BEFORE THE
NEW YORK STATE
PUBLIC SERVICE COMMISSION

IN THE MATTER OF A PROCEEDING ON MOTION OF THE COMMISSION REGARDING THE RATEMAKING IMPACTS ON SUEZ NEW YORK INC. AND NEW YORK AMERICAN WATER INC. OF CHANGES IN THE DEFINITION OF A QUALIFIED NEW YORK MANUFACTURER UNDER NEW YORK STATE LAW.

SUEZ WATER NEW YORK INC.

P.S.C. Case No. 17-W-0232

DIRECT TESTIMONY OF
JAMES C. CAGLE

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is James C. Cagle. My business address is 461 From Road, Paramus, New Jersey 07652.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am the Vice President of Rates and Regulatory Affairs for SUEZ Water Management & Services Inc. ("SUEZ M&S" or "M&S").

Q. WHAT ARE YOUR JOB RESPONSIBILITIES?

A. As Vice President of Rates and Regulatory Affairs, I am primarily responsible for the management and direction of rate case filings for SUEZ's regulated operating utilities. I am also responsible for oversight of certain rate related compliance and reporting requirements as prescribed by the various regulatory commissions having jurisdiction over the SUEZ regulated utilities.

Q. PLEASE OUTLINE YOUR EDUCATIONAL AND PROFESSIONAL QUALIFICATIONS.

A. I received a Bachelor of Accountancy degree from the University of Oklahoma in 1987 and am a Certified Public Accountant licensed in the State of Texas. I was initially employed by SUEZ M&S as Director, Regulatory Business in October of 2007 and have held my current position since March 2010. Previous to that, I was employed by Atmos Energy

Corporation, a natural gas utility operating in twelve states, as Manager, Rates and Revenue Requirements. My tenure at Atmos began in 1989 and continued until I came to SUEZ Water except for the period from September 1997 through February 1998 when I was employed by GTE (now Verizon) in its Costing department.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes, most recently in Case 16-W-0130. I have also testified before several other state commissions on various regulatory issues.

Q, WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?

A. The purpose of my testimony is to describe the status of SUEZ Water New York Inc. ("SWNY" or the "Company") as a Qualified New York Manufacturer ("QNYM") for state income tax ("SIT") purposes, to explain how the Company is currently accounting for accumulated deferred SIT on its books and records and to propose specific ratemaking treatment in this case related to the Company's exclusion from QNYM status.

Q. ARE YOU SPONSORING EXHIBITS IN SUPPORT OF YOUR TESTIMONY IN THIS CASE?

A. Yes. I am sponsoring JCC-1, Calculation of Surcharge and Revenue Requirement Impacts for Activities Prior to 2/1/2018; and JCC-2, Impact of

Change in Qualified Manufacturer Status, Revised Revenue Requirement vs. Order Revenue Requirement – Summary.

Q. WHAT IS A QUALIFIED NEW YORK MANUFACTURER OR QNYM?

A. On March 31, 2014, New York Governor Andrew Cuomo signed into law S.B. 6359-D, A 8559-D (Chapter 59), enacting significant changes to New York State's corporate tax regime, most of which took effect for the 2015 tax year. The legislation created important tax benefits specifically applicable to certain qualified manufacturers (i.e., QNYMs), some which were effective for tax years beginning on or after January 1, 2014. Among the benefits is a 0% business income tax rate. To be considered a QNYM, a company must meet both a property and receipts test which requires that: 1) either all or at least $1 million of manufacturing property is in New York; and 2) at least 50% of receipts must be from manufacturing.

Q. WHAT IS THE COMPANY'S STATUS AS A QNYM?

A. The Company qualified as a QNYM effective January 1, 2014 and will hold that status through December 31, 2017. Thus, during that time period, the Company benefited from a 0% SIT rate, which was reflected in the Commission's Order in Case 16-W-0130. A recently enacted state law, effective January 1, 2018, changed the definition of QNYM in a manner that excludes water utilities such as the Company. Therefore, starting

January 1, 2018, the Company will no longer be a QNYM and therefore will no longer receive the benefit of a 0% SIT rate. Instead, the Company will be subject to SIT.

