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BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP
Chairman
GARY PIERCE
Commissioner
BRENDA BURNS
Commissioner
BOB BURNS
Commissioner
SUSAN BITTER SMITH
Commissioner

Arizona Corporation Commission

DOCKETED

JUL 16 2013

DOCKETED BY ne

STAFF REPORT FOR THE PETITION TO AMEND DECISION NOS. 71854 AND 72579 PURSUANT TO ARS § 40-252 REGARDING 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
DECISION NO. 73992
ORDER

Open Meeting
June 27, 2013
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Johnson Utilities, LLC, dba Johnson Utilities Company (“Johnson” or “Company”) is a Class A water and wastewater public service corporation. The Company is headquartered in Scottsdale, Arizona, but its service area encompasses various areas of Pinal County, Arizona. In the test year, ending December 31, 2007, the Company served an average of 17,541 water customers and 21,596 wastewater customers.

2. The Company has filed a petition as described below arising from the Arizona Corporation Commission’s (“Commission”) recent policy change regarding income taxes.

Background

3. On September 15, 2011, the Commission issued Decision No. 72579, which established the current rates for Johnson. This Decision amended the rates that had been set for

1 Johnson in Decision No. 71854, issued August 25, 2010. Decision No. 72579 also provided that
2 Johnson could seek an allowance for income taxes generated as a result of its operations if the
3 Commission changed its policy regarding the treatment of income taxes for subchapter S
4 corporations.

5 4. On February 21, 2013, in Decision No. 73739, the Commission adopted a policy
6 allowing every utility entity, other than subchapter C corporations and tax-exempt entities, to seek
7 to include in its cost of service an income tax allowance based on the lower of comparable
8 subchapter C corporate income tax expense, or the combined personal income tax obligation
9 created by the distribution of the utility's profits.

10 5. On March 8, 2013, the Company filed a petition to amend Decision No. 71854
11 pursuant to Arizona Revised Statutes ("A.R.S.") § 40-252. The Company has included full
12 schedules that appropriately fulfill the new income tax policy requirements and the resulting
13 recognition of an income tax allowance. Staff has confirmed that the amount that the Company is
14 seeking to collect for income taxes is less than it would be if the Company had elected to be taxed
15 as a stand-alone C corporation. The increase to the revenue requirement for water customers is
16 \$125,071, or an increase of 0.95 percent, and the increase to the revenue requirement for
17 wastewater customers is \$747,274, or an increase of 6.58 percent. Staff concurs with these
18 amounts because they comply with the Commission's new policy and will therefore result in just
19 and reasonable rates.

20 6. In its filing, the Company is not proposing any changes to its fair value rate base,
21 which is negative \$2,414,613 for its water division and \$17,270,553 for its wastewater division.
22 Adopting the increases proposed by the Company would increase the Company's revenue
23 requirements to \$9,899,013 and \$12,339,134 for its water and wastewater divisions, respectively.

24 7. For the water division, there is no impact to the fair value rate of return ("FVROR")
25 because the fair value rate base is negative, i.e., the revenue requirement is based on an operating
26 margin. The impact to rates is *de minimis* because the amount of the increase is so small.

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1 8. For the wastewater division, the FVROR remains at 8.0 percent, or may become
2 12.33 percent, depending on the ratemaking classification for the income tax issue, as discussed
3 in Finding of Fact Nos. 14 – 16 below.

4 9. The Company's current rates, based on a 2007 test year, were approved in Decision
5 No. 71854, as amended by Decision No. 72579. In that case, the Company requested recognition
6 of income tax expense in its application, but it was disallowed as the Commission's policy at that
7 time did not recognize income tax for pass-through entities that had no income tax liability.
8 However, also at that time, the Commission was in the process of evaluating changes to this
9 policy, which ultimately resulted in Decision No. 73739.

10 10. In its petition, the Company stated that, if its application is approved, the Company
11 would not need new rates to be effective prior to July 1, 2019.

12 11. Staff notes that the new Commission income tax policy has no stay-out
13 requirements. Further, Decision No. 71854 (amended by Decision No. 72579) was the
14 Company's first rate case since the granting of its Certificate of Convenience and Necessity by
15 Decision No. 60223 (May 27, 1997).

16 12. Because of the length of time between rate cases that would occur if the Company
17 did not file a new rate application for several years, Staff recommends that the Company be
18 ordered to file a full rate case application for its water and wastewater divisions by no later than
19 June 30, 2015, using a 2014 calendar year test year.

20 **Notice**

21 13. Staff asked the Company to provide the notice attached as Attachment 1 to the Staff
22 Memorandum in a special direct mailing to all of its customers by May 8, 2013. Staff also asked
23 the Company to provide the attached notice to all parties to this case by May 8, 2013.

