



0000111682

# ORIGINAL EXCEPTION

RECEIVED

BEFORE THE ARIZONA CORPORATION COMMISSION

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

2010 MAY 17 P 3:51

COMMISSIONERS

KRISTIN K. MAYES, Chairman  
GARY PIERCE  
PAUL NEWMAN  
SANDRA D. KENNEDY  
BOB STUMP

AZ CORP COMMISSION  
DOCKET CONTROL

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

## EXCEPTIONS OF JOHNSON UTILITIES TO RECOMMENDED OPINION AND ORDER

MAY 17, 2010

Arizona Corporation Commission  
DOCKETED

MAY 17 2010

DOCKETED BY

Snell & Wilmer

LLP  
LAW OFFICES  
One Arizona Center, 400 E. Van Buren  
Phoenix, Arizona 85004-2202  
(602) 382-6000

**TABLE OF CONTENTS**

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

**Page**

I. INTRODUCTION ..... 1

II. SUMMARY OF EXCEPTIONS ..... 1

III. THE RECOMMENDED OPINION AND ORDER DOES NOT ESTABLISH JUST AND REASONABLE RATES IN VIOLATION OF ARIZONA LAW ..... 3

    A. Overview of the Legal Standards ..... 3

        1. Rates and Charges Must be Just and Reasonable ..... 3

        2. The Commission’s Determination of Just and Reasonable Rates Must be Supported by the Evidence ..... 4

        3. Procedural Requirements Applicable to Setting Rates ..... 5

    B. The ROO Disregards the Substantial Weight of Evidence ..... 5

IV. THE RATE BASE ADJUSTMENTS IN THE ROO ARE NOT SUPPORTED BY THE WEIGHT OF EVIDENCE ..... 6

    A. Plant-in-Service ..... 6

        1. The ROO Erroneously Applies an Arbitrary 10% Disallowance for Water and Wastewater Plant That Was Not Adequately Supported According to Staff ..... 7

        2. The ROO Erroneously Applies an Arbitrary 7.5% Disallowance for Affiliate-Constructed Plant ..... 20

        3. The ROO Erroneously Fails to Make Corresponding Adjustments to the AIAC and CIAC Accounts to Remove the Disallowed Water and Wastewater Plant ..... 25

        4. The ROO Erroneously Fails to Reclassify \$2,201,386 From Post Test Year Plant to Test Year Plant ..... 26

        5. The ROO Erroneously Fails to Include \$1,021,076 in Properly Includable Post Test Year Plant ..... 31

        6. The ROO Erroneously Excludes Plant Deemed Not Used and Useful ..... 34

        7. Excess Capacity ..... 37

    B. Unexpended Hook-up Fees (CIAC) ..... 42

V. OPERATING INCOME ISSUES ..... 44

    A. Central Arizona Groundwater Replenishment District (“CAGR D”) Assessments ..... 44

    B. Income Taxes ..... 46

VI. MISCELLANEOUS ISSUES ..... 51

    A. Discontinuance of Hook-Up Fees ..... 51

**TABLE OF CONTENTS**  
**(continued)**

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

**Page**

B. Correction Regarding Attorney Fees .....52

1     **I. INTRODUCTION.**

2             On May 7, 2010, the Administrative Law Judge (“ALJ”) in the above-captioned  
3 proceeding issued a Recommended Opinion and Order (“ROO”). Pursuant to A.A.C.  
4 R14-3-110(B), Johnson Utilities, LLC, dba Johnson Utilities Company (“Johnson  
5 Utilities” or the “Company”) hereby files its exceptions to the ROO.

6             At hearing, for its Water Division, Johnson Utilities introduced substantial  
7 evidence to support a decrease in revenues of \$2,879,022, or a decrease of 21.86%, for a  
8 total revenue requirement of \$10,293,877 (Exhibit A-4, Volume II at 3), and an adjusted  
9 rate base of \$3,539,562. (Exhibit A-4, Volume II at 3; *see also* Johnson Utilities Notice  
10 of Filing Closing Schedules (“Johnson’s Final Schedules”) Water Division, Schedule C-  
11 1). For its Wastewater Division, the Company provided substantial evidence to support  
12 an increase in revenues of \$2,326,532, or an increase of 20.49%, for a total revenue  
13 requirement of \$13,680,546, (Exhibit A-4, Volume III at 3), and an adjusted rate base of  
14 \$17,479,735. (Exhibit A-2, Volume III, page 4; *see also* Johnson’s Final Schedules,  
15 Wastewater Division, Schedule B-1).

16             As discussed and summarized in the table below, the ROO erroneously ignores  
17 and disregards the substantial weight of evidence presented by Johnson Utilities and  
18 instead adopts virtually every recommendation of Utilities Division Staff (“Staff”) in this  
19 case to significantly reduce the Company’s rate base and revenue requirement for both  
20 its water and wastewater Divisions, contrary to Arizona law. Johnson Utilities has  
21 attached hereto for the Commission's convenience proposed amendments addressing  
22 certain of the deficiencies with the ROO.

23     **II. SUMMARY OF EXCEPTIONS.**

24             For the Commission's convenience, Johnson Utilities has summarized its  
25 exceptions in the following table:  
26

<b>JOHNSON UTILITIES RATE CASE EXCEPTIONS</b>			
<b>Issue</b>	<b>ROO</b>	<b>Johnson Utilities' Exception</b>	<b>Brief Citation/ Amendment No.</b>
<b>Plant-in-Service, Affiliate Profit and Post Test Year Plant</b>			
Plant-in-Service	10% blanket disallowance to plant-in-service for inadequately supported plant.	The disallowed plant was supported and should be included in rate base: <b>\$7,433,707 (Water)</b> <b>\$10,892,391 (Wastewater)</b>	Section IV.A.1 Amendment #1
Affiliate Profit	7.5% blanket disallowance to plant-in-service to remove affiliate profit	The disallowance for affiliate profit is tremendously overstated. The following amounts should be added back into rate base: <b>\$5,017,752 (Water)</b> <b>\$7,352,364 (Wastewater)</b>	Section IV.A.2 Amendment #2
Post-Test Year Plant	Disallowance of reclassification of post test year plant; Disallowance of post test year plant	Reclassify the following amount of post test year plant as test year plant: <b>\$2,201,386 (Wastewater)</b> Include the following post test year plant: <b>\$1,021,076 (Wastewater)</b>	Section IV.A.4-5 Amendment #3
<b>Plant Not Used and Useful</b>			
Rickee Water Main	Disallowance of cost to construct water main	Cost of <b>\$731,125</b> be included in rate base	Section IV.A.6.a Amendment #4
Magma Sewer Force Main	Disallowance of cost to construct sewer main	Cost of <b>\$690,186</b> be included in rate base	Section IV.A.6.b Amendment #4
Precision WWTP	Disallowance of cost to construct WWTP	Cost of <b>\$1,696,806</b> be included in rate base	Section IV.A.6.c Amendment #4
<b>Excess Capacity</b>			
Storage Capacity	Plant constitutes excess capacity	Cost of <b>\$433,238</b> be included in rate base	Section IV.A.7.a Amendment #5
San Tan WWTP	Plant constitutes excess capacity	Cost of <b>\$5,443,062</b> be included in rate base	Section IV.A.7.b Amendment #5
<b>Other Issues</b>			
Unexpended Hook-Up Fees	Include HUFs in rate base	Exclude <b>\$6,931,078</b> of water HUFs from rate base	Section IV.B Amendment #6
CAGR D	Disapprove CAGR D adjustor	Approve CAGR D adjustor	Section V.A Amendment #7
Income Tax Expenses	Disallow income tax expense in revenue requirement	Include income tax expense in revenue requirement	Section V.B Amendment #8
Discontinuance of Hook-Up Fees	Discontinue HUF tariff	Permit Company to continue to collect HUFs	Section VI.A Amendment #9
Rate Case Expenses	\$100,000 in rate base expense	Clarify that rate case expenses for each division is <b>\$100,000</b> , for a total rate case expense of <b>\$200,000</b> .	Section VI.B Amendment #10

1     **III.    THE RECOMMENDED OPINION AND ORDER DOES NOT ESTABLISH**  
2     **JUST AND REASONABLE RATES IN VIOLATION OF ARIZONA LAW.**

3     **A.    Overview of the Legal Standards.**

4         **1.    Rates and Charges Must be Just and Reasonable.**

5             The Commission is established by Article 15, Section 1, of the Arizona  
6     Constitution. The Commission's rate-setting authority is derived from Article 15,  
7     Section 3, which provides, in pertinent part, that the Commission "shall have full power  
8     to, and shall, prescribe just and reasonable classifications to be used and just and  
9     reasonable rates and charges to be made and collected by public service corporations  
10    within the State for service rendered therein." *Ariz. Const. Art. XV, § 3.*

11            When setting rates for public service corporations, the Commission should focus  
12    on the principle that "total revenue, including income from rates and charges, should be  
13    sufficient to meet a utility's operating costs and to give the utility and its stockholders a  
14    reasonable rate of return on the utility's investment." *Scates v. Arizona Corp. Comm'n*,  
15    118 Ariz. 531, 533-34, 578 P.2d 612, 614-15 (App. 1978). Although the Commission's  
16    authority to prescribe rates is plenary (*see Tucson Elec. Power Co. v. Arizona Corp.*  
17    *Comm'n*, 132 Ariz. 240, 242, 645 P.2d 231, 233 (1982)), the Commission's rate-making  
18    authority is subject to the "just and reasonable" clauses of Article 15, Section 3, of the  
19    Arizona Constitution. *Residential Utility Consumer Office v. Arizona Corp. Comm'n*,  
20    199 Ariz. 588, 591, 20 P.3d 1169, 1172 (App. 2001).

21            Under the Arizona Constitution, "the Commission is required to find the fair  
22    value of the company's property and use such finding as a rate base for the purpose of  
23    determining what are just and reasonable rates." *Arizona Corp. Comm'n v. Arizona*  
24    *Public Service Co*, 113 Ariz. 368, 370, 555 P.2d 326, 328 (1976) (citing *Simms v. Round*  
25    *Valley Light & Power Co.*, 80 Ariz. 145, 294 P.2d 378 (1956)). "Thus, the rates  
26    established by the Commission should meet the overall operating costs of the utility and

1 produce a reasonable rate of return [or operating margin]. It is equally clear that the  
2 rates cannot be considered just and reasonable if they fail to produce a reasonable rate of  
3 return [or margin in the case of a cooperative] or if they produce revenue which exceeds  
4 a reasonable rate of return.” *Scates*, 118 Ariz. at 534, 578 P.2d at 615 (emphasis added).

5 **2. The Commission’s Determination of Just and Reasonable Rates**  
6 **Must be Supported by the Evidence.**

7 “The acceptance of evidence presented by one person over that presented  
8 by another is not necessarily decisive because the weight given any of the evidence is  
9 within the Commission's discretion, so long as that discretion is not abused.” *City of*  
10 *Tucson v. Citizens Utilities Water Co.*, 17 Ariz. App. 477, 480-481, 498 P.2d 551, 554-  
11 555 (emphasis added) (citing *Arizona Corp. Comm’n. v. Arizona Water Co.*, 85 Ariz.  
12 198, 335 P.2d 412 (1959)). “It is, however, also well established ‘that a reasonable  
13 judgment concerning all relevant factors is required in determining the fair value of the  
14 properties at the time of inquiry.’” *City of Tucson*, 17 Ariz. App. at 481, 498 P.2d at 555  
15 (App. 1972) (citing *Arizona Water Co.*, 85 Ariz. at 200, 335 P.2d at 414). “If the  
16 Commission ‘refuses to consider all the relevant factors, the fair value of the properties  
17 cannot have been determined under our Constitution.’ Mere speculation and arbitrary  
18 conclusions are not substantial evidence and cannot be determinative.” *City of Tucson*,  
19 17 Ariz. App. at 481, 498, P.2d at 555 (emphasis added) (quoting *Arizona Water Co.*, 85  
20 Ariz. at 200, 335 P.2d at 414). When considering the Commission’s decisions in a rate  
21 making context, the Courts will look at the evidence only to determine if the decision is  
22 unreasonable in that it lacks substantial support in the record, is arbitrary, or is otherwise  
23 unlawful. *Chaparral City Water Co. v. Arizona Corp. Comm’n*, Case No. 1 CA-CC 05-  
24 0002, Mem. (App., Feb. 13, 2007) (citing *Simms*, 80 Ariz. at 154-155, 294 P.2d at 384).  
25 Moreover, in establishing just and reasonable rates, the Commission may not simply  
26 “back into a result.” *See generally id.*

1                   **3.     Procedural Requirements Applicable to Setting Rates.**

2                   The process and procedures the Commission follows to gather and  
3 consider evidence in setting rates are quasi-judicial in character. Perhaps the clearest  
4 statement of the Commission’s duties is found in *State ex rel. Corbin v. Arizona Corp.*  
5 *Comm’n*, 143 Ariz. 219, 693 P.2d 362 (App. 1984):

6                   [A proceeding to set rates] carries with it fundamental procedural  
7 requirements. There must be a full hearing. There must be evidence  
8 adequate to support pertinent and necessary findings of fact. Nothing can  
9 be treated as evidence which is not introduced as such. . . . Facts and  
10 circumstances which ought to be considered must not be excluded. Facts  
11 and circumstances must not be considered which should not legally  
12 influence the conclusion. Findings based on the evidence must embrace the  
13 basic facts which are needed to sustain the order....

