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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF VEOLIA WATER IDAHO, INC. FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER SERVICE IN THE STATE OF IDAHO	)))))))	**CASE NO. VEO-W-22-02**

REBUTTAL TESTIMONY OF JAMES CAGLE FOR

VEOLIA WATER IDAHO, INC.

MARCH 8, 2023

Q. Please state your name, occupation and business address.

A. I am James C. Cagle, Vice President, Rates and Regulatory Affairs for Veolia Water MS (Paramus), Inc. ("VWM&S"). My business address is 461 From Road, Paramus, NJ 07652.

Q. Are you the same James Cagle that filed direct testimony in this proceeding?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to discuss:

Staff's proposed ratebase calculation as it relates to average vs. end of period

Staff's and micron's comments regarding the Company's proposed DSIC mechanism.

Removal of deferred debits appropriately included in rate base.

Staff's proposal regarding working capital

Staff's proposed adjustments to VWM&S costs

Q. Please describe Staff's proposed rate base treatment.

A. As described in Mr. English's testimony on page 8, lines 19, Staff calculated rate base using the Average of Monthly Averages.

Q. What is the difference between Staff's proposed rate base and the test year end rate base as of December 31, 2022?

A. Per Staff's work paper included as Exhibit 102 attached to Mr. English's testimony, Staff's proposed rate base is $261,118,238. Per that same work paper, the rate base as of December 31, 2022 would be $275,069,384. So Staff's proposed rate base, using the Average of Monthly Averages approach, is $13,951,146 less than rate base ending December 31, 2022.

The rate base proposed by the Company, projected to March 31, 2023 and updated through the rebuttal testimony of Mr. Njuguna, is $280,685,480. Staff's use of the Average of Monthly Averages approach results in a proposed rate base that is substantially lower than the Company's proposal. If Staff were to use rate base as of December 31, 2022, it would still be lower than the Company's proposal, but the difference is much less. .

Q. When are rates anticipated to become effective in this case?

A. Currently the Company would anticipate the Commission would render a decision in mid-April for rates effective around May 1, 2023.

Q. If the Commission were to adopt Staff's average rate base methodology, would the costs associated with that rate base match the period of recovery?

A. No. Utilizing the amounts provided in Staff's rate base referenced above, no recovery would be allowed approximately $14 Million of rate base in service as of December 31, 2022, creating significant regulatory lag.

Stated another way, if the Commission adopts Staff's rate-base methodology, the Company will be unable to recover approximately $1.4 Million in revenue requirement during this rate case. This creates a lag in recovery that, in turn, can result in under-recovery and more frequent rate cases.

Q. How quickly is the company's ratebase increasing?

A. The Company's last rate case was settled and no rate base amount was stated in the Order. However, comparing the projected rate base as of March 31, 2021 as filed in the Company's last rate case filing of approximately $229.6 Million to the projected rate base as of March 31, 2023 of approximately $280.7 Million, rate base has increased approximately $51M or approximately 11% per year. If adjusting for the Eagle water acquisition adjustment and reduction in the TCJA regulatory liability, rate base is increasing approximately 8.5% per year.

Q. What is the current inflation rate?

A. The inflation rate, measured by the percent change in the consumer price index, over the past two years has averaged 6.35%. (4.7% in 2021, and 8.0 in 2022). The latest information for 2023 indicates a 6.4% rate of inflation. While this is not as great as the double-digit inflation seen in the late 1970s and early 1980s, the inflation rate is substantially higher than in most years since then.

Q. Does utilizing an average rate base allow the company an adequate opportunity to earn a reasonable rate of return?

A. Considering the increases in rate base, and inflation, no. If the Company's recovery is based on backward-looking averages of ratebase in prior months, in an environment of high inflation and large increases in rate base, the Company's recovery will always be substantially lower than current ratebase would allow. When the four-month lag between investment and recovery is added to this, the Company's rate of return can be substantially below what it is entitled to."

Q. Staff references previous commission Orders that discuss revenue increases and cost savings resulting from capital expenditures. Please discuss.

