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**BEFORE THE ARIZONA CORPORATION COMMISSION**

COMMISSIONERS

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

Arizona Corporation Commission

**DOCKETED**

AUG 25 2010

DOCKETED BY ne

IN THE MATTER OF THE APPLICATION OF  
JOHNSON UTILITIES, L.L.C., 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

DECISION NO. 71854

OPINION AND ORDER

DATES OF HEARING:

January 27, February 26 (Procedural Conferences);  
April 20, (Pre-Hearing Conference); April 23, 24, 27  
(Hearing); July 23 (Procedural Conference/Oral  
Arguments); September 21, 24, 25, October 1, 2, 5, 6,  
and 7, 2009 (Hearing).

PLACE OF HEARING:

Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE:

Teena Wolfe

APPEARANCES:

Mr. Jeffrey W. Crockett, Mr. Bradley S. Carroll and  
Mr. Robert Metli, SNELL & WILMER, on behalf of  
Johnson Utilities, LLC;

Mr. Craig A. Marks, CRAIG A. MARKS, PLC, on  
behalf of Swing First Golf, LLC;

Ms. Jodi Jerich, Director, Mr. Daniel Pozefsky, Chief  
Counsel and Ms. Michelle Wood, Staff Attorney, on  
behalf of the Residential Utility Consumer Office;

Mr. James E. Mannato, Town Attorney, on behalf of  
the Town of Florence; and

Ms. Nancy Scott, Ms. Ayesha Vohra, and Ms. Robin  
Mitchell, Staff Attorneys, Legal Division, on behalf of  
the Utilities Division of the Arizona Corporation  
Commission.

1 Company.<sup>221</sup> Staff stated that Decision No. 71414 also discontinued that utility's authority to collect  
 2 HUFs, as Staff is recommending in this case.<sup>222</sup>

3 We are not persuaded by the Company's arguments in favor of departing from the normal  
 4 ratemaking treatment of CIAC. We agree with Staff that the NARUC USOA definition of CIAC  
 5 does not hinge upon whether or not CIAC is expended or unexpended, as the Company argued, but  
 6 on whether or not (1) the CIAC was provided by someone other than the owner, (2) the CIAC is  
 7 non-refundable, and (3) the purpose of the CIAC is to fund plant.<sup>223</sup> We recognize that the Company  
 8 collects HUFs well in advance of providing service to customers for whom the HUF is credited, and  
 9 that it is the Company's practice in regard to the timing of its HUF collection that is responsible in  
 10 part for the resulting magnitude of CIAC balances in the test year. As Staff and RUCO argued, the  
 11 actual test year end balances of CIAC should be included in rate base, and Staff's adjustments for the  
 12 water and wastewater divisions will therefore be adopted.

#### 14 C. Fair Value Rate Base Summary

15 Based on the discussion of rate base issues set forth above, we find the Company's OCRB  
 16 for its water division to be (\$2,414,613) and for its wastewater division to be \$136,562. As the  
 17 Company did not prepare RCND schedules, the OCRB for its water and wastewater divisions  
 18 constitute its FVRB.

### 20 IV. OPERATING INCOME ISSUES

#### 21 A. Central Arizona Groundwater Replenishment District ("CAGRDR")

22 The CAGRDR was established in 1993 by the Arizona legislature to serve as a groundwater  
 23 replenishment entity for its members.<sup>224</sup> The CAGRDR is operated by the Central Arizona Water  
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26 <sup>221</sup> Staff Reply Br. at 5.

27 <sup>222</sup> Staff Br. at 5.

28 <sup>223</sup> Direct Testimony of Staff witness Jeffrey Michlik (S-38) at 18; citing to NARUC USOA 271, Contributions in Aid of Construction.

<sup>224</sup> Rebuttal Testimony of Company witness Brian Tompsett (Exh. A-5) at 17.