14                   \*           \*           \*

15                   A proceeding before the Commission that involves the required taking and  
16 weighing of evidence, determinations of fact based upon the consideration  
17 of the evidence, and the making of an order supported by such findings, has  
18 a quality resembling that of a judicial proceeding. Hence, it is frequently  
19 described as a proceeding of a *quasi-judicial* character. The requirement of  
20 a “full hearing” has obvious reference to the tradition of judicial  
21 proceedings in which evidence is received and weighed by the trier of the  
22 facts. The “hearing” is designed to afford the safeguard that the one who  
23 decides shall be bound in good conscience to consider the evidence, to be  
24 guided by that alone, and to reach his conclusion uninfluenced by  
25 extraneous considerations, which in other fields might have play in  
26 determining purely executive action. The “hearing” is the hearing of  
evidence and argument.

*In ex rel. Corbin*, 143 Ariz. at 224, 693 P.2d at 367 (quoting *Morgan v. United States*,  
298 U.S. 468, 56 S.Ct. 906, 80 L.Ed. 2d 1288 (1936) (citations omitted)).

**B.     The ROO Disregards the Substantial Weight of Evidence.**

                  As set forth above, the Commission’s decision must be based on factual findings  
that are supported by the evidence presented by the parties in this proceeding, with due  
regard to the expertise and credibility of the witnesses, as well as the authorities and

1 precedent supporting the parties' positions. An order issued by the Commission cannot  
2 disregard the evidence. The ROO disregarded the substantial evidence offered by  
3 Johnson Utilities to support its case-in-chief and instead, rubber-stamped Staff's  
4 recommendations on virtually every contested issue, thereby significantly reducing the  
5 Company's rate base and revenue requirement.

6 **IV. THE RATE BASE ADJUSTMENTS IN THE ROO ARE NOT**  
7 **SUPPORTED BY THE WEIGHT OF EVIDENCE.**

8 **A. Plant-in-Service.**

9 The water division and wastewater division rate bases proposed by Johnson  
10 Utilities, Staff and the Residential Utility Consumer Office ("RUCO") in the case are as  
11 follows:

	<u>Original Cost Rate Base</u>	<u>Fair Value Rate Base</u>
<b><u>Water Division</u></b>		
Company <sup>1</sup>	\$3,539,562	\$3,539,562
Staff <sup>2</sup>	\$(13,863,166)	\$(13,863,166)
RUCO <sup>3</sup>	\$(5,556,766)	\$(5,556,766)
<b><u>Wastewater Division</u></b>		
Company <sup>4</sup>	\$17,479,735	\$17,479,735
Staff <sup>5</sup>	\$136,562	\$136,562
RUCO <sup>6</sup>	\$11,252,776	\$11,252,776

22 <sup>1</sup> Exhibit A-4, Volume III at 4; *see also* Johnson's Final Schedules, Water Division, Schedule B-

23 <sup>2</sup> Staff's Final Schedule JMM-W2.

24 <sup>3</sup> RUCO's Final Schedules, Water District Schedule SURR RLM-2.

24 <sup>4</sup> A-2, Volume III, page 4; *see also* Johnson's Final Schedules, Wastewater Division, Schedule B-1.

25 <sup>5</sup> Staff's Final Schedule JMM-WW2.

26 <sup>6</sup> RUCO's Final Schedules, Wastewater District Schedule SURR RLM-2.

1                   **1. The ROO Erroneously Applies an Arbitrary 10% Disallowance**  
2                   **for Water and Wastewater Plant That Was Not Adequately**  
3                   **Supported According to Staff.**

4                   Johnson Utilities provided substantial evidence at hearing to support the  
5 removal of only \$885,064 from its Water Division plant-in-service account, which as  
6 shown below, represented the amount for which the Company was unable to provide  
7 supporting documentation. (Exhibit A-2, Volume II at 7). In addition, Johnson Utilities  
8 provided substantial evidence at hearing to support the removal of only \$1,047,941 from  
9 its Wastewater Division plant-in-service account, which as shown below, represented the  
10 amount for which the Company was unable to provide adequate supporting  
11 documentation. (Exhibit A-2, Volume III at 7). As discussed below, the remainder of  
12 the Company's water and wastewater plant-in-service costs were supported by contracts,  
13 invoices, cancelled checks, and/or line extension agreements, together with accounting  
14 records, bank statements, plant schedules, reconciliations, and other documentation.

15                   The ROO erroneously adopts Staff's recommendation to impose an arbitrary  
16 across-the-board disallowance of 10% to plant-in service, resulting in staggering  
17 decreases to Water Division plant-in-service of \$7,433,707 and to Wastewater Division  
18 plant-in-service of \$10,892,391. (ROO at 5, lines 2-4, and page 9, lines 18-19). While  
19 this 10% disallowance was characterized by the Staff witness as minimal, it is simply  
20 beyond reason that *any* disallowance exceeding \$18,000,000 could be characterized as  
21 "minimal." For the reasons discussed below, Johnson Utilities urges the Commission to  
22 reject this disallowance to plant-in-service and adopt the Company's proposed plant-in-  
23 service numbers.

24                   At the hearing, Johnson Utilities provided evidence that in response to Staff Data  
25 Requests JMM 1-44 and JMM 9-1, the Company provided copies of contracts, invoices,  
26 cancelled checks, and/or line extension agreements to support its water and wastewater

1 plant costs. (Exhibit A-2, Volume II at 7). In addition, in responses to Staff Data  
2 Requests JMM 1-43, JMM 1-44, JMM 4-1, JMM 4-2, JMM 4-3, JMM 7-1, JMM 7-2,  
3 JMM 9-1, JMM 9-2 and JMM 12-1, Johnson Utilities provided its accounting records,  
4 bank statements, plant schedules, reconciliations and other information supporting plant  
5 costs. (Exhibit A-2, Volume II at 7-8).

6 Set forth below is a summary of the plant costs and the supporting documentation  
7 provided by Johnson Utilities to Staff for the Water Division:

<u>Type of Documentation</u>	<u>Cost Booked</u>
LXA only	\$23,126,031
LXA plus back-up	\$15,402,986
Invoices	\$ 5,703,569
Contracts, cancelled checks, bank statements	\$29,222,823
Plant costs booked in an earlier year but subsequently removed and not in test year rate base	\$ 81,087
<b>Total</b>	<b>\$73,536,516</b>
<b>Total requested by Staff</b>	<b>\$74,421,579</b>
<b>Missing documentation</b>	<b>\$ 885,064</b>

15 (Exhibit A-4, Volume II at 13-14).

16 Set forth below is a summary of the plant costs and the supporting documentation  
17 provided by Johnson Utilities to Staff for the Wastewater Division:

<u>Type of Documentation</u>	<u>Cost Booked</u>
LXA only	\$ 31,275,040
LXA plus back-up	\$ 20,453,490
Invoices	\$ 8,197,464
Contracts, cancelled checks, bank statements	\$ 59,806,578
<b>Total</b>	<b>\$126,810,065</b>
<b>Total requested by Staff</b>	<b>\$126,810,065</b>
<b>Missing documentation</b>	<b>\$ 1,047,941</b>

24 (Exhibit A-4, Volume III at 12).

25 Despite the acknowledgment of Staff's witness that Johnson Utilities "submitted  
26

1 voluminous documents" to support its plant costs, the ROO nevertheless adopts Staff's  
2 arbitrary 10% disallowance and decreases Water Division plant-in-service by \$7,433,707  
3 and Wastewater Division plant-in-service by \$10,892,391 (ROO at 6, line 13, and page  
4 9, lines 18-19). The Staff witness decided upon these enormous disallowances not by  
5 identifying and removing specific plant costs which were found to be unsupported or  
6 inadequately supported, but rather by assessing a blanket 10% disallowance for all plant-  
7 in-service. (Exhibit S-38 at 14; Exhibit S-44 at 15; and Tr. Vol. XI at 1661 [Michlik]).  
8 Even though on cross-examination regarding whether copies of line extension  
9 agreements, construction agreements, invoices, receipts, and other supporting  
10 documentation is the type of documentation that a utility would submit to substantiate  
11 plant costs, Staff witness Michlik responded: "Yes." (Tr. Vol. IX at 1643 [Michlik]). In  
12 some cases, the Company provided estimates of plant costs, which the Staff witness  
13 admitted on cross-examination may be used for plant cost accounting if actual costs are  
14 not known under NARUC accounting. (Tr. Vol. XI at 1648 [Michlik]).<sup>7</sup>

15 The ROO's adoption of Staff's disallowance is arbitrary as the record contains no  
16 supportable basis for a 10% reduction to plant-in-service other than a statement by Staff  
17 that sometimes Staff recommends disallowances in the range of 10% to 100%. (Exhibit  
18 S-38 at 14; *see also* Exhibit A-2, Volume II at 9). The ROO incredibly states that there  
19 is no basis in the record to support the Company's allegation that the 10 percent  
20 disallowance proposed by Staff is arbitrary (ROO at 8 lines 12-13). Yet, the ROO's  
21 arbitrary deduction is nearly impossible to reconcile given Staff's oral testimony that line  
22 extension agreements, construction agreements, invoices, receipts and other supporting  
23

24 <sup>7</sup> According to the Uniform System of Accounts for Class A Water Utilities, Subsection D:  
25 "Utility plant account shall be charged with construction costs estimated, if not known, of the  
26 utility plant contributed by others or constructed by the utility using contributed cash or its  
equivalent." (Exhibit A-55).

1 documentation are the types of documentation that a utility would traditionally submit to  
2 substantiate plant costs. (Tr. Vol. XI at 1643 [Michlik]). These types of documentation  
3 are exactly the types of documentation that Johnson Utilities provided to Staff in this  
4 case. The Staff witness admitted on cross-examination that he did not identify any  
5 specific item of plant that was inadequately documented or unsupported by Johnson  
6 Utilities. (Tr. Vol. XI at 1660-1661 [Michlik]). In addition, because Staff's  
7 disallowance did not apply to any specific item of plant, the Company never received  
8 sufficient information to challenge the disallowance or raise a reasonable defense  
9 regarding the plant costs that were disallowed. (Exhibit A-2, Volume II at 9).

10 While the Staff witness testified that "only a minimal 10 percent disallowance is  
11 warranted in this case," that was small consolation to Johnson Utilities which suffered a  
12 nearly \$20,000,000 reduction to its rate base for this so-called "minimal" disallowance:

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

20 A. (BY MR. MICHLIK) Yes.

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

23 A. Well, correct for the double counting, but, yes, because we  
24 recommended 80 or 90 percent or even 100 percent except for the  
25 very few plant invoices that were provided to Staff on the  
wastewater side.

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

1 In this case, Johnson Utilities continually sought to provide plant documentation  
2 that would satisfy Staff, but Staff's requirements kept changing and it became very clear  
3 to the Company that the Staff witness was not going to be satisfied. The following  
4 sequence of excerpts from the cross-examination of the Staff witness at the hearing will  
5 illustrate the point.