A. As related to revenues, the Company's revenue normalization includes annualized customer growth both to the end of December (in its response to Production Request No. 163) as well as additional customer growth through March 2023 in order to match revenues to the test year end. As related to cost savings, there might be some small savings in maintenance costs. However, these small savings would pale in comparison to the inflation and additional capital expenditures that will occur during the period between the midpoint of Staff's average test year and the date on which rates will go in effect.

Stated another way, the period of time between the midpoint of Staff's proposed average test year and the date on which new rates will go into effect is approximately 10 months. In this environment of inflation and large investments, the Company's rate base will increase substantially during that 10 months, and any small savings can be expected to be immaterial. Staff's approach would decrease or deny the opportunity to recover on the value of investments made during this period.

Q. What is your recommendation?

A. It is difficult to adopt recommendations that address such issues when the result is the matching of rates to recover the costs in which rates will go into effect increase rates to customers. However, our recommendation is that the Commission reconsider the old Orders relied on by Staff and consider the regulatory lag created, the mismatch in revenues to rate base, ratebase growth, inflation, from a holistic standpoint and utilize a test year end rate base in this case.

Working Capital

Q. Is Staff's elimination of the Company's proposed Working capital allowance appropriate?

A. No. As Staff states, utilizing a 1/8th method is one of the generally accepted methods of calculating working capital.

Q. Is the Company's proposed working capital allowance calculated as Staff stated?

A. Not exactly. While generally correct, the Company's calculation utilized O&M expense and removed amortization expense amounts which could be considered non-cash. The Company then applied the 1/8th method to the remaining amount to arrive at the Cash Working Capital Allowance. The balance of materials and supplies and prepayments were then added to arrive at the total Cash Working Capital Allowance.

Q. What is your recommendation?

A. As an acceptable methodology, I believe the proposed Working Capital Allowance is appropriate ($3,997,317 at December 31, 2022 or $4,282,288 as projected at March 31, 2023) as adjusted for the O&M expense per this rebuttal. However, if the Commission agrees with Staff regarding Cash Working Capital, the balance of Materials and Supplies and Prepayments $1,583,204 at December 31, 2023 or $1,555,760 as projected at March 31, 2023) should be included in rate base. Were the Company to have performed a lead/lag study to calculate working capital, these items would have been included as separate line items in rate base.

Distribution System Improvement Charge ("DSIC")

Q. Does Staff support implementation of a DSIC?

A. No. While supporting the company's work to replace or upgrade aging infrastructure, staff's position is that recovery through traditional ratemaking is appropriate as described in Mr. Culbertson's testimony (page 18 beginning on line 7). Staff also points out that other Idaho utilities have been denied such mechanisms.

Q. Have States that have DSIC or similar infrastructure mechanisms also allowed similar mechanisms for electric and gas utilities?

A. No. While other interim cost recovery mechanisms for electric and gas utilities may exist, many states have allowed DSIC or DSIC like mechanisms only for water companies recognizing the need for such mechanisms to provide for the replacement of aging infrastructure. Per the National Association of Water Companies, of the 24 States allowing DSIC, only two (Pennsylvania and West Virginia) allow DSIC for other utility sectors.

Q. Would Staff have an opportunity to review the projects included in the DSIC?

A. Yes, this is a component of the DSIC mechanism as described in my previous testimony.

Q. Would the implementation of a DSIC mechanism address a portion of the regulatory lag issues when utilizing an average historic test year?

A. Yes, in part. Because recovery of DSIC infrastructure would begin between full rate case filings, it would partially assist in reducing regulatory lag. However, it would not address the regulatory lag created at the time of implementation of rates in a rate case.

Q. How are DSIC mechanism viewed by rating agencies?

A. DSIC mechanisms are viewed favorably by rating agencies. S&P Global in its research update dated September 5, 2019, (Included as Exhibit No. 18) describes this view. "Our assessment of SWR's[1] and SWNJ's[2] business risk profiles are based on both entities' lower-risk and rate-regulated water and wastewater utility businesses. SWR serves about 2.1 million customers across New Jersey, New York, Delaware, Rhode Island, Pennsylvania, and Idaho, whereas SWNJ serves about 1.2 million customers in New Jersey and New York. We view both companies' management of regulatory risk as above

[1] Now Veolia Utility Resources LLC.
[2] Now Veolia Water New Jersey, Inc.

average, partially reflecting the extensive use of constructive regulatory mechanisms, including distribution system improvement charge (DSIC) riders, a revenue decoupling mechanism, and multiyear rate plans in certain jurisdictions. Under our base-case scenario, we expect that the companies will continue to effectively manage regulatory risk, in part due to the frequency of rate case filings, and will continue to use riders that we collectively view as favorable for both companies' credit quality."

