IN THE SUPREME COURT

STATE OF ARIZONA

JOHNSON UTILITIES, LLC, an Arizona Limited Liability Company, Petitioner, v. ARIZONA CORPORATION COMMISSION; and TOM FORESE, BOB BURNS, ANDY TOBIN, BOYD W. DUNN and JUSTIN OLSON, in their official capacities as members of the Arizona Corporation Commission, Respondents.	Arizona Supreme Court Case No. CV-19-0105-PR Court of Appeals, Division One Case No. 1 CA-CV 18-0197 Arizona Corporation Commission Docket No. WS-02987A-18-0050

ARIZONA CORPORATION COMMISSION'S RESPONSE TO PETITION FOR REVIEW

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I. INTRODUCTION

The Arizona Corporation Commission ("Commission") hereby responds to the Petition for Review ("Petition") filed by Johnson Utilities, L.L.C. ("Johnson") and respectfully recommends the Court decline review. Johnson's Petition requests review of the Arizona Court of Appeals' Opinion ("Opinion") finding that the Commission has both constitutional and statutory authority. pursuant to the Arizona Constitution, article 15, § 3, and Arizona Revised Statutes ("A.R.S.") § 40-321(A), to appoint an interim manager over a regulated entity when the Commission finds circumstances warrant such an appointment. The Court of Appeals additionally found that the appointment of an interim manager did not constitute an unlawful interference with the Company's management. Both of these determinations were correctly reached pursuant to long-standing existing law relating to the Commission's authority. Op. at 2, ¶ 2.

Johnson seeks to expand this Court's review to a factual determination of whether the Commission's appointment of an interim manager for Johnson was justified based on a review of the evidence before the Commission. This is improper. The Court of Appeals' Opinion only decided the legal issue of whether the Commission possesses the constitutional and statutory authority to appoint interim managers. The Court of Appeals was correct in affirming the Commission's authority to appoint an interim manager when the public interest warrants such a remedy. *Id.* at ¶¶ 1-2. Because the Opinion correctly confirmed the Commission's constitutional and statutory authority provides for the remedy of interim managers, this Court should decline to accept review of Johnson's Petition.

II. STATEMENT OF MATERIAL FACTS

Johnson is a public service corporation engaged in the provision of water and wastewater services in Pinal County, Arizona, pursuant to Certificates of Convenience and Necessity ("CC&Ns") granted by the Commission in Decision No. 60223. [Pet., Ex. A at 027:20-23; Decision No. 76785 at 25:20-23], *In The Matter of the Commission's Investigation of the Billing and Water Quality Issues of Johnson Utilities, LLC*, Docket No. WS-02987A-18-0050 (July 24, 2018).] Johnson's service area includes portions of Queen Creek and the unincorporated San Tan Valley area as well as portions of Florence. The Commission regulates Johnson pursuant to article 15 of the Arizona Constitution and Title 40 of the Arizona Revised Statutes.

Since Johnson began providing water and wastewater services in 1998, the utility has been plagued by an ongoing series of violations of statutes, rules and regulations enforceable by multiple governmental entities, including the Commission. [*Id.* at 029:23-030:2, 094-198, 312-325; Decision No. 76785 at 27:23-28:2, 92-196, Ex. A at 1-7, Ex. B at 1-7.] The Commission finally launched an investigation into Johnson's management and operations in March 2018. Following a 12-day evidentiary hearing, the Commission issued Decision No. 76785 (the "Decision"), which found that an interim manager was appropriate because Johnson's management was incapable of properly conducting the utility's water and wastewater operations, to the detriment of the health and safety of the public and that of Johnson's customers. [*Id.* at 281-310; Decision No. 76785 at 279-308.] The Decision contains over 300 pages recounting the testimony and

evidence presented during the hearing and presenting the legal authority and conclusions of law in support of the appointment. In keeping with the "interim" nature of the remedy, the Decision provides that Johnson may apply for termination of the interim management appointment upon a showing that Johnson's services have been restored to a quality level that is acceptable to the Commission, the benchmark of which is that Johnson's services "are in all respects just, reasonable, safe, proper, adequate, and sufficient" and that the cessation of the interim management "would not present an unreasonable risk of service." [*Id.* at 310:1-5; Decision No. 76785 at 308:1-5.]

