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IDAHO PUBLIC
UTILITIES COMMISSION

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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE PETITION OF SUEZ WATER IDAHO, INC. FOR AUTHORIZATION TO ELIMINATE COLLECTION OF GROSS-UP PAYMENTS ASSOCIATED WITH CONTRIBUTIONS IN AID OF CONSTRUCTION	Case No. SUZ-W-20-01

DIRECT TESTIMONY OF JARMILA CARY

ON BEHALF OF SUEZ WATER IDAHO INC.

JUNE 22, 2020

Q. Please state your name and business address.

A. My name is Jarmila Cary. My business address is 8248 West Victory Road, Boise, Idaho 83709.

Q. By whom are you employed, and in what capacity?

A. I am the Director of Finance and Customer Service for SUEZ Water Idaho Inc. ("SUEZ" or "Company").

Q. Please summarize your professional experience and educational background.

A. I was granted a Bachelor of Science in Business, with a major in Accounting, from the University of Idaho in December 1996. I have been employed by SUEZ since June 1997 as Senior Accountant and later as Manager of Accounting except for a brief leave of absence from June 2008 through August 2009. I became Director of Finance in September 2015. In March 2018 my role expanded to include oversight of Customer Service.

Q. Please describe your duties as Director of Finance and Customer Service.

A. I have oversight over the Company's financial activities including planning, variance analysis, operational reporting, payroll, accounts payable, and development and monitoring of business metrics. I participate in rate filings, monitor capital expenditure investment, and define and implement changes in management initiatives. I am also the key contact person within SUEZ's Idaho Division for centralized functions such as Accounting, Audit, Tax, Treasury and Procurement. In March 2018, my role expanded to include oversight of the Customer Service department, including billing functions, call center, meter reading, customer service field work activities, cashiering, etc. Additionally, I provided testimony before the Idaho Public Utilities Commission in the Company's 2011 and 2014 general rate cases, 2018 filing for approval of sale and acquisition of Eagle Water Company, and 2019 filing for exemption from Utility Customer Relation Rules 311(4) and (5) related to customer contact requirements, accepting payments during disconnection, and eliminating customer convenience fees.

Q. What is the purpose of your testimony?

A. The purpose of this testimony is to support and further describe SUEZ's proposal to no longer collect the federal and state income tax gross-up amount related to Contributions in Aid of Construction (CIAC).

Q. Would you please summarize your testimony?

A. My testimony describes contributions in aid of construction (CIAC), the tax gross-up component of CIAC, how this historically has been treated for rate-making and corporate income tax purposes, the 2017 Federal Tax Cuts and Job Act which eliminated the exemption from income taxation on CIAC for water utilities, the Company's proposed changes, and the associated impact to customers.

Q. Would you please explain what CIAC is?

A. Contribution in Aid of Construction (CIAC) is a cash payment, or services or property received from a person, business or governmental agency, provided at no cost to a regulated public utility for facility construction purposes. CIAC contributions are collected and used by the utility to offset the costs in excess of the utility's approved cost for expansion, improvement, or replacement of the water facilities to provide service to new customers through a water main extension or for special facilities associated with providing service to a non-contiguous (isolated, not inter-connected) water system, or certain other circumstances. Contributed payments or property are categorized as a "CIAC Contribution" or an "Advance." As a result of the recent tax law changes, starting in 2018 both CIAC and Advances were again included as taxable income to water utilities. While CIAC contributions for water distribution facilities (water main line extensions) are non-refundable, Advances relate to source of supply, storage and booster pumping facilities (ie. construction of a new well). Advances also are partially refundable to the party who requested service (if that party has completed a Special Facilities Agreement allowing for refunds) because these facilities expand the utility's capacity to serve additional customers. The amount of the original Advance refunded per customer connection is based on the formula outlined in the utility's tariff and the refund occurs as customers connect to receive service during the term of the agreement. SUEZ's agreements for advanced property are for a 15-year period. Un-refunded Advances for construction convert to CIAC at the expiration of that term and remain on the books of the utility as a permanent reduction to the rate base investment.

CIAC is collected as a utility company receives customer requests for infrastructure additions to provide service to customers that cannot be serviced economically. For example, the additional revenue requirement resulting from the cost of connecting water pipes to a remote location would likely exceed the revenues that would be recovered from the customers served through existing rates. As utilities cannot recover the projected costs by raising utility prices (either at the individual or the collective level) absent approval by the public utility commission, customers requesting uneconomic services must make an upfront payment for the cost of the project. CIAC is collected from the developer, home builder, or customer to prevent existing customers from incurring excess costs required for connecting new customers. The CIAC amount is determined using a methodology as defined in the utility's tariff. The utility maintains control of the contributed infrastructure along with responsibility for its maintenance and operation. In addition, an estimated amount of CIAC for a water main extension is paid upfront by the party requesting utility service for later true-up after completion of the construction project.

Q. Where in SUEZ's tariff are developers required to provide facilities for extension of service?

A. SUEZ's Tariff includes provisions for Special Facilities, which state:

74. Special facilities shall include source of supply, storage, and booster pumping facilities which may be required to render adequate water service to an area for which such service has been requested. Special facilities to not include transmission or distribution line facilities.

