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Andrea Gaston

From: John and Rebecca LeSueur <ljesueur@hotmail.com>
Sent: Tuesday, June 13, 2017 12:40 PM
To: Forese-Web; Tobin-Web; RBurns-Web; Little-Web; Dunn-Web
Subject: Additional Information Regarding Income Tax Expense

Arizona Corporation Commission

DOCKETED

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JUN 14 2017

Commissioners,

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Thank you for letting me address you today. Please know that my purpose for doing so was to provide you and the interested public with as much sunshine as possible regarding the origins of Commissioner Pierce's position on the income tax issue identified in the recent indictment. Below is detailed information and links to information in eDocket that document the information I attempted to summarize in the timeline I sent you earlier today.

Imputed Income Tax Expense History

Sunrise Water Company (08-0406)

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1. On December 8, 2009, Craig Marks docketed exceptions on behalf of Sunrise Water Company to the Recommended Opinion and Order issued in its rate case. The exceptions contained draft language for two suggested amendments. The first suggested amendment sought recovery of income tax expense for Sunrise Water Company, which was operating as an S Corp. (<http://docket.images.azcc.gov/0000105916.pdf>).
2. Sometime between December 8, 2009 and December 15, 2009, I briefed Commissioner Pierce regarding Sunrise Water Company's exceptions and expressed my opinion that its income tax recovery request had merit, and that he should sponsor the suggested amendment. Commissioner Pierce instructed me to prepare a proposed amendment.
3. On December 15, 2009, I drafted and docketed Pierce Proposed Amendment 1 in the Sunrise Water Company rate case that would adopt the Company's income tax recovery request. (<http://docket.images.azcc.gov/0000106127.pdf>)
4. On December 15 or 16, 2009, Commissioner Pierce voted in favor of the Recommended Opinion and Order, as amended, even though his Proposed Amendment was not adopted. (Audio/video of this open meeting is no longer hosted on the Commission's website.)

Sahuarita Water Company L.L.C. (09-0359)

1. Rate case file July 17, 2009 requesting recovery of an imputed income tax expense (<http://docket.images.azcc.gov/0000101275.pdf>).
2. January 18, 2011, Judge Rodda issues Recommended Opinion and Order. (<http://docket.images.azcc.gov/0000122049.pdf>)
3. On January 27, 2011, Larry Robertson files exceptions seeking recovery of income tax expense. (<http://docket.images.azcc.gov/0000122261.pdf>)

4. On January 31, 2011, Chairman Pierce docketed Pierce Proposed Amendment 1. The amendment stated: "At a recent Commission open meeting, the Commission agreed to examine the merits of imputing income tax expenses to S-corps and LLCs in its ongoing water workshops. While we believe it is prudent to follow the current policy today, we do not wish to prejudice SWC in the event the Commission determines to alter this policy in the future. Accordingly, in the event the Commission alters its policy in the future, SWC may file a motion to amend this Order, and SWC's authorized revenue requirement hereunder, pursuant to A.R.S. 3 40-252, to reflect the change in Commission policy." (Note: the commission followed this approach in subsequent cases addressing the issue until a majority of the Commissioners agreed with Commissioner Pierce's position in 2013 and the income tax policy for tax pass-through entities was decided in the water workshops). Audio/video of this open meeting is no longer available on the Commission's website.

Johnson Utilities Rate Case (08-0180)