1 Conservation District, which operates the Central Arizona Project.<sup>225</sup> The CAGR D provides a  
2 mechanism for landowners and designated water supply providers such as Johnson Utilities to  
3 demonstrate a 100-year water supply under Arizona's assured water supply rules ("AWS Rules"),  
4 which became effective in 1995.<sup>226</sup> Members of the CAGR D must pay the CAGR D to replenish (or  
5 recharge) any groundwater pumped by the member that exceeds the pumping limits imposed by the  
6 AWS rules.<sup>227</sup> The CAGR D includes the Phoenix, Tucson and Pinal County active management  
7 areas ("AMAs").<sup>228</sup> Johnson Utilities completed the process for becoming a Member Service Area  
8 of the CAGR D on or about June 9, 2000.<sup>229</sup> Joining the CAGR D is one of the steps in the process of  
9 becoming a designated provider, which means a water provider that has demonstrated to the Arizona  
10 Department of Water Resources ("ADWR") that it has a 100-year water supply.<sup>230</sup> The AWS Rules  
11 were designed to protect groundwater supplies within each AMA and to ensure that people  
12 purchasing or leasing subdivided land within an AMA have a water supply of adequate quality and  
13 quantity.<sup>231</sup> The AWS Rules require new subdivisions to demonstrate to ADWR that a 100-year  
14 water supply is available to serve the subdivision before home sales can begin.<sup>232</sup> An assured water  
15 supply can be demonstrated in one of two ways: the subdivision owner can prove an assured water  
16 supply for the specific subdivision and receive a certificate of assured water supply (CAWS") from  
17 ADWR; or alternatively, a subdivision owner can receive service from a city, town, or private water  
18 company that has been designated by ADWR as having a designated water supply.<sup>233</sup>  
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24 <sup>225</sup> Co. Br. at 28.

25 <sup>226</sup> Rebuttal Testimony of Company witness Brian Tompsett (Exh. A-5) at 17.

26 <sup>227</sup> *Id.*

27 <sup>228</sup> *Id.*

28 <sup>229</sup> *Id.* at 18.

<sup>230</sup> *Id.*

<sup>231</sup> *Id.*

<sup>232</sup> *Id.*

<sup>233</sup> *Id.*

1 The costs of the CAGR D are covered by a replenishment assessment levied on CAGR D  
 2 members.<sup>234</sup> Designated water supply providers such as Johnson Utilities that serve a Member  
 3 Service Area pay a replenishment tax directly to the CAGR D according to the number of acre-feet of  
 4 "excess groundwater" they deliver within their service areas during a year.<sup>235</sup> The amount due the  
 5 CAGR D is based on CAGR D's total cost per acre-foot of recharging groundwater, including the  
 6 capital costs of constructing recharge facilities, water acquisition costs, operation and maintenance  
 7 costs and administrative costs.<sup>236</sup> By statute, the replenishment tax must be calculated separately for  
 8 each AMA.<sup>237</sup> Johnson Utilities is a designated provider in both the Phoenix and Pinal County  
 9 AMAs.<sup>238</sup> Johnson had a CAGR D assessment of \$883,842 in the test year.<sup>239</sup> Instead of recovery of  
 10 the test year amount of CAGR D expense, Johnson requested approval of a CAGR D adjutor  
 11 mechanism in this case.<sup>240</sup>

13 The Company, RUCO and Staff agreed that the CAGR D is an important tool in Arizona's  
 14 groundwater conservation efforts, and that the Company should recover its CAGR D expenses. The  
 15 Company's ratepayers and the general public benefit from the Company having a designation of  
 16 assured water supply, because such designations result in more efficient regional planning than the  
 17 alternative of requiring individual developers within a certificated area to each obtain a CAWS.<sup>241</sup>

19 As RUCO stated, the issue before us is not whether to allow the Company to recover its  
 20 CAGR D expense, but the manner of the expense recovery.<sup>242</sup> Staff recommended that an adjutor  
 21 mechanism be established, but with specific conditions that would require the Company to keep the  
 22 Commission closely informed of the CAGR D fee calculation and would allow the Commission to  
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24 <sup>234</sup> *Id.*

25 <sup>235</sup> *Id.* at 18-19.

26 <sup>236</sup> *Id.* at 19.

27 <sup>237</sup> *Id.*

28 <sup>238</sup> *Id.*

<sup>239</sup> *Id.*

<sup>240</sup> *Id.*

<sup>241</sup> Staff Br. at 20.

<sup>242</sup> RUCO Reply Br. at 5.

1 closely monitor the Company's collection of CAGR D fees and the Company's treatment of monies  
2 collected to pay the CAGR D fees. The Company was in favor of the establishment of a CAGR D  
3 recovery mechanism, but was unwilling to agree to abide by the conditions that Staff argued are  
4 necessary to safeguard the Company's ratepayers.