6 In pre-filed testimony, the Staff accounting witnessed testified as follows:

7 Q. What constitutes "complete and authentic" information?

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

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

23 (Exhibit S-38 at 11 [Michlik]). Although the Staff witness identified a variety of  
24 documentation that would constitute "complete and authentic information," later in his  
25 testimony he inexplicably narrows the scope of documents that would suffice for such  
26 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

1 support the actual costs of the affiliate.  
2 (Exhibit S-38 at 15 [Michlik]). Throughout his surrebuttal testimony, the Staff witness  
3 continued to maintain that the only appropriate source documentation to support plant  
4 costs are invoices:

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

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

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

16 One of the justifications in the ROO for the 10% disallowance of plant costs was  
17 that Johnson Utilities Company failed to timely provide the requested documentation to  
18 Staff. (ROO at 9, lines 17-22, and page 10, lines 1-2). To the contrary, the record  
19 supports the fact that throughout the case, Johnson Utilities went to great lengths to  
20 provide the documentation requested by Staff, and that documentation was often  
21 voluminous. As set forth in Exhibit A-69, responses to Staff data requests JMM 1-43  
22 and JMM 1-44 were provided to Staff on September 22, 2008. Staff had requested  
23 documentation for plant additions for both the Water Division (JMM 1-43) and the  
24 Wastewater Division (JMM 1-44). In response, the Johnson Utilities provided four  
25 volumes of documents by year as requested. In addition, the Company provided the  
26 following response to each data request:

1           Response to JMM 1-43:

2           Attached, by year, are copies of line extension agreements, construction  
3           agreements, invoices, receipts and other supporting documentation for the  
4           water plant additions listed in this data request. Johnson Utilities has not  
5           attached complete copies of the line extension agreements and construction  
6           agreements due to the volume of paper that would create. Rather, the  
7           company has attached the first page of the agreement and the attachments  
8           which describe the water plant constructed and the costs. If the Utilities  
9           Division Staff requires a complete copy of any agreement, Johnson  
10          Utilities will provide a copy upon request. Also, please note that the plant  
11          costs for fire hydrants are, in some cases, included in line extension and/or  
12          construction agreements. Where the company has separate invoices or  
13          other documentation for fire hydrants, it is tabbed separately from the other  
14          water plant. Johnson Utilities has a small number of additional invoices to  
15          provide in response to this data request. These invoices will be provided  
16          shortly.

17           Response to JMM 1-44:

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

(Exhibit A-69).

            The Staff witness admitted under cross-examination that not only did Staff thank  
            Johnson Utilities for its supplemental responses, at no time did Staff raise any objection  
            as to the form of the submitted documentation in a supplemental data request:

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

A.       (BY MR. MICHLIK) Sure. This is a follow-up to JMM 1-43 and

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

JMM 1-44. "Thank you for the plant costs documentation provided. However, the cost of the 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 cost of the plant addition. For example, in documentation provided for the sewer division's 1999 plant additions for account No. 361 was approximately \$949,000 less than the actual cost reported \$3,771,477. Please reconcile the differences by providing additional information where needed and indicated on each advance agreement the account numbers to which the costs were recorded."

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

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

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

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

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

A. No.

(Tr. Vol. XI at 1654-1655 [Michlik]).

Under cross-examination, Staff's witness again testified that the only proper documentation to support plant costs was the underlying construction invoices:

Q. (BY MR. CROCKETT) Mr. Michlik, in the context of evaluating a rate application and conducting an audit on a utility, what sort of documents does Staff need to conduct a proper evaluation?

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

1 (Tr. Vol. X at 1529-1530 [Michlik]). The cross-examination of the Staff witness  
2 continued:

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

5 A. Based on the lack of underlying supporting documentation. What I  
6 mean by that is actual invoices.

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

8 On cross-examination related to affiliate-constructed plant costs, the Staff  
9 witness first testified that Johnson Utilities did not provide necessary supporting  
10 documentation. However, when pressed, the Staff witness acknowledged that the  
11 documentation may have been provided, but then testified that it was not verifiable:

12 Q. (BY MR. CROCKETT) And do you have any sense for whether  
13 these numbers that you see on this spreadsheet are in line with what  
14 other utilities might allocate for overhead?

15 A. (BY MR. MICHLIK) No, we don't, because you never gave us the  
16 underlying supporting documentation. So for the automotive  
17 expense of \$79.04, the data request clearly asks for your underlying  
18 supporting documentation for that. Legal and accounting expense  
19 of \$2,292.08, you should have been able to provide us with some  
20 documentation for that. Insurance -- I can go on and on. Basically  
21 we asked for it; you didn't give it to us; all you did was give us a  
22 spreadsheet. I don't know how you created this spreadsheet.

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

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

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

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

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

5 Q. (BY MR. CROCKETT) But if you had the underlying support for  
6 this construction, you could have compared that to the stated  
7 overhead and profit rate of 5 percent for the contract to determine  
8 whether these numbers are accurate; is that correct?

9 A. (BY MR. MICHLIK) Right, and we would also need the contract  
10 piece, too.

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

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

15 Q. Well --

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

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

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

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

(Tr. Vol. XI at 1629-1630 [Michlik]). Finally, when confronted with the fact that  
Johnson Utilities did provide the requested information by account number and project,  
the Staff witness then argued that while a spreadsheet and the underlying information

1 was provided, a lead sheet was not provided so Staff could not trace the spreadsheet to  
2 the underlying documentation:

3 Q. (BY MR. CROCKETT) Mr. Michlik, one more question before I  
4 move on from A-63. If you would turn to the back of that exhibit  
5 and if you would look at Attachment 13-1b that starts on the page at  
6 the bottom that is identified as JU-8023. Do you see that?

7 A. (BY MR. MICHLIK) Yes.

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

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

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

14 However, one more time, when pressed on the sufficiency of the documentation,  
15 the Staff witness had to again admit that the appropriate documentation was in fact  
16 provided:

17 Q. (BY MR. CROCKETT) Would you turn with me to the attachment  
18 7.1. Would you identify for me what this is?

19 A. (BY MR. MICHLIK) That is a spreadsheet.

20 Q. And what does it do?

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

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

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

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

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

A. Well, that is all the company had. I assume they gave it to us. (Transcript Vol. XI at 1656 [Michlik]). The Staff witness further testified that one of the reasons the Company's documentation was not accepted was that it did not correlate to the spreadsheets that were provided to explain the documentation. Yet, under cross-examination, the Staff witness admitted that he could not currently identify any instance when such documentation did not correlate to the spreadsheets. Further, he confirmed that Staff never identified any such instances in its written testimony; and he admitted that Staff simply opted to made a blanket disallowance:

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

A. (BY MR. MICHLIK) 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.

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.

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

3 A. No.

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

6 A. No.

7 Q. You just made a blanket disallowance?

8 A. Yes.

9 (Tr. Vol. XI at 1660-1661 [Michlik]) (emphasis added). Thus, the uncontroverted  
10 evidence in this rate case is that Staff did not identify one single item of plant that was  
11 properly documented by Johnson Utilities. Rather, Staff simply opted to make a  
12 "minimal" \$20,000,000 disallowance.

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

15 Q. (BY MR. CROCKETT) Did you not testify -- well, you have been  
16 critical of the company for not providing invoices in certain  
17 instances; is that correct?

18 A. (BY MR. MICHLIK) Correct.

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

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

22 (Tr. Vol. X at 1596-1597 [Michlik]). However, the Staff witness did not deny that  
23 invoices were provided by Johnson Utilities:

24 Q. (BY MR. CROCKETT) Okay. If you turn to the next page, JU-  
25 2154, what is that document?

26 A. (BY MR. MICHLIK) An invoice.

Q. And that is from Clear Creek Associates?

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

A. Yes.

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

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

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

A. Yes.

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

A. Yes.

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

What this extended sequence of excerpts from the hearing shows is that the Staff witness was not going to be satisfied with any level of documentation supplied by Johnson Utilities. Moreover, it shows that the Company was facing an ever moving target regarding the documentation required to satisfy the Staff witness. The evidence in this case demonstrates that Johnson Utilities submitted ample plant documentation to support its rate application. There is simply no basis for imposing what amounts to a \$20,000,000 penalty against the Company based upon Staff's arbitrary 10% blanket disallowance of plant-in-service. For the foregoing reasons, Johnson Utilities requests that the Commission reverse the \$7,433,707 disallowance of Water Division plant-in-service and the \$10,892,391 disallowance for Wastewater Division plant-in-service so that these amounts may be properly included in the Company's rate base. For the Commission's convenience, Johnson Utilities has attached Proposed Amendment No. 1 to address this exception.

**2. The ROO Erroneously Applies an Arbitrary 7.5% Disallowance for Affiliate-Constructed Plant.**

For the Water Division, Staff proposed—and the ROO adopts—the

1 removal of \$5,017,752 from plant-in-service for affiliate profit. (Staff's Final Schedule  
2 JMM-W3). However, Staff improperly utilized an affiliate profit percentage of 7.50%  
3 for all plant-in-service, regardless of whether such plant was constructed by an affiliate  
4 of Johnson Utilities or an unrelated third-party. For the Wastewater Division, Staff  
5 proposed—and the ROO adopted—the removal of \$7,352,364 of affiliate profit based on  
6 affiliate-constructed wastewater plant which is 7.5% of nearly the entire cost of the  
7 Wastewater Division's plant-in-service cost. (Staff's Final Schedule JMM-WW3).

8 In its response to Staff Data Request JMM 9.2, Johnson Utilities provided Staff  
9 with a complete listing of all water plant that was constructed by affiliates of the  
10 Company. (Exhibit A-2, Volume II at 5). Based upon this information, affiliate-  
11 constructed water plant totaled \$26,847,516, which is fully consistent with the plant  
12 documentation (*i.e.*, contracts, invoices, cancelled checks, line extension agreements,  
13 etc.) provided by the Company in response to Staff Data Request JMM 1.43. (*Id.*). In  
14 addition, the Company provided evidence and testimony that affiliate-constructed  
15 wastewater plant totaled only \$45,724,508. (Exhibit A-2, Volume III at 5).

16 Johnson Utilities does not dispute that affiliate transactions require greater  
17 scrutiny than non-affiliate transactions. However, Johnson Utilities does take issue with  
18 the ROO's determination regarding what constitutes an "affiliate" under Arizona law,  
19 thereby causing such transactions to become subject to such increased scrutiny. When  
20 calculating affiliate profit, the ROO concluded that certain entities with which the  
21 Company has done business should be treated as affiliates based solely upon the  
22 familial relationships of members of these entities and members of Johnson Utilities.  
23 (Cite). At hearing, it was Staff's position that "family relationships" make any  
24 transaction between the Company and these other entities related party transactions, and  
25 therefore, they should be treated the same as affiliate transactions. Yet family relations  
26 alone do not create affiliate transactions under either Arizona or federal law.

1 The Commission's own Affiliated Interests Rules provide as follows:

2 'Affiliate,' with respect to the public utility, shall mean any other entity  
3 directly or indirectly *controlling or controlled by, or under direct or*  
4 *indirect common control with*, the public utility. For purposes of this  
5 definition, the term 'control' (including the correlative meanings of the  
6 terms 'controlled by' and 'under common control with'), as used with  
7 respect to any entity, shall mean the power to direct the management  
8 policies of such entity, whether through ownership of voting securities, or  
9 by contract, or otherwise.

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

11 Staff has not provided any evidence, other than alleged family relations, that  
12 Johnson Utilities has any control over these separate entities within the meaning of  
13 A.A.C. R14-2-801(1). The Commission's definition equates "affiliate" with the power  
14 to direct management policies. Only an entity which can be directed is deemed to be an  
15 affiliate. Absent sufficient ownership of voting securities, contract or some other right  
16 to direct management policies, the other entity is not an "affiliate." In addition, Courts  
17 examining whether control can be imputed through family attribution have consistently  
18 ruled no. *Propstra v. U.S.*, 680 F. 2d 1248 (9th Cir 1981); *Bright v. U.S.*, 658. F.2d  
19 1248 (5th Cir 1981). The Ninth Circuit stated as follows in *Propstra v. U.S.*:

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

27 Next, although the ROO cited inadequate documentation to justify removing  
28 affiliate profit of 7.5% on all plant constructed, the Company has provided  
29 uncontroverted evidence that the 7.5% disallowance is grossly overstated. For example,  
30 the affiliate contracts and the responses provided to Staff by the Company in its data

1 responses (Staff data requests JMM 1-43 and JMM 4-2) clearly show that the affiliate  
2 contracts included a mark-up of 5-10% for affiliate profit and overhead—not just  
3 affiliate profit. (Exhibit A-2, Volume II at 5-6). Further, as explained by the Company  
4 in its response to Staff Data Request JMM 9-2, the Company’s affiliates added 10% to  
5 the base contract cost to cover overhead and profit, and the affiliate profit represented  
6 only 2% of the base contract cost. (Exhibit A-2, Volume II at 6).

7 The Company does not dispute the Commission’s authority to exclude affiliate  
8 profit from plant-in-service. To this end, the Company provided uncontroverted  
9 evidence that for the Water Division, an adjustment of \$469,832 was made to plant-in-  
10 service to remove affiliate profit on affiliate-constructed water plant totaling  
11 \$26,847,516 (Exhibit A-2, Volume II at 4); and for the Wastewater Division, an  
12 adjustment of \$800,179 was made to plant-in-service to remove affiliate profit on  
13 affiliate-constructed sewer plant totaling \$45,724,508. (Exhibit A-2, Volume III at 5).  
14 The Company has also provided uncontroverted evidence that the appropriate affiliate  
15 profit percentage on affiliate contracts is 1.75% not 7.5%. (Exhibit A-2, Volume II at 4-  
16 5).