Q. Does Staff discuss the benefits Idaho customers receive from the S&P Global rating?

A. Staff witness Terry discusses the benefits customers receive by being a subsidiary of VNA being lower debt rates as well as benefit from gaining economies of scale with purchasing inventory. Idaho ratepayers are certainly benefiting from constructive mechanisms in the other five Veolia utility states that have revenue decoupling, partially and fully forecasted test years, as well as DSIC mechanisms.

Q. Did Micron's witness York make any suggestions regarding the DSIC Mechanism?

A. Yes. Ms. York suggested including a reduction for the depreciation expense associated with the value of the retired assets. The DSIC mechanism approved for Veolia Water Delaware, Inc. includes such a provision which could easily be included in a DSIC mechanism for Veolia Water Idaho. Ms. York expresses a concern that appears to result from something regarding synchronization, though the entirety of the concern is not clear to me. If the concern is regarding a base spending[3] amount similar to the DSIC provisions for Veolia Water New Jersey, Inc., such a provision could be added. Including a base

[3] "Base spending" means the level of investment equal to the water utility's depreciation expense for utility plant accounts: 343 (Transmission & Distribution Mains), 345 (Services), and 348 (Hydrants), as reported in the water utility's most recent annual report."

spending amount would mean that the DSIC surcharge calculation would include a reduction in the overall level of capital expenditures to be recovered through the mechanism be reduced for depreciation expense related to the historic level of depreciation expense in the related NARUC plant accounts addressing both issues.

Shared Assets

Q. Please address Staff's adjustments to the costs related to shared assets.

A. As stated in the testimony of Ms. Jacobs, the M&S Company makes capital expenditures, generally related to investments in information technology hardware and software, as well as other assets to benefit VWID and its affiliates. In the absence of the M&S company investments in these assets, VWID would have needed to make these investments on a standalone basis in order to support its operations and the delivery of reliable service to its customers.

The calculation of the costs attributed to Idaho, based upon the Modified Massachusetts Allocation Methodology ("MAM"), was included in the Company's filing. Staff had a few concerns regarding the allocation:

- The allocations being at cost,
- Adding a return for Shared Assets including a return for the parent company
- Concerns around depreciation expense
- The wage adjustment factor
- The insurance premium adjustment.

Q. What costs related to shared assets are allocated from VWM&S?

A. As described in the Company's cost allocation manual, only the book cost, i.e. the departmental costs and depreciation expense of the shared assets, is recorded. No return is included in the booked costs. For ratemaking purposes, the Company is requesting that a return be allowed on the overall investment made to serve its utilities customers including Idaho. This component compensates the Company as a whole for the investment in shared assets but is retained by VWID on its books and records and does not enrich its affiliate VWM&S.

Previous to the adoption of the cost allocation manual in 2015, capital expenditures generally related to investments in Information Technology hardware and software, as well as other assets related to the corporate office, would have been allocated on a one-time basis to each operating company and reflected as assets on the operating company's balance sheet. As such, the allocated cost of the assets increased the operating company's rate base and was recovered in rates through depreciation expense and return. However, it was determined that the recording of partial assets on the books of subsidiary companies was incorrect as the ownership responsibility for those assets lies with VWM&S. Additionally, if the allocation of such assets needed to be changed due to changes in the level of services (for example additional utility customers needing to share in those costs through an acquisition), the reallocation of such "baby assets" would be required at least annually. In order to come to the appropriate result, the current methodology was adopted.

