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BEFORE THE ARIZONA CORPORATION COMMISSION

**COMMISSIONERS**

Arizona Corporation Commission

SUSAN BITTER SMITH, *Chairman*  
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AZ CORP COMMISSION  
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IN THE MATTER OF THE APPLICATION  
OF SOUTHWEST ENVIRONMENTAL  
UTILITIES, L.L.C. FOR APPROVAL OF A  
CERTIFICATE OF CONVENIENCE AND  
NECESSITY TO PROVIDE WATER AND  
WASTEWATER SERVICES IN PINAL  
COUNTY, ARIZONA.

DOCKET NO. WS-20878A-13-0065

REPLY BRIEF OF SOUTHWEST  
ENVIRONMENTAL UTILITIES, L.L.C.

CROCKETT LAW GROUP PLLC  
1702 East Highland Avenue, Suite 204  
Phoenix, Arizona 85016  
602.441.2775

Southwest Environmental Utilities, L.L.C. ("SEU" or the "Company") filed its Closing Brief in this case on June 12, 2015. Utilities Division Staff ("Staff") filed its Responsive Brief ("Response Brief") on June 29, 2015. While Staff continues to oppose hook-up fees ("HUFs") for SEU, Staff fails to provide any substantive analysis to support its opposition, which opposition is based entirely on Staff's policy of always opposing HUFs in the initial grant of a certificate of convenience and necessity ("CC&N"). SEU hereby files its Reply Brief addressing the assertions contained in Staff's Response Brief.

1. **The Commission Can and Has Approved HUFs with an Initial CC&N.**

A reading of the Response Brief shows that there is no disagreement between Staff and SEU that the Arizona Corporation Commission ("Commission") can and has approved HUFs with the initial grant of a CC&N. Staff acknowledges that the Commission approved HUFs for Johnson Utilities, L.L.C. ("Johnson Utilities") in the order approving its initial CC&N.<sup>1</sup> In that case,<sup>2</sup> just like in this case, Staff opposed the water and wastewater HUFs requested by the new utility. Notwithstanding Staff's opposition, the Commission approved the requested HUFs for Johnson Utilities in Decision 60223. Thus, Decision 60233 clearly establishes that the Commission can and has approved HUFs in the initial grant of a CC&N.

<sup>1</sup> Staff Response Brief at 2, lines 11-12.

<sup>2</sup> See consolidated Dockets WS-02987A-95-0284 and WS-02987A-95-285.

1 While the Commission temporarily eliminated the HUFs for Johnson Utilities when it  
2 issued Decision 71854, it subsequently reinstated the HUFs a year later in Decision 72579 as a  
3 result of the utility's request that the Commission correct Decision 71854.<sup>3</sup> The Commission's  
4 decision to approve the continuation of the HUFs in Decision 72579 is clear validation of its  
5 decision to allow HUFs in the first instance with the grant of the initial CC&N.

6 Staff argues that the Commission reinstated the HUFs in Decision 72579 "with the benefit  
7 of having examined the performance history of [Johnson Utilities] in a full rate case, something  
8 the ACC does not yet have the benefit of with SEU."<sup>4</sup> This argument is nonsensical because it  
9 ignores the fact that the Commission first approved HUFs for Johnson Utilities in its initial CC&N  
10 case without the benefit of a rate case. Applying Staff's flawed logic, the Commission could  
11 never approve initial rates for a utility because it would not have "the benefit of having examined  
12 the performance history ... in a full rate case." It bears noting that Staff carefully examined SEU's  
13 construction cost estimates and found them to be "reasonable and appropriate."<sup>5</sup>

14 Staff also mischaracterizes the Company's position when it states in its Response Brief  
15 that "[i]n essence, SEU first asserts that, since the Commission reinstated the HUFs in Johnson 3  
16 that it eliminated in Johnson 2, the ACC should adopt them in this instance."<sup>6</sup> To be clear, it is  
17 SEU's position (and an undisputed fact) that: (i) the Commission can and has approved HUFs in  
18 the initial grant of a CC&N, as evidenced by Decision 60223; and (ii) the Commission should  
19 approve the HUFs based upon the testimony and evidence presented in this case and a lack of any  
20 substantive analysis to support Staff's opposition to the HUFs.