### 5 **1. Staff Proposed Adjustor and Conditions**

6 Staff recommended that the Company recover its CAGR D tax assessment through the use of  
7 an adjustor mechanism, subject to specific enumerated conditions. Staff recommended that the  
8 CAGR D adjustor mechanism only be authorized with the following conditions attached:  
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- 10 1. The initial adjuster fee shall apply to all water sold after the date new  
11 rates from this case become effective. In order to calculate this initial  
12 fee, the Company shall submit the 2008 data, as per condition No. 7  
13 below, within 30 days of the date of the final order in this matter.
- 14 2. The Company shall, on a monthly basis, place all CAGR D monies  
15 collected from customers in a separate, interest bearing account  
16 ("CAGR D Account").
- 17 3. The only time the Company can withdraw money from the CAGR D  
18 Account is to pay the annual CAGR D fee to the CAGR D, which is due  
19 on October 15<sup>th</sup> of each year.
- 20 4. The Company must provide to Staff a semi-annual report of the  
21 CAGR D Account and CAGR D use fees collected from customers and  
22 paid to the CAGR D, with reports due during the last week of October  
23 and the last week of April each year.
- 24 5. The Company must provide to Staff, every even-numbered year (first  
25 year being 2010) by June 30<sup>th</sup>, the new firm rates set by the CAGR D  
26 for the next two years.
- 27 6. The CAGR D adjustor fees shall be calculated as follows: The total  
28 CAGR D fees for the most current year in the Phoenix AMA shall be  
divided by the gallons sold in that year to determine a CAGR D fee per  
1,000 gallons. Similarly, the total CAGR D fees for the most current  
year in the Pinal AMA shall be divided by the gallons sold in that year  
to determine a CAGR D fee per 1,000 gallons.
7. By August 25th of each year, beginning in 2010, the Company shall  
submit for Commission consideration its proposed CAGR D adjustor  
fees for the Phoenix and Pinal AMAs, along with the calculations and

1 documentation from the relevant state agencies to support the data used  
 2 in the calculations. Failure to provide such documentation to Staff  
 3 shall result in the immediate cessation of the CAGR D adjustor fee.  
 Commission-approved fees shall become effective on the following  
 October 1st.

- 4 8. If the CAGR D changes its current method of assessing fees (i.e. based  
 5 on the current volume of water used by customers) to some other  
 6 method, such as, but not limited to, future projection of water usage, or  
 total water allocated to the Company, the Company's collection from  
 customers of CAGR D fees shall cease.
- 7
- 8 9. As a compliance item, the Company shall submit a new tariff reflecting  
 9 the initial adjustor fee as per Condition No. 1 above and shall annually  
 submit a new tariff reflecting the reset adjustor fee prior to the fee  
 becoming effective.<sup>243</sup>

## 10 2. Company Arguments Against Conditions

11 The Company opposed or requested modification of Staff's recommended Condition Nos. 3,  
 12 4,5, 7, and 8. Staff opposed the Company's requested modifications to Staff's recommended  
 13 conditions.<sup>244</sup>

### 14 a. Condition No. 3

15 The Company stated that it is concerned that Condition No. 3 lacks sufficient flexibility to  
 16 allow for changes in CAGR D's payment policies and other policies with regard to the use of  
 17 CAGR D monies.<sup>245</sup> The Company submitted that it should be permitted to withdraw funds from the  
 18 CAGR D account as necessary to comply with the conditions of its membership in the CAGR D, as  
 19 those conditions exist now or as they may be modified in the future.<sup>246</sup>

20 Staff stated that the Company's requested modification of Condition No. 3 should be  
 21 disregarded, as the Company should not be allowed to spend funds in the CAGR D account for any  
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 27 <sup>243</sup> Staff Br. at 20-21, citing to Revised Surrebuttal Testimony of Jeffrey Michlik (Exh. S-43) at 4.

<sup>244</sup> Staff Reply Br. at 21-23.

<sup>245</sup> Rebuttal Testimony of Company witness Brian Tompsett (Exh. A-5) at 20.

<sup>246</sup> *Id.*

1 purpose other than the CAGR D expense item than has been analyzed in this proceeding and that the  
 2 proposed adjustor is designed to recover.<sup>247</sup>

3 b. Condition No. 4

4 The Company argued that a single annual report, instead of the semi-annual report required  
 5 by Condition No. 4, would be sufficient for Staff's verification of the accounting for CAGR D  
 6 monies collected and remitted.<sup>248</sup> Staff opposed the Company's requested modification of Condition  
 7 No. 4 because Staff believes it is important for the Commission to have the ability closely monitor  
 8 the Company's collection of CAGR D fees and the state of the CAGR D Account.<sup>249</sup>

10 c. Condition No. 5

11 The Company opposed Condition No. 5, arguing that the information it requires is publicly  
 12 available and it would be more efficient for Staff to obtain the information directly from CAGR D.<sup>250</sup>  
 13 The Company also argued that compliance with regulatory conditions adds costs that are ultimately  
 14 borne by the ratepayers and should only be imposed as necessary to achieve important regulatory  
 15 objectives.<sup>251</sup>

17 Staff opposed modification of Condition No. 5 because the rates established by the CAGR D  
 18 involve calculations with many variables that may or may not be accessible or publicly available on  
 19 the CAGR D's website now or in the future.<sup>252</sup> Staff stated that because the Company will be in  
 20 possession of the information as part of its own record keeping and compliance requirements, it will  
 21 therefore be in the best position to provide the Commission and Staff with the information.<sup>253</sup> Staff  
 22 indicated that as a result of this rate case, it lacks confidence in the Company's record keeping  
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25 <sup>247</sup> Staff Br. at 21.

