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SOAH DOCKET NO. 473-20-4709.WS  
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PUBLIC UTILITY COMMISSION  
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APPLICATION OF MONARCH § BEFORE THE STATE OFFICE OF  
UTILITIES I L.P. FOR AUTHORITY §  
TO CHANGE RATES § ADMINISTRATIVE HEARINGS

**MONARCH UTILITIES I L.P.'S RESPONSE TO COMMISSION STAFF'S  
NINTH REQUEST FOR INFORMATION**

To: Public Utility Commission of Texas (Commission), by and through its attorney of record, Rashmin J. Asher, Legal Division, 1701 N. Congress Avenue, P.O. Box 13326, Austin, Texas 78701.

Monarch Utilities I L.P. (Monarch) files its Responses to Public Utility Commission Staff's (Commission Staff) Ninth Request for Information (RFI) to Monarch received on November 23, 2020. Pursuant to an agreement between Monarch and Commission Staff, these responses are timely filed. Pursuant to 16 Tex. Admin. Code (TAC) § 22.144(c)(2)(F), Monarch agrees and stipulates that all parties may treat the responses as if the answers were filed under oath.

Respectfully submitted,

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& TOWNSEND, P.C.**  
816 Congress Avenue, Suite 1900  
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(512) 322-5800  
(512) 472-0532 (Fax)

/s/ William A. Faulk, III

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**ATTORNEYS FOR MONARCH UTILITIES I  
L.P.**

**CERTIFICATE OF SERVICE**

I hereby certify that notice of the filing of this document was provided to all parties of record via electronic mail on December 1, 2020, in accordance with the Order Suspending Rules, issued in Project No. 50664.

/s/ William A. Faulk, III

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WILLIAM A. FAULK, III

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**MONARCH'S RESPONSE TO  
COMMISSION STAFF'S NINTH RFI**

In reference to the Redacted Rebuttal Testimony of Victoria R. Shupak, beginning page 9, line 19, through page 10, line 6:

**Staff 9-1** Admit or deny: no federal income tax was paid on the gain being recognized as income on MUI each year as a result of New Mexico Utilities, Inc. (NMUI).

**RESPONSE:** Admit. No income tax was paid given the consolidated group net operating losses. However, the income recognized for NMUI did create a federal income tax liability.

Prepared by: Victoria Shupak, Monarch Utilities I L.P.

Sponsored by: Victoria Shupak, Monarch Utilities I L.P.

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**MONARCH'S RESPONSE TO  
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**Staff 9-2** Would the gain recognized as income on MUI each year be deferred for tax purposes if MUI was not consolidated for tax purposes with its affiliates?

**RESPONSE:** The gain from the condemnation and sale of New Mexico Utilities, Inc. in 2009 would be deferred and recognized as income each year, even if MUI was not consolidated for tax purposes.

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**MONARCH'S RESPONSE TO**  
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**Staff 9-3** With regard to the statement on page 9, lines 8–10, explain in detail why the loss for Wiedenfeld Water Works should be included when calculating the consolidated tax savings adjustment.

**RESPONSE:** In Docket No. 50319, Monarch requested approval to transfer the assets, customers, and CCNs of SWWC Utilities, Inc. dba Water Services, Inc. to Monarch. Wiedenfeld Water Works (“WWW”), as part of SWWC Utilities, Inc. dba Water Services, Inc., is included in that transfer. On November 4, 2020, the Commission issued an order in Docket No. 50319 approving the transaction to proceed. WWW was included in Monarch’s cost of service and rate filing package as a known and measurable adjustment. Therefore, WWW should be included in Monarch’s results when determining the consolidated tax savings adjustment.

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**Staff 9-4** Did the Wiedenfeld Water Works loss decrease the annual federal income tax liability of MUI or any of its affiliates? If the answer is yes, please provide appropriate documentation to support this assertion.

**RESPONSE:** Yes. Please see Confidential Attachment DL-1 to the direct testimony of Debi Loockerman for supporting information from the consolidated tax return taken from Schedule II-E-23 of Monarch's rate filing package. This documentation provides the detail of income and offsetting losses included in the taxable income calculation for the consolidated group. Specifically, please reference the Wiedenfeld Water Works column included in this documentation showing a taxable loss of \$75,360.

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**Staff 9-5** Please reference the tax laws that supported the assertion that the \$75,360 loss due to the purchase of Wiedenfeld Water Works should be included as an adjustment to consolidated tax savings.

**RESPONSE:** Monarch filed a consolidated tax return with its affiliates as allowed under federal tax law. The consolidated tax savings adjustment is not a requirement under federal tax law but rather a requirement under Tex. Water Code § 13.185(f) for ratemaking purposes. Please see Monarch's responses to Staff 9-3 and Staff 9-4 for the reasons why the WWW loss should be included in the consolidated tax savings adjustment.

