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BEFORE THE ARIZONA CORPORATION COMMISSION

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

Docket No. WS-02987A-08-0180

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing  
the Direct Settlement Testimony of Patrick J. Quinn, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 17th day of January, 2014.

  
Daniel W. Pozefsky  
Chief Counsel

1 AN ORIGINAL AND THIRTEEN COPIES  
2 of the foregoing filed this 17th day  
3 of January, 2014 with:

3 Docket Control  
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6 Phoenix, Arizona 85007

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6 mailed this 17th day of January, 2014 to:

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JOHNSON UTILITIES  
DOCKET NO. WS-02987A-08-0180

DIRECT SETTLEMENT TESTIMONY  
OF  
PATRICK J. QUINN

ON BEHALF OF  
THE  
RESIDENTIAL UTILITY CONSUMER OFFICE

JANUARY 17, 2014

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**EXECUTIVE SUMMARY**

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The Arizona Residential Utility Consumer Office (“RUCO”) presents the direct testimony of RUCO’s Director, Mr. Patrick Quinn, in support of the Proposed Settlement Agreement of the Johnson Utilities, LLC, rate case that settles the issue of the pass through of the income tax expense for Corporations other than a “C” Corporation. Mr. Quinn recommends that the Arizona Corporation Commission adopt the Proposed Settlement Agreement as it is fair to both the consumer and Johnson Utilities and is in the public interest under the Commission’s current income tax policy.

RUCO supports the Proposed Settlement Agreement in its entirety because it is the best resolution under the circumstances to resolve the area of income tax pass through for Johnson Utilities.

1 **INTRODUCTION**

2 **Q. Please state your name, occupation and business address for the**  
3 **record.**

4 A. My name is Patrick J. Quinn. I am the Director of the Arizona Residential  
5 Utility Consumer Office ("RUCO"). My business address is 1110 W.  
6 Washington Street, Suite 220, Phoenix, Arizona 85007.

7  
8 **Q. Please state your educational background and qualifications in the**  
9 **utility regulation field.**

10 A. I have a BS in Mathematics and a MBA from the University of South  
11 Dakota. Additionally, I have 35 plus years of experience in the  
12 Telecommunications Industry and the Consulting business dealing with  
13 utility regulation. I have testified over 50 times before state and federal  
14 regulatory commissions on issues including finance, economics, pricing,  
15 policy and other related areas.

16  
17 **Q. What is the purpose of your testimony?**

18 A. The purpose of my testimony is to explain RUCO's support of Johnson  
19 Utilities Proposed Settlement Agreement ("Agreement").

20  
21 **Q. Have you participated in other settlement negotiations?**

22 A. Yes. I have participated in settlement negotiations from both the utility  
23 company's prospective as well as the consumer side. I have been

1 involved in several recent negotiations and have provided settlement  
2 testimony before the Arizona Corporation Commission during past rate  
3 case hearings.

4

5 **THE SETTLEMENT PROCESS**

6 **Q. Was the negotiation process that resulted in the Settlement**  
7 **Agreement a proper and fair process?**

8 A. Yes. This Agreement is the result of several months of negotiation and a  
9 willingness among RUCO and the Company to compromise.

10

11 **Q. Did all the parties sign the Agreement?**

12 A. Yes. RUCO and Johnson Utilities were the signatories to this agreement  
13 as RUCO was the only party that objected to the income tax pass through.

14

15 **Q. Why is a negotiated settlement process an appropriate way to**  
16 **resolve this matter?**

17 A. A negotiated settlement finds common ground that the parties can  
18 support. RUCO believes that this agreement is a balanced agreement  
19 and the rate increase resulting from the collection of income tax expense  
20 is just and reasonable.

21

22

23

1 **BACKGROUND**

2 **Q. Can you please provide a brief background on this case?**

3 A. Yes. On September 15, 2011, the Commission issued Decision No.  
4 72579, establishing the current rates for Johnson Utilities. This Decision  
5 amended the rates that had been set for Johnson in Decision No. 71854,  
6 issued August 25, 2010. Decision No. 72579 also provided that Johnson  
7 could seek an allowance for income taxes generated as a result of its  
8 operations if the Commission changed its policy regarding the treatment of  
9 income taxes for pass-through entities.