1. On May 7, 2010, Judge Wolfe (now Jibillian) docketed a Recommended Opinion and Order in Johnson Utilities rate case (08-0180). (<http://docket.images.azcc.gov/0000111382.pdf>)
2. On May 17, 2010, Jeff Crockett docketed exceptions to the ROO on behalf of Johnson Utilities containing language for ten suggested amendments. (<http://docket.images.azcc.gov/0000111682.pdf>) Number eight of the suggested amendments related to obtaining recovery of imputed income tax expense to compensate George Johnson for the increase in his personal income tax liability attributable to utility revenues.
3. On June 25, 2010, Commissioner Pierce docketed Pierce Proposed Amendment 1 (<http://docket.images.azcc.gov/0000113589.pdf> -- which adopted the language of Johnson Suggested Amendment 8) and Pierce Proposed Amendment 2 (<http://docket.images.azcc.gov/0000113588.pdf> -- which adopted the language of Johnson Suggested Amendment 6).
4. On August 4, 2010, Commissioner Pierce docketed a letter to the parties seeking a response to several questions. (<http://docket.images.azcc.gov/0000115497.pdf>)
5. On August 25, 2010, the Commission adopted Decision # 71854. Commissioner Pierce voted in favor of the Recommended Opinion and Order, as amended, even though neither of his two docketed amendments were adopted. (Note: I do not recall whether Commissioner Pierce ever offered his proposed amendments for adoption during the Open Meeting. I could not confirm whether he had because the audio/video of the August 2010 Open Meeting has been removed from the Commission's website.) Under the rates approved in Decision No. 71854, a residential water customer with an average usage of 6,931 gallons per month with a 3/4-inch water meter experienced a monthly rate decrease of \$12.78, or approximately 30.01 percent, from \$42.59 per month to \$29.81 per month, and a residential wastewater customer residential wastewater customer with a 3/4-inch water meter experienced a monthly rate decrease of \$5.71, or approximately 14.83 percent, from \$38.50 per month to \$32.79 per month.
6. On February 28, 2011, Johnson Utilities files a request to amend Decision No. 71854 pursuant to ARS 40-252. Commission voted to reopen the case on July 12, 2011. (Procedural order lays out procedural history -- <http://docket.images.azcc.gov/0000127654.pdf>).
7. On August 2, 2011, Commission holds a public comment meeting on Johnson's rehearing application in San Tan Valley.
8. On August 11, 2011, Commission considers but rejects Johnson Utilities request for recovery of income tax expense. The Commission determined that certain of the Company's requested modifications to Decision No. 71854 did not warrant further Commission consideration, but voted to direct Staff to

prepare and docket an order incorporating the following requested modifications to be considered at its September Open Meeting:

1. The change of the wastewater late fee from \$40 per month to 1.5 percent per month.
 2. The addition back of \$18,244,755 in disallowed wastewater plant, which includes the \$10,892,391 disallowance for inadequately supported plant and the \$7,352,364 disallowance related to affiliate profit.
 3. The reinstatement of hook-up fee tariffs for water and wastewater divisions.
 4. The determination of a rate of return of 8.0 percent for the wastewater division.
 5. The inclusion of language permitting the Company to request income tax expense prospectively in a future A.R.S. 40-252 Petition if the Commission changes its policy relating to imputed income tax expense.
9. On August 26, 2011, Staff filed information regarding the rate impact of changing Decision No. 71854 as discussed in the August 11 open meeting. <http://docket.images.azcc.gov/0000129081.pdf>
10. On September 6, 2011, the Commission voted to modify Decision No. 71854. Decision No. 72579, which amended Decision No. 71854, did not change rates for water customers, but a residential wastewater customer on a 3/4-inch meter experienced an increase of \$6.56 or approximately 20 percent over the rates approved in Decision No. 71854, from \$32.79 to \$39.35 per month.
11. On July 16, 2013, the Commission approved an imputed income tax expense for Johnson Utilities by a 4 to 1 vote (<http://docket.images.azcc.gov/0000146924.pdf> -- Brenda Burns dissenting). The typical bill impact for a 3/4-inch meter residential customer using the average of 6,931 gallons per month was \$0.47 for a water customer and \$2.65 for a wastewater customer.

Generic Water Workshop Docket (06-0149)