After the Commission issued its Decision in July 2018, Johnson filed a barrage of lawsuits with a singular focus: challenging the Commission's authority to appoint an interim manager. Op. at 3, ¶ 4; [Comm'n Rsp. To Pet. Special Action, Ex. A – G.] On one such occasion, this Court denied special action relief "without prejudice to refile in the court of appeals." Ariz. Supreme Court No. CV-18-0221-SA, Order at 1 (Aug. 22, 2018). The Court of Appeals accepted jurisdiction but denied relief. In its Opinion, the Court of Appeals affirmed the Commission's constitutional and statutory authority to appoint an interim manager where circumstances warrant.

III. ISSUE PRESENTED

Did the Court of Appeals correctly determine that the Commission has the necessary authority, under the Ariz. Const., art. 15, § 3 and A.R.S. § 40-321, to appoint an interim manager under circumstances the Commission deems appropriate?

IV. ADDITIONAL ISSUE PRESENTED BUT NOT DECIDED BY THE COURT OF APPEALS

Does the Commission's constitutional authority under Ariz. Const., art. 15, § 3 to make and enforce reasonable rules, regulations and orders for the convenience, comfort, safety and preservation of the health of a utility's customers provide the Commission with another independent basis of authority to impose an interim manager under appropriate circumstances?

V. ARGUMENT

A. The Court Of Appeals Correctly Found That The Commission's Power To Appoint An Interim Manager Stems From Both Its Constitutional And Statutory Authorities.

This Court grants review only under limited circumstances such as where there is no controlling law, there is a split of authority, or where there is a wrongly decided important issue of law. *See* Ariz. R. Civ. App. P. 23(d)(3). None of these grounds are implicated by Johnson's Petition.

The Commission acted squarely within its constitutional authority to order an interim manager, on a temporary basis, to correct severe technical and financial irregularities with a regulated entity. Under art. 15, § 3 of the Arizona Constitution, the Commission's powers include: 1) the power to make reasonable rules, regulations, and orders by which such corporations shall be governed in the transaction of business within the state; 2) the plenary and exclusive power to set just and reasonable classifications to be used and just and reasonable rates to be made and collected by public service corporations; 3) the power and duty to prescribe the forms of contracts and systems of keeping accounts to be used by such corporations operating in Arizona; and 4) the power to make and enforce

reasonable rules, regulations and orders for the convenience, comfort, safety and preservation of the health of a utility's customers.

Arizona courts have interpreted the Commission's authority under section 3 to mean that the Commission may create rules, regulations, and orders to protect the convenience, comfort, safety, and health of consumers of public service corporations, which is a function of effective ratemaking. *Ariz. Corp. Comm'n v. State ex rel. Woods*, 171 Ariz. 294-95 (1992); *Miller v. Ariz. Corp. Comm*, 227 Ariz. 21, 27, ¶ 23 (App. 2011); *Garvey v. Trew*, 64 Ariz. 342, 346-47 (cert. denied, 329 U.S. 784, 67 S.Ct. 297, 91 L.Ed. 673 (1946) (recognizing that the Commission "may exercise all powers which may be necessary or essential in connection with the performance of its duties.") The Commission moreover receives deference from a court evaluating whether a rule, regulation, or order is reasonably necessary for effective ratemaking; such deference ensures the Commission's ability to lend its unique expertise in fulfilling its duty to protect utility customers from abuse and overreaching by public service corporations. *Woods*, 171 Ariz. at 294-97; *Miller*, 227 Ariz. at 28-29. The Commission's appointment of an interim manager was an act undertaken for the protection of Johnson's consumers against a utility that has shown a disregard for the provision of safe, reliable, and adequate service.