17 Although the ROO disputes the Company’s contention that there was a lack of  
18 consistency between Staff’s pre-filed testimony and its testimony at hearing regarding  
19 what percentage of plant was constructed by affiliates, (ROO at p 25 line 21, 26 lines: 1-  
20 2), the evidence provided by the Company was uncontroverted. Staff’s pre-filed  
21 testimony stated:

22 Q. Based on all of the documentation that the Company provided,  
23 what are Staff’s conclusions?

24 A. The Company used affiliates to construct approximately all plant  
25 after 1998.

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

1 Q. (BY MR. CROCKETT) So the company -- is it your testimony,  
2 Mr. Michlik, that 100 percent of Johnson Utilities' plant was  
constructed by affiliates.

3 A. (BY MR. MICHLIK) No. But we can't put a valuation on what  
4 was -- what the IACC amount was by developers.

5 (Tr. Vol. X at 1576 [Michlik].

6 On the issue of allocation of overhead, Staff once again raised the same refrain  
7 that Johnson Utilities failed to provide documentation as to how the Company allocates  
8 overhead to its affiliate contracts. The ROO supports Staff's adjustment. (ROO at 31,  
9 lines 24-26). Yet when pressed on cross-examination, the Staff witness again had to  
10 admit that such documentation was in fact provided:

11 Q. (BY MR. CROCKETT) Okay. And I'm sorry. I keep going back  
12 to A-63, but one more thing. Since this references it, 13-1d, you  
13 ask for the company to explain how they allocate their overhead.  
14 And would you agree that the company provided a response under  
15 13-1d regarding how it applies—how it allocates overhead? Mr.  
Michlik, I'm asking you if you acknowledge that the company has  
provided the expense.

16 A. (BY MR. MICHLIK) Yes.

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

18 For the foregoing reasons, the Company requests that the plant totaling  
19 \$5,017,752 for the Water Division and \$7,352,364 for the Wastewater Division  
20 classified in the ROO as "affiliate profit" be reinstated in the Company's rate base. For  
21 the Commissions convenience, the Company has attached Proposed Amendment No. 2.

22 If the Commission rejects the 10% blanket disallowance for inadequately  
23 supported plant and the 7.5% blanket disallowance for affiliate profit as contained in the  
24 ROO, then Johnson Utilities will have a positive rate base for its wastewater division. In  
25 its pre-filed testimony and at hearing, the Company provided evidence to support a cost  
26

1 of equity of 12.0%, a cost of debt of 8.0%, and a weighted average cost of capital  
2 (“WACC”) of 11.89%. (Exhibit A-2, Volume I at 3). In its pre-filed testimony and at  
3 hearing, RUCO argued for a cost of equity of 8.31%, a cost of debt of 8.0%, and a  
4 WACC of 8.18%. (Exhibit R-9 at 3-4). Thus, if the Commission elects to set a rate-of-  
5 return on the positive rate base, as opposed to an operating margin, there is evidence in  
6 the record to support such a decision.

7 **3. The ROO Erroneously Fails to Make Corresponding**  
8 **Adjustments to the AIAC and CIAC Accounts to Remove the**  
9 **Disallowed Water and Wastewater Plant.**

10 The ROO erroneously fails to make corresponding adjustments to  
11 advances-in-aid-of-construction (“AIAC”) and contributions-in-aid-of-construction  
12 (“CIAC”) to remove the \$7,433,707 of disallowed Water Division plant-in-service and  
13 the \$10,892,391 of disallowed Wastewater Division plant-in-service. (Exhibit A-2,  
14 Volume II at 9; Exhibit A-2, Volume III at 9). Based upon Johnson Utilities' initial  
15 filing, AIAC funded approximately 61% of the Water Division net plant-in-service (46%  
16 of the Wastewater Division) and CIAC funded approximately 32% of the Water Division  
17 net plant-in-service (39% of the Wastewater Division). (*Id.*).

18 In making its disallowance for inadequately supported plant, the ROO completely  
19 ignores the sources of funding for that plant, and fails to make an adjustment to either  
20 AIAC or CIAC associated with the disallowed plant. (*Id.*). To ignore the necessary  
21 corresponding adjustments to AIAC and CIAC creates a mismatch and results in an  
22 understatement of rate base to the detriment of Johnson Utilities. (*Id.*). Thus, if the  
23 Commission accepts the 10% disallowance of water and wastewater plant contained in  
24 the ROO (which it should not), then the ROO violates the matching principle of rate-  
25 making unless corresponding adjustments are made to AIAC and CIAC to address the  
26 plant disallowances.

1                   **4. The ROO Erroneously Fails to Reclassify \$2,201,386 From Post**  
2                   **Test Year Plant to Test Year Plant.**

3                   The ROO adopts Staff's recommendation that \$3,222,494 of the  
4                   Wastewater Division plant be excluded as post test-year plant. (ROO at 14, lines 17-18).  
5                   However, the record supports Johnson Utilities' contention that during the rate case, the  
6                   Company discovered that \$2,201,386 of plant originally classified at post test year plant  
7                   and booked to plant in 2008 was actually placed into service in 2007 (the "Hunt  
8                   Highway Project"). (Exhibit A-2, Volume III at 14; *see also* Johnson's Final Schedules,  
9                   Wastewater Division, Schedule B-2 at 3.4). In its rebuttal filing, this plant was  
10                  reclassified from post test year plant to test year plant-in-service.

11                  Despite the fact that Johnson Utilities had identified the Hunt Highway Project in  
12                  its rebuttal testimony, the Staff engineer did not further evaluate whether this project  
13                  was, in fact, placed in service in 2007 and instead "left it up to the accounting section to  
14                  figure that out." (Tr. Vol. X at 1497 [Scott]). The Staff's accounting witness, in turn,  
15                  testified that it was the engineer who could not determine when the plant went into  
16                  service. (Tr. Vol. X at 1593 [Michlik]). However, the Staff engineer testified that there  
17                  was no question in his mind that the Hunt Highway Project was placed in service in  
18                  2007. (Tr. Vol. X at 1498 [Scott]). At the hearing, the Staff engineering witness  
19                  admitted that he had not looked at or analyzed the \$2,201,386 of plant that the Company  
20                  had re-identified as test-year plant. Rather, he testified that that analysis was done by the  
21                  Commission's accounting section:

22                  Q. (BY MR. CROCKETT) You understood that that was the  
23                  company's position, that this plant was not, in fact, post-test-year  
24                  plant, but was actually plant-in-service in the test year?

25                  A. (BY MR. SCOTT) I'm getting a little confused here because what  
26                  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

1 the test year. So I didn't follow that discussion with the company or  
2 Staff accounting section. So I'm not clear on these -- all of these  
3 lift stations, so I would have to defer that question to our Staff  
4 accountant.

4 Q. To Mr. Michlik?

5 A. Yes.

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

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

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

15 A. Yes.

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

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

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

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

26 (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, placed in service:

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

7           A.    (BY MR. MICHLIK) I have it.

8           Q.    You have that. Okay. Were you here earlier today when I  
9           discussed 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-  
20          year plant, and then they looked back and there was some type of  
21          error in their accounting records. And so the time between their  
22          direct and surrebuttal -- or rebuttal and rejoinder testimony you  
23          changed or moved some of the post-test-year plant into current test  
24          year, is my understanding.

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

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

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

1 the plant identified in lines 6 through 19 was actually plant that was  
2 completed and booked -- or was completed and placed into service  
3 in 2007?

4 A. We -- it was just the company's presentation. We didn't do an  
5 adjustment for it or anything. Is that your question?

6 Q. Yeah. Did you analyze this exhibit?

7 A. Did I analyze it, yeah. We analyzed it, and the company first  
8 wanted it as post-test-year plant and now it's -- two-thirds of it is in  
9 test-year plant. Our engineer was unable to determine when it was  
10 placed in service.

11 Q. And was that --

12 A. That was his testimony.

13 Q. That was his testimony today?

14 A. I think so.

15 Q. That he was unable to determine that?

16 A. Yes.

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

17 In addition, even though the Staff engineer testified that there was no question in  
18 his mind that the Hunt Highway Project was placed in service in the test year, Staff still  
19 disallowed the plant as post test-year plant:

20 Q. (BY MR. CROCKETT) Now, Mr. Scott, the line 19, do you see  
21 what Mr. -- do you see what Mr. Bourassa's note or comment says  
22 on that item, the Hunt Highway force main?

23 A. (BY MR. SCOTT) Yes.

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

26 A. Yes.

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

2 A. Yes.

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

6 A. Yes.

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

8 A. During the test year.

9 Q. During the test year?

10 A. Yes.

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

12 A. No.

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

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

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

20 A. Yes.

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

22 **5. The ROO Erroneously Fails to Include \$1,021,076 in Properly**  
23 **Includable Post Test Year Plant.**

24 The ROO erroneously fails to include \$1,021,076 in properly includable  
25 post test year plant. In addition, the actual post test year plant costs for two projects  
26 totaling \$1,021,076 (the Parks Lift Station project at a cost of \$486,714, and the Queen

1 Creek Leach Field project at a cost of \$534,394). (Exhibit A-2, Volume III at 14-15).  
2 The net increase in plant the Company proposed in its rebuttal filing was \$537,607.  
3 (Exhibit A-2, Volume III at 15). The Parks lift station was constructed for use initially  
4 by a Fry's shopping center that was started in 2007. (Exhibit A-5 at 34). The ROO  
5 completely ignores Johnson Utilities' evidence supporting the fact that without  
6 completion of the Parks Lift Station, the Company would have been forced to pay for  
7 vaulting and hauling the wastewater generated by the Fry's shopping center. (*Id.*). The  
8 physical transportation of the wastewater by truck to the Pecan wastewater treatment  
9 plant ("Pecan WWTP") would have been very costly. (*Id.*).

10 All of the excess treated effluent flows from the Pecan WWTP during the test  
11 year which required disposal were being sent offsite to Shea Homes' Trilogy Encanterra  
12 development during the construction of that project. (Exhibit A-5 at 35). These flows  
13 were well in excess of the demands needed for the Encanterra golf course. (*Id.*). The  
14 Queen Creek Leach Field was constructed to dispose of the excess effluent that Shea  
15 Homes agreed to take during construction to alleviate the 2007 level of effluent disposal  
16 needs. (*Id.*).

17 There have been several recent decisions in which post test year plant was  
18 allowed in rate base. In each of these decisions, the Commission approved the inclusion  
19 of post test year plant in rate base because the plant was revenue neutral (*i.e.*, necessary  
20 for the provision of service to customers at end of test year) and completed and placed in  
21 service a reasonable time before the hearing so that it can be inspected and audited.<sup>8</sup>

22 <sup>8</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*  
24 *Vista Water Company*, Commission Decision No. 65350 (Nov. 1, 2002); *Arizona Water*  
25 *Company—Northern Group*, Commission Decision No. 64282 December 28, 2001); *Paradise*  
26 *Valley Water 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).

1 (Exhibit A-2, Volume III at 18). The ROO completely ignored the Company's  
2 uncontroverted evidence through the testimony of its expert witness that supported the  
3 fact that these two projects were revenue neutral and were necessary for reasons of  
4 reliability, to serve the test year-end level of customers. (Exhibit A-2, Volume III at 15).  
5 In addition, both the Parks Lift Station and the Queen Creek Leach Field were completed  
6 and placed in service a reasonable time before the hearing, allowing for audit and  
7 inspection. (Exhibit A-2, Volume III at 19).

8 Staff determined that the Parks Lift Station was, in fact, used and useful during  
9 the test year, but did not make an adjustment to plant-in-service because it was skeptical  
10 about the information it was provided to verify the cost. (Exhibit S-44 at 6). For the  
11 Queen Creek Leach Field, Staff stated that it was unable to determine whether the  
12 project is used and useful. (*Id.*). Consequently, Staff did not propose to include this  
13 plant in rate base and recommended the project be looked at in a subsequent case.  
14 (Exhibit S-44 at 7). Because these two projects have been funded with CIAC, if the  
15 Commission were to decide to exclude these two projects, a corresponding amount of  
16 CIAC should also be removed, thereby resulting in a net zero impact on rate base.  
17 (Exhibit A-2, Volume III at 15).

18 The ROO also adopts Staff's position that the Company has not substantiated its  
19 claim that the additions are revenue neutral. (Staff Brief at 11). Yet according to the  
20 uncontroverted testimony of Company expert accounting witness Thomas Bourassa,  
21 these two projects are both revenue neutral and necessary for reasons of reliability to  
22 serve the test year-end level of customers. (Exhibit A-2, Volume III at 15).