21 Certainly, there is nothing to prevent the Commission from considering HUFs approved  
22 for SEU in this docket when the Commission hears the Company's first rate case, just as the  
23 Commission did in the case of Johnson Utilities as noted by Staff. In fact, Staff has recommended  
24 that "[t]he Company be required to file a rate application no later than six months following the  
25 fifth anniversary of the date the Company begins providing service to its first customer,"<sup>7</sup> and

26 <sup>3</sup> See Docket WS-02987A-08-0180.

27 <sup>4</sup> Staff Response Brief at 2, lines 14-16.

28 <sup>5</sup> Engineering Memorandum (April 21, 2015) attached as Attachment A to Staff Report at pages 1 and 6.

<sup>6</sup> Staff Response Brief at 2, lines 4-6.

<sup>7</sup> Staff Report at 4.

1 SEU fully supports this recommendation. Thus, the Commission will have an opportunity to  
2 review the continued reasonableness of the HUFs in the Company's first rate case, just as it will  
3 review the initial rates and charges that are approved in this docket.

4 **2. The Owner of SEU has Extensive Experience in the Operation of Water and Wastewater**  
5 **Utilities.**

6 In its Response Brief, "Staff posits that, though a consideration, the Commission should not solely  
7 or substantially rely on the reputation and/or performance of a sister company (or its principal) as the main  
8 basis for decisions germane to SEU's CC&N application."<sup>8</sup> Staff's point here is not clear to SEU,  
9 especially in light of Staff's repeated references to the experience, financial capability and technical  
10 capability of George Johnson and Johnson Utilities in the following quotes taken from the April 28, 2015  
11 Staff Report:

- 12 • Mr. George H. Johnson and Mrs. Jana S. Johnson own Southwest. Mr. & Mrs.  
13 Johnson also own Johnson Utilities, LLC ("Johnson Utilities"), a public utility  
14 company that has for many years provided wastewater and water utility services  
15 to the public, in portions of Pinal County, Arizona. Johnson Utilities currently  
16 serves approximately 30,900 wastewater customers and approximately 23,400  
17 water utility customers, which includes both residential and commercial  
18 customers. Johnson Utilities serves an area between Queen Creek and Florence in  
19 Pinal County.<sup>9</sup>
- 20 • Mr. George Johnson, the owner of Johnson Utilities, has demonstrated the ability  
21 to formulate, develop and operate water and wastewater utilities in Arizona. ...  
22 Mr. Johnson is also the owner of Southwest.<sup>10</sup>
- 23 • Based on the information provided in this docket and from Staff's review of other  
24 available materials regarding the Company and related affiliate, Staff concludes  
25 that: (1) Southwest has no prior operating experience, but the owner, Mr. Johnson,  
26 has many years' experience; (2) there is no evidence of negative determinations  
27 and/or questionable business practices regarding Southwest, its affiliate and/or  
28 owner; and (3) Southwest through its owner, Mr. George Johnson, has adequate  
financial capability to provide the requested services.<sup>11</sup>
- SEU is owned by George Johnson. Mr. Johnson has many years of experience  
operating wastewater systems. Staff concludes that the Applicant is technically  
capable of constructing and operating the proposed WWTP.<sup>12</sup>

<sup>8</sup> Staff Response Brief at 2-3.

<sup>9</sup> Staff Report dated April 28, 2014, at 1 (emphasis added).

<sup>10</sup> Staff Report dated April 28, 2014, at 6 (emphasis added).

<sup>11</sup> Staff Report dated April 28, 2014, at 6 (emphasis added).

<sup>12</sup> Staff Report, Attachment A (Engineering Memorandum dated April 21, 2015) at 1 (emphasis added).

- SEU is owned by George Johnson. Mr. Johnson has many years of experience operating water systems. Staff concludes that the Applicant is technically capable of constructing and operating the proposed water system.<sup>13</sup>

While Staff's point remains unclear, it is absolutely clear based on the record in this case that Mr. Johnson has the requisite utility experience, financial capability and technical capability to operate SEU. Regarding the HUFs requested by SEU, it is relevant that Mr. Johnson has had substantial experience with HUFs that have been in place for Johnson Utilities since the company began nearly 20 years ago. Based upon his "extensive experience" in the water and wastewater business, to use Staff's words,<sup>14</sup> Mr. Johnson has determined that HUFs for SEU are necessary and appropriate in order to ensure that customers have reasonable rates and that the risk associated with new development is properly allocated to the developers where it belongs. With any new development, there is significant risk that lots will not sell or that sales will occur more slowly than the developer anticipated. Allocating a portion of the cost of backbone infrastructure on the developer helps ensure that development risk is not shifted to existing customers.