Q. WAS THE COMPANY'S QNYM STATUS ADDRESSED IN THE COMPANY'S LAST RATE CASE ORDER?

A. Yes. QNYM status was expressly discussed in the Order in Case 16-W-0130 on pages 19 and 20 and in the Joint Proposal attached as Exhibit 1 to that order on page 18, Section XIV titled Qualified New York Manufacturer Credit. In summary, due to its QNYM status and resulting 0% SIT rate, SWNY had built up a QNYM regulatory liability as the Company had been collecting current and deferred SIT in rates since January 1, 2014. The Order in Case 16-W-0130 established a target amount of the QNYM regulatory liability of $8.5 million to be utilized for ratemaking purposes, which the Company is amortizing at an amount of $236,111 per month. This amortization began in February 2017, the first month of Rate Year One under the rate plan established in Case 16-W-0130. Treatment of the differential between the actual balance of the QNYM regulatory liability as of January 31, 2017 and the target amount was to be included in the Company's next base rate filing. In addition, the Company's current rate plan reflects a 0% SIT rate and expense on the Company's business income base for all three years of the rate plan. As it relates to this case, the Joint Proposal adopted by the Commission expressly states that "In the event the Company is no longer deemed a QNYM during this Rate Plan or beyond, due to a change in law or otherwise, the Company will defer the revenue requirement impact of all tax expense associated with such a change for future recovery from ratepayers." The rate plan also allows the Company to seek deferral treatment for the revenue requirement impact for changes in operating expense due to any other legislative action.

Q. WHAT ARE THE COMPANY'S CURRENT RATE YEARS ESTABLISHED IN THE COMPANY'S LAST RATE CASE FILING?

A. Rate Year 1 is the twelve months ending January 31, 2018. Rate Years 2 and 3 are the twelve months ending January 31, 2019 and 2020, respectively.

Q. HOW DID QNYM STATUS IMPACT THE COMPANY'S REVENUE REQUIREMENT IN EACH OF THE RATE YEARS UNDER THE COMPANY'S CURRENT RATE PLAN?

A. In each of the Company's rate years, the previously estimated regulatory liability of $8.5 million is included as a reduction to rate base and is being amortized over a 3-year period at a rate of $238,111 per month. No SITs were included in any of the rate year revenue requirement calculations. With the loss of QNYM status as of January 1, 2018, state accumulated deferred income tax ("SADIT") must be re-established at the correct level, the SIT expense (both current and deferred) must be accounted for by the last month of Rate Year 1, and the balance of the regulatory liability (which is now a regulatory asset) must be established as of the end of Rate Year 1. For Rate Years 2 and 3, the SADIT balance must be projected forward through each Rate Year, the amortization of the previously estimated regulatory liability should cease, and SIT expense will accrue.

Q. WHAT WAS THE BALANCE IN THE REGULATORY LIABILITY ACCOUNT AS OF JANUARY 31, 2017?

A. The amount was $7,656,442 as of that date.

Q. PLEASE DESCRIBE THE PROCESS THE COMPANY PLANS TO UNDERTAKE TO REVERSE THE IMPACT OF THE QNYM STATUS CHANGE.

A. First, the projected amount of the calculated regulatory liability (now asset) will be determined as of December 31, 2017. Second, to account for the increased revenue requirement that would have occurred in month one of Rate Year 1 as mentioned above, the Company proposes to include an estimate of the additional revenue requirement related to that month in the regulatory liability. The resulting amount would be amortized and included as a surcharge to customers over a period of time and would also be reconciled over that same time period with any over or under recovery to be addressed in future rate case filings. Additionally, as actual amounts become known, the balance should be updated through January 31, 2018 as available.

For Rate Years 2 and 3, the Company utilized the revenue requirement calculations per the Order in Case 16-W-0130 to calculate the additional amount of revenue requirement needed to re-establish SITs. The revenue requirement calculation reflects the following: 1) the components of the revenue requirement are decreased by the level of SADIT; 2) the projected balance of the previously estimated regulatory liability is removed from the calculation as well as the amortization of that liability; and 3) SIT expense (both current and deferred) are included in the calculation of the revenue requirements including the associated impact in federal income tax expense and ADIT.

Q. HAS THE COMPANY REINSTATED DEFERRED SIT BALANCES AS REQUIRED BY GAAP?

A. Yes. Based on ASC 740-10 "Income Taxes": "Deferred tax asset and liability amounts are re-measured when tax rates change to approximate more closely the amounts at which those assets and liabilities will be realized or settled." As of June 30, 2017, the impact was known and quantifiable and therefore recorded on the books of the SUEZ New York Business Units that are impacted (New York, Westchester, and Owego/Nichols).

Q. WHAT ARE THE RESULTS OF THAT ENTRY FOR SWNY?

A. As of June 30, 2017, the balance of the Regulatory Liability before re-establishing the SADIT was $6,475,887 ($7,656,442 - $236,111 per month x 5 months). Of the total amount of Accumulated SITs to be re-established was a credit of $12,718,916, a State NOL carry-forward debit balance of $2,774,191 and a debit balance of $2,185,425 in the regulatory liability (now asset) account. Please see Exhibit JCC-1 attached to this testimony showing the detailed balances.