1. On January 4, 2011, Chairman Pierce scheduled a Staff Meeting in which he explained his belief that the Commission had mistakenly failed to allow income tax recovery for Sunrise Water Company and Johnson Utilities and expressed a desire to study the issue generically in upcoming water workshops as well as in any forthcoming rate cases (e.g., Pima Utilities Case). (In the same Staff Meeting, Commissioner Pierce expressed his belief that the Commission had inappropriately deducted unexpended hook-up fees from rate base in the past. I believe Utilities Division Director, Steve Olea, explained to the Commission at this time that he agreed with Commissioner Pierce on this issue and that Staff would no longer recommend deduction of unexpended hook-up fees in future rate cases. I cannot confirm if my memory is correct because the audio of this Staff Meeting is no longer hosted on the Commission's website.)
2. On February 25, 2011, Commission Staff docketed notice of the imputed income tax workshop (<http://docket.images.azcc.gov/0000123363.pdf>). The workshop was held on March 25, 2011. Audio and video of this meeting is no longer hosted on the Commission's website, but three presentations can be found on eDocket: (Staff presentation <http://docket.images.azcc.gov/0000124177.pdf>) (Jeff Crockett presentation <http://docket.images.azcc.gov/0000124240.pdf>) (Ray Jones presentation <http://docket.images.azcc.gov/0000138136.pdf>)
3. On June 15, 2012, Chairman Pierce docketed a draft policy regarding income tax expense for pass-through entities. (<http://docket.images.azcc.gov/0000137466.pdf>)
4. On June 27, 2012, Staff filed a Staff Report recommending against Commissioner Pierce's draft income tax policy. (<http://docket.images.azcc.gov/0000137598.pdf>)
5. On July 3, 2012, Paul Walker filed comments in favor of Commissioner Pierce's draft policy (<http://docket.images.azcc.gov/0000137724.pdf>).

6. On July 12, 2012, Bonnie Oconnor filed comments in favor of Commissioner Pierce's draft policy. (<http://docket.images.azcc.gov/0000137999.pdf>)
7. On July 17, 2012, AARP filed 172 emails against Commissioner Pierce's draft policy. (<http://docket.images.azcc.gov/0000138061.pdf>)
8. On July 17, 2012, Craig Marks filed comments in favor of Commissioner Pierce's draft policy. (<http://docket.images.azcc.gov/0000138042.pdf>)
9. On July 20, 2012, Ray Jones filed comments in favor of Commissioner Pierce's draft policy. (<http://docket.images.azcc.gov/0000138136.pdf>)
10. On February 11, 2013, Commissioner Pierce docketed a revised draft income tax policy. (<http://docket.images.azcc.gov/0000142249.pdf>)
11. On February 12, 2013, the Commission voted to approve Commissioner Pierce's revised draft income tax policy. (<http://docket.images.azcc.gov/0000142958.pdf>)

Pima Utilities Company (11-0329)

1. File rate case 8/29/11 with Commissioner Spitzer as witness on the imputed income tax issue. (<http://docket.images.azcc.gov/0000136182.pdf>)
2. On May 29 through June 1, 2012, the Commission holds hearings on Pima Utility rate case. Commissioners paid close attention to Commissioner Spitzer's testimony on the income tax issue.
3. On September 28, 2012, Jibillian docketed a recommended opinion and order, disallowing recovery of income tax expense. (<http://docket.images.azcc.gov/0000139725.pdf>)
4. On October 24, 2012, Pima Utilities files exceptions but does not take exception to the income tax treatment due to the Commission not appearing ready to change its policy. Pima Utilities requests the Commission to continue studying the issue in the generic proceedings. (<http://docket.images.azcc.gov/0000140171.pdf>)
5. On November 7, 2012, Chairman Pierce docketed Pierce proposed amendment 1 to allow recovery of an imputed income tax expense if the Commission changes its policy in the future. (<http://docket.images.azcc.gov/0000140400.pdf>)

Summary

Of course, this information does not answer all of the questions raised in the indictment. For example, it does not answer the question of whether the payments made to Sherry Pierce from Nov. 2011 to August 2012 and the December 2012 emails concerning the potential acquisition of property were benign or malignant.

It does answer some of the questions though:

1) The allegations in indictment do not adequately explain Commissioner Pierce's actions and activities regarding the income tax treatment for tax-pass through entities.

2) The statement in paragraph 3 of the indictment that Commissioner Pierce rejected Johnson's position on the income tax issue in 2010 is erroneous. On June 25, 2010, Commissioner Pierce docketed a proposed amendment to adopt the Company's position on the income tax issue and remained consistent in his view on that issue since he first developed it in December 2009 in the Sunrise Water case.