Johnson summarily contends that the appointment of an interim manager cannot be interpreted as reasonably related to the Commission's ratemaking authority. [Pet. at 5.] Courts have consistently rejected the argument that the Commission's ratemaking authority is restricted to setting rates. For instance, in *Sierra Club – Grand Canyon v. Ariz. Corp. Comm'n*, the court rejected the Sierra

Club's position that the Commission's ratemaking authority did not apply to decisions about pilot programs or waivers under the Commission's REST rule. 237 Ariz. at 568, 574, ¶10 (App. 2015). To take another example, in *Miller v. Ariz. Corp. Comm'n*, the court found a sufficient nexus existed between the Commission requiring utilities to diversify their energy resources and the Commission's ratemaking power. 227 Ariz. 21, 25, ¶¶ 14-18. And in *Arizona Corp. Com'n v. State ex rel. Woods,* the court held that the Commission's constitutional ratemaking authority extends to its regulation of "all transactions between a public service corporation and its affiliates that may significantly affect economic stability and thus impact the rates charged by a public service corporation." *Woods*, 171 Ariz. at 295. Simply put, Arizona case law has not viewed "ratemaking" in such a restrictive manner. *Sierra Club – Grand Canyon Chapter*, 237 Ariz. at 574, ¶ 10. Rather, the courts have recognized the Commission's ratemaking authority to promote "effective regulation of public service corporations and consumer protection." *Woods*, 171 Ariz. at 290.

The Court of Appeals correctly decided that art. 15, § 3 grants the Commission jurisdiction to appoint interim management to ensure the financial viability of a public service corporation and the corresponding rates; this ensures the adequacy of the utility's operations, service, and the condition of its equipment and facilities. Op. at 11, ¶ 24.

Johnson also argues that replacing a manager and assuming control of other managerial aspects goes beyond the ACC's ratemaking authority and overreaches its constitutional authority. [Pet. at 6.] Johnson argues that prior cases suggest the

Commission's role should be limited to monitoring the decisions of the utility's management. [Pet. at 6.] Limiting the Commission to a monitoring role as urged by Johnson is inconsistent with the *Woods* court's characterization of the Commission's power:

> The Commission was not designed to protect public service corporations and their management but, rather, was established to protect our citizens from the results of speculation, mismanagement, and abuse of power. To accomplish those objectives, the Commission must have the power to obtain information about, and **take action to prevent, unwise management or even mismanagement and to forestall its consequences.**

Woods, 171 Ariz. at 296 (Emphasis added).

Johnson also contends that the Commission should have employed less intrusive means than the appointment of an interim manager. [Pet. 7.] The issue of whether the Commission should have done something less than appoint an interim manager is an issue of fact and is not before this Court. However, given Johnson's history of non-compliance, environmental violations, and financial malfeasance, the Commission was compelled to act to protect Johnson's customers from unsafe and inadequate service and operations. [Pet. at 281-310; Decision No. 76785 279-308.]; *See Miller*, 227 Ariz. at 28-29 ¶¶ 30-31 (the Commission properly considered "risks associated with contemplated action or inaction" and its authority to take action to prevent ultimate prejudice to ratepayers). *See also Miller*, 227 Ariz. at 24, ¶ 11 (noting the test of jurisdiction is whether or not the tribunal has power to enter upon the inquiry, not whether its conclusion in the course of it is right or wrong).

In sum, the Commission acted within its broad ratemaking authority, its authority to make and enforce orders affecting the public welfare, and its authority under Arizona statutes including A.R.S. § 40-321(A).

B. As The Court Of Appeals Found, The Commission Was Also Empowered To Appoint An Interim Manager Pursuant To Its Delegation Of Authority Under A.R.S. § 40-321(A).

