring on February 22, 2009. Johnson Utilities estimated the total amount of the release to be approximately 9,000 gallons. The Company used a hydrovac truck to jet the sewer lines and clear the blockages. The clean-up was uneventful. There was no contact from the general public with the spill area. Sewer service to the Cambria subdivision was not discontinued or interrupted at any time. There was no adverse effect to the public health or safety, and ADEQ communicated to Johnson Utilities that the SSO will not result in a notice of violation ("NOV") or any further action by ADEQ.

Johnson Utilities reports NOV's to the Utilities Division Director within seven days of receipt as required by Decision 65840 (April 22, 2003). However, there is no requirement that the Company report periodic operational anomalies such as SSOs to the Commission unless those events result in an NOV. Neither legal counsel for Johnson Utilities nor the Company's representative who attended the March 3, 2009, Open Meeting were aware of the SSO in the Cambria subdivision at the time of the Open Meeting. While I was aware of the SSO, I was attending to business in the Company's service area in Pinal County on the day of the Open Meeting. Thus, when the Commissioners discussed two past SSOs in the Pecan Ranch subdivision adjacent to Queen Creek Wash, there was no discussion of the Cambria SSO. When I became aware of this oversight, the Company voluntarily provided information to the Commissioners on the Cambria SSO via e-mail on March 13,2009.

1 (Exhibit SF-12 at 1-2). While SFG casts aspersions regarding Johnson Utilities'  
2 motives and actions surrounding the February 22, 2009 SSO, SFG fails to refute anything  
3 contained in the statements of Mr. Tompsett quoted above. Again, the record in this case  
4 shows that Johnson Utilities has a good record regarding SSOs.

5 **C. Defamation Lawsuits.**

6 In 2008, Johnson Utilities filed defamation claims against five defendants in Pinal  
7 County Superior Court Case No. S-1100-CV-200801968. While admitting absolutely no  
8 direct knowledge regarding the facts or merits of the defamation claims asserted by  
9 Johnson Utilities in the lawsuits, SFG witness Sonn Rowell brands the lawsuits  
10 "frivolous" and states that the Company is using them to "harass" customers. (Exhibit  
11 SF-40 at 6). Moreover, Ms. Rowell admits that she does not even know the elements to  
12 prove a claim of defamation in court. (Tr. Vol. VIII at 1091). In fact, what little indirect  
13 information she has regarding the defamation lawsuits she obtained from a newspaper  
14 article. (Exhibit SF-40 at 6). The following exchanges from the hearing transcript  
15 demonstrate Ms. Rowell's complete lack of foundation and legal competence to assert the  
16 claims contained in her revised direct testimony:

17 Q. (By Mr. Crockett) You don't consider yourself to be an expert on  
18 legal issues?

19 A. (By Ms. Rowell) No.

20 \* \* \* \*

21 Q. Okay. Do you know what the elements are to prove a claim of  
22 defamation in court?

22 A. No.

23 \* \* \* \*

24 Q. Do you know whether a party may be sanctioned for filing a  
25 frivolous lawsuit?

26 A. I think they can.

1 Q. Do you know whether Johnson Utilities has been sanctioned in this  
2 case for filing the defamation lawsuit?

3 A. I don't.

4 Q. Have you reviewed a copy of the complaint filed by Johnson Utilities  
5 in the defamation lawsuit?

6 A. I have not.

7 Q. Have you ever asked to receive a copy of the complaint?

8 A. I have not.

9 Q. Is it fair to say then that you don't have any knowledge of the specific  
10 allegations contained in the complaint?

11 A. Specific, no.

12 (Tr. Vol. VIII at 1090-1091, 1122-1123). Despite a complete lack of evidence to  
13 support its testimony regarding these lawsuits, SFG accuses Johnson Utilities of "white-  
14 collar thuggery." This type of over-the-top hyperbole is embedded in virtually all of the  
15 pleadings and testimony that have been proffered by SFG in this rate case.<sup>16</sup>

16 Mr. Tompsett testified at the hearing that the defamation cases were settled with  
17 each of the five defendants, and that the parties entered into respective settlement  
18 agreements. (Tr. Vol. VII at 1038). Mr. Tompsett further testified that the settlement  
19 agreements disposed of all issues raised in the litigation, and that Johnson Utilities  
20 intended to dismiss the litigation. (*Id.*). This is yet another attempt by SFG to interject  
21 an irrelevant issue in this rate case.