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**Staff 9-6** With regard to the statement on page 10, lines 1–2, provide documentation that MUI is paying the tax deferred by NMUI.

**RESPONSE:** In the 2009 federal consolidated tax return of SouthWest Water Company and Subsidiaries, NMUI elected to defer the gain associated with an involuntary conversion of its water and wastewater assets under Internal Revenue Code (IRC) Section 1033 (a) (2) and Regulation Section 1.1033(a)-2(c). Please see ***Confidential*** Attachment Staff 9-6.1, being filed under seal, for a copy of the election filed with the IRS.

Section 1033 of the Internal Revenue Code (IRC 1033) allows a company that has experienced an involuntary conversion (condemnation) to defer the tax gain if it replaces the condemned assets with similar assets within a specified period of time. At the time of the condemnation and sale in 2009, NMUI was a direct subsidiary of SouthWest Water Company (the same parent as MUI). NMUI purchased the stock of MUI from SouthWest Water Company, which satisfied the requirement under IRC 1033 to replace the condemned assets with similar assets. This then allowed the deferral of gain from the condemnation and sale of NMUI. As such, the tax basis of MUI's operating assets had to be reduced by the gain generated on the condemnation under IRC 1033.

IRC 1033 further provides the manner that this deferred gain is recognized as income in future years. The gain deferred by NMUI will be recognized incrementally in years 2009 through 2034 with its replacement assets. This gain recognition results in less tax depreciation over time creating more taxable income and more tax for MUI. Please refer to ***Confidential*** Attachment Staff 9-6.2, being filed under seal, for a schedule of the annual recognition of the NMUI IRC 1033 gain by MUI. Additionally, ***Confidential*** Attachment Staff 9-6.3, being filed under seal, provides the page of the 2018 SW Merger and Subsidiaries consolidated tax return that displays the inclusion of MUI's annual IRC 1033 gain recognition for 2018.

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**Staff 9-7** Please explain why it is reasonable that MUI pay the tax deferred by NMUI when the tax is a result of MUI's actions rather than NMUI's net income.

**RESPONSE:** MUI is simply paying the deferred tax in accordance with federal tax law. Section 1033 of the Internal Revenue Code ("IRC 1033") allows a company which has experienced an involuntary conversion (condemnation) to defer the tax gain if it replaces the condemned assets with similar assets within a specified period of time. At the time of the condemnation and sale in 2009, NMUI was a direct subsidiary of SouthWest Water Company (the same parent as MUI). NMUI purchased the stock of MUI from SouthWest Water Company, which satisfied the requirement under IRC 1033 to replace the condemned assets with similar assets. This then allowed the deferral of gain from the condemnation and sale of NMUI.

IRC 1033 further provides the manner that this deferred gain is recognized as income in future years. The tax basis of MUI's operating assets must be reduced by the gain generated on the condemnation. This tax basis reduction results in less tax depreciation over time creating more taxable income and more tax for MUI.

Prepared by: Kent Cauley, Monarch Utilities I L.P.  
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**Staff 9-8** Given MUI's assertion on page 10, line 2 that "MUI is paying the tax deferred by NMUI," please explain how the statement on page 10, lines 8-10, "The stock acquisition will not affect the rates charged by Monarch Utilities I, LP (LP) and will not alter any of the existing operations" is a true statement.

**RESPONSE:** The statement on page 10, lines 8-10 specifically indicates that rates charged by Monarch will not be affected by the NMUI transaction. This is true in that the tax paid by MUI on the deferred gain is not included as income tax expense in the Monarch rate application. As a result, Monarch is not requesting an increase in rates related to higher taxes from this deferral of gain. In the same light, the gain must be removed from the consolidated tax savings adjustment calculation so it does not affect the rates of Monarch. If this gain is not removed from the calculation, Monarch's rates would be inappropriately reduced directly as a result of the NMUI transaction. The statement and intent for setting Monarch's rates is to remove the effects of the NMUI transaction entirely as if it did not occur.

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**Staff 9-9** Reference page 9, lines 8 through 11 regarding the tax loss of \$75,360 due to the purchase of Wiedenfeld Water Works. Provide the tax documents, or identify the document in the record, that show the \$75,360 loss reduced taxable income on the consolidated tax record that included MUI's income.

**RESPONSE:** Please see Confidential Attachment DL-1 to the direct testimony of Debi Loockerman for supporting information from the consolidated tax return taken from Schedule II-E-23 of Monarch's rate filing package. This documentation provides the detail of income and offsetting losses included in the taxable income calculation for the consolidated group. Specifically, please reference the WWW column included in this documentation showing a taxable loss of \$75,360.

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