23 For the foregoing reasons, Johnson Utilities requests that the Parks Lift Station  
24 and the Queen Creek Leach Field (totaling \$1,021,076 in plant for the Wastewater  
25 Division) which are classified in the ROO as "post test-year plant" be included in the  
26 Company's rate base. For the Commissions convenience, the Company has attached

1 Proposed Amendment No. 3.

2           **6. The ROO Erroneously Excludes Plant Deemed Not Used and**  
3           **Useful.**

4           Johnson Utilities agreed with the removal of \$3,395,894 in Water Division  
5 plant-in-service and \$2,209,026 in Wastewater Division plant-in-service that was found  
6 to be "not used and useful." (Exhibit A-2, Volume II at 11 and Volume III at 11).  
7 However, the Company strongly opposes the removal from plant-in-service of (i) the  
8 \$731,125 cost of constructing four miles of 12-inch water main to serve the Silverado  
9 Ranch development; (ii) the \$690,186 cost of constructing four miles of 8-inch force  
10 sewer main to serve the Silverado Ranch development; and (iii) the \$1,696,806 cost of  
11 constructing the Precision Wastewater Treatment Plant ("Precision WWTP"). As  
12 discussed below, the decision to construct each of these projects was prudent, and the  
13 plant should be allowed in rate base. To exclude the plant in rate base would result in  
14 rates that are not just and reasonable.

15           **a. Rickee Water Main.**

16           For its Water Division, Johnson Utilities agreed with the removal  
17 of \$3,395,894 in plant that was found to be not used and useful. (Exhibit A-2, Volume  
18 II at 11). However, the Company strongly disagrees with the ROO's removal of the  
19 \$731,125 cost of constructing four miles of 12-inch water main to serve the Silverado  
20 Ranch development (331-Transmission and Distribution Mains--Rickee Water plant 4  
21 miles of 12-inch mains). (*Id.*; *see also* Exhibit A-4, Volume II at 7). Although the  
22 water transmission main is not currently serving customers, the testimony and evidence  
23 in the case was uncontroverted that the Company was required to build this plant in  
24 order to serve a new development. (*Id.*). The evidence is undisputed that Johnson  
25 Utilities received a *bona fide* request for water service from the developer of Silverado  
26 Ranch, which obligated the Company to extend service under its certificate of

1 convenience and necessity ("CC&N"). (Exhibit A-7 at 14). The evidence is undisputed  
2 that Johnson Utilities entered into the Silverado Ranch Master Utility Agreement  
3 ("Silverado Agreement") in good faith, which contractually obligated the Company to  
4 construct the water main. (*Id.*). The evidence is undisputed that the water main was  
5 constructed within a roadway that has already been paved by the developer, and that the  
6 water main is in place and ready to provide water to customers within Silverado Ranch  
7 once homes are constructed. (*Id.*).

8 By comparison, the Staff witness seemed unaware that the Silverado Agreement  
9 was even provided to Staff, and he admitted that he did not even read the agreement:

10 Q. (BY MR. CROCKETT) Did you review a copy of the master  
11 utility agreement for Silverado Ranch?

12 A. (BY MR. MICHLIK) No.

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

16 A. It might have been.

17 (Tr. Vol. X at 1570 [Mitchlik]). Johnson Utilities provided uncontroverted  
18 evidence and testimony to support the fact that the decision to construct the Rickee water  
19 main was prudent. (Exhibit A-2, Volume II at 11). Therefore, it would be inappropriate  
20 and inequitable to remove the \$731,125 cost of the water main from rate base, and would  
21 result in rates that are not just and reasonable. For the Commission's convenience, the  
22 Company has attached Proposed Amendment No. 4 to add back into rate base the  
23 \$731,125 cost of the Rickee water main.

24 **b. Magma Sewer Force Main.**

25 For its Wastewater Division, Johnson Utilities agreed with the  
26 recommended removal of \$2,209,026 in plant that was found not to be used and useful.

1 (Exhibit A-2, Volume III at 11). However, the Company strongly disagrees with the  
2 ROO's removal of the \$690,186 cost of constructing four miles of 8-inch force sewer  
3 main to serve the Silverado Ranch development (360-Collections Sewer Force--Magma  
4 approx. 4 miles of 8-inch). (*Id.*). The discussion in Section IV.A.6(a) above regarding  
5 the uncontroverted evidence of the construction of the Rickee water main applies  
6 equally to the 8-inch sewer force main that was constructed by Johnson Utilities to serve  
7 Silverado Ranch, and is incorporated herein by reference.

8 Johnson Utilities provided uncontroverted evidence and testimony to  
9 support the fact that the decision to construct the 8-inch force sewer main for the  
10 Silverado Ranch development was prudent. (*Id.*). Therefore, it would be inappropriate  
11 and inequitable to remove the \$690,186 cost of the sewer force main from rate base, and  
12 would result in rates that are not just and reasonable. For the Commission's  
13 convenience, the Company has attached Proposed Amendment No. 4 to add back into  
14 rate base the \$690,186 cost of the 8-inch force sewer main.

15 **c. Precision WWTP.**

16 Johnson Utilities strongly disagrees with the ROO's removal of the  
17 \$1,696,806 cost of the Precision WWTP from plant-in-service.<sup>9</sup> The Precision WWTP  
18 is located adjacent to and south of Bella Vista Road within the Johnson Ranch  
19 development. (Exhibit A-5 at 36). The Arizona Department of Environmental Quality  
20 ("ADEQ") issued Aquifer Protection Permit No. P-105004 for the Precision WWTP on  
21 April 8, 2004 authorizing the collection and treatment of an average monthly flow of 0.3  
22 million gallons per day of wastewater. (*Id.*). While the Precision WWTP is not  
23 currently in use, the decision by Johnson Utilities to build the plant was unavoidable,

24 \_\_\_\_\_  
25 <sup>9</sup> The plant costs of the Precision WWTP consist of the following: (i) 354-Structures and  
26 Improvements for \$14,491; (ii) 381-Plant Sewers for \$5,749; and (iii) 381-Plant Sewers  
for \$1,675,846.

1 based upon the requirements of ADEQ. (*Id.*). In 2002, ADEQ implemented new  
2 policies requiring that wastewater treatment capacity be fully constructed and  
3 operational prior to subdivision approvals. (*Id.*). As a result of this new policy, ADEQ  
4 ceased issuing approvals to construct sanitary facilities to developers within Johnson  
5 Ranch and other developments unless and until Johnson Utilities constructed the  
6 Precision WWTP. (*Id.*). Staff acknowledged that it had no reason to dispute the  
7 Company's contention that it had no choice but to construct the Precision WWTP. (Tr.  
8 Vol. at 1504-1505 [Scott]). Because the decision by Johnson Utilities to construct the  
9 Precision WWTP was a necessary prerequisite to the approval of additional residential  
10 home construction in Johnson Ranch, the Precision WWTP should not be excluded from  
11 plant-in-service on the grounds that it is not used and useful. (Exhibit A-5 at 36-37).  
12 Excluding the Precision WWTP from rate base will result in rates that are not just and  
13 reasonable. For the Commission's convenience, the Company has attached Proposed  
14 Amendment No. 4 to add back into rate base the \$1,696,806 cost of the Precision  
15 WWTP.

16 **7. Excess Capacity.**

17 **a. Water Division- Rancho Sendero 0.5 MG Storage Tank.**

18 Staff proposed excess capacity adjustments to Water Division plant-  
19 in-service totaling \$1,127,065, as follows: (i) removal of \$433,238 from account 307-  
20 Wells and Springs (Anthem-Rancho Sendero Well #1) (the "Rancho Sendero Well #1")  
21 and (ii) removal of \$693,827 from account 330-Distribution Reservoirs and Standpipe  
22 (Anthem-Rancho Sendero WP -0.5 MG) (the "Rancho Sendero 0.5 MG Storage  
23 Tank").<sup>10</sup> (Exhibit S-38 at 9; Exhibit S-36, Exhibit MSJ at 12). The ROO adopted

24 <sup>10</sup> In the ROO, the administrative law judge appears to have switched the costs of the  
25 Rancho Sendero Well #1 and the Rancho Sendero 0.5 MG Storage Tank. According to  
26 Staff's Exhibit MSJ at page 12, the Rancho Sendero Well #1 has an original cost of  
\$433,238 and the Rancho Sendero 0.5 MG Storage Tank has an original cost of

1 Staff's recommendation to disallow the Rancho Sendero 0.5 MG Storage Tank, but  
2 rejected Staff's recommendation to disallow the 600 gallon-per-minute ("GPM") Rancho  
3 Sendero Well #1. Instead, the ROO disallows the 300 GPM Rancho Sendero Well #2 as  
4 excess capacity, which is then valued at \$346,914.<sup>11</sup> (ROO at 20, lines 12-13). While  
5 Johnson Utilities believes that the 300 GPM Rancho Sender Well #2 is needed to  
6 provide safe and reliable service to customers at Anthem at Merrill Ranch, the Company  
7 can accept the disallowance of the well from plant-in-service in exchange for retaining in  
8 rate base the 600 GPM Rancho Sendero Well #1. However, the Rancho Sendero 0.5  
9 MG Storage Tank is clearly needed to serve the test year level of customers, and is not  
10 excess capacity. Removing this storage tank from Water Division plant-in-service will  
11 result in rates that are not just and reasonable.

12 The Anthem at Merrill Ranch system has two water plants which each connect to  
13 the distribution system. (Exhibit A-5 at 6). The first water plant consists of a 1.0 MG  
14 storage tank and Anthem Well #1, a 600 GPM well located adjacent to the 1.0 MG  
15 storage tank. (*Id.*). The second water plant consists of: (i) the Rancho Sendero 0.5 MG  
16 Storage Tank; (ii) the adjacent 600 GPM Rancho Sendero Well #1; and (iii) the adjacent  
17 300 GPM Rancho Sendero Well #2. (*Id.*). All three wells and both water storage tanks  
18 are necessary to provide safe and reliable water service to Anthem at Merrill Ranch.  
19 (*Id.*).

20 The disallowances for excess capacity in the ROO are based upon Staff's analysis  
21 and recommendations, but there are fundamental defects with Staff's analysis. (Exhibit

22 \$693,827.

23 <sup>11</sup> According to the ROO, the \$346,914 constitutes one half of the documented cost of  
24 the 600 GPM Anthem Ranch Sendero Well #2. For this disallowance, the ROO  
25 accepted the Company's proposed growth rate of 366 new customers per year. (ROO at  
26 20, lines 1-4). However, it appears that the ROO mistakenly uses the \$693,827 cost of  
the Rancho Sendero 0.5 MG Storage Tank instead of the \$433,238 cost of the Rancho  
Sendero Well #1 for its calculation of the disallowance for excess well production  
capacity.

1 A-5 at 7). First, Staff substantially underestimated customer growth through 2012 at  
2 Anthem at Merrill Ranch. (*Id.*). Staff states that there were 857 customers on the  
3 Anthem water system at the end of test year 2007. Staff then used a linear regression  
4 analysis to reach an estimate of 1,780 customers at the end of 2012, for an average  
5 growth rate of approximately 185 customers per year. (Exhibit S-36, Exhibit MSJ at 22;  
6 Exhibit A-5 at 7). However, in 2008, a year for which the Company provided actual  
7 data, Johnson Utilities added 366 customers. (Exhibit A-5 at 7). In fact, the Staff  
8 witness testified that he had no reason to dispute that 366 customers were added. (Tr.  
9 Vol. X at 1459 [Scott]). The number 366 is approximately twice Staff's estimated  
10 average annual growth rate of 185 customers. (Exhibit A-5 at 7. Multiplying 366 by  
11 five years and adding that number to the test year-end customer count of 857 produces a  
12 customer count of 2,687 at the end of 2012.<sup>12</sup> (Exhibit A-5 at 8). Furthermore, Staff  
13 acknowledged that its lineal regression analysis, used to estimate customer growth,  
14 utilized four data points (September, October, November, and December) from which  
15 home sales are typically significantly lower than they are at earlier times of the year.  
16 (Tr. Vol. X at 1519 [Scott]).