10

11 On February 21, 2013, in Decision No. 73739, the Commission adopted a  
12 policy allowing every utility other than a Sub-S corporation and other tax-  
13 exempt entities, to seek to include in its cost of service an income tax  
14 allowance based on the lower of comparable "C" corporate income tax  
15 expense, or the combined personal income tax obligations created by the  
16 distribution of the utility's profits.

17

18 On March 8, 2013, the Company filed a petition to amend Decision No.  
19 71854 and approve the collection of income tax expenses in its rates  
20 going forward.

21

1           On July 16, 2013, the Commission issued Decision No. 73992 approving  
2           Johnson Utilities Petition to Amend Decision No. 71854, by approving  
3           Johnsons request for collection of income tax expense.

4

5           **SUMMARY OF TESTIMONY**

6           **Q.     Please summarize your testimony.**

7           A.     RUCO supports the Agreement as it reduces the wastewater annual  
8           increase previously approved by the Commission by approximately  
9           \$289,000. RUCO also maintains its right to challenge future filings when  
10          income taxes are approved for pass through to entities other than tax  
11          paying entities.

12

13          **SETTLEMENT PROVISIONS**

14          **Q.     In summary, what are the benefits to the residential ratepayer?**

15          A.     RUCO believes that this Agreement is fair to both the consumer and  
16          Johnson Utilities and is in the public interest under the current  
17          Commission policy on income taxes for the following reasons:

18               (1)    The Agreement reduces Johnson Utilities recoverable income tax  
19               expense from 36.66 percent to a more appropriate level of 25.0  
20               percent.

21               (2)    The Agreement requires an independent verification by a Certified  
22               Public Accounting Firm ("CPA") that the weighted average of the

1 income taxes paid by all of the Company shareholders for year  
2 2007 is at least equal to or greater than 25 percent.

3 (3) The reduction in recoverable income tax expense will save  
4 Johnson Utilities wastewater division ratepayers approximately  
5 \$289,000 on an annual basis.

6 (4) The Agreement requires the Company to file yearly earnings  
7 reports for years 2013 and 2014.

8 (5) The Agreement will not impair RUCO's right to challenge in future  
9 rate case filings the imputation of income tax expense.

10

11 **PUBLIC INTEREST**

12 **Q. How is the public interest satisfied by the Agreement?**

13 A. The Agreement satisfies the public interest from RUCO's perspective in  
14 that it provides favorable terms and protections for residential consumers  
15 under the Commission's current income tax policy.

16

17 **AREAS OF IMPORTANCE**

18 **Q. Can you briefly discuss the areas you believe are most important to**  
19 **RUCO in reaching a settlement agreement?**

20 A. Yes. A major concern to RUCO was the income tax expense, 36.5  
21 percent, the Commission had approved for recovery under Decision No.

1           73992<sup>1</sup>. RUCO believed that the income tax expense recovery was  
2           excessive and represented the highest amount of tax expense that would  
3           be recovered under the assumption that Johnson Utilities was taxed the  
4           same as a "C" Corporation.

5  
6   **Q. Did RUCO negotiate a reduction in income tax expense for Johnson**  
7   **Utilities?**

8   **A.** Yes. This was a critical concession from RUCO's standpoint - the  
9           reduction in recoverable income tax expense will       save       Johnson  
10          Utilities wastewater division ratepayers approximately \$289,000 on an  
11          annual basis. .Another requirement that was important to RUCO is  
12          independent confirmation from an independent CPA firm identifying the  
13          actual tax expense paid by the shareholders of Johnson Utilities. RUCO's  
14          intent is to independently verify that ratepayers are not paying any more in  
15          taxes than the actual taxes paid by the shareholders. While neither  
16          concession is optimal, RUCO feels that it is the best that can be done for  
17          ratepayers under the Commission's current policy.

18  
19  
20

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<sup>1</sup> The major concern to RUCO is the policy itself which allows the Company to recover income taxes it does not pay. RUCO disagrees with the policy, however, that issue is not the subject of the Settlement.

1 **Q. Another concern to RUCO is the issue on the amount of increase to**  
2 **residential rates. Please explain this issue.**

3 A. Yes. RUCO's priority is to analyze monthly rate increases and act in the  
4 best interests of the ratepayers under the circumstances. Through the  
5 negotiation process specifically related to the income tax pass through  
6 RUCO was able to lower the average monthly increase from \$2.65 to  
7 \$1.63.

8  
9 **Q. Does this conclude your testimony on the Agreement?**

10 A. Yes it does.