

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 KRISTIN K. MAYES
CHAIRMAN

3 GARY PIERCE
COMMISSIONER

4 SANDRA D. KENNEDY
COMMISSIONER

5 PAUL NEWMAN
COMMISSIONER

6 BOB STUMP
COMMISSIONER

7
8 IN THE MATTER OF THE APPLICATION OF
9 JOHNSON UTILITIES, LLC FOR AN
10 INCREASE IN ITS WATER AND
WASTEWATER RATES FOR CUSTOMERS
WITHIN PINAL COUNTY, ARIZONA.

Docket No. WS-02987A-08-0180

11 **RESIDENTIAL UTILITY CONSUMER OFFICE'S**
12 **EXCEPTIONS**

13 The Residential Utility Consumer Office ("RUCO") files these exceptions to the
14 Recommended Opinion and Order ("ROO") issued on March 9, 2010 regarding Johnson
15 Utilities, LLC's ("Johnson" or "Company") rate application. RUCO believes that overall, the
16 ROO is fair, well-reasoned and should be approved by the Commission. While not every
17 position advocated by RUCO was adopted, RUCO's exceptions are limited to three issues –
18 the ROO's 10% proposed operating margin, the proposed remedies for the Company's
19 environmental violations, and an accounting error associated with the CAGR expense.
20

21 **OPERATING MARGIN**

22 The ROO recommends a 10% operating margin for both the water and wastewater
23 divisions. An operating margin may be applied in situations where a Company has a negative
24

1 rate base. Here, the ROO recommends a negative rate base for both the water and the
2 wastewater divisions.

3 The Commission should take a very hard look at the recommended operating margin for
4 the very reasons set forth in the ROO.

5 Authorizing an operating margin for a utility the size of the
6 Company is problematic. Any part of an operating margin that is
7 not used to cover legitimate utility expenses would accrue to the
8 utility as income. Allowing a utility to collect an operating margin in
9 rates has the potential to allow the utility to accrue a net income
10 similar to the return earned by a utility that has made an investment
11 in plant. In other words, authorizing an operating margin when
12 there is no rate base investment has the potential of allowing the
13 utility to realize a profit without making any investment, creating a
14 windfall for the utility, without the utility having put any capital at
15 risk.

16 We do not wish to reward the Company for having a
17 negative or negligible rate base. However, neither do we wish to
18 have the Company's customers placed in jeopardy as they might be
19 if the Company is unable to meet its legitimate operating expenses.

20 ROO at 50-51- footnotes omitted.

21 What makes the present case different from the normal situation where an operating
22 margin is being considered is the amount of equity in the Company's capital structure. The
23 Company's actual capital structure is **all** equity¹, which means that the Company has
24 significant cash flows. The Company's cash flow can be measured by adding its depreciation
expense to its operating income. The cash flow in this case will not be needed to pay off debt.
An operating margin is appropriate when there is a concern that the Company is unable to
maintain enough cash flow to meet its expenses and debt service and provide service to its
customers. That is not a great concern here.

¹ At the time of the hearing, the Company's capital structure included debt which consisted of a loan which was scheduled to be paid off on December 31, 2009. R-8 (Rigsby Direct – Attachment F). Assuming this loan was paid off, the Company no longer has any debt service obligations that RUCO is aware of.

Another way to look at it is to consider, if approved, what an operating margin would equate to in terms of rate base. RUCO has done an analysis which is set forth as follows:

PRO FORMA RATE BASE CALCULATION

Water Division

	<u>ROO</u>	<u>RUCO</u>
Recommended Operating Income	\$ 1,307,438	\$ 921,091
Divided By: Recommended Operating Margin	<u>10.00%</u>	<u>8.18%</u>
Pro Forma Rate Base	<u>\$ 13,074,380</u>	<u>\$ 11,260,281</u>

Wastewater Division

	<u>ROO</u>	<u>RUCO</u>
Recommended Operating Income	\$ 1,045,913	\$ 838,192
Divided By: Recommended Operating Margin	<u>10.00%</u>	<u>8.18%</u>
Pro Forma Rate Base	<u>\$ 10,459,130</u>	<u>\$ 10,246,846</u>

The conclusion is for the water division, an operating margin² of 10% would be the same as awarding the Company a FVRB of \$13,074,380. For the wastewater division, an operating margin of 10% would be the same as awarding the Company a FVRB of \$10,459,130. This is simply too much, would reward the Company for a negative rate base and establish rates that are not just and reasonable under the circumstances. It could set a

² RUCO has provided the same calculation using its recommended operating margin of 8.18% applied to the ROO's recommended operating income adjusted for the CAGR error explained more fully below.

