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BEFORE: Commissioner ToNola D. Brown-Bland, Presiding
Chairman Edward S. Finley, Jr.
Commissioner Bryan E. Beatty
Commissioner Don M. Bailey
Commissioner Jerry C. Dockham
Commissioner James G. Patterson
Commissioner Lyons Gray

IN THE MATTER OF:

Application of Public Service Company
of North Carolina, Inc., for a General
Increase in its Rates and Charges

VOLUME 6

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P R O C E E D I N G S

COMMISSIONER BROWN-BLAND: All right. Let's come back on the record, and we will resume with Ms. Force's cross of witness Hevert.

ROBERT B. HEVERT; Having previously been sworn, testified as follows:

CONTINUED CROSS EXAMINATION BY MS. FORCE:

Q Good afternoon, Mr. Hevert.

A Good afternoon.

Q Hope you had a nice lunch.

A It's always good here.

Q Oh, good. Good. I -- I'm going to pick right up with questions. I understand you have a flight to catch, so I'll try to move it along.

A Thank you very much.

Q I passed out an article, it's two-sided, and this -- does it not show where it appeared on your copy?

A Yeah. I think right there is a November 10, 2014 date.

Q And it -- does it say -- on the bottom of mine it says USA Today. Does it say that on yours? I'll bring it and show it to you. I'll submit to you --

A That -- that's fine. On front it says Money. I assume this is the Money section of USA Today.

Q That's right. I'm puzzled how come it did not copy, but the article is one that appeared a couple of years ago, right, November of 2014, and I -- I'd ask you to take a look at it because on the second page it talks about utility stocks.

A Yes.

Q You -- do you ever confer -- consult the paper, the USA Today paper?

A Typically not for this purpose --

Q Okay.

A -- but I'm certainly aware of it.

Q I suppose sports or something else, but some investors would rely on it, wouldn't they?

A I suppose some may.

Q Well, the -- at the top of the second page it says, "Utilities, those stodgy dividend-paying stocks, are on fire" -- "a little bit like high-flying tech stocks in the 1990s." And I won't read the part about it getting too crazy, but I'm curious, as I recall, those high-tech stocks were high-growth stocks, and I'm -- I've always thought of utility stocks as being more secure investments for folks that pay -- you know, they pay regular dividends, but not as high growth. Am I right about that?

COMMISSIONER BROWN-BLAND: Mr. Hevert, can you hold on to your answer for minute? Ms. Force, can we just go ahead and identify --

MS. FORCE: Oh, I apologize. Yes. I'd ask -- I think this is the third for --

COMMISSIONER BROWN-BLAND: This is Number 4.

MS. FORCE: Number 4 for -- so it's Attorney General Hevert Cross Examination Exhibit Number 4.

COMMISSIONER BROWN-BLAND: So this will be so identified.

MS. FORCE: Thank you.

COMMISSIONER BROWN-BLAND: Thank you.

(Whereupon, Attorney General Hevert Cross Examination Exhibit Number 4 was marked for identification.)

COMMISSIONER BROWN-BLAND: Mr. Hevert, can you remember the question?

THE WITNESS: I -- I -- I think so, yes. Thank you.

COMMISSIONER BROWN-BLAND: Thank you.

A I think generally people would look to -- oh, let me back up. You'll often hear of people speaking about growth stocks and value stocks. Growth stocks may be those such as tech sectors with relatively high growth rates. Value stocks are stocks with lower growth rates, tend to trade at lower market multiples. I think most people would put utilities in the value stock category as opposed to the growth stock category.

Q Okay. And if you go down a few paragraphs where it -- paragraph starts, "Last week." The second sentence there says, "The P-E ratio," and I think that's profit -- priced earnings, right?

A Priced earnings, yes.

Q Excuse me --"priced earnings ratio of utilities is now roughly 17.7, above its average priced earnings of 14.5 dating back to 1990, according to Bespoke." Do you know who Bespoke is?

A I -- I do. It's an investment management firm.

Q And would you agree that realizing that this was in 2014, that that P/E ratio of 17.7 was high relative to the average going back to the 1990s?