In addition to its plenary ratemaking authority, the Commission's Decision falls within its statutory authority. Pursuant to the Ariz. Const., art. 15, § 6, the legislature can expand the Commission's constitutional authority, but it cannot limit it. Arizona Revised Statutes § 40-321 empowers the Commission to determine what is just, reasonable, safe, proper, adequate, or sufficient in a water and wastewater company's operations.

Beyond the legislature's express direction that the Commission *shall* enforce its remedies by "order or regulation," the legislature did not impose any other limitations or directives on the Commission to fulfill this mandatory function. *Id.*; *see J.D. v. Hegyi*, 236 Ariz. 39, 40-41, ¶ 6 (2014) (noting where statutory language is subject only to one reasonable meaning, the courts apply that meaning). Thus, the Court need not consider any authority beyond this express statutory language. *See Burlington N. & Santa Fe Ry. v. Ariz. Corp. Comm'n*, 198 Ariz. 604, 606, ¶ 11 (App. 2000) (statutory language will not be impliedly broadened beyond that expressly provided).

Relying upon *Phelps Dodge Corp. v. Arizona Elec. Power Co-op, Inc.,* 207 Ariz. 95 (2004), Johnson argues that any delegation of authority by the legislature to the Commission must be explicit and cannot be inferred. [Pet. at 9.] However,

the Court in *Phelps Dodge* was referring to § 40-202, wherein the Arizona Supreme Court had already found that this section bestowed no power on the Commission beyond that already provided by the constitution or specifically granted otherwise by the legislature. *Phelps Dodge Corp.,* 207 Ariz. at 112, ¶ 58. Importantly, the *Phelps Dodge* court noted that the Commission could have relied upon § 40-202 if such authority "may be reasonably implied from the statutory scheme so as to carry out the purpose and intent of the legislative mandate." *Id*. at 112, ¶ 59, (*citing Ethridge v. Arizona State Bd. of Nursing*, 165 Ariz. 97 (App. 1989)). This is unlike the situation here, where the Commission's broad constitutional powers and A.R.S. § 40-321(A) together allow it to take such actions as necessary to protect ratepayers and promote the public interest.

Johnson also relies upon *City of Surprise v. Ariz. Corp. Comm'n*, 246 Ariz. 206, ¶ 1 (2019), to support its position that under a strict construction of the Constitution and implementing statutes, the Commission's authority to appoint an interim manager was not specifically set out in the statute and thus cannot be implied. Johnson misses the point. First, A.R.S. § 40-321(A) does not implement the Commission's constitutional authority; it is an additional delegation of authority to the Commission. Second, A.R.S. § 40-321(A) lists specific parts of the Company's operations and states that if the Commission finds they "are unjust, unreasonable, unsafe, improper, inadequate or insufficient, the commission shall determine what is just, reasonable, safe, proper, adequate or sufficient, and shall enforce its determination by order or regulation." The statute is silent on what corrective action can be taken in deference to the Commission's broad legislative

discretion in such cases. The Court of Appeals correctly determined that it need not look beyond the express language of this statute to find the authority allowing the Commission to impose an interim manager. Op. at 10 ¶ 21.

In sum, Johnson's arguments are unpersuasive and do not support its Petition for Review.

C. The Court Of Appeals Correctly Found That The Commission's Appointment Of An Interim Manager Does Not Impermissibly Interfere With Johnson Utilities' Ownership Of The Company.

The managerial interference doctrine is a judicial construct designed to protect regulated corporations from over-reaching and micro-management of their internal affairs by the Commission. *S. Pac. Co. v. Ariz. Corp. Comm'n*, 98 Ariz. 339, 343 (1965).