22 **D. Sewer System Overflow Adjacent to Queen Creek Wash.**

23 SFG asserts, based upon the testimony of Ms. Rowell, that Johnson Utilities  
24 contaminated Queen Creek Wash with raw sewage as a result of an SSO that occurred the  
25 weekend of May 17-18, 2008. (SFG Post Hearing Brief at 3). However, in his

26 <sup>16</sup> Johnson Utilities notes for the record that SFG and Mr. Ashton have recently sought  
leave of court to amend their counterclaims to assert defamation against George Johnson  
in Maricopa County Superior Court Case No. CV2008-000141.

1 Supplemental Rebuttal Testimony dated March 23, 2009 (Exhibit A-6), Mr. Tompsett  
2 refutes this assertion by testifying that the SSO was contained in a concrete spillway  
3 adjacent to Queen Creek Wash, and that Johnson Utilities does not believe any raw  
4 sewage made its way into the wash. (Exhibit A-6 at 5). Mr. Tompsett testified that the  
5 SSO was caused by the clogging of lift station pumps with construction debris and  
6 household products, including mop heads, which should never have been discharged into  
7 a sanitary sewer, and not as the result of any negligence or malfeasance on the part of  
8 Johnson Utilities. (*Id.*).

9 Mr. Tompsett testified that in response to the SSO, ADEQ issued Compliance  
10 Order P-57-08 dated July 14, 2008, which led to a consent order between ADEQ and  
11 Johnson Utilities dated September 15, 2008. (*Id.* at 6). Pursuant to the consent order, and  
12 as a public service, Johnson Utilities treated the standing storm water in Queen Creek  
13 Wash which came from storm water runoff from adjacent subdivisions on either side of  
14 the wash, as well as upstream runoff. (*Id.* at 5-6). On November 17, 2008, ADEQ issued  
15 a termination of consent order on the basis that Johnson Utilities had demonstrated to  
16 ADEQ that the requirements imposed under the consent order were met. (*Id.* at 6.).  
17 Johnson Utilities is now awaiting administrative closure of the NOV identified as No.  
18 97512 which is associated with the SSO. (*Id.*).

19 Mr. Tompsett testified that there were no reported or known adverse health  
20 consequences to residents in the area of the SSO, and there is no evidence in this case to  
21 controvert that testimony. Ms. Rowell (who admittedly based her testimony on  
22 "published reports" and not any first-hand knowledge or independent due diligence)  
23 acknowledged under cross-examination that the SSO adjacent to Queen Creek Wash did  
24 not affect SFG. (Tr. Vol. VIII at 1119). And, while raising the issue of pump sizing at  
25 the neighboring sewage treatment plant, she concedes that she has no training in the  
26 design, construction or operation of sewer collection systems or wastewater treatment

1 plants, nor does she even understand how sewer collection systems or wastewater  
2 treatment plants operate. (*Id.* at 1086-1087). Moreover, Ms. Rowell testified that she  
3 has not even visited the wastewater facilities of Johnson Utilities, other than driving by  
4 them in her car. (*Id.* at 1108). Clearly, Ms. Rowell's testimony regarding the SSO is not  
5 credible.

6 **E. Storage of Sewage Sludge.**

7 SFG asserts that Johnson Utilities illegally stored sewage sludge at one of the  
8 Company's waste disposal plants, resulting in three related NOVs. (SFG Post Hearing  
9 Brief at 4-5). However, in his Supplemental Rebuttal Testimony dated March 23, 2009  
10 (Exhibit A-6), Mr. Tompsett testified that Johnson Utilities vigorously contests this  
11 allegation because it is without merit. (Exhibit A-6 at 6). As discussed above, an NOV  
12 "is an informal compliance assurance tool used by ADEQ to put a responsible party ... on  
13 notice that the Department believes a violation of an environmental requirement has  
14 occurred." (Exhibit A-38) (emphasis added). There is no evidence that ADEQ has taken  
15 any formal action as a result of the NOVs. In addition, Mr. Tompsett testified that  
16 Johnson Utilities has fully and timely complied with all requirements of the NOVs. (Tr.  
17 Vol. VII at 1034). There is no evidence in this case to the contrary.