75. Should an Applicant propose a Residential, Commercial, Industrial or Municipal Development requiring a special facility or special facilities, the Applicant shall advance the cost of such facility or facilities.

For <u>individual residential customers</u> when a company water main does not front a customer's property, the utility company will pay for water main line extension if the cost does not exceed $500 per service connection. Where the cost exceeds $500 per connection, the customer shall incur the additional cost calculated using cost of installing an 8" inside diameter main, and enter into Main Extension Agreement with the utility. See ¶ 64

Q. Is the contribution provided to the company typically a large or small amount?

A. Contributed property or payments made to SUEZ are based on the scope of the construction project, number of customer connections, and infrastructure required to provide utility service to those customers. The range of CIAC provided to SUEZ for projects completed during the period from 2016 through March 2020 ranged from $4,700 to nearly $1,570,000, with an average contribution amount of $128,510 (*see* Cooper Direct, Exhibit 2).

Q. How has CIAC historically been treated for purposes of ratemaking for water utilities?

A. The CIAC contributed amount (or any property acquired or constructed with the amount) is not included in the utility's rate base for ratemaking purposes. The rate base investment that the utility company is allowed to earn a return on is reduced by the amount of contributed property. The contributions remain on the books of the company as a permanent contra-asset, depreciated at the same rate as the associated plant facility. When the associated plant is retired and removed from service, the related contributions remain and continue amortizing at the same rate.

Q. How has CIAC historically been treated under the federal tax code for water utilities?

A. Under the Tax Reform Act of 1986, contributions in aid of construction were designated as taxable income to utility companies. Subsequently, the Tax Reform Act of 1996 enacted an exemption that made water and sewer utilities exempt from recording CIAC as taxable income. The Tax Cuts and Jobs Act of 2017 (TCJA), which reduced corporate income tax rates, also eliminated the 1996 exemption from taxable income for CIAC. As of January 2018 the TCJA required water and sewer utilities to once again incur income tax on contributed or advanced property.

Q. What has the IPUC done in response to the changes to the tax code you have just described?

A. On December 16, 1987, the Commission issued Order No. 21660, which initiated an investigation into the treatment of CIAC and requested regulated utilities to recommend methods of treating the associated CIAC tax for rate making purposes. Based on the individual aspects of each utility company, the Commission Order declined to set a standard policy for all utilities and instead allowed utilities to adopt one of several different methodologies. These included: 1) charging its shareholders the additional expense for the tax on the CIAC with no impact to utility customers (as proposed by Pacific Power and Light Company); 2) small water and telephone utilities could utilize a full gross-up method whereby the person making the contribution would pay the full tax obligation on the contribution. The utility would depreciate the contribution for tax purposes and pass through that benefit to ratepayers; 3) Boise Water Corporation (now SUEZ), as the only "large" water utility, was authorized to enter into escrow agreements with developers (*see* Order No. 20955); 4) for co-generators and small power producers, the net present value method was used, in which the contributor was given the benefit of the net present value of tax depreciation. Under this method, no residual is absorbed by the utility or ratepayers.; and 5) other utilities were allowed to treat the income tax paid on contributions in aid of construction as rate based and charge it to the ratepayers over time. Another method considered but not adopted, was proposed by Intermountain Gas Company. It proposed that CIAC be grossed-up for net present value of the revenue requirement for rate base treatment of the tax on the contribution.

In 2017, when the 1996 CIAC exemption was eliminated, the Commission issued Order 33965 in Case No. GNR-U-18-01. This Order required regulated utilities to account for the financial benefit of the TJCA tax rate reduction as a deferred regulatory liability and to file a report with the Commission identifying and quantifying all tax changes, and propose appropriate tariff changes.

Q. Describe SUEZ's filing and IPUC Order addressing the most recent change in tax code.

A. In March 2018 SUEZ filed its report with the Commission in response to Case GNR-U-18-01 Order 33965, regarding the impact of the tax law changes on the cost and rates of the Company and proposed to address deferred tax liabilities in a future general rate case. The Company also sought Commission approval to gross-up contributed property for the new CIAC income tax obligation.

Effective June 1, 2018 in case GNR-U-18-01, Order No. 34074, SUEZ received authorization by the Commission to decrease its rates by $2,722,791 or 5.6% and to gross-up its CIAC calculation for the tax obligation. The calculated 21.56% tax gross-up to be collected from developers was based on the difference between the tax cost to the utility less the present value of the future tax benefits of depreciation expense deductions associated with contributed property.

Q. What impacts have these approved changes to SUEZ's tariff regarding CIAC and related tax obligation had on SUEZ customers?

A. As the Company has subsequently learned, the TJCA has dramatically impacted development and imposed a tax on utility companies for all contributions received. Also, because the taxability of CIAC does not impact publicly-owned municipal water companies, public utilities are at a competitive disadvantage in attracting growth within its service area. As a result, builders are burdened with the tax on CIAC. SUEZ believes this is driving housing and construction costs higher and that those costs are being passed on to home buyers. All else being equal, developers have a disincentive to undertake projects in public utility service areas because passing the CIAC tax cost to developers adds additional development costs to each construction project. SUEZ has experienced such situations, which are described in Witness Cooper's direct testimony and Exhibit 3. This also has a detrimental effect on existing public utility customers because absent development, there are fewer new customers to help absorb costs.