**3. Staff's Recommendation Opposing HUFs in this Case Lacks Any Substantive Analysis.**

Staff denies that it has relied solely upon a policy of no HUFs for initial CC&Ns in opposing SEU's request for HUFs.<sup>15</sup> However, Staff has not cited a single case of an initial water or wastewater CC&N where it recommended approving HUFs for the applicant, and after conducting its own search, SEU was unable to find any such cases. It stands to reason that if Staff does not have a policy of always opposing HUFs for initial CC&Ns, then at some time in some case over the past 20 years, Staff would have recommended HUFs for an initial CC&N.<sup>16</sup> The fact is that Staff never recommends HUFs for initial CC&Ns and that is the beginning and end of its substantive analysis.

Staff attempts to argue in its Response Brief that it actually did some substantive analysis in this case apart from merely applying its unilateral recommendation against HUFs for initial CC&Ns, asserting as follows:

As set forth at page 2 of Ms. Rimback's Memorandum (Attachment C) to the Staff Report, "Staff's chief concern is in regards to the Company assumptions used for the level of investor funds included in projected plant in service and the projected cash flow to operate the Company. Staff's recommendations were developed with a view to increasing the level

<sup>13</sup> Staff Report, Attachment A (Jian Liu Memorandum dated April 21, 2015) at 6 (emphasis added).

<sup>14</sup> Staff Response Brief at 2, line 22.

<sup>15</sup> Staff Response Brief at 3, lines 3-4.

<sup>16</sup> Staff opposed HUFs for Johnson Utilities in its September 24, 1996 Staff Report in Docket WS-02987A-95-0284 almost 19 years ago.

1 of investor funds and generating a rate of return which will provide adequate cash flow to  
2 operate the Company. Only after an analysis of relevant factors including, without  
3 limitation, revenue and expenses, cash flow, rate design and, of great import, SEU's  
4 proposed equity contributions, did Staff recommend that no HUFs were appropriate for  
5 either the Company's water and wastewater systems.<sup>17</sup>

6 Apart from this assertion in its Response Brief, where in the record is Staff's discussion  
7 or analysis of "the Company assumptions used for the level of investor funds included in projected  
8 plant in service and the projected cash flow to operate the Company?" Where is Staff's discussion  
9 or analysis regarding "increasing the level of investor funds" and its effect on rate of return and  
10 cash flow? Staff's own witness at the hearing contradicts its assertions regarding the extent of  
11 the substantive analysis that was performed on the HUFs, as highlighted by the following  
12 exchange between the administrative law judge and Ms. Rimback:

13 *Q. Can you tell me how you -- how did you derive those percentages?*

14 *A. I removed the hookup fees, and by removing that, I came up with a*  
15 *much higher amount in their backbone plant that the company*  
16 *would have to invest. The company had them at 57 percent for water*  
17 *and 67 percent for wastewater.*<sup>18</sup>

18 With the HUFs proposed by SEU, the Company's owner would fund a very healthy 57.5%  
19 of the backbone water plant and 67.18% of the backbone wastewater plant. This is a substantial  
20 financial commitment totaling more than \$6.3 million in the first five years. By eliminating the  
21 HUFs, however, Staff would force the Company's owner to fund 87.24% of the backbone water  
22 plant and 91.50% of the backbone wastewater plant, a total exceeding \$9 million. According to  
23 Staff witness Mary Rimback, Staff excluded the HUFs because SEU "needs to be invested,"<sup>19</sup> but  
24 she agreed that the Company would still have equity invested even with the proposed HUFs,  
25 stating that "[i]t's a matter of how much they're going to be invested."<sup>20</sup> Yet, she provided no  
26 analysis to explain why Staff's higher equity level is better than the level proposed by SEU. She  
27 simply points out that Staff's equity is higher, and it is higher simply because Staff removed the  
28 HUFs.