17 Based upon an estimate of 2,687 customers at the end of 2012, there is no excess  
18 capacity in the storage capacity at Anthem at Merrill Ranch. (Exhibit A-5 at 9).  
19 Johnson Utilities' two storage tanks have a combined storage capacity of 1.5 million  
20 gallons. (*Id.*). The ROO adopts Staff's recommendation to remove the 0.5 million  
21 gallon storage tank as excess capacity. (ROO at 22, lines 6-9; Exhibit S-36, Exhibit MSJ  
22 at 12). However, this would leave Anthem at Merrill Ranch with only 1.0 million gallons  
23 of storage in a single tank. (Exhibit A-5 at 11). Using Staff's peak factor of 400 gallons

24 \_\_\_\_\_  
25 <sup>12</sup> In fact, Johnson Utilities introduced a letter from Pulte Homes indicating the following  
26 estimates: for 2010, 290 lots sold; for 2011, 559 lots sold; and for 2012 and beyond, 500 lots  
sold. (*see* Exhibit A-52).

1 per day of storage capacity per service connection, then multiplying by 2,687 service  
2 connections at the end of 2012, then adding Staff's figure of 120,000 gallons per day for  
3 fire flow, produces a storage capacity requirement of 1,194,800 gallons. (*Id.*). This  
4 storage requirement exceeds the storage capacity of the 1.0 million gallon tank by  
5 approximately 20%. (*Id.*).

6 Further, pursuant to Arizona Administrative Code R18-5-503, Johnson Utilities  
7 must maintain storage for the average daily demand peak flow for a minimum of one  
8 day. (*Id.*). For system design and planning purposes, Johnson Utilities uses a figure of  
9 260 gallons per household per day for customer usage. (*Id.*). Multiplying 260 gallons  
10 by the 2,687 customers at the end of 2012, and then multiplying that number by two (for  
11 two days' worth of storage) produces a storage requirement of 1,397,240 gallons.  
12 (Exhibit A-5 at 10-11). This storage requirement exceeds the capacity of the 1.0 million  
13 gallon tank without allowing for fire flow storage, thereby creating serious safety and  
14 reliability concerns for the Anthem at Merrill Ranch water system if the 0.5 million  
15 gallon tank is removed as excess capacity. (Exhibit A-5 at 11).

16 An additional problem with Staff's recommendation is that both Rancho Sendero  
17 Well #1 and Rancho Sendero Well #2 pump directly into the Rancho Sendero 0.5 MG  
18 Storage Tank, as opposed to the distribution system. (*Id.*). Therefore, it is not possible  
19 to pump Rancho Sendero Well #1 into the water distribution system without going  
20 through the Rancho Sendero 0.5 MG Storage Tank. (*Id.*). At hearing, the Staff witness  
21 agreed modifying the water system to directly connect Rancho Sendero Well #2 to the  
22 distribution system would be expensive, and more importantly, would remove important  
23 redundancy and water production capability. (*Id.*; see also Tr. Vol. X at 1484 [Scott]).  
24 The same argument would necessarily apply to Rancho Sendero Well #1. Thus, the  
25 Staff witness acknowledged that the storage tank will continue to be used as part of the  
26 operating distribution system despite the fact that Staff has recommended its

1 disallowance. (Tr. Vol. X at 1485 [Scott]). This is simply inequitable. Since Staff  
2 acknowledged that the Rancho Sendero 0.5 MG Storage Tank will continue to be used as  
3 part of the water system, the cost of that storage tank should be included in rate base and  
4 considered used and useful.

5 Johnson Utilities provided uncontroverted evidence and testimony to support the  
6 fact that the Rancho Sendero 0.5 MG Storage is not excess capacity. Therefore, it would  
7 be inappropriate and inequitable to remove the \$693,827 cost of the Rancho Sendero 0.5  
8 MG Storage Tank from rate base, and would result in rates that are not just and  
9 reasonable. For the Commission's convenience, the Company has attached Proposed  
10 Amendment No. 5 to add back into rate base the \$693,827 cost of the Rancho Sendero  
11 0.5 MG Storage Tank.

12 **b. Wastewater Division-Santan Wastewater Treatment**  
13 **Plant (Phase II).**

14 The ROO adopts Staff's recommendation to disallow the  
15 \$5,443,062 cost of constructing the 1.0 MGD Phase II ("Phase II") of the Santan  
16 Wastewater Treatment Plant ("Santan WWTP") on the basis that Phase II is excess  
17 capacity. (Staff's Final Schedule JMM-WW3). However, uncontroverted evidence was  
18 presented at hearing that the Phase II capacity will be put to use by late 2009 to treat  
19 wastewater flow that will be redirected from Johnson Utilities' Pecan wastewater  
20 treatment plant ("Pecan WWTP"), which is currently nearing constructed capacity.  
21 (Exhibit A-5 at 38). By interconnecting the Section 11 wastewater treatment plant,  
22 Santan WWTP and Pecan WWTP by force mains, Johnson Utilities has greater  
23 operational flexibility in treating wastewater flows and it allows the Company to obtain  
24 the maximum benefit from its combined wastewater treatment capacity in lieu of having  
25 to build costly new treatment plants or plant expansions. (*Id.*). Instead, Johnson  
26 Utilities can use available capacity at its Santan WWTP. (Exhibit A-5 at 39). In fact,

1 Staff testified that if, during the test year, the Pecan WWTP had 3 million gallons per  
2 day of capacity, Staff probably would not have recommended any disallowance at that  
3 plant. (Tr. Vol. X at 1513 [Scott]). The uncontroverted evidence at hearing showed  
4 that Johnson Utilities was planning/engineering upgrades to the Morning Sun Farms and  
5 Circle Cross lift stations and was planning/engineering the construction of one mile of  
6 new force main, which would enable the Company to redirect existing flows from the  
7 Pecan WWTP to the Santan WWTP. (*Id.*). The uncontroverted evidence at hearing  
8 further showed that by so doing, Johnson Utilities could delay the costly construction of  
9 an additional 2.0 MGD treatment expansion at the Pecan WWTP. (*Id.*). Staff concurred  
10 that a utility would not want to build plant capacity today if it can adequately address  
11 the capacity issues by moving flow to another plant. (Tr. Vol. X at 1517-1518 [Scott]).

12 Johnson Utilities provided uncontroverted evidence and testimony to support the  
13 fact that Phase II of the Santan WWTP is not excess capacity. Therefore, it would be  
14 inappropriate and inequitable to remove the \$5,443,062 cost of Santan WWTP Phase II  
15 from rate base, and would result in rates that are not just and reasonable. For the  
16 Commission's convenience, the Company has attached Proposed Amendment No. 5 to  
17 add back into rate base the \$5,443,062 cost of Santan WWTP Phase II.

18 **B. Unexpended Hook-up Fees (CIAC).**

19 Johnson Utilities strongly opposes the recommendation adopted in the ROO to  
20 include \$6,931,078 of unexpended hook-up fees (*i.e.*, CIAC) in rate base. (ROO at 36,  
21 lines 14½-16½). The Company collects hook-up fees ("HUFs") in advance of the time  
22 the Company will be expected to provide service to the customers for whom the HUFs  
23 are credited. (Exhibit A-2, Volume II at 15). The period between the time a HUF is  
24 collected, the time the capital improvements to provide capacity are constructed, and the  
25 date that a customer connects to the system can be a year or longer. (*Id.*). Thus, for a  
26 period of time, the customer who is credited with the HUF is not present on the system

1 and the plant required to serve that future customer is not constructed and recorded in  
2 plant. (*Id.*). Including the unexpended HUFs in rate base not only creates a mismatch in  
3 rate base, but existing ratepayers receive a windfall because existing rate payers get  
4 credit for HUFs paid on behalf of future customers who have not yet connected to the  
5 system. (Exhibit A-2, Volume II at 15-16). The capacity to serve those future customers  
6 has not been constructed, nor has cost of the future capacity been reflected in rate base.  
7 (Exhibit A-2, Volume II at 16). The Company's collection of HUFs ensures that funds  
8 are available for new and needed capacity when construction begins, not after-the-fact.  
9 (*Id.*).

10 The evidence in this case is uncontroverted that the collected HUFs are restricted  
11 and can only be spent on new capacity. (Exhibit A-2, Volume II at 17). The evidence is  
12 also uncontroverted that the Company does not benefit from excluding unexpended  
13 CIAC from rate base, and that existing rate payers are not harmed in any way. (*Id.*).

14 The ROO agrees with the Staff position to exclude both the plant costs and related  
15 CIAC and AIAC from rate base for its proposed plant not used and useful and excess  
16 capacity adjustments, presumably to recognize the rate base mismatch that would occur  
17 if the corresponding adjustments are not made. (Exhibit A-4, Volume II at 11).  
18 Hypothetically speaking, if Johnson Utilities had in fact constructed plant with the  
19 unexpended HUFs, and Staff had determined that there was excess capacity in such plant  
20 or that such plant was not used and useful, then Staff would have made a corresponding  
21 adjustment to CIAC after removing the plant from rate base, just as Staff is proposing  
22 with its "not used and useful" and "excess capacity" plant adjustments in this case. (*Id.*).  
23 Thus, there is no good reason why the same adjustment should not be made with regard  
24 to the unexpended HUFs.

25 For the foregoing reasons, it would be inappropriate and inequitable to include  
26 the \$6,931,078 of unexpended HUFs (*i.e.*, CIAC) in rate base, and would result in rates

1 that are not just and reasonable. For the Commission's convenience, the Company has  
2 attached Proposed Amendment No. 6 to remove the \$6,931,078 of unexpended HUFs  
3 from rate.

4 **V. OPERATING INCOME ISSUES.**

5 **A. Central Arizona Groundwater Replenishment District ("CAGR")**  
6 **Assessments.**

7 The Central Arizona Groundwater Replenishment District ("CAGR") was  
8 established in 1993 by the Arizona legislature to serve as a groundwater replenishment  
9 entity for its members.<sup>13</sup> (Exhibit A-5 at 17). The CAGR provides a mechanism for  
10 landowners and water providers such as Johnson Utilities to demonstrate a 100-year  
11 assured water supply under the State's Assured Water Supply Rules ("AWS Rules")  
12 which became effective in 1995. (*Id.*). As a member of the CAGR, the landowner or  
13 water provider must pay the CAGR to replenish (or recharge) any groundwater  
14 pumped by the member which exceeds the pumping limitations imposed by the AWS  
15 Rules. (*Id.*). The CAGR includes the Phoenix, Tucson and Pinal County Active  
16 Management Areas ("AMAs"). (*Id.*). Johnson Utilities completed the process for  
17 becoming a member service area ("Member Service Area") of the CAGR on or about  
18 June 9, 2000. (Exhibit A-5 at 18).<sup>14</sup>

19 Joining the CAGR is one of the steps in the process of becoming a designated  
20 provider, which means a water provider that has demonstrated to the Arizona  
21 Department of Water Resources ("ADWR") that it has a 100-year water supply. (*Id.*).

22 \_\_\_\_\_  
23 <sup>13</sup> The CAGR is operated by the Central Arizona Water Conservation District, which operates  
the Central Arizona Project.

24 <sup>14</sup> Johnson Utilities notes that at the Open Meeting on February 26, 2002, to discuss an order in  
25 Docket No. WS-02987A-01-0795, Commissioners Mundell, Spitzer and Irwin all indicated  
26 support for establishing an adjuster mechanism for the pass-through of a CAGR assessment.  
Decision 64598 in that docket included a finding of fact that the matter of CAGR taxes should  
be addressed in the Company's next full rate case (Decision No 64598 at 2, line 6).

1 The AWS Rules were designed to protect groundwater supplies within each AMA and to  
2 ensure that people purchasing or leasing subdivided land within an AMA have a water  
3 supply of adequate quality and quantity. (*Id.*). Thus, in each AMA, new subdivisions  
4 must demonstrate to ADWR that a 100-year assured water supply is available to serve  
5 the subdivision before sales can begin. (*Id.*). An assured water supply can be  
6 demonstrated in two ways. First, the owner of a subdivision can prove an assured water  
7 supply for that specific subdivision and receive a certificate of assured water supply  
8 from ADWR. (*Id.*). Alternatively, the owner of a subdivision can receive service from a  
9 city, town or private water company which has been designated by ADWR as having an  
10 assured water supply. (*Id.*).

11 The costs of the CAGR D are covered by a replenishment tax or replenishment  
12 assessment levied on CAGR D members. (*Id.*). Designated water providers such as  
13 Johnson Utilities that serve a Member Service Area pay a replenishment tax directly to  
14 the CAGR D according to the number of acre-feet of “excess groundwater” they deliver  
15 within their service areas during a year. (Exhibit A-5 at 18-19). The amount of the  
16 replenishment tax is based on CAGR D’s total cost per acre-foot of recharging  
17 groundwater, including the capital costs of constructing recharge facilities, water  
18 acquisition costs, operation and maintenance costs and administrative costs. (Exhibit A-  
19 5 at 19). By statute, the replenishment tax must be calculated separately for each AMA.  
20 (*Id.*). Johnson Utilities is a designated provider in both the Phoenix AMA and the Pinal  
21 AMA. (*Id.*).