To avoid incurring this added CIAC tax cost, developers may opt to form and operate their own small water systems which will have significant ramifications in the future as they will face water quality regulation changes and may not have the funding necessary to keep investing in the facility infrastructure, maintenance, and replacement.

Q. What is the current CIAC tax requirement in the SUEZ tariff?

A. Based on Order 34074 effective June 2018, SUEZ began collecting the 21.56% tax gross-up on CIAC from developers and incurring a CIAC tax liability from January 2018.

Q. What change(s) is the Company requesting?

A. While contributions remain taxable under Federal tax law, to prevent impediments to future development within SUEZ's service area and keep customer costs low, the Company is proposing to adopt the "no CIAC tax gross-up" method. Under this approach, SUEZ would pay the taxes on CIAC instead of collecting the funds to pay the tax from developers. The income tax effect will be recorded in the accumulated deferred income tax (ADIT) accounts which will reduce ADIT in future rate cases. Future tax depreciation funded by non-grossed up CIAC will cause the deferred tax asset to reverse over its tax life, increasing ADIT liabilities as the tax benefit of the additional depreciation is realized over time. This future depreciation reduces current tax expense and incrementally reduces the revenue requirement in future rate cases.

The associated tax on CIAC would be included in rate base and the deferred tax balances would be amortized over a proposed 25-year period.

Q. What would be the wording of a revised tariff?

A. 1) SUEZ's tariff pages Sheet 26 will be modified to remove Section 85 and also the Tax Gross-up Factor Template.

2) Remove "income tax," reference from Water Main Extension Agreements, sections 2 and 3, Sheets 27, 33 and 36:

3) Remove "income tax," from for Non-Contiguous Water System Agreements section 4, Sheet 43 and from section 6 on Sheets 44 and 45:

These tariff changes are reflected in Exhibits A and B to SUEZ's Petition filed contemporaneously herewith, which include an underline and strikeout version of the affected portions of SUEZ's tariff (Exhibit A) and a clean version of the tariff showing the proposed changes incorporated (Exhibit B).

Q. What are the benefits to existing customers of the requested changes?

A. Based on the Company's analysis of developer-funded construction projects from 2016 forward (*see* Witness Cooper's direct testimony and Exhibit 1), the average annual revenue from development projects was more than sufficient to cover the revenue requirement of the CIAC tax obligation, as well as the added incremental operating cost for serving those customers. SUEZ believes that if the Company pays the tax obligation on CIAC rather than collecting it from developers that will remove a barrier for growth and help keep customer charges low. Because growth is self-sustaining and benefits existing customers by spreading costs over a larger customer base, and because of its experience post-TCJA implementation, the Company asserts that requiring developers to fund the utility's tax obligation for CIAC is ultimately detrimental to SUEZ's existing utility customers.

This proposed change will not harm and will ultimately benefit customers because the revenue generated by these developments more than offsets the revenue requirement of the tax if paid by the Company.

Q. How will developers already in the process be treated? Will there be any "refund" of gross-up previously collected from developers?

A. The Company is proposing to cease grossing-up contributed property at the effective date of the Commission's Order authorizing this change. The date the CIAC becomes taxable is the date of the transfer of ownership to SUEZ, so for projects that are not closed as of the effective date of a Commission Order authorizing the change, the gross-up would be refunded. For those projects that have closed before such an Order and the tax liability to SUEZ has accrued, the gross-up would be retained. Otherwise, the proposed changes would impact only future development projects going into service after the effective date of the Commission's Order and so long as the existing tax laws remain in effect.

Additionally, even though the Company's CIAC income tax obligation began at the beginning of 2018, the Company was not authorized to collect tax on contributions between January and June 2018. The Company is not seeking to collect any tax retroactively from developers. The tax collected to date will offset the Company's associated CIAC tax obligation.

Q. What is the estimated average annual CIAC tax collected and how would this impact SUEZ's current customers?

A. Depending on the development activity and construction projects initiated, SUEZ received between $5M and $8M in CIAC contributions annually, since 2014.

Using the existing 21.56% tax gross up rate on contributions, the associated tax obligation collected would range between $1M and $2M annually. A $2M average annual CIAC tax obligation compared to a rate base investment of $180M is approximately 1%. The average annual revenue from the 2016 - March 2020 completed developer construction projects using a 2019 average revenue by meter size, was $16,055 and is approximately 5 times higher than the approximate $3,200 revenue requirement needed for CIAC tax (see Witness Cooper's Exhibit 2). Based on this analysis, development growth and the revenue it generates is more than sufficient overall to cover the revenue requirement for the CIAC tax obligation when paid by the Company. By removing this barrier for growth, current customers will benefit from an increase in future projects.

Q. Does this conclude your testimony?

A. Yes.