Johnson's argument that there "must be some line drawn at what can be considered reasonably related to ratemaking" falls flat. [Pet. at 5.] The courts have drawn this line, and Johnson simply does not like where that line has been drawn. The Court of Appeals correctly determined that despite interference with management, the Commission's broad ratemaking authority exists where there is a sufficient nexus between the Commission's governance of public service corporations and its ratemaking functions. *Miller*, 227 Ariz. at 28, ¶ 27, 29, ¶ 31. To find otherwise "would subvert the intent of the framers to limit the Commission's ratemaking powers so that it could do no more than raise utility rates to cure the damage . . . ." *Woods,* 171 Ariz. at 296. Even under the most restrictive of interpretations advanced by the *Pacific Greyhound* court, the rules reviewed in *Woods* were found to be reasonably necessary for ratemaking. *Woods,*

171 Ariz. at 297. The Court of Appeals correctly found the appointment of an interim manager under appropriate circumstances – here, to correct severe operational and financial mismanagement of a regulated water and wastewater provider – to be within the Commission's ratemaking function.

Johnson's Petition fails to recognize, however, that the facts of this particular matter, the facts underlying *this* appointment, were not before the Court of Appeals; they are also not before this Court. To the extent Johnson requests that this Court consider whether the Commission's appointment of an interim manager for Johnson Utilities impermissibly interfered with its management, the Court must decline review. Such analysis would be a fact-dependent inquiry that goes to the merits of the Commission's underlying Decision No. 76785 (the decision that appointed the interim manager). That decision is not before this Court.

Likewise, Johnson's arguments that the Commission's appointment of an interim manager to "conduct the business and affairs" of the Company on an interim basis impermissibly encroaches on Johnson's ownership and constitutes "an effective seizure of Johnson Utilities' assets and bank accounts," and significantly impedes its ability to "grow its business" due to a moratorium on new utility connections are part of this fact specific inquiry that is likewise not properly before this Court. [Pet. 1, 2, 4, 5.]

Only the legal issue of the Commission's authority is before this Court.

The Court of Appeals correctly determined that the managerial interference doctrine in no way precludes the Commission from exercising its constitutional and statutory power to protect Johnson Utilities' consumers and the public welfare;

rather, this "judicial construct [is] designed to protect regulated corporations from over-reaching and micro-management of their internal affairs by the Commission." *Miller*, 227 Ariz. at 27, ¶ 23; *Phelps Dodge Corp., Inc.*, 207 Ariz. at 113-14, ¶ 65. "An obvious corollary of the [managerial interference doctrine] is that if there has been an abuse of managerial discretion, and the public interest has been adversely affected thereby, the Commission is empowered to intervene." Op. at 8, ¶ 16 (*citing Metro. Edison Co. v. Penn. Pub. Util. Comm'n*, 437 A.2d 76, 80 (Pa. Cmwlth. Ct. 1981)). In other words, the Court of Appeals only, and appropriately, determined that the doctrine itself does not prohibit control of management incidental to the Commission's attempt to control rates. Op. at 8, ¶ 16.

VI. CONCLUSION

The Court of Appeals correctly determined that, subject to the substantive limitations of the managerial interference doctrine, both Ariz. Const. art. 15, § 3 and A.R.S. § 40-321(A) provide that the Commission may impose an interim manager for a public service corporation under circumstances that the Commission determines, in its discretion, are appropriate. Op. at 11, ¶ 24. The Court of Appeals did not address whether the facts and circumstances warranted the appointment of an interim manager for Johnson. It would not be proper for the Court to engage in that exercise now. The Commission's actions were not taken lightly. An investigation and a 12-day evidentiary hearing followed years of unsuccessful attempts to regulate Johnson in the same manner as the Commission successfully regulates similar entities, but to no avail. In order to protect the public health and safety, the Commission exercised its authority to appoint an interim

manager over a regulated utility in financial and operational distress. It acted within its authority in doing so. For the abovementioned reasons, the Commission respectfully requests that the Court deny Johnson's Petition for Review. Should the Court accept jurisdiction, the Court of Appeals Opinion should be affirmed.

RESPECTFULLY SUBMITTED this 8th day of May 2019.

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