18 **F. Test Year.**

19 SFG disingenuously argues that Johnson Utilities made a series of "dilatory"  
20 filings and then "ignored" Commission Decision 68235 requiring a rate case filing by  
21 May 1, 2007, using a 2006 test-year. (Post Hearing Brief at 5). These assertions are  
22 simply contrary to the evidence in this case. At the hearing, SFG introduced several  
23 pleadings and a letter filed by Johnson Utilities regarding its requested delay of the rate  
24 case filing deadline. (*See* Exhibits SF-3, SF-4, SF-5 and SF-6). As set forth in a motion  
25 to extend compliance dates (Exhibit SF-3) filed by Johnson Utilities on March 30, 2007,  
26 the Company notified the Commission that it had filed—that same day—an application

1 for authority to sell all of its water and wastewater assets to the Town of Florence, and  
2 requesting that the Commission cancel its certificates of convenience and necessity. (Ex  
3 SF-3 at 2). Alternatively, and in the event that the sale to the Town of Florence did not  
4 close, Johnson Utilities requested an extension of the rate case filing deadline and  
5 permission to use a 2007 test year. This pleading was followed by pleadings filed  
6 October 1, 2007 (Exhibit SF-4) and December 27, 2007 (Exhibit SF-6), as well as a letter  
7 to docket control dated December 6, 2007 (Exhibit SF-5). These pleadings and  
8 correspondence were not "dilatatory" filings, but good faith and reasonable requests by  
9 Johnson Utilities to extend a rate case filing deadline in the face of a planned sale of the  
10 water and wastewater assets to the Town of Florence.

11 In a letter dated September 18, 2007, from the Commission's former Chief  
12 Counsel to Johnson Utilities' former legal counsel, Mr. Kempley stated as follows:

13 As you can tell, Staff is not interested in requiring JUC to submit a rate case  
14 that would not be a productive part of the Commission's ongoing regulatory  
15 oversight. Nor is Staff interested in creating any impediments to a possible  
16 municipal acquisition of JUC. At the same time, Staff continues to believe  
17 that a review of the reasonableness of JUC's rates at the earliest practicable  
18 date is an important requirement if JUC is going to remain in business as a  
19 public service corporation.

17 In order to balance these competing concerns, I have been authorized to  
18 advise you of Staff's position with regard to your requested delay to JUC's  
19 rate case filing. Staff is willing to accede to changing the requirements such  
20 that a rate case filing could be made utilizing a calendar year 2007 test year.  
21 However, Staff believes that the date that such filing should be required is  
22 no later than March 31, 2008, rather than June 30, 2008. Staff believes that  
23 a March 31, 2008 filing date provides an adequate period of time to prepare  
24 such a rate case filing. Of course, consistent with the suggestion in your  
25 letter, Staff would anticipate that no further delays to this proposed rate case  
26 filing would be requested or granted.

(Attachment to Exhibit SF-4).

23 The sale of the water and wastewater assets to the Town of Florence did not  
24 ultimately close. Consistent with Mr. Kempley's letter, Johnson Utilities filed its rate  
25 case application by March 31, 2008 using a 2007 test year. Staff accepted the application  
26

1 and found the filing sufficient in a letter filed with docket control dated August 1, 2008.  
2 The Company's timely filing of a request to extend the rate case filing deadline and use a  
3 2007 test year before the expiration of the original filing deadline of May 1, 2007,  
4 combined with the Commission's acceptance of the rate case filing using a 2007 test year  
5 consistent with Mr. Kempley's letter, constitute compliance by Johnson Utilities with  
6 Decision 68235. SFG's assertion that the Company ignored a Commission order simply  
7 misstates the facts.<sup>17</sup>

### 8 G. Superfund Tax.

9 SFG argues that Johnson Utilities is not authorized to assess the so-called  
10 Superfund tax on water sales to its customers because it is a usage-based tax. (SFG Post  
11 Hearing Brief at 9). At issue is whether the Superfund tax is a "privilege, sales or use  
12 tax" which may be collected from customers by the Company pursuant to A.A.C. R14-2-  
13 409(D)(5). Johnson Utilities addressed this argument in its Closing Brief at some length  
14 and will not repeat the entire argument here. However, by way of summary, Mr.  
15 Bourassa testified that the Superfund tax is a transaction privilege sales tax that may be  
16 collected by the Company pursuant to A.A.C. R14-2-409(D)(5). (Exhibit A-3 at 5-6).  
17 Mr. Bourassa further testified that the Superfund tax is reported on Arizona Transaction  
18 Privilege Tax Form TPT-1 under Business Class Code 041, and that guidance on this tax  
19 is found in Arizona Department of Revenue Transaction Privilege Tax Ruling TPR 93-

20  
21 <sup>17</sup> SFG's over-the-top attacks on Johnson Utilities in this case are further evidenced by the  
22 fact that SFG devotes two pages of its brief addressing whether Johnson Utilities  
23 adequately responded to its request for admission. *See* SFG Post Hearing Brief at 14-16.  
24 In its data request 3.11, SFG asked the Company to "admit or deny that in Decision  
25 68235, the Commission ordered Utility to file a rate case for its water and wastewater  
26 divisions by May 1, 2007, using a 2006 test year." *Id.* Johnson Utilities responded in the  
first line of its response as follows: "In Decision 68235, the Arizona Corporation  
Commission ordered that Johnson Utilities file a rate case for the water and wastewater  
divisions using a 2006 test year by May 1, 2007." Notwithstanding the fact that the  
Company clearly answered the question, SFG complains that "[n]one of the words admit,  
deny, yes or no appear anywhere in Utility's 168-word response."