26 <sup>248</sup> Rebuttal Testimony of Company witness Brian Tompsett (Exh. A-5) at 20.

27 <sup>249</sup> Staff Br. at 22.

28 <sup>250</sup> Rebuttal Testimony of Company witness Brian Tompsett (Exh. A-5) at 20.

<sup>251</sup> *Id.* at 20-21.

<sup>252</sup> Staff Br. at 22.

<sup>253</sup> *Id.*

1 abilities, and the submittal required by Condition No. 5 is necessary to confirm that the Company is  
 2 charging its customers the correct rates.<sup>254</sup>

3 d. Condition No. 7

4 The Company stated that it is not clear what consideration or approval the Commission  
 5 would exercise with regard to the assessment, and therefore opposes Condition No. 7.<sup>255</sup> The  
 6 Company argued that this requirement is unnecessary as the CAGR D assessments are fixed by  
 7 CAGR D and are not subject to interpretation.<sup>256</sup>

8 Staff stated that Condition No. 7 is important because it allows the Company to receive the  
 9 required documentation first from CAGR D, and Staff and the Commission must have the ability to  
 10 review the calculations and documentation, including the CAGR D invoice.<sup>257</sup> Staff stated that the  
 11 language "for Commission consideration" should not be changed because it is standard language that  
 12 allows the Commission to monitor and ultimately approve the exact adjustor fee charged to  
 13 customers.<sup>258</sup> Staff stated that the Commission review and approval process each year would ensure  
 14 that the Company is submitting data to ADWR that is consistent with annual reports filed with the  
 15 Commission, that the Company is not misinterpreting the correct assessment rate, and that the  
 16 Company is calculating the customer fee correctly.<sup>259</sup>

17 e. Condition No. 8

18 The Company opposed Condition No. 8's requirement that the collection of fees cease should  
 19 the CAGR D change its current method of assessing fees.<sup>260</sup> The Company argued that if the  
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25 <sup>254</sup> Staff Reply Br. at 8.

26 <sup>255</sup> Rebuttal Testimony of Company witness Brian Tompsett (Exh. A-5) at 21.

27 <sup>256</sup> *Id.*

28 <sup>257</sup> Staff Br. at 22; Tr. at 912.

<sup>258</sup> Staff Br. at 22.

<sup>259</sup> Staff Reply Br. at 8.

<sup>260</sup> Rebuttal Testimony of Company witness Brian Tompsett (Exh. A-5) at 21.

1 CAGRDR changes its method of assessing fees, that Johnson would likewise change the way it passes  
2 through the fee to its customers, consistent with the CAGRDR changes.<sup>261</sup>

3 Staff stated that Condition No. 8 should be retained because it is unlikely that CAGRDR would  
4 change the assessment methodology without notice, and if it were changed, the Company could  
5 request a modification of the approved methodology.

### 6 3. RUCO Proposed Expense Adjustment and Opposition to Adjustor

7 RUCO asserted that the use of an adjustor mechanism is not a necessary or appropriate  
8 means for the recovery of CAGRDR expense.<sup>262</sup> RUCO argued that the circumstances of the CAGRDR  
9 assessment do not warrant an adjustor mechanism because it is a routine yearly expense and because  
10 its progressive increase is not volatile.<sup>263</sup> RUCO stated that rate stability is important in today's  
11 economic environment, and because adjustors lead to changes in residential ratepayers' rates, they  
12 should be approved only in extraordinary circumstances.<sup>264</sup> RUCO also argued that oversight of  
13 Staff's proposed adjustor would unnecessarily and inappropriately increase the Staff's workload.<sup>265</sup>

14 RUCO recommended that the CAGRDR be treated as an expense, and proposed a  
15 normalization adjustment to test year expenses based on the known and measurable costs of the  
16 Company's CAGRDR assessments through 2010.<sup>266</sup> RUCO's proposed adjustment is based on the  
17 Company's test year water sold and a 2009-2010 composite of Phoenix AMA and Pinal AMA  
18 CAGRDR fees per thousand gallons.<sup>267</sup> RUCO asserted that because the Company has stated an  
19 intention to file a new rate case every three years, RUCO's recommended adjustment would provide  
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25 <sup>261</sup> *Id.*

<sup>262</sup> RUCO Br. at 8-14; Reply Br. at 5.