A I do.

Q Now, if you look at those Value Line tables that I passed out earlier for those comparable stocks, looks like they're higher than that now; is that -- would you agree, for the most part? Not all of them, but almost all of them are.

A I -- I would agree that utilities are being valued quite highly now relative to their historical average. If you go back to this chart on what you have as Exhibit 4, there are a couple of things that you'll notice. Each time the price-to-earnings multiple hits a high point, it subsequently falls in value. And, in fact, the second-to-last paragraph states that although the sector's P/E is well above its long-term average, it likely will revert back to its longer term mean. That's what we see. When the sector gets valued as highly as it is now, it tends to revert closer to its longer term mean. In early 2015 we saw the sector valued very highly, and by June it had lost 13 percent of its value.

In one month the utility sector just now has lost -- it's lost about 6 percent of its value in the most recent month at a time, again, when the sector had been trading at a high level.

So to your question, yes, I agree the current values are higher than they were in 2014, but I think if we were to look at the history and if we were to look at what happens whenever these valuations hit high levels, it's likely they'll revert back to their longer term mean, which means that the sector will lose value. And I think that's what is stated here in the remainder of this article.

Q Okay. Thanks. So I have another question that's kind of a start-off question, and that is -- or -- or maybe like a background question. When you -- you do these -- you give testimony in both electric and gas utilities on rate of return, don't you?

A Yes, I do.

Q Quite a few I see in your exhibits to your testimony. So would you say that as between the two, especially if you're looking at an electric -- at electric utilities like we have in North Carolina that are integrated as opposed to being distribution only utilities, that the rate of return would be higher for those electric utilities?

A I -- I think generally speaking, utility -- excuse me -- vertically integrated electric utilities do face risks that either distribution electric do not face or gas utilities do not face in terms of the ownership, the operation, the environmental mandates associated with the generation portfolio. The question as to what the risk differential is between the sectors becomes more difficult because quite often it's a matter of regulatory treatment, it's a matter of the relative constructiveness of the jurisdiction in which they reside. There are a lot of other factors that come in to play. But generally speaking, I agree that electric generation does include operating issues, regulatory issues, environmental issues that gas utilities do not necessarily face.

Q And so I think there's two parts to your response, and I want to make sure I understand. From a regulatory standpoint, the rates of return that are authorized by commissions tend to be a little bit higher?

A Well, it's interesting. If you look over time, over a long period of time, I would say the difference between the two has been in the 10 to 20 basis point range. But there are times at which they're very close. There -- there are years in which there's virtually no difference.

Q Okay. And from a market standpoint, also, I -- I would think, if there's some more risk involved with electric companies then it may be that they command a higher rate of return from investors or cost of capital, I guess you'd call it.

A It -- it -- it could be, but if -- for example, on I think it's Exhibit 3 that you handed out, the Value Line sheets, you look at the beta coefficients for these gas companies, Atmos is .8 --

Q And just for clarification, I'm sorry --

A Oh, sure.

Q -- you're looking in the upper left corner of these?

A I'm so sorry. Yes. It's the upper left-hand box.

Q It's hard to see it, but it's about the fifth line? Says beta?

A That's right.

Q Okay.

A .8, and beta is a measure of the relative risk relative to the overall market for a given company. Here these beta coefficients are in the range of .8 to .75, .8, not a whole lot different than what we see on the electric side.

Q And since you mentioned beta, we're going to come back to it later a little bit --

A Okay.

Q -- and we're on that page. When you talk about beta, that's a way that -- it's sort of a shorthand for the particular company compared to the market relative risk; am I right?

A Yes. It's the volatility of the company's returns relative to the volatility of the overall market.

Q So if it's a company that has a 1.2, is that --

do some of them have a beta that -- of that number?

A Typically not utilities, but some do.

Q Right. Okay. But if they had a 1.2, then they would be riskier than the market.

A Correct.

Q So it's sort of like a percentage, 100 percent is -- is the average, and if you're more than that, that 120 would be more than that and 80 would be less?

A Correct. The --

Q Can't see what it says for Atmos, but it's --

A Right. The -- a -- a company with a beta coefficient of 1 is as risky as the market.

