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Arizona Corporation Commission

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COMMISSIONERS

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

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

**SUPPLEMENTAL COMMENTS
IN SUPPORT OF JOHNSON
UTILITIES PROPOSED
AMENDMENTS NOS. 12 AND 9**

On May 7, 2010, the Administrative Law Judge issued a Recommended Opinion and Order ("ROO") in the above-captioned docket which was scheduled for consideration by the Arizona Corporation Commission ("Commission") at its regular Open Meeting on May 26-27, 2010. The Commission discussed the ROO at length and then held over the matter for further discussion at a future open meeting. At the Open Meeting on July 28, 2010, there was significant additional discussion by the Commission regarding the ROO, but the matter was again held over for additional discussion, and subsequently scheduled for consideration at a Special Open Meeting to be held on August 11, 2010. Much of the debate regarding the ROO has focused upon the large and unprecedented disallowances of utility plant based upon Staff's unsupported assertions of "inadequately supported plant costs." To aid the Commission in its discussion at the August 11 Open Meeting, Johnson Utilities is providing the following additional information.

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1 **Keeping up with Explosive Growth.**

2 As the record in this case clearly shows, Johnson Utilities experienced explosive
3 population growth within its certificated territory in the ten years from the
4 commencement of service in 1998 through the end of the 2007 test year. George
5 Johnson initially formed Johnson Utilities in 1997 to serve the Johnson Ranch
6 development. Johnson Ranch was very successful and the development grew quickly,
7 along with other developments in the area. Johnson Ranch became a Class A utility in
8 2005 for its water division and in 2006 for its wastewater division. By the end of the
9 2007 test year, Johnson Utilities had approximately \$200,000,000 of utility plant in
10 service. This is actual constructed utility plant in the ground serving customers, and it is
11 undisputed. During this period of perhaps the fastest growth that Arizona has ever seen,
12 Johnson Utilities kept up with the voracious demand for water and wastewater
13 infrastructure, and developers and thousands of new customers received the utility
14 services they desired and demanded in a timely and safe manner. That being said,
15 hindsight is 20/20, and there are things that Johnson Utilities could have done better with
16 respect to record keeping.

17 **Record-Keeping.**

18 In the early years, Johnson Utilities did not have the robust record-keeping
19 practices and procedures that have been developed and implemented in more recent
20 years. While Johnson Utilities acted in good faith by relying on engineering cost
21 estimates and other documentation that is acceptable under National Association of
22 Regulatory Utility Commissioners ("NARUC") standards,¹ the Company acknowledges

23 ¹ Staff witness Michlik agreed at the hearing that estimates may be used for plant costs under NARUC
24 accounting:

25 **Q. (BY MR. CROCKETT) Would you agree that under NARUC accounting instructions
26 that an estimate may be used for plant cost accounting if the actual numbers aren't known?**

A. (BY MR. MICHLIK) Yes.

1 that it did not do as good a job as was possible as it relates to record keeping. However,
2 the Company has made great strides since then to implement the robust record-keeping
3 and accounting practices and procedures discussed in the following section. Johnson
4 Utilities can assure the Commission that it recognizes the essentiality of robust record-
5 keeping and accounting, and that it takes those responsibilities of a public service
6 corporation very seriously.

7 **Record-Keeping and Accounting Practices and Procedures.**

8 Johnson Utilities has revised its bookkeeping system and the Company is
9 currently compliant with all requirements of the NARUC Uniform System of Accounts
10 for Class A utilities. In 2007, Johnson Utilities contracted a full time certified public
11 accountant, Scott Demmon, who works in-house for the Company and supervises a
12 corporate staff of three accounting personnel who work full time on utility company
13 accounting. Prior to commencing work for Johnson Utilities, Mr. Demmon spent seven
14 years working for private utility companies. In addition to Mr. Demmon and his staff,
15 the records and accounting of Johnson Utilities are checked by two separate outside
16 certified public accounting firms: Ullmann & Company, P.C., and Hammond, Travers &
17 Tuttle, P.C.

18 **Johnson Utilities Proposed Amendment No. 12.**

19 On July 26, 2010, Johnson Utilities docketed Johnson Utilities Proposed
20 Amendment No. 12 ("Proposed Amendment 12") and urged its adoption by the
21 Commission, along with the adoption of Mayes Proposed Amendments 1 and 2.
22 Proposed Amendment 12 incorporates the Company's Alternative 2 (as discussed at page
23 12 of Johnson Utilities' Analysis of Positive Rate Base Alternatives filed June 4, 2010),
24 using an 8.18% rate of return, which is the weighed average cost of capital
25
26

1 recommended by the Residential Utility Consumer Office in the case.² Under Proposed
2 Amendment 12, Johnson Utilities customers in the aggregate would see a 25.52%
3 reduction to water rates and a 1.68% reduction to wastewater rates, for a combined
4 reduction in rates of 14.48%. In the aggregate, these reductions are substantially similar
5 to the reductions recommended by Staff in its final rate case schedules (which is based
6 upon a negative rate base and operating margin). In fact, the difference between the
7 combined water and wastewater reductions under the Company's Proposed Amendment
8 12 and Staff's combined figure is less than 1.50%. However, by adopting Proposed
9 Amendment 12, the Commission will avoid the very adverse consequences of a Class A
10 utility with negative rate base, and will benefit customers with a utility company that is
11 financially healthy and stable.