<sup>263</sup> RUCO Br. at 12-13.

26 <sup>264</sup> *Id.*

<sup>265</sup> *Id.*

27 <sup>266</sup> RUCO Br. at 8; 14; Tr. at 205; Direct Testimony of RUCO witness Rodney Moore (Exh. R-1) at 16-17; RUCO  
Final Schedules RLM 7 and RLM-16.

28 <sup>267</sup> RUCO Final Schedule RLM-16.

1 the Company with complete recovery of the CAGR expense without requiring extraordinary  
2 ratemaking treatment for a routine cost.<sup>268</sup>

3 In support of its recommendation that a CAGR adjustor mechanism be put in place for the  
4 Company, Staff stated that the CAGR assessment represents a significant annual expense for the  
5 Company, which is anticipated to progressively increase, and that in order to keep its membership in  
6 the CAGR, the Company must pay the fee.<sup>269</sup> Staff asserted that the CAGR assessment is  
7 amenable to an adjustor mechanism because the assessment, unlike a pass-through tax, is not easily  
8 calculated and assigned.<sup>270</sup> Staff noted that the Commission has approved adjustor mechanisms  
9 where appropriate in order to advance important policy concerns that protect the public interest.<sup>271</sup>  
10 Staff stated that the Commission has approved adjustors for expenses that are not extremely volatile  
11 for Demand Side Management and the Renewable Energy Standards Tariff, based on a  
12 determination that the advancement of energy conservation programs and the move to renewable  
13 sources of energy were necessary policy considerations to advance the public interest.<sup>272</sup> Staff  
14 opined that it would be appropriate, in the Commission's support of groundwater conservation, to  
15 adopt the Staff's recommendation regarding an adjustor for the Company's CAGR assessment.  
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#### 18 4. Conclusion

19 We agree with Staff that this Commission has in the past approved adjustor mechanisms  
20 where appropriate to advance important policy concerns that protect the public interest. The  
21 CAGR adjustor mechanism that Staff designed, inclusive of all eight conditions without  
22 modification, appears to be a just and reasonable means of dealing with the costs of the CAGR.  
23 Conservation and wise stewardship of increasingly stressed water supplies is a matter of paramount  
24 concern in Arizona, and we believe that it is important to send appropriate signals to water  
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26 <sup>268</sup> RUCO Br. at 14.

27 <sup>269</sup> Staff Br. at 20, citing to Revised Surrebuttal Testimony of Jeffrey Michlik (Exh. S-43) at 1.

28 <sup>270</sup> *Id.*

<sup>271</sup> Staff Reply Br. at 7-8.

1 companies regarding their duty to fully engage in conservation programs administered by the  
 2 ADWR. The CAGR D assessment fee is not discretionary for Companies such as Johnson Utilities,  
 3 and the Commission believes that the CAGR D participation represents the kind of investment that is  
 4 appropriate for timely cost recovery. To not allow the Company to recover its CAGR D costs in real  
 5 time may threaten the Company's ability to participate in the CAGR D program and would send a  
 6 negative signal to water providers regarding this Commission's support for sound regional  
 7 approaches to achieving safe yield in Active Management Areas. While we are not satisfied with the  
 8 Company's past accounting methodologies, and are supportive of the steps taken in this Order to  
 9 require Johnson Utilities to come into compliance with NARUC accounting standards, we believe  
 10 Staff's adjustor mechanism proposal will accord the Commission maximum oversight over the  
 11 application of the adjustor mechanism. We will therefore approve the CAGR D adjustor mechanism,  
 12 inclusive of all eight conditions proposed by Staff.  
 13

14 **B. Rate Case Expense**

15 The Company requested recovery of \$100,000 in rate case expense for each division.<sup>273</sup>  
 16 There was no disagreement on the amount of expense. Staff recommended normalization of the  
 17 expense over three years, and the Company agreed.<sup>274</sup> RUCO recommended an amortization of five  
 18 years to reflect the Company's propensity for not timely filing rate applications.<sup>275</sup> The Company  
 19 pointed out that RUCO's CAGR D expense normalization assumed that the Company would be filing  
 20 a rate case in three years.<sup>276</sup> We find that the three year normalization period is appropriate, and will  
 21 adopt it.  
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26 <sup>272</sup> *Id.*

27 <sup>273</sup> Rebuttal Testimony of Company witness Thomas Bourassa (Exh. A-2) Vol. II at 23.

28 <sup>274</sup> *Id.*

<sup>275</sup> RUCO Br. at 7.