<sup>17</sup> Staff Response Brief at 3, lines 4-12.

<sup>18</sup> Reporter's Transcript of Proceedings (Docket WS-20878A-13-0065) at 116-117.

<sup>19</sup> *Id.* at 118-119.

<sup>20</sup> *Id.* at 122-123.

1           What Staff should be considering is whether SEU, if the Company grows as projected,  
2 will have a reasonably positive rate base at the end of five years. With the proposed HUFs, and  
3 using Staff's figures, SEU will have original cost rate bases of \$1,456,494 for water and  
4 \$2,448,586 for wastewater at the end of five years.<sup>21</sup> Rate base totaling \$3,905,080 at the end of  
5 the first five years of operation is a healthy rate base for a new utility, and it certainly shows that  
6 SEU will be invested in the utility business. Moreover, the Company has not proposed initial  
7 rates that are artificially low or HUFs that are unreasonably high. Rather, the rate design and  
8 HUFs were specifically developed by the Company and its consultant Tom Bourassa to produce  
9 a reasonable rate base at the end of five years.

10           SEU has provided legitimate reasons for the proposed HUFs. Company witness Brad  
11 Cole testified at the hearing that "hook-up fees are important for both new and established utilities  
12 because they help keep rates lower, and it helps mitigate the risk of building the backbone plant,  
13 and it puts a proportionate share of the responsibility on the developer and not on the utility or  
14 the ratepayers."<sup>22</sup> Mr. Cole continued, "as long as it's not disproportionate, it's beneficial for  
15 both the utility and the ratepayers."<sup>23</sup> Staff acknowledged these facts in its Response Brief in  
16 stating that "SEU correctly posits that the use of HUFs serves to shift risks to developers and  
17 lower rates to customers."<sup>24</sup>

18           Mr. Cole further testified that the proposed HUFs would only cover a portion of SEU's  
19 costs of building backbone infrastructure, and that the balance of the costs would be funded by  
20 the Company.<sup>25</sup> Staff asserts in its Response Brief that "the Commission has no way to determine  
21 whether the Company will proceed to invest an appropriate amount of its own funds in the long  
22 term or rely mainly on funds from HUFs."<sup>26</sup> But where would the additional investment come  
23 from to build the necessary backbone infrastructure if not from the owner of the utility? Staff's  
24 assertion rings hollow in the face of the positive track record established by the owner of SEU.

25 <sup>21</sup> See Schedule MJR-W1 IS (line 41) and Schedule MJR-WW1 IS (line 59) of Attachment C to the Staff  
26 Report.

27 <sup>22</sup> Reporter's Transcript of Proceedings (Docket WS-20878A-13-0065) at 29-30.

28 <sup>23</sup> *Id.* at 30, lines 4-6.

<sup>24</sup> Staff Response Brief at 3, lines 19-20.

<sup>25</sup> *Id.* at 30, lines 7-12.

<sup>26</sup> Staff Response Brief at 2, lines 16-18.

1 Mr. Johnson has invested millions of his own dollars in Johnson Utilities over the past 20 years.  
2 Staff acknowledges in the Response Brief that it “is familiar with Mr. Johnson’s extensive  
3 experience in the water service and wastewater service arenas, as an independent regulated  
4 utility.”<sup>27</sup> SEU submits that a record has been sufficiently established to show that SEU will be  
5 properly and timely capitalized by its owner, and that Staff’s concerns are without merit.

6 Staff attempts to make an issue out of the fact that when Decision 71854 was docketed in  
7 August 2010, “Johnson Utilities ha[d] amassed off-site HUFs of \$6,931,078 in its water division  
8 and \$16,505 in the wastewater division.”<sup>28</sup> However, the large balance in the water HUF account  
9 was a unique and temporary circumstance caused by the Great Recession that began in 2008.<sup>29</sup>  
10 During the early 2000s when home construction was booming, developers platted thousands of  
11 lots and paid HUFs associated with those lots. When construction slowed dramatically, so did  
12 the need to construct backbone infrastructure. This led to a higher balance in the water HUF  
13 account for a time. This is a circumstance that will certainly not repeat itself any time soon, and  
14 in any event, the HUFs were fully investigated in the last Johnson Utilities rate case.