1 20. (*Id.*). This testimony by Mr. Bourassa that the Superfund tax is a transaction  
2 privilege sales tax was un-refuted by SFG. Neither Staff nor RUCO have contested the  
3 pass-through of the Superfund tax by the Company. SFG's argument should be rejected.

4 **H. Surreptitious Recording of Johnson Utilities' Employee.**

5 On February 1, 2008, Mr. Ashton surreptitiously recorded his conversation with  
6 Gary Larsen, an employee of Johnson Utilities at the time of the recording. SFG Post  
7 Hearing Brief at 6; Exhibit A-18). Although Mr. Larsen asked Mr. Ashton on more than  
8 one occasion whether he was being recorded, Mr. Ashton assured him that he was not,  
9 which was a lie. (Exhibit A-18 at 6, 22). Mr. Ashton's testimony in this case should be  
10 evaluated against the backdrop of his self-serving deception of Mr. Larsen. Similarly,  
11 Mr. Larsen's statements should also be viewed in their proper context—that is, an  
12 employee who attended a secret meeting with a person who was in a dispute with his  
13 employer.

14 There are two other points which warrant brief discussion. SFG uses an exchange  
15 between Messrs. Ashton and Larsen to support its argument that the employees of  
16 Johnson Utilities do what they are told because they are afraid of George Johnson. (SFG  
17 Post Hearing Brief at 6). First, it should be noted that Mr. Larsen does not use the word  
18 "afraid." (*Id.*). Second, while Mr. Larsen does state that employees of the Company are  
19 "doing what they are told to do," that is the nature of being an employee. (*Id.*). SFG  
20 obviously prefers a company where the employees do not do what they are asked to do.

21 In another exchange with Mr. Ashton at his secret meeting, Mr. Larsen opines that  
22 the Commission is afraid of Mr. Johnson. (*Id.*). It is quite surprising that SFG would  
23 even include such a ridiculous comment in its brief. While Mr. Larsen may believe that  
24 the Commission is afraid of Mr. Johnson, the Commission certainly is not afraid of  
25 George Johnson.

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**I. Effluent Supplied to the Club at Oasis.**

Mr. Tompsett testified that Johnson Utilities delivers effluent from its Section 11 wastewater treatment plant to the Club at Oasis LLC, for use on the golf course pursuant to an Effluent Storage and Distribution Lease dated January 1, 2006. (Exhibit A-6 at 16). Mr. Tompsett testified that the Company discovered it was not charging the Oasis golf course for the effluent. (*Id.*). Mr. Tompsett testified that the Oasis golf course should have been charged for the effluent delivered, and that Johnson Utilities and Utilities Division Staff addressed and corrected for the oversight in the rate case. Mr. Bourassa accounted for the revenues associated with the delivery of effluent to the Oasis golf course in Rebuttal Schedule C-2 to his Rebuttal Testimony. (Tr. Vol. IX at 1386; Exhibit A-2, Vol. II). Staff also noted in the Staff Brief that it made an adjustment for the under-billing at the Oasis golf course. (Staff Brief at 24-25).

SFG alleges that the Johnson Utilities did not discover the oversight as stated in Mr. Tompsett's testimony, but that the Company got caught. The evidence in this case does not support such an assertion.

**J. SFG Billing Issues.**

Mr. Tompsett has testified candidly in this proceeding that Johnson Utilities made some mistakes on SFG bills. (Tr. Vol. VII at 946-948). Mr. Tompsett also testified that Johnson Utilities corrected those mistakes and applied appropriate credits to the accounts of SFG. (*Id.*). The appropriate place to address the remaining billing dispute between Johnson Utilities and SFG is the complaint docket (WS-02987A-08-0049)

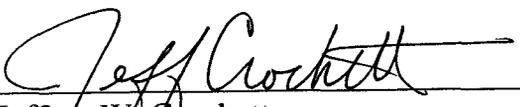
**K. SFG's Nine Recommendations.**

Johnson Utilities addressed SFG's nine recommendations in its Closing Brief, and will not repeat its arguments in this brief.

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RESPECTFULLY SUBMITTED this 11th day of December, 2009.

SNELL & WILMER L.L.P.

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