With the current methodology, capital expenditures, generally related to information technology such as the PeopleSoft accounting software upgrade and Powerplan asset accounting software etc., are now recorded on the VWM&S balance sheet and the depreciation expense on these assets is allocated to the operating companies based upon the three-factor formula as a part of VWM&S charges. The carrying costs associated with assets are calculated and recovered from the utility customers who receive the benefit of the assets as a part of rate case filings. The carrying costs are calculated utilizing the capital structure, debt and equity rates included in the rate case filing.

The intention is that the revenue requirement be the same for these assets under either the updated method or the previous method.

Q. What are shared assets important to VWID and its customers?

A. Utilizing shared assets for general ledger accounting, customer billing, budgeting, and other common application provides VWID with systems for which it is only paying an allocated portion. As stated in the adopted testimony of Ms. Jacobs, "the M&S company makes capital expenditures, generally related to investments in information technology hardware and software, as well as other assets to benefit VWID and its affiliates. In the absence of the M&S company investments in these assets, VWID would have needed to make these investments on a standalone basis in order to support its operations and the delivery of reliable service to its customers." Allowing carrying costs at the allowed rate of return provides a reasonable incentive for VWID to avoid paying for standalone systems to meet its and its customer's needs.

Q. Is there are recent Commission decision from which analogies can be drawn?

A. Yes. In the Matter of Idaho Power Company's Application for an Accounting Order for Costs Associated with Cloud Computing Arrangements (IPC-E-20-11), Idaho Power stated that the current accounting treatment provides a financial disincentive for it to invest in certain cloud computing arrangements. Idaho Power proposed to capitalize all costs associated with cost-effective cloud computing because the cloud computing investments are “equivalent to that of a traditional on-premise [information technology] solution.”

While not exactly the same, I believe the proposal and subsequent Order, addressed such disincentives.

Q. Please comment on Staff’s concern about the proposed return.

A. The intention is that the return be consistent with that ultimately allowed by the Commission in this proceeding. If the Commission allows a return different than that proposed by the Company, an adjustment should be made to the return amount consistent with that decision.

Q. How are the depreciation or amortization rates determined for shared assets?

A. As mentioned above, shared assets are generally comprised of Information Technology hardware and software, as well as other assets related to the corporate office. Approximately 20% of the overall asset value is the implementation costs of cloud computing arrangements, which are amortized over the lives of the arrangements. Otherwise, IT assets are depreciated over their expected lives or, if leased, over the term of the lease as is appropriate for GAAP purposes. The benefits provided by shared assets, as described above, apply to all entities which utilize those shared assets. As a result, the Company does its best to match the depreciable rates of the assets with the actual expected lives of the assets. As the these depreciation costs are governed by GAAP, they are depreciated on an individual basis rather than a group basis like most utility assets. Additionally, the amount allocated to Idaho is a relatively small portion (approximately 8.5%) of the total VWM&S depreciation expense.

Q. What is your recommendation?

A. I recommend that the commission reject Staff's adjustment reducing depreciation expense, and include the carrying cost component adjusted to reflect the decision of the commission in this case.

<u>VWM&S Department Costs</u>

Q. Please address Staff's adjustments to VWM&S departments.

A. Staff has suggested that certain legal and HR department costs be removed from the revenue requirement as well as the cost related to the Chief Operating Officer.

Q. What are the responsibilities of the VWM&S Legal department?

A. Per the Company's cost allocation manual, the responsibilities of the VWM&S Legal department are as follows:

Handle all matters related to general litigation involving the corporation;

- Perform legal services for securities and corporate financial transactions, financial reporting and disclosures, business organizations, mergers, acquisitions and business development, corporate governance, internal controls and risk management, insurance, executive compensation;
- Manage legal services for commercial and contract law matters for the corporation, including real estate matters and land use permits;
- Serve as board secretary and support corporate governance functions, board of directors meetings, legal opinion letters, assists audit and compliance functions, performs and attests internal controls, and ensures compliance with corporate registration and regulation;

- Retain and manage external counsel to provide legal representation in specialized areas of law and to manage variable legal work;
- Legal work supporting the negotiation of water purchase agreements and other procurement contracts as well as legal work related to franchise renewals, water rights;
- Provide legal advice and representation with regard to intellectual property matters;
- Perform legal services for matters involving environmental law for the corporation including environmental permitting activities, due diligence, defense in enforcement actions, compliance advice, representation in environmental cleanup and environmental litigation costs;
- Provide legal advice, representation and counseling in matters arising under federal and state water regulatory laws, regulations and policies as they relate to the Company's utility related assets for water and waste water;
- Provide risk management services including management of the insurance and surety bond programs; and,
- Manage and administers corporate legal and regulatory compliance programs, other than Ethics Compliance.