1 precedent which would promote the concept of a negative rate base which is contrary to the
2 public interest.

3 RUCO recommended the application of its 8.18 WACC as the operating margin for the
4 water division. If the Commission were to determine a negative rate base for the wastewater
5 division, RUCO would make the same recommendation of no more than 8.18% be applied as
6 an operating margin. This recommendation represents the highest number RUCO would
7 recommend to achieve what RUCO believes is the ROO's purpose. RUCO would certainly
8 support a lower number if the Commission were to feel so inclined. Given the Company's cash
9 flows, the record would clearly support an operating margin lower than 8.18%.

10 **ENVIORNMENTAL REMEDIES**

11 RUCO is deeply troubled by the evidence in the record concerning the Company's
12 environmental violations. From RUCO's perspective, the ROO acknowledges the problems
13 but offers no solutions.

14 One would have to turn a blind eye to not recognize a problem that affects the public's
15 health and safety from the evidence in the record. Perhaps even more alarming is the
16 Company's attitude toward the problem, and the Company's attitude toward remedying the
17 problem. The ROO dismisses the evidence regarding Johnson's numerous environmental
18 violations because it is not "first hand." However, the Commission is not bound by the heresay
19 rules of evidence. ARS §40-243(A) states:

20
21 A. All hearings and investigations before the commission or a
22 commissioner shall be governed by this article, and by rules of practice
23 and procedure adopted by the commission. Neither the commission nor
24 a commissioner shall be bound by technical rules of evidence, and no
informality in any proceeding or in the manner of taking testimony
before the commission or a commissioner shall invalidate any order,

1 decision, rule or regulation made, approved or confirmed by the
2 Commission.

3 Therefore, Arizona law specifically permits the Commission to consider the evidence in
4 the record and to accord it the weight it deems proper. In RUCO's opinion, the Commission
5 should give great weight to the evidence presented of Johnson's violations and order the relief
6 RUCO recommends in its Brief.

7 Moreover, as suggested above, the preponderance of the evidence standard goes to
8 the "weight" of the evidence, not the type of evidence. See, for example Doubek v. Greco, 7
9 Ariz. App. 102, 104-105 436 P.2d 494, 496-497 Ariz. App. 1968. The Arizona Supreme Court
10 has defined preponderance of the evidence as follows:

11 By preponderance of the evidence is meant such proof as
12 satisfies the conscience and carries conviction to an intelligent mind.
13 North Chicago St. R. Co. v. Fitzgibbons, 180 Ill. 466, 54 N.E. 483. It
14 does not necessarily depend upon the number of witnesses. The
15 capacity of the submitted testimony to enforce belief upon the arbiters
16 of fact to whom it is submitted is the touchstone of preponderance as
17 applied to the testimony of witnesses. McKee v. Verdin, 96 Mo. App.
18 268, 70 S.W. 154. In other words, the ultimate test is, does the
19 evidence convince the trier of fact that one theory of the case is more
20 probable than the other. In cases of this nature, the commission is the
21 trier of fact, and, as we have repeatedly said, unless its conclusion is
22 arbitrary and cannot be supported on any reasonable theory of the
23 evidence, we are bound thereby, even if we, sitting as triers of fact,
24 would reach a different conclusion on the evidence.

Cole v. Town of Miami, 52 Ariz. 488, 497, 83 P.2d 997 1006 Ariz. 1938.

25 The standard is not based on the type of evidence, but the weight of the evidence.
26 Whether the evidence is first hand or not, should not be controlling. What is controlling is
27 whether the evidence in the record lends the Commission to the conclusion that it is more
28 probable than not that the violations occurred, and the public health and safety is at risk. From
29 the evidence in the record it would be impossible to conclude that the violations did not occur,

1 given the testimony. Brian Tompsett, the Company's Vice President, was asked at the
2 hearing about the Notice of Violations in general and if there was any validity to them.
3 Transcript at 743. Mr. Tompsett's response:

4 Q. So do you think there is any validity to any of them?

5 A. The letter of the law citing specific statutes, yes, there will be some
6 validity to some of the statutes that are quoted. But I don't think all of
7 the statutes that are alleged, the alleged violations are valid, no.