12 In the Affidavit of Thomas J. Bourassa, CPA, submitted in support of Johnson
13 Utilities' Analysis of Positive Rate Base Alternatives filed June 4, 2010, Mr. Bourassa
14 summarized the tremendous detriments of a negative rate base and operating margin for
15 a Class A utility such as Johnson Utilities, which include the following:

- 16 • A negative rate base will make it difficult or likely impossible for
17 Johnson Utilities to attract additional equity in the future, either from
18 current members/shareholders or from future outside investors.
19 Such a lack of access to additional equity would relegate the
20 Company to reliance upon advances-in-aid-of-construction and/or
21 contributions-in-aid-of-construction to fund future growth, which
22 would do little to increase equity in the Company.
- 23 • A negative rate base will make it difficult or impossible for Johnson
24 Utilities to borrow money because lenders are generally unwilling to
25 loan money to a utility with negative equity. Even if the Company
26 could find a willing lender, it is virtually certain that such a lender
would require a higher interest rate to cover the substantial risk
associated with lending to a company with negative equity.

² Staff did not present cost of capital testimony in the case.

- 1 • The elimination of \$37,643,787 in rate base substantially reduces
2 depreciation expense, thereby decreasing operating cash flow. The
3 reduction of operating cash flow will make it much more difficult for
4 Johnson Utilities to fund plant replacements in the future.

5 The adoption of Proposed Amendment 12 would avoid these very adverse
6 consequences of a negative rate base, and likewise avoid the harmful precedent of a
7 Class A utility with an operating margin. Moreover, a positive rate base will produce
8 benefits for customers, such as lower vendor costs. For example, the Arizona
9 Department of Environmental Quality requires that Johnson Utilities maintain letters of
10 credit on each of its wastewater treatment plants. Johnson Utilities' bank currently
11 provides these letters of credit without charge because of the Company's equity position
12 and solid financial condition. Johnson Utilities also receives more favorable rates from
13 vendors as a result of the Company's equity position and strong financial condition,
14 which benefits the Company's customers. With negative equity or even zero equity,
15 Johnson Utilities will certainly face higher expenses, which ultimately must be borne by
16 customers.

17 Further, a positive rate base will ensure that Johnson Utilities has access to
18 needed capital in the future. The Company has already ascertained the need to expand
19 the Pecan wastewater treatment plant. If a rate case order is adopted with zero to
20 negative equity, Johnson Utilities face much higher costs in order to attract capital to
21 fund future construction. This will leave current customers paying for the costs of future
22 growth in an area of metropolitan Phoenix which will likely be one of the first to begin
23 growing again when the economy improves. Thus, it will certainly benefit existing
24 customers if the Company has a positive rate base.

25 The adoption of Proposed Amendment 12 would still remove \$2,860,844 from
26 plant-in-service for inadequately supported plant and an additional \$5,442,902 from

1 plant-in-service for affiliate profit,³ for a combined disallowance of more than
2 \$8,300,000. Such a disallowance is more than adequate to send a strong message that
3 the Commission is serious about the obligation of a public service corporation to
4 properly maintain its books and records.

5 **Hook-Up Fee Tariff--Johnson Utilities Proposed Amendment No. 9.**

6 Johnson Utilities strongly disagrees with the ROO's recommendation to
7 discontinue the Hook-Up Fee ("HUF") Tariff. Johnson Utilities presented testimony at
8 the hearing that the current HUF only covers 40-45% of the Company's costs of
9 providing service to a new subdivision, while the remaining 55-60% is funded by equity.
10 Although the Company's water HUF account had a balance of \$6,931,078 at the end of
11 2007, these fees were collected for developments where construction stopped due to the
12 slow-down in the real estate market. However, Johnson Utilities will be required to meet
13 its obligations to build plant for these developments when construction resumes. Thus,
14 the Company believes it would be inequitable to existing customers to discontinue the
15 HUF tariff and require them to bear costs of future growth.

16 HUFs collected by Johnson Utilities are deposited in an interest-bearing restricted
17 account, and may only be used to fund backbone water and wastewater infrastructure.
18 On an annual basis, Johnson Utilities provides a report to the Commission detailing its
19 collection and disbursement of HUFs. In 2006, Jim Dorf, formerly of the Commission's
20 Utilities Division Staff, conducted a thorough audit of the Company's HUF accounts and
21 found nothing improper or amiss.

22 Johnson Utilities requests that the Commission continue in effect the existing
23 HUF tariff. With its exceptions filed May 17, 2010, Johnson Utilities attached Johnson

24 ³ Johnson Utilities notes for the record that the plant-in-service amounts that the Company filed in this
25 rate case already removed affiliate profit associated with plant constructed by affiliates of Johnson
26 Utilities. The removal of an additional \$5,442,902 for affiliate profit under Proposed Amendment 12 is
above and beyond the amounts already removed by the Company for affiliate profit.

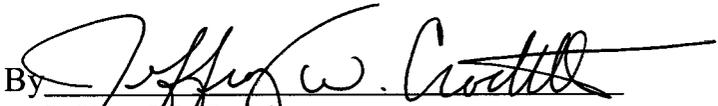
1 Utilities Proposed Amendment No. 9 to allow the continuation of the Company's HUF
2 tariff. For the Commission's convenience, the Company has attached another copy of
3 Johnson Utilities Proposed Amendment No. 9 to this filing.

4 **Conclusion.**

5 In summary, Johnson Utilities respectfully requests that the Commission adopt
6 Johnson Utilities Proposed Amendments Nos. 12 and 9, together with Mayes Proposed
7 Amendments 1 and 2.

8 RESPECTFULLY SUBMITTED this 9th day of August, 2010.

9 SNELL & WILMER L.L.P.

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16 ORIGINAL and 13 copies filed this
17 9th day of August 2010, with:

18 Docket Control
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22 COPIES of the foregoing hand-delivered this
23 9th day of August, 2010, to:

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**JOHNSON UTILITIES PROPOSED
AMENDMENT NO. 9**

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