Q. Is it reasonable to assume such services can be provided by outside counsel?

A. No. Such services are not reasonably assignable to outside counsel. Neither would it be reasonable to assume such services could be acquired for the amount allocated from VWM&S for such services of approximately $160k. Outside counsel is retained to handle specialized issues related to Idaho law, and are not a substitute for in-house legal counsel.

Q. How many employees are in the VWM&S legal department providing services to VWID?

A. There are 10 VWM&S employees in the legal department that provide services that benefit Idaho. Three provide services to the utilities while 7 provide services to the utilities as well as other Veolia business units.

Q. How are the costs of the legal department allocated?

A. As described in the Cost Allocation Manual, the costs of VWM&S employees are allocated based upon a Modified Massachusetts Allocation Methodology. Employees providing services to utilities are allocated only to the utilities. Employees also providing services to other SWM&S business units are based upon a the same methodology however the allocation factors utilized includes allocations to the other Veolia business units which are receiving services from a given department. Consequently, approximately 9.5% of the costs of the "utility only" employees are allocated to Idaho while approximately 7.7% of the employee costs that provide services to all business units to which VWM&S provides services, including the utilities, are allocated to Idaho. The costs of employees which do not provide services to the regulated utilities, including Idaho, are not allocated to the regulated utilities, including Idaho.

Q. Why is this reasonable?

A. Sharing the costs of the legal department provides a significant breadth of expertise for the legal services needed for Idaho is appropriate. Costs for corporate governance, intellectual property, internal controls, privacy, environmental law, litigation, to name a few of the functions are best provided from a corporate perspective rather than an individual operating division perspective and only a portion of such costs are allocated to Idaho.

Q. Is there a specific example of this you can provide?

A. Yes. As previously mentioned, Staff witness Terry discusses the benefits customers receive by being a subsidiary of VNA being lower debt rates as well as benefit from gaining economies of scale with purchasing inventory. Debt funding is raised at VWID's immediate parent (VUR) and a portion of the costs of achieving such borrowings is one part of the Legal department costs, through its responsibilities surrounding corporate financial transactions, benefiting Idaho directly as well as other utility business units. Similarly, achieving the benefits from gaining economies of scale is also a part of legal costs through contract negotiation and review, which benefits not only Idaho but the other businesses as well. In both instances, only a portion of the overall cost is allocated to Idaho.

Q. What are the responsibilities of the VWM&S Human Resources ("HR") department?

A. Per the Company's cost allocation manual, the responsibilities of the VWM&S HR department are as follows:

- The recruitment, screening, and selection of internal and external candidates;
- Establishing relocation programs and management of employee relocations, including all administration and execution costs of the relocation program;
- Design and administer compensation processes including job evaluations, annual salary planning, incentive programs, executive compensation, deferred compensation, long term incentive programs;

- Design, management and implementation of health, prescription, life insurance, pension and retirement, reimbursement accounts, employee assistance programs, and other benefits for all employees;
- Manage strategy, negotiations, and contract interpretation. This includes arbitration resolution, mutual gains bargaining, local management support on grievances, discipline, adherence to the contract and training;
- Identification, development, and delivery of training programs to enhance the skills and capabilities of the workforce;
- Provide support on Human Resources technology and processes, technology strategy and solutions, portfolio management, corporate and ad hoc reporting, data analysis, data integrity and oversight, and system testing; and, process and release management;
- Succession planning, performance management, career development, mentoring, executive coaching, career planning & development, and employee/organizational assessments;
- Management and administration of all short and long term disability programs and FMLA, whether done internally or by a third party; disability insurance premiums, if any, and the cost of claims for self- insured programs and insured programs with a deductible; medical services required by the Company for disability cases, such as second opinions, consultations, etc.; disability case management and return to work programs; investigations of short term disability claims; legal services, whether internal or external, related to disability cases;

- Provide safety training requirements and communication tools, needs assessments and training program development, and compliance reporting, including investigation leadership and support; and,
- Labor Relations including contract negotiations and grievance management.