24 **Terminology**

25 14. The Commission's new policy on the income tax issue for pass-through entities
26 refers in the body of the policy to an "imputed income tax expense"; however, in items 5, 6, and 7
27 listed on page 3 of the policy statement, it refers to an "income tax allowance." Although this

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1 terminology may appear insignificant, the classification of this adjustment impacts the
2 calculation of the FVROR.

3 15. If the income taxes were classified as an imputed expense, the FVROR for this case
4 would not be impacted (will remain 8.0 percent) for the Johnson wastewater division. If the
5 income taxes were classified as an allowance, the resulting FVROR could be 12.33 percent.
6 Within the context of this case, however, the actual rate impact to customers is the same under
7 either classification.

8 16. Staff believes that, for the purposes of accounting, auditing, bookkeeping, and other
9 associated activities, the Commission was correct on page 3 of its policy statement in classifying
10 the income taxes for pass-through entities as an "allowance." This classification is also consistent
11 with that used in Texas (referred to on page 2 of the Commission's policy statement) and with
12 that used by the Federal Energy Regulatory Commission. However, for ratemaking purposes, the
13 Commission will classify this adjustment as an imputed expense, which is the intent of the
14 Commission's policy.

15 Rate Design

16 17. The Company has proposed a rate design that includes both an increase to the
17 monthly minimum charge and an increase to the commodity charge for its water division, and an
18 increase to its monthly minimum charge for its wastewater division as there is no commodity
19 charge (except for the purchase of effluent) for wastewater service.

20 18. Staff concurs with the Company on its proposed rate design. For informational
21 purposes, the typical bill impact analysis for a ¾-inch meter residential customer using the
22 average of 6,931 gallons per month is as follows:

23 Water current bill is \$29.81
24 proposed bill would be \$30.28
increase would be \$0.47 or 1.58%.

25
26 Wastewater: current bill is \$39.35
27 proposed bill would be \$42.00
increase would be \$2.65 or 6.73%.

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1 **Staff Recommendations**

2 19. Staff recommends approval of the rate increases requested by the Company in the
3 amounts of \$125,071 for its water division and \$747,274 for its wastewater division.

4 20. Staff further recommends approval of the associated rate design proposed by the
5 Company in its application.

6 21. Staff further recommends that the Company be ordered to file a full rate case
7 application for both its water and wastewater divisions by no later than June 30, 2015, using a
8 2014 calendar year test year.

9 **CONCLUSIONS OF LAW**

10 1. Johnson Utilities, LLC, dba Johnson Utilities Company, is a public service
11 corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§40-250
12 and -252.

13 2. The Commission has jurisdiction over the Company and over the subject matter of
14 the application.

15 3. Notice of the proceeding and an opportunity to be heard have been afforded in the
16 manner prescribed by law.

17 4. For the purposes of evaluating this application, the information set forth in Finding
18 of Fact Nos. 6 – 8 serve as appropriate fair value information for the Commission's consideration.

19 5. The Commission may determine appropriate ratemaking classifications pursuant to
20 Article XV, Section 3 of the Arizona Constitution, and the rates proposed herein are just and
21 reasonable.

22 6. Decision Nos. 71854 and 72579 are hereby modified to provide for recovery of
23 income taxes through rates.

24 7. Staff's recommendations are reasonable and hereby approved.

25 **ORDER**

26 IT IS THEREFORE ORDERED that Decision Nos. 71854 and 72579 are hereby modified
27 to permit Johnson Utilities, LLC, DBA Johnson Utilities Company, to recover income taxes as
28 requested in its March 8, 2013 petition.

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IT IS FURTHER ORDERED that the recommendations of Staff discussed in Findings of Fact 19 through 21 are reasonable and are hereby adopted.

IT IS FURTHER ORDERED that this decision shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

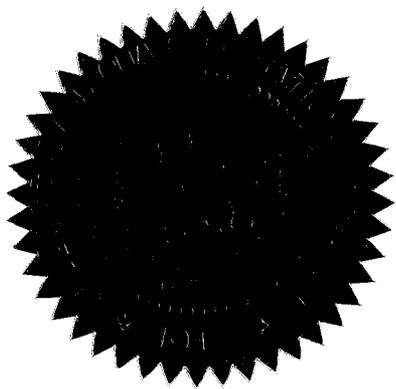

CHAIRMAN


COMMISSIONER


COMMISSIONER


COMMISSIONER


COMMISSIONER



IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 16th day of July, 2013.


JODI JERICH
EXECUTIVE DIRECTOR

DISSENT: 

DISSENT: _____

SMO:DWC:lhmvJFW

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