8 The Company even validates some of the violations. What is more troubling is
9 why the Company believes it received so many NOV's. Mr. Tompsett believes that
10 ADEQ is out to get the Company:

11 Q. What about 2009? It doesn't seem like the company is off to a good
12 start in 2009. Any particular reason there have been these
13 violations in 2009?

14 A. Well, I guess the most accurate way to describe that is we have an
15 ongoing dispute with ADEQ over the issuance of notices of
16 violations to Johnson Utilities in particular. It is our opinion that they
17 make a special effort to issue violations, and selectively issue
18 violations to our company rather than others.

19 Q. So does the Company feel that it is being treated unfairly by ADEQ?

20 A. Short answer would be yes.

21 Q. Do you know why the company – why ADEQ may be singling
22 Johnson Utilities out for these violations?

23 A. Well, it is our opinion that they are selectively enforcing more
24 stringently against Johnson Utilities than they do against other
companies across the state. And we have done FOIA requests with
that in mind, and the evidence that has been presented by ADEQ
seems to suggest that that is in fact the case. Transcript at 740-741.

25 Given this record, the ROO suggests that the Commission require the Company
26 to advise the Commission of all outstanding NOV's, advise the Commission of the
27 status of the NOV's and the efforts the Company is making to resolve the NOV's. ROO

1 at 56-57. RUCO does not oppose the ROO's recommendations, but believes that the
2 Commission, based on the record, should monitor the Company closer at least until the
3 NOVs are cleared up. The ROO criticizes RUCO's recommendations as being
4 duplicative of ADEQ's requirements. ROO at 56. RUCO does not believe its
5 recommendations are any more duplicative than the ROO's recommendations. But
6 even if that was the case, RUCO's recommendations should still be considered. The
7 ROO is correct that the roles of ADEQ and the Commission should not be duplicative.
8 The Commission's role concerns the public's health and safety and the provision of
9 service. ADEQ's role is enforcement. Sometimes in carrying out their respective roles
10 the appropriate remedies may be the same. If additional monitoring is appropriate, the
11 Commission should not rely on ADEQ to carry out the Commission's role.
12

13 **CAGRD**

14 After the ROO was issued, it was pointed out to RUCO that the amount of
15 gallons RUCO used to calculate its test year CAGRD expense was wrong. RUCO
16 used the test year gallons sold provided in the Company's application – 2,631,314. R-
17 2, Sch. RLM-16, A-1 at 16. The CAGRD fee only applies to the number of gallons sold
18 associated with groundwater, not the total number of gallons. RUCO has made the
19 correction and determined that the correct adjustment is \$1,169,923 – see attached
20 Revised CAGRD adjustment.
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1 RESPECTFULLY SUBMITTED this 18th day of May, 2010

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5 Daniel W. Pozefsky
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23 By _____
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**RUCO REVISIONS TO ROO
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 1
CAGRD EXPENSE**

LINE NO.	DESCRIPTION	(A)	(B)	(C)
		CAGRD GALLONS (in 000's)	CAGRD FEE (per 1,000 Gal.)	CAGRD EXPENSE
		TEST YEAR (Col. C / Col. B)	TEST YEAR (Per CAGRD Website)	TEST YEAR (Per G/L)
1	TEST-YEAR CAGRD FEES - PHOENIX AMA	1,164,969	\$ 0.7365	\$ 858,000
2	TEST-YEAR CAGRD FEES - PINAL AMA	38,450	\$ 0.6721	25,842
3	TOTALS	<u>1,203,419</u>		<u>\$ 883,842</u>
	CALCULATION OF THE 2009/2010 CAGRD FEE	NORMALIZED (Per Lines 1 & 2)	2009/2010 (Per CAGRD Website)	NORMALIZED (Col. A X Col. B)
4	CAGRD - PHOENIX AMA	1,164,969	\$ 0.976	\$ 1,137,010
5	CAGRD - PINAL AMA	38,450	\$ 0.856	32,912.9
6	TOTALS	<u>1,203,419</u>		<u>\$ 1,169,923</u>
7	ADJUSTED CAGRD FEES			<u>\$ 1,169,923</u>
8	RUCO ADJUSTED CAGRD FEES (See RLM-8, Col. (F))			<u>\$ 1,169,923</u>