Q. HOW HAS THE COMPANY PROJECTED SADIT?

A. The Company's tax department has determined that the projected levels of SADIT from June 30, 2017 to the end of the year will not be significantly material to the calculation and are difficult to accurately project. Therefore, for purposes of this analysis and the proposed rate treatment, the Company proposes that such balances be trued up once known.

Q. HOW HAS THE COMPANY PROJECTED THE BALANCE OF THE REGULATORY LIABILITY?

A. The balance of the regulatory liability as of June 30, 2017 is $2,185,425 which is a net amount reflective of the amortization of the QNYM balance and the change in the value of SADIT from January 1, 2015 through June 30, 2017. The balance of the regulatory asset as of January 1, 2018 is calculated as $3,602,091 (the $2,185,425 balance as of June 30, 2017 plus the $236,111 monthly accrual times the 6 monthly periods from July through December 2017). The balance of the regulatory liability account at the end of the Company's first Rate Year (twelve months ending January 31, 2018) adds an additional $236,111 to the December balance and, as the income (or loss) of the last month of Rate Year 1 (i.e., January 2018) will be taxed, the tax liability for this month should be added to the regulatory asset balance. While not precisely known at this time, the Company has included $154,576 as a placeholder for this amount, which should be updated when known or more accurately estimable such that the balance of the regulatory asset account is approximately $3,992,778.

Q. WHAT IS THE CURRENT SIT RATE PER YEAR AS OF JANUARY 1, 2018?

A. The SIT rate is 8.34% as of this date. This rate was utilized to calculate the SADIT amounts included in the attached exhibits as well as the revenue requirement impacts in the rate plan.

Q. HOW DOES THE CHANGE IN QNYM STATUS IMPACT CASH FLOW AND RELATED CARRYING COSTS?

A. The Company has calculated the revenue requirement impacts of the amounts discussed above and believes these factors are included in its calculations in Exhibits JCC-1 and JCC-2.

Q. WHAT WOULD BE THE IMPACT ON THE COMPANY'S EARNINGS IF IT WERE NOT ABLE TO ADDRESS THE ISSUE OF STATE TAX

LIABILITY BEGINNING JANUARY 1, 2018 BY INSTITUTING A SURCHARGE MECHANISM FOR STATE INCOME TAXES, AND CONTINUING THE AMORTIZATION OF THE REGULATORY LIABILITY ESTABLISHED IN THE COMPANY'S LAST RATE CASE?

A. At the end of the rate plan, the total amount of the regulatory liability would be fully amortized, the amount of current and deferred SITs for one month of Rate Year 1, and all of Rate Years 2 and 3 would not have been recovered from ratepayers. Without action by the Commission, the earnings of the Company would be decreased by the amount of the surcharges calculated in this case and additionally the Company believes that this would create a permanent rate base offset to its per-books amounts until such time as the issues are addressed.

Q. PLEASE DESCRIBE ANY RELATED FEDERAL INCOME TAX IMPACTS TO ANY OF THE ITEMS LISTED ABOVE.

A. As applicable, SITs are generally deductible for federal income tax purposes. The impact of any change in FIT as a result of the availability of this federal tax deduction is incorporated into the Company's calculations.

Q. WHAT IS THE COMPANY'S PROPOSED RECOVERY PERIOD FOR ANY REGULATORY ASSET (REVENUE SHORT-FALL)?

A. The Company is proposing to implement two surcharges. The first is to recover the amount of the regulatory asset as of the end of Rate Year 1 and, for purposes of the exhibits and calculations in this testimony, the Company has proposed recovery over a 4-year period such that at the end of the Company's current rate plan (assuming a surcharge contemporaneous with the Company's rate plan), approximately $2 million of the balance would remain. The second surcharge is to recover the revenue requirement impact of SITs for the remaining rate years in each of those rate year periods. The Company is also willing to explore utilization of a single surcharge on customers' bills that would add both surcharges identified above together.

Q. ARE THERE ALTERNATIVES TO IMPLEMENTING RECOVERY OF THE REVENUE REQUIREMENT IMPACTS?

A. The Company sees no reasonable alternative. As was the case when the QNYM issue arose, the resulting change in the revenue requirement was accounted for and reflected in customers' rates in the Company's last rate case. As the QNYM status has changed, the revenue requirement impacts of the change in tax law will be incurred by the Company and must be recovered such that the Company is made whole.

Q. IS IT POSSIBLE TO MITIGATE RATEPAYER IMPACTS?

A. To a certain extent some mitigation is possible while still making the Company whole. The Company has proposed a surcharge term to recover the amount of the regulatory asset that is longer than the three-year amortization included in the Company's last rate case. To further mitigate ratepayer impacts, this could be extended to a longer period.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.