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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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COMMISSIONERS

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

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JUN 11 2010

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

DOCKET NO. WS-02987A-08-0180

**STAFF'S RESPONSE TO JOHNSON  
UTILITIES, LLC**

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") files its response to the filing made by Johnson Utilities, LLC ("Johnson" or "Company") in response to the Commission's request for additional information made at the May 26, 2010, Open Meeting. The recommendations of Staff and its positions have been outlined in its Opening and Reply Briefs as well as its testimony, which it incorporates by reference. Staff maintains that the Recommended Opinion and Order ("ROO") is well reasoned and should be adopted, but understands the Commission's desire to more fully develop the record regarding the ROO's recommendation of an operating margin. While Staff did not view the Commission's request for schedules showing the impact of various operating margins on the Company's revenue requirement as an open invitation to relitigate issues that were thoroughly vetted during an 11-day evidentiary hearing, Staff must nevertheless respond to the Company's continued objections regarding the issues of disallowances that were adopted by the ROO.

**I. THE COMPANY DID NOT PROVIDE THE SCHEDULES AS DIRECTED BY THE COMMISSION.**

Both Staff and RUCO submitted schedules and affidavits illustrating the results of using an operating margin of 3%, 5% and 7%. The Company seems to have only complied with a portion of the directive – an argument for a rate base with a rate of return. However, the Commission directed the parties to file schedules reflecting operating margins of 3%, 5% and 7%. The following exchange is instructive:

1 Q. MR. OLEA [ to Chairman Mayes]: I thought you had said that all of the  
2 parties should put into the record under affidavit their comparison of the  
3 results of an operating margin of 3, 5, 7, or anything else that we thought was  
4 appropriate, including the rate of return or whatever.

5 A. CHMN. MAYES: Correct.

6 Q MR. OLEA: Or if we wanted to argue for rate base, we would use RUCO's  
7 weighted average cost of capital, and then all of the parties could respond to  
8 that. So I'm thinking all of the parties are going to file whatever they file on  
9 June 4, and then we could all respond to each other by June 11.

10 A. CHMN. MAYES: Correct. Any disagreements with that? <sup>1</sup>

11 The Company has presented two alternatives, neither of which comport with the total  
12 directive of the Commission. The first alternative purports to be based on the ROO.<sup>2</sup> However, this  
13 assertion by the Company is misleading. The only similarity with the ROO is the acceptance of the  
14 disallowances for plant not used and useful and post test year plant. Every other assumption  
15 proposed by the Company in Alternative 1 reflects a Company recommendation pertaining to a rate  
16 base disallowance that it has proffered throughout this case. The Company has also proposed a  
17 reduction from rate base of 10% of members' equity for unsupported plant. In addition, the  
18 Company has used its litigation position on rate of return, using 11.89%, while also using a rate of  
19 return of 10% and the RUCO recommended rate of return of 8.18%. The Company has essentially  
20 provided no new information to assist the Commission in arriving at its position; the Company is  
21 merely advancing the position that it has maintained throughout this case.

22 The Company states that its Alternative 2 is virtually identical to Alternative 1, but reduces its  
23 recommended rate base (after rejecting practically every disallowance proposed by the ROO) by  
24 7.5% on its proposed recommendation related to affiliate constructed plant.<sup>3</sup> The Company again  
25  
26

27 <sup>1</sup> Open Meeting Transcript, May 26, 2010 at 91-92.

28 <sup>2</sup> Company's Analysis of Positive Rate Base Alternatives at 10 (June 4, 2010).

<sup>3</sup> *Id.* at 12.

1 applied its recommended rate of return of 11.89%, 10% and RUCO's recommended rate of return of  
2 8.18%.

3 The Company's alternatives provide no new information upon which to reach an informed  
4 decision. With the exception of the acceptance (for purposes of providing information and not by  
5 way of waiver of its position) of minor disallowances, the Company's alternatives are nothing more  
6 than a restatement of its litigation position, which continue to be unpersuasive, as explained in Staff's  
7 previously filed briefs, and should be disregarded.