15 Finally, Staff cites the following passage from Decision 71414 in the final H2O, Inc., rate  
16 case:

17 [I]f the Company is allowed to continue to collect hook-up fees and developer  
18 advances as the primary means of funding infrastructure, the short-term benefits  
19 associated with that strategy could result in devastating long-term consequences  
20 when the source of contributed capital no longer exists and customers alone are left  
21 to support a utility with minimal equity investment in its infrastructure. Under such  
22 a scenario, the only likely source of funds would be in the form of substantial, and  
23 likely frequent, rate increases because the utility has very little rate base upon which  
24 it would be entitled to earn a return.

25 SEU would point out that the concerns voiced in this passage have certainly not come to  
26 pass in the case of Johnson Utilities, which is owned by the same person who owns SEU. Johnson  
27 Utilities has collected HUFs since day one and the company has never suffered from a lack of  
28 access to capital to fund new construction, nor has it come in for frequent rate increases. In fact,  
at a recent Staff Meeting held on June 16, 2015, the chief counsel for the Residential Utility

<sup>27</sup> Staff Response Brief at 2, lines 22-23.

<sup>28</sup> Staff Response Brief at 3, lines 15-18.

<sup>29</sup> Obviously, the \$16,505 balance in the wastewater HUF account was negligible.

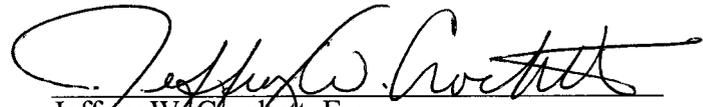
1 Consumer Office stated that Johnson Utilities' rates "are some of the lowest rates in the state, or  
2 at least they are surely on the low side."<sup>30</sup> With the HUFs that have been requested by SEU  
3 (which fund only a portion of the backbone infrastructure), the Company will clearly build equity  
4 while keeping developer risk on the developers where it belongs and by maintaining utility rates  
5 that are reasonable.

6 **4. Conclusion.**

7 SEU has presented ample reasons why the requested HUFs should be approved. There  
8 are clear benefits to ratepayers in the form of lower risk to ratepayers and lower rates, points  
9 which are undisputed by Staff. Further, the proposed level of HUFs which covers only a portion  
10 of the backbone infrastructure costs ensures that the Company will build sufficient equity so that  
11 it is appropriately invested in the business. Staff has failed to provide any substantive analysis or  
12 compelling reason why the HUFs should be rejected, standing instead on its categorical denial of  
13 HUFs for initial CC&Ns. Clearly, the Commission can and has approved HUFs for a new utility,  
14 as evidenced by the case of Johnson Utilities. For all of these reasons, SEU requests that the  
15 proposed HUFs be approved.

16 RESPECTFULLY submitted this 10<sup>th</sup> day of July, 2015.

17 CROCKETT LAW GROUP PLLC

18 

19 Jeffrey W. Crockett, Esq.  
20 1702 East Highland Avenue, Suite 204  
21 Phoenix, Arizona 85016-4665  
22 Attorney for Southwest Environmental Utilities,  
23 L.L.C.

24 **ORIGINAL** and thirteen (13) copies  
25 filed this 10<sup>th</sup> day of July, 2015, with:

26 Docket Control  
27 ARIZONA CORPORATION COMMISSION  
28 1200 West Washington Street  
Phoenix, Arizona 85007

<sup>30</sup> See the audio recording from the June 16, 2015 Staff Meeting starting at the 44:32 minute mark.

CROCKETT LAW GROUP PLLC  
1702 East Highland Avenue, Suite 204  
Phoenix, Arizona 85016  
602.441.2775

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**COPIES** of the foregoing hand-delivered  
this 10<sup>th</sup> day of June, 2015, to:

Dwight Nodes, Chief Administrative Law Judge  
Hearing Division  
ARIZONA CORPORATION COMMISSION  
1200 West Washington Street  
Phoenix, Arizona 85007

Janice Alward, Chief Counsel  
Legal Division  
ARIZONA CORPORATION COMMISSION  
1200 West Washington Street  
Phoenix, Arizona 85007

Steve Olea, Director  
Utilities Division  
ARIZONA CORPORATION COMMISSION  
1200 West Washington Street  
Phoenix, Arizona 85007