22 In this case, Johnson Utilities removed the \$883,842 CAGR D tax assessment  
23 from purchased water expense in the test year and proposed that the tax be passed-  
24 through to customers on their monthly bills. (*Id.*). Staff supports the pass-through of the  
25 CAGR D tax assessment, with 10 conditions. (Exhibit S-43 at 2-3). At hearing, Johnson  
26 Utilities raised several legitimate concerns or objections to Staff’s recommendations.

1 However, despite the assertion in the ROO that “the Company has very clearly expressed  
2 an unwillingness to comply with the requirements necessary for proper administration  
3 and oversight of the proposed CAGR D adjustor mechanism,” no such evidence appears  
4 in the record of this case. (ROO at 45, lines 7½ - 9 ½). At no time has Johnson Utilities  
5 ever stated or in any way intimated that it would not abide by conditions imposed by the  
6 Commission in connection with the adopting of an adjuster mechanism for pass-through  
7 of the CAGR D assessment. To the extent there is any doubt in this regard, the Company  
8 fully intends to abide by any and all conditions attached to the CAGR D adjustor  
9 mechanism if adopted by the Commission.

10 Johnson Utilities requests that the Commission adopt the CAGR D adjuster  
11 mechanism that has been proposed by Staff and the Company in this case, together with  
12 any conditions the Commission may attach to that adjuster mechanism, including those  
13 conditions that have been recommended by Staff. For the Commission's convenience,  
14 the Company has attached Proposed Amendment No. 7 to allow the CAGR D adjuster  
15 mechanism.

16 **B. Income Taxes.**

17 The ROO supports the positions of Staff and RUCO to exclude income taxes  
18 from the determination of the revenue requirement for Johnson Utilities because the  
19 Company is a limited liability company and pass-through entity for income tax purposes.  
20 (ROO at 48, lines 10-11). The Staff and RUCO positions rest on the fact that Johnson  
21 Utilities does not itself pay income taxes at the company level, but rather the taxable  
22 income and tax liability passes through to its member owners who must then pay the  
23 taxes.

24 However, neither Staff nor RUCO deny that the income tax liability of the  
25 member owners of Johnson Utilities is directly attributable to the taxable income of the  
26 Company. Moreover, the evidence in the case also shows that Johnson Utilities pays the

1 tax liability of its member owners pursuant to an agreement between the Company and  
2 its member owners. (Exhibit A-2, Volume II at 24). Clearly, the Staff and RUCO  
3 position leads to an inequitable and discriminatory outcome, because an S-corporation or  
4 limited liability company will suffer from a lower revenue requirement and operating  
5 income than a C-corporation which is entitled to income tax expense. (*Id.*). Ultimately,  
6 the tax payment comes from the S-corporation or limited liability company itself because  
7 the member owners insure that their taxes are paid by the entities that generate them.  
8 (*Id.*). In fact, the situation is analogous to a C-corporation subsidiary of a public utility  
9 holding company which files a consolidated "corporate family" tax return. (*Id.*).  
10 Although the subsidiary C-corporation utility does not file its own separate tax return,  
11 this Commission has traditionally allowed income taxes of the utility to be computed on  
12 a stand-alone basis and included in the revenue requirement. (*Id.*). There is no good  
13 policy reason or other reason to reach a different result with regard to an S-corporation  
14 or a limited liability company. By denying income tax expense to the S-corporation or  
15 limited liability company, the rate payers receive an unjustified windfall from the lower  
16 revenue requirement and operating income that results from the exclusion of income tax  
17 expense. (*Id.*).

18 Rate making should be applied in a manner which produces reasonable and  
19 realistic results, regardless of the legal form of the utility. (Exhibit A-4, Volume II at  
20 19). Inclusion or exclusion of income taxes should not be limited to technical  
21 distinctions, but rather should be based on whether or not it is fair and does not  
22 discriminate. (*Id.*). The income taxes that must be paid by the members of a limited  
23 liability company such as Johnson Utilities are inescapable business outlays directly  
24 attributed to the utility and are directly comparable to the taxes paid by C-corporations.  
25 (*Id.*).

26 It is undisputed that the Commission is constitutionally endowed with very broad

1 power to prescribe classifications and to establish categories to consider in setting rates  
2 for public service corporations, which includes authority to consider classification for  
3 income tax expenses. A.R.S. § 40-254.01, subd. E; Ariz. Const. Art. 15, § 1 *et seq.*; *see*  
4 *also Consolidated Water Utilities, Ltd. v. Arizona Corp. Comm'n*, 178 Ariz. 478, 484,  
5 875 P.2d 137, 143 (App. 1993). Thus, the Commission has the authority to allow the  
6 recovery of income tax expense on a case by case basis. In *Consolidated Water Utilities,*  
7 *Ltd. v. Arizona Corp. Comm'n*, the Arizona Court of Appeals ruled as follows:

8 In Arizona, the decision to allow or disallow that tax expense is to be made  
9 by the Commission, not the courts. *See also Tucson Gas*, 15 Ariz. at 306,  
10 138 P. at 786 (the Commission has exclusive power over rate cases, and  
11 this “exclusive field may not be invaded by the courts, the legislative or  
12 executive.”).

13 (*Id.*).

14 State commissions vary as to whether income taxes for pass-through entities are  
15 allowed in cost of service. Although Johnson Utilities did not conduct an exhaustive  
16 search, the Company has found cases in Florida,<sup>15</sup> Indiana,<sup>16</sup> Kentucky,<sup>17</sup> Vermont,<sup>18</sup> and  
17 Wisconsin,<sup>19</sup> where the public service commissions in those jurisdictions have  
18 disallowed income tax recovery for pass-through entities. However, Johnson Utilities  
19 has identified cases in California,<sup>20</sup> Kansas,<sup>21</sup> Michigan,<sup>22</sup> New Jersey,<sup>23</sup> New Mexico,<sup>24</sup>

19 <sup>15</sup> *See for example: In Re: Proposed Revisions to Rules 25-30.020, . . . , Pertaining to Water*  
20 *and Wastewater Regulation*, Docket No. 911082-WS (1993 WL 590740 (Fla.P.S.C)); *see also Re*  
21 *B&C Water Resources, L.L.C.* Docket No. 080197-WU (2008 WL 3846530 (Fla.P.S.C.)); and  
22 *see also Re Anglers Cove West, Ltd.* Docket No. 070417-WS (2008 WL 3846530 (Fla.P.S.C.)).

21 <sup>16</sup> *See In re Pioneer Village Water, Inc.*, (1998 WL 999991 (Ind. U.R.C. 1998)).

22 <sup>17</sup> *See In the Matter of: An Application of Ridge-Lea Investments, Inc. for an Adjustment of*  
23 *Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, Docket 2008-00364  
(2008 WL 4696006 (Ky.P.S.C.)).

23 <sup>18</sup> *See Re Shoreham Telephone Company Inc.*, Docket No. 6914 (2004 WL 2791514 (Vt.P.S.B.),  
24 181 Vt. 57, 915 A.2d 197 (2006)); *see also Re Vermont Electric Power Company, Inc.* Docket  
25 No. 7174 (251 P.U.R.4<sup>th</sup> 331, 2006 WL 1714971 (Vt.P.S.B.)).

25 <sup>19</sup> *See Re St. Croix Valley Natural Gas, Inc.*, Docket No. 5230-GR-104 (2006 WL 707437  
(Wis.P.S.C.)).

26 <sup>20</sup> California has included an allowance for income tax expenses as part of rates when evaluating

1 South Carolina,<sup>25</sup> Texas,<sup>26</sup> Washington,<sup>27</sup> and again Wisconsin,<sup>28</sup> where the state  
2 commissions have allowed income tax recovery for pass-through entities.

3 Perhaps the best rationale for the allowance of income tax recovery for pass-  
4 through entities was set forth in *ExxonMobil Oil Corp. v. Federal Energy Regulatory*  
5 *Comm'n*, 487 F.3d 945, 376 U.S.App.D.C. 259, (D.C. Cir. 2007). In that case, the  
6 Federal Energy Regulatory Commission ("FERC") adopted a policy of full income tax  
7 allowances for limited partnerships. (*Id.* at 952). FERC determined that income taxes  
8 paid by partners on their distributive share of the pipeline's income are "just as much a  
9 cost of acquiring and operating the assets of that entity as if the utility assets were owned  
10 by a corporation." (*Id.*). Consistent with the evidence presented by Johnson Utilities in  
11 support of allowing income tax expense for pass-through entities, FERC found no good  
12 reason to limit the income tax allowance to corporations, given that "both partners and

---

13 utilities that are organized as limited partnerships. See *ARCO Products Co. v. SFPP, L.P.*, 81  
14 CPUC2d 573 at 16 (1998).

15 <sup>21</sup> See *Re Madison Telephone, L.L.C.*, Docket No. 07—MDTT-195-AUD (2007 WL 2126360  
(Kan.S.C.C.)).

16 <sup>22</sup> See *Re Detroit Thermal, L.L.C.*, Case No. U-13691 (2005 WL 2230278 (Mich.P.S.C.)).

17 <sup>23</sup> See *Re Maxim Sewerage Corporation BPU*, Docket No. WR97010052 (1998 WL 223177  
(N.J.B.P.U.)).

18 <sup>24</sup> The New Mexico Supreme Court found that a sole proprietorship may include income tax  
19 expenses in rate base in "an amount equal to the tax the Company would pay if incorporated" as  
20 a standard C corporation. *Moyston v. New Mexico Public Serv. Comm'n*, 63 P.U.R. 3d 522, 412  
21 P.2d 840, 851 (1966).

22 <sup>25</sup> See *Re Madera Utilities, Inc.*, Docket No. 2003-368-S (2004 WL 1714912 (S.C.P.S.C.)), see  
23 also *Re Development Services, Inc.*, Docket No. 2004-212-S (2005 WL 712315 (S.C.P.S.C.)).

24 <sup>26</sup> "The income taxes required to be paid by shareholders of a Subchapter S corporation on a  
25 utility's income are inescapable business outlays and are directly comparable with similar  
26 corporate taxes which would have been imposed if the utility operations had been carried on by  
a corporation." *Suburban Utility Corp. v. Public Utility Comm'n of Texas*, 652 S.W. 2d 358,  
364 (1983). Accordingly, the Texas Supreme Court held that the S corporation was "entitled to  
a reasonable cost of service allowance for federal income taxes actually paid by its shareholders  
on [the company's] taxable income or for taxes it would be required to pay as a conventional  
corporation, whichever is less." *Id.*

27 See *Washington Utilities and Transportation Commission v. Rainer View Water Company, Inc.*,  
Docket No. UW-010877 (2002 WL 31432725 (Wash.U.T.C.)).

28 See *Re CenturyTel of the Midwest-Kendall, Inc.*, Docket No. 2815-TR-103 (2001 WL  
1744202 (Wis.P.S.C.) see also *Re CenturyTel of Central Wisconsin, L.L.C.*, Docket No. 2055-  
TR-102 (2002WL 31970289 (Wis.P.S.C.)).

1 Subchapter C corporations pay income taxes on their first tier income.” (*Id.*). Moreover,  
2 FERC determined that income taxes paid on the partners' distributive share of the  
3 pipeline's income were properly “attributable” to the regulated entity because such taxes  
4 must be paid regardless of whether the partners actually receive a cash distribution. *See*  
5 *United States v. Basye*, 410 U.S. 441, 453, 93 S.Ct. 1080, 35 L.Ed.2d 412 (1973) (“[I]t is  
6 axiomatic that each partner must pay taxes on his distributive share of the partnership's  
7 income without regard to whether that amount is actually distributed to him.”). (*Id.*).  
8 Based on this aspect of partnership law, FERC concluded that income taxes paid by  
9 investors in a limited partnership are “first-tier” taxes that may be allocated to the  
10 regulated entity's cost-of-service. (*Id.*).

11 In *ExxonMobil*, the petitioners argued that these taxes are ultimately paid by  
12 individual investors—not the pipeline—and thus it was improper for FERC to allow  
13 income tax as an expense to the regulated entity. (*Id.*). However, FERC reasonably  
14 addressed this concern, explaining:

15 Because public utility income of pass-through entities is attributed directly  
16 to the owners of such entities and the owners have an actual or potential  
17 income tax liability on that income, the Commission concludes that its  
18 rationale here does not violate the court's concern that the Commission had  
19 created a tax allowance to compensate for an income tax cost that is not  
20 actually paid by the regulated utility.