8 **II. THE ROO'S ADOPTION OF A DISALLOWANCE FOR INADEQUATE**  
9 **DOCUMENTATION IS CONSISTENT WITH PAST COMMISSION DECISIONS**  
10 **AND SHOULD BE ADOPTED.**

11 The Company persists in its arguments that adequate documentation was provided, thus  
12 rendering Staff's disallowance of 10% of its plant and the ROO's adoption of the Staff  
13 recommendation arbitrary.<sup>4</sup> The Company's assertions lack merit and simply are not true. The  
14 Company attempts to shift the focus away from its lack of compliance with Commission rule and  
15 Commission decision, by its constant reiteration that adequate documentation was provided. It was  
16 uncontroverted that the Company failed to keep its books and records in accordance with  
17 Commission rules<sup>5</sup> and in accordance with the National Association of Regulatory Commissioners  
18 ("NARUC") Uniform System of Accounts ("USOA")<sup>6</sup> and in compliance with the very Commission  
19 Decision that granted Johnson's Certificate of Convenience and Necessity ("CC&N").<sup>7</sup>

20 First, it is helpful to remember that the disallowance was only 10%. In the Commission's  
21 recent decision regarding Arizona-American Water Company, a Class A utility, the Commission  
22 disallowed over \$2,015,170 in plant for inadequate documentation.<sup>8</sup> Arizona-American argued that it  
23 had engineering estimates for the plant and that the plant was providing service and that it would be  
24 punitive to exclude the estimated unsupported costs. The Commission disagreed with the Arizona-

25 <sup>4</sup> Johnson Utilities' Analysis of Positive Rate Base Alternatives at 5-7-21.

26 <sup>5</sup> Arizona Administrative Code ("A.A.C.") § R14-2-610(D)(1). This rule states in part: "Each utility shall keep general  
27 and auxiliary accounting records reflecting the *cost of its properties...* and all other accounting and statistical data  
28 *necessary to give complete and authentic information as to its properties...*" (emphasis added).

<sup>6</sup> NARUC USOA, Accounting Instructions ¶13 (General-Records for each plant).

<sup>7</sup> Decision No. 60223 (May 27, 1997) at 14-15.

<sup>8</sup> Decision No. 71410 (December 8, 2009) at 24-26.

1 American arguments and adopted Staff's recommended disallowance, which was 100% for the plant  
2 in question, not just 10% as recommended for Johnson in this case.

3 The Company contends that it provided "voluminous documentation"<sup>9</sup> Let us examine just  
4 one item of the documentation provided to Staff by the Company.

5 During the evidentiary hearing, the Company introduced a notebook, almost 4 inches thick,  
6 pages of invoices regarding a project, Circle Cross Ranch.<sup>10</sup> These documents were produced by the  
7 Company on January 14, 2009, in response to a Staff data request. A review of these documents  
8 reveals project invoices, waiver and release on progress payments that span the years 2003-2008.  
9 While it may be helpful for the Company's internal management to maintain records by project,  
10 Commission rules require books to be maintained in accordance with the NARUC USOA. The  
11 USOA requires plant to be kept by plant account, which the Company did not do consistently. Staff's  
12 audit process is necessary and appropriate for verifying operating expenses and rate base costs.  
13 Staff's audit process and requirements for reviewing supporting documentation is required by  
14 Arizona Administrative Code ("A.A.C.") § R14-2-610(D)(1). This rule states in part: "Each utility  
15 shall keep general and auxiliary accounting records reflecting the *cost of its properties...* and all other  
16 accounting and statistical data *necessary to give complete and authentic information as to its*  
17 *properties...*" (emphasis added). Staff was unable to match the invoices provided to individual plant  
18 accounts and to the Company's General Ledger.

19 While the Company maintains that it provided Staff continually with documents to support its  
20 plant, it was not always timely. In a letter dated *April 21, 2009*, the Company supplemented its  
21 response to a Staff data request, a data request that *was issued in August 2008*. This information was  
22 provided a mere two days before the commencement of the hearing. It is unreasonable to require  
23 Staff to audit those records on the eve of trial. But despite the lateness of the responses, Mr. Michlik  
24 testified, even though the Company was late he, nevertheless, attempted to review the provided  
25 documents.<sup>11</sup>

26  
27 <sup>9</sup> Company Analysis of Positive Rate Base Alternatives at 20.

28 <sup>10</sup> Exhibit A-70.

<sup>11</sup> Tr. at 1713:22-1714:7.

1 The genesis of the Company's argument is based on the premise that it is Staff's  
2 responsibility to match each invoice, each construction contract, each cancelled check to the  
3 appropriate plant classification and plant account. The premise is false. The Company bears the  
4 burden of proof.<sup>12</sup> To shift the burden otherwise, would turn the rate application on its head.  
5 Without the disallowance proposed by Staff and adopted by the ROO, companies would need only to  
6 deliver to Staff boxes of checks, invoices, main extension agreements and the like, with the  
7 expectation that Staff will be obliged to place them in the proper plant accounts. The Company's  
8 arguments continue to be unpersuasive and should be rejected.