Q. How many employees in the VWM&S HR department provide services to VWID?

A. There are 12 VWM&S employees in the legal department that provide services benefitting VWID. Two provide services to the utilities while 10 provide services to the utilities as well as other VWM&S business units.

Q. How are the costs of the HR department allocated?

A. The process is the same as described above for Legal department costs. Where, approximately 9.5% of the costs of the "utility only" employs are allocated to Idaho while approximately 7.7% of the employees costs that provide services to all business units to which VWM&S provides services, including the utilities are allocated to Idaho. Again, the costs of employees which do not provide services to the regulated utilities including Idaho are not allocated to the regulated utilities including Idaho.

Q. Why is this reasonable?

A. Like legal department, the shared costs of the HR department provides a significant breadth of expertise for the H.R. services needed for Idaho. As an example, one of HR's responsibilities is the design, management and implementation of health, prescription, life insurance, pension and retirement, reimbursement accounts, employee assistance programs, and other benefits for all employees. HR administers these plans for all eligible employees and the costs of such administration is allocated to each company (whether regulated or unregulated) to which the plans apply.

Q. What has Staff recommended regarding costs associated with the VWM&S Legal department and HR department costs?

A. Staff has recommended a reduction in Legal and HR costs allocated from VWM&S of $33,890 and $35,356 respectively with the belief that there are costs being allocated to Idaho that are not related to Idaho.

Q. What is your recommendation?

A. As described above, the allocation is designed so that the costs of employees which do not provide services to the regulated utilities, including Idaho, are not allocated to the regulated utilities including Idaho. The cost of employees that provide no service to the regulated utilities are not allocated to the regulated utilities.

Therefore, I recommend that the Commission deny Staff's adjustments to VWM&S costs for Legal department and HR department costs.

Q. Staff states that the main responsibility of corporate executives is to increase profits for shareholders. Is that the case?

A. No. The main responsibilities of an executive at a utilities company is to ensure that the utilities operates efficiently and effectively, meets its strategic objectives, and provides high-quality services to its customers while complying with applicable regulations. This includes managing and overseeing operations, employees, resources and assets, ensuring the utility operates efficiently and effectively. Executives are also responsible for ensuring compliance with regulations and managing the company's financial resources, including budgeting, forecasting and financial reporting. A part of managing the company's financial resources are to request changes in prices through the rate case process in order to ensure the financial viability of the utilities.

Q. What is the function of the Office of the Chief Operating Officer ("COO")?

A. The COO is responsible overseeing all business activities of the Veolia utilities including management of the general managers, approval of capital commitments and capital projects, setting and defining priorities etc., as well as supporting the operations before the Board of Directors. The COO role manages the leadership team including all operational matters such as water quality, EH&S, technical services, capital planning and delivery, people and leadership management etc. Counter to Staff's claim, the COO clearly benefits Idaho ratepayers as well as the customers of Veolia's other regulated utilities.

Q. What has Staff recommended regarding costs associated with the COO?

A. Staff has recommended excluding related allocated costs of $61,237 on the basis that it does not benefit Idaho ratepayers but supports the board of directors and helps the parent company earn a profit for shareholders.

Q. What is your recommendation?

A. As Staff's contention is incorrect, I recommend that the Commission deny Staff's adjustments to VWM&S costs for the COO of $61,237 as well as the adjustment to remove the allocation portion of training and travel for corporate executives of $1,286.

Q. What is the actual 2023 merit increase percentage?

A. The actual weighted average merit increase granted is 3.62% and will be effective April 1, 2023.

Q. What is your recommendation?

A. We recommend that the Commission include the proposed salary increase percentage with the expectation that it desire is to better match the costs to be incurred to the period in which rates will be in effect.

Q. Does this conclude your rebuttal testimony?

A. Yes.