21 (*Id.*). (Emphasis added). FERC also emphasized that “the return to the owners of pass-  
22 through entities will be reduced below that of a corporation investing in the same asset if  
23 such entities are not afforded an income tax allowance on their public utility income.”  
24 (*Id.*). FERC determined that “termination of the allowance would clearly act as a  
25 disincentive for the use of the partnership format,” because it would lower the returns of  
26 partnerships vis-à-vis corporations, and because it would prevent certain investors from  
realizing the benefits of a consolidated income tax return. (*Id.* at 952-953, 376

1 U.S.App.D.C. at 266-267).

2 Johnson Utilities submits that it is better policy for the Commission to  
3 allow the inclusion of income tax expense in the Company's revenue requirement. For  
4 the foregoing reasons, the Company requests that income tax be included as an expense  
5 in the determination of its revenue requirement. For the Commission's convenience,  
6 Johnson Utilities has attached Proposed Amendment No. 8 to allow the inclusion of  
7 income tax expense in determining the Company's revenue requirement.

8 **VI. MISCELLANEOUS ISSUES.**

9 **A. Discontinuance of Hook-Up Fees.**

10 Johnson Utilities strongly disagrees with the ROO's recommendation to  
11 discontinue HUFs. The current HUF only covers from 40-45% of the Company's costs  
12 of providing service to a new subdivision. (Exhibit A-5 at 30). The remaining 55-60%  
13 of the cost of the subdivision is funded by equity. (*Id.*). Although the Company's water  
14 HUF account still had a balance of \$6,931,078 at the end of 2007; these fees have been  
15 collected for developments where construction stopped due to the slow-down in the real  
16 estate market. (Exhibit A-5 at 31). However, in the coming years Johnson Utilities will  
17 be required to meet its obligations to build plant for these developments that were started  
18 during the real estate boom. (*Id.*). Thus, the Company believes that it would be  
19 inequitable to discontinue the HUF tariff.

20 Staff asserts that due to the company's inadequate accounting records, Staff is  
21 recommending that a certified public accounting firm attest to the company's  
22 membership equity level of 40% in order for the company to reapply for HUFs. (Exhibit  
23 S-39 at 15). However, on an annual basis, Johnson Utilities provides a report to the  
24 Commission detailing its collection and disbursement of HUFs. (Exhibit A-7 at 7). In  
25 2006, Mr. Jim Dorf, formerly of the Commission's Utilities Division Staff, conducted a  
26 thorough audit of the Company's HUF accounts and found nothing improper or amiss.

1 (*Id.*). While Mr. Dorf indicated to Mr. Brian Tompsett that he would be producing a  
2 written report regarding the HUF accounts, the Company never received anything in  
3 writing from the Commission. (*Id.*). However, Mr. Dorf confirmed with Mr. Tompsett  
4 that the audit had not disclosed anything unusual or improper regarding the way that  
5 Johnson Utilities was collecting, using and accounting for its HUFs. (*Id.*).

6 For the foregoing reasons, Johnson Utilities requests that the Commission  
7 continue in effect the existing HUF tariff. For the Commission's convenience, Johnson  
8 Utilities has attached Proposed Amendment No. 9 to allow the continuation of the  
9 Company's HUF tariff.

10 **B. Correction Regarding Attorney Fees.**

11 Johnson Utilities, Staff and RUCO all agree that the Company is entitled to rate  
12 case expense in the amount of \$100,000 for the Water Division and \$100,000 for the  
13 Wastewater Division, for a total rate case expense of \$200,000. (Exhibit A-2, Volume II  
14 at 23; Exhibit A-2, Volume III at 27). Although the ROO correctly states that there is no  
15 disagreement among the parties as to the amount of rate case expense, the ROO  
16 incorrectly identifies only \$100,000 of total rate case expense for this proceeding. For  
17 the Commission's convenience, Johnson Utilities has attached Proposed Amendment No.  
18 10 to allow the recovery of \$100,000 for the Water Division and \$100,000 for the  
19 Wastewater Division, for a total rate case expense of \$200,000.

20 RESPECTFULLY SUBMITTED this 17th day of May, 2010.

21 SNELL & WILMER L.L.P.

22  
23 By   
24 Jeffrey W. Crockett  
25 Robert J. Metli  
26 One Arizona Center  
Phoenix, AZ 85004-2202  
Attorneys for Johnson Utilities, LLC

1 ORIGINAL and 13 copies filed this  
2 17th day of May 2010, with:

3 Docket Control  
4 ARIZONA CORPORATION COMMISSION  
5 1200 West Washington Street  
6 Phoenix, Arizona 85004

7 COPIES of the foregoing hand-delivered this  
8 17th day of May, 2010, to:

9 Teena Wolfe, Administrative Law Judge  
10 Hearing Division  
11 ARIZONA CORPORATION COMMISSION  
12 1200 W. Washington Street  
13 Phoenix, Arizona 85007

14 Ayesha Vohra, Staff Attorney  
15 Legal Division  
16 ARIZONA CORPORATION COMMISSION  
17 1200 W. Washington Street  
18 Phoenix, Arizona 85007

19 Steve Olea, Director  
20 Utilities Division  
21 ARIZONA CORPORATION COMMISSION  
22 1200 W. Washington Street  
23 Phoenix, Arizona 85007

24 COPIES of the foregoing sent via e-mail and  
25 first-class mail this 17th day of May, 2010, to:

26 Craig A. Marks  
CRAIG A. MARKS, PLC  
10645 N. Tatum Blvd., Suite 200-676  
Phoenix, Arizona 85028  
Attorney for Swing First Golf, LLC

Daniel W. Pozefsky, Chief Counsel  
Residential Utility Consumer Office  
1110 West Washington St., Suite 220  
Phoenix, Arizona 85007

**Snell & Wilmer**

LLP  
LAW OFFICES  
One Arizona Center, 400 E. Van Buren  
Phoenix, Arizona 85004-2202  
(602) 382-6000

- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10
- 11
- 12
- 13
- 14
- 15
- 16
- 17
- 18
- 19
- 20
- 21
- 22
- 23
- 24
- 25
- 26

James E. Mannato  
Florence Town Attorney  
775 N. Main Street  
P. O. Box 2750  
Florence, Arizona 85253

*Grindall*

---

**PROPOSED  
AMENDMENTS**

**JOHNSON UTILITIES PROPOSED AMENDMENT NO. 1**

**Plant in Service**

**DELETE** from page 8, line 12 through page 9, line 19 and **REPLACE** with “The evidence presented at the hearing demonstrated that the Company provided the Commission with documentation regarding all but \$885,064 for plant costs for the water division and \$1,047,941 of plant costs for the wastewater division. Accordingly, Staff’s proposed 10 percent disallowance of \$7,433,707 for the water division and \$10,892,391 for the wastewater division is not reasonable. Accordingly, we will adopt the Company’s recommended disallowance for excess capacity of \$885,064 for the water division and \$1,047,941 for the wastewater division.

**MAKE CONFORMING CHANGES**

**JOHNSON UTILITIES PROPOSED AMENDMENT NO. 2**

**Affiliate Profit**

**DELETE** the following:

Page 30, line 6 through line 14.

Page 31, line 2 beginning with "As" through line 26.

Page 33, line 3 through line 5.

**INSERT** the following on page 33, line 4:

"Based on the evidence presented at the hearing, we do not agree that a 7.5 percent reduction is appropriate. The Company has provided sufficient evidence to support an affiliate profit amount of 1.75 percent. The Company has proposed an adjustment for affiliated profit of \$469,832 for the water division and \$800,179 for the wastewater division. Johnson Utilities proposal is based on the amount of plant in service it acknowledged was constructed by affiliates: \$26,847,516 for the water division, and \$45,724,508 for the wastewater division, multiplied by 1.75 percent. Because the record supports the Company's proposed plant constructed by affiliates as well as an affiliate profit amount of 1.75 percent, we will adopt the Company's recommendation as reasonable.

**MAKE CONFORMING CHANGES**

**JOHNSON UTILITIES PROPOSED AMENDMENT NO. 3**

**Post-Test Year Plant**

**DELETE** page 14, line 5 through line 19 and **REPLACE** with “It is undisputed that the Company did not incur these costs during the test year. However, the Company presented evidence demonstrating that inclusion of such costs was revenue neutral and necessary for reliability purposes to serve the test year-end customers. Moreover, both the Parks Lift Station and the Queen Creek Leach Field were completed and placed in service a reasonable time to allow for audit and inspection. Therefore, consistent with previous Commission decisions regarding inclusion of post-test year plant, \$3,222,494 of plant for the wastewater division should be included in rate base.

**MAKE CONFORMING CHANGES**

## **JOHNSON UTILITIES PROPOSED AMENDMENT NO. 4**

### **Plant Not Used and Useful**

a. **Rickee Main**

**DELETE** page 15, line 18 through line 22 and **REPLACE** with “The evidence presented at the hearing demonstrated that the Company was required to build this plant in order to serve a new development. As the decision to construct the water main was prudent, it would be inappropriate and inequitable to remove the \$731,125 cost from rate base. We therefore find this plant to be used and useful and the cost should be included in rate base.

b. **Magma Sewer Force Main**

**DELETE** page 16, line 8 through line 12 and **REPLACE** with “The evidence presented at the hearing demonstrated that the Company was required to build this plant in order to serve a new development. As the decision to construct the force main was prudent, it would be inappropriate and inequitable to remove the \$690,186 cost from rate base. We therefore find this to be used and useful and the cost should be included in rate base.

c. **Precision WWTP**

**DELETE** page 17, line 1 starting with “We” through the end of the paragraph and **REPLACE** with “The evidence presented at the hearing demonstrated that the Company was required by the ADEQ to build this plant. In addition, the WWTP was necessary to serve 2007 test year level customers. As the decision to construct this plant was prudent, it would be inappropriate and inequitable to remove the \$1,696,806 from rate base. We therefore find this to be used and useful and the cost should be included in rate base.

MAKE CONFORMING CHANGES

**JOHNSON UTILITIES PROPOSED AMENDMENT NO. 5**

Excess Capacity

a. Storage Capacity

**DELETE** page 21, line 21 through page 22, line 9 and **REPLACE** with “We do not agree that the plant constitutes excess capacity as the evidence demonstrates that it is integral to the operation of the Anthem and Merrill Lynch water system. We therefore find this plant to be used and useful and the \$433,238 cost should be included in rate base.

b. San Tan WWTP

**DELETE** page 23, line 3 through line 12 and **REPLACE** with “Based on the evidence presented, we do not agree that the plant constitutes excess capacity. We therefore find this plant to be used and useful and the \$5,443,062 cost should be included in rate base.

MAKE CONFORMING CHANGES

**JOHNSON UTILITIES PROPOSED AMENDMENT NO. 6**

Unexpended Hook-Up Fees

**DELETE** from page 36, line 6 through line 17 and **REPLACE** with “We are persuaded by the evidence presented by the Company that demonstrates that including the unexpended HUFs in rate base not only creates a mismatch in rate base, but results in existing customers receiving a windfall because such customers receive a credit for HUFs paid on behalf of future customers who have not connected to the system. The Company’s collection of HUFs ensure that funds are available for new and needed capacity when construction begins. Accordingly, we will not include \$6,931,078 of unexpended HUFs in rate base.

MAKE CONFORMING CHANGES

**JOHNSON UTILITIES PROPOSED AMENDMENT NO. 7**

**CAGR**

**DELETE** from page 45, line 2 through line 18 and **REPLACE** with “We will therefore approve the CAGR adjustor mechanism, inclusive of all eight conditions proposed by Staff.

**MAKE CONFORMING CHANGES**

**JOHNSON UTILITIES PROPOSED AMENDMENT NO. 8**

Income Tax Expenses

**DELETE** from page 48, line 1 after “non-discriminatory.” through line 11 and **REPLACE** with:

“We agree that the tax liability issue should receive fair and non-discriminatory treatment, and agree with the Company that this issue is one of “form over substance” that should not create either a windfall for the ratepayers or a detriment to the Company. We therefore will allow for the inclusion of income tax expense in the Company’s revenue requirement.

**MAKE CONFORMING CHANGES**

**JOHNSON UTILITIES PROPOSED AMENDMENT NO. 9**

**Discontinuance of Hook-Up Fees**

**DELETE** from page 53, line 4 through line 11 and **REPLACE** with “We agree with the Company that it be permitted to continue to collect HUFs as necessary.

**MAKE CONFORMING CHANGES**

**JOHNSON UTILITIES PROPOSED AMENDMENT NO. 10**

Rate Case Expenses

**INSERT** after “expense” on page 45, line 20 “for each division.”

**MAKE CONFORMING CHANGES**