### 9 **III. EQUITY AND PLANT IN SERVICE ARE NOT SYNONYMOUS.**

10 The Company contends that since the granting of its CC&N, it has invested over \$29 Million  
11 in equity.<sup>13</sup> The Company's Alternative 1 proposes a reduction from rate base of 10% of Members'  
12 Equity for unsupported plant. However, equity investment does not equal plant used and useful to  
13 customers during the test year.

14 Members' Equity is only one of multiple components of the Company's balance sheet. Plant  
15 is only one of multiple components of the Company's balance sheet. Since all sources of funds  
16 provide financing for all uses of funds, no individual source (e.g., Members' Equity) can be directly  
17 associated with the financing of any individual use (e.g., Plant). A \$29 Million infusion of cash by  
18 members increases Members' Equity by \$29 million and Cash by \$29 Million, but it does not  
19 increase Plant. If the Company's Members' Equity equaled Plant, a \$29 Million infusion of cash by  
20 members would also result in a \$29 Million increase in Plant, and it does not. The Company's  
21 arguments and its proposed Alternative 1 should be disregarded.

### 22 **IV. THE ROO'S RECOMMENDATIONS REGARDING AFFILIATE PROFIT SHOULD** 23 **BE ADOPTED.**

24 It appears that the majority, if not all construction was performed by an affiliate of Johnson,  
25 Central Pinal Contracting. Staff could not determine whether the transactions between Johnson and  
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27 <sup>12</sup> See *South Fla. Natural Gas Co. v. Florida Pub. Serv. Comm'n*, 534 So.2d 695 (Fla.1988); *Florida Power Corp. v.*  
*Cresse*, 413 So.2d 1187, 1191 (Fla.1982); *Sunshine Utils. v. Florida Pub. Serv. Comm'n*, 577 So.2d 663, 666 (Fla. 1st  
28 DCA 1991).

<sup>13</sup> Company Analysis of Positive Rate Base Alternatives at 4.

1 its affiliates were at arm's-length. The Company claimed that it competitively bid its construction  
2 projects but did not retain those bids, so Staff could not conduct an audit of the bids. As Mr. Michlik  
3 testified, fair competitive bids protect ratepayers from being charged too much for plant.<sup>14</sup> As the  
4 testimony showed, Mr. Tompsett was a part owner of Central Pinal Contracting and at the same time,  
5 an executive of the Company.<sup>15</sup> Although he indicated that he did not participate in the bidding and  
6 the review process of the bids,<sup>16</sup> his role as an owner of the construction affiliate and an executive in  
7 the Company present conflicting interests.

8 Further in Staff's review of canceled checks and bank statements submitted by the Company  
9 in support of payments made for plant, Staff's review noted payments to a Company affiliate.<sup>17</sup> The  
10 bank records did not indicate payments made to any other construction entity other than an affiliate.  
11 Staff selected the midpoint (7.5) of the range of 5% to 10% mark-up range found in the  
12 documentation provided to Staff by the Company.<sup>18</sup>

13 It is the duty and responsibility of a regulated utility to serve its customers in a fair and  
14 equitable manner. A utility cannot overcharge customers or buy services from related entities at  
15 extravagant prices and expect its ratepayers to pay those costs. A utility has an obligation to get a  
16 competitive price for services to customers. This includes the obligation not to promote profitability  
17 for the Company or another interested company in a transaction that may not be at arm's-length to the  
18 detriment of its customers.

19 **V. CONCLUSION.**

20 It is troublesome to Staff that a Class A utility has a negative rate base. However, the  
21 evidence points to this conclusion. Facts are stubborn things, said John Adams, and whatever may be  
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23 <sup>14</sup> Ex. S-38 (Michlik Direct) at 12.

24 <sup>15</sup> Tr. at 849:22-850:14.

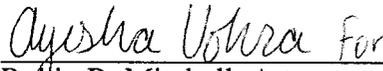
25 <sup>16</sup> Tr. at 869:20-870:9.

26 <sup>17</sup> Ex. S-45 (Michlik Surrebuttal – Wastewater) at 11.

27 <sup>18</sup> *Id.* at 13.

1 our wishes, our inclinations, or the dictates of our passion, they cannot alter the state of facts and  
2 evidence. Staff would urge the Commission to reject the alternatives proposed by Johnson.

3 RESPECTFULLY SUBMITTED this 11<sup>th</sup> day of June, 2010.

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