Q Okay. Okay. Now, you recommended a rate of return in this case of 10.6 percent. You filed testimony July 1st, 2016, this -- this year. Well, you filed a lot of testimony. This is one in Missouri on behalf of Union Electric Company, a subsidiary of Ameren Corporation. Does that sound familiar?

A It does.

Q And in that testimony you recommended a cost of capital for an electric company of 9.9 percent in your filed testimony; am I right?

A I don't recall there whether I had a specific recommendation or a range, but the -- in that testimony what I was asked to do was to give specific consideration to some of the Commission's prior orders as it related to methodological issues. And if you read the testimony, I believe what it would say is that were I not to have done that, my recommendation would have been higher.

Q And I think you said in your testimony that you have a range of 9.75 to 10.50. Would you agree with that, subject to check? You want to look?

A No. I -- I would agree with that.

Q Okay. So I'm going to --

MS. FORCE: Would you do that?

MR. GRANTMYRE: Is it this?

MS. FORCE: That's it. Yes. Thanks.

Q You'll recognize this one. This is your exhibit. I'm just passing out your --

A Sure.

Q -- Exhibit 1. This is what I'm looking at, and this says --

A Thank you.

Q Maybe I'm looking at the wrong one. Yeah. RB -- I'm sorry. It says up here --

A Yeah.

Q -- RBH-1?

A Yeah. I'll just be sure it's the same.

Q And that's a three-page exhibit because you do -- and that's your Constant Growth Discounted Cash Flow Model; is that right?
A I -- I don't have a copy of the exhibit, but --
Q Oh.
A I'm sorry.
Q I'll give it to you.
A That's okay.
Q I took it back with me. We were looking it up. It's the same thing, but you --
A Thank you.
Q So the first page that I show is for a 30-day average stock price.
A Yes. That's right.
Q And you also did the same -- it's the same analysis, I believe, for 90-day and then 100-day.
A 180 days.
Q Excuse me. 180-day average stock price.
A Correct.
Q Okay. So we were talking a while ago about the -- how the DC -- your Constant Growth Discounted Cash Flow Model works, and essentially it's looking at dividends plus growth; am I right --
A That's right.

Q -- to recap? So if we look at the far left column, those are your proxy companies, right, Atmos?

A Yes.

Q Laclede, I think that's different -- they have a different name now.

A They -- they've renamed themselves Spire.

Q Same folks, right?

A Correct.

Q Okay. So the column 3 shows the yield -- dividend yield; am I right?

A Yes.

Q When you do -- as an example so that we can see what you've done for each of these stocks, if you were to take that -- your far right columns, you come up with a mean ROE, so that's column 11, by adding your column 4 plus -- which is that unexpected dividend, with the average earning growth in column 9; am I right?

A Yes. That's correct.

Q So that column 9, for the mean anyway, is your growth number, and the expected dividend yield in column 4 is your dividend number.

A Right. So column 11 equals column 4 plus column 9.

Q So the -- and -- and 4, that isn't exactly the dividend yield. It's -- you've reflected a little bit of growth in that?

A Correct.

Q All right. And the growth that you figure is -- for the mean takes into account your average growth in column 9.

A That's right.

Q All right. So if we look down at mean, then, basically we've added the expected dividend plus an average of earnings growth, and if we look down that full column 11, then your -- your proxy group mean is 9.36 ROE and your proxy group median is 9.42 percent, right?

A Correct.

Q Now, I -- I -- I realize you have others there, and -- and -- so if we were to look at the high number, this gets a little bit more complicated, I think, but when you came up with that average earnings growth, I think that growth in earnings, that's kind of a controversial one for various witnesses, isn't it? They have different methods of getting that?

A It's not for me, but for -- for others, yes.

Q I've seen you use this in other cases, too, I think.

A Right.

Q But you use multiple. If you look in column 5, 6, 7 and 8, those are all different estimates of growth --

A That's --

Q -- that you used, and you didn't just use one number. You just didn't go on this Value Line and pull that number. You pulled it from several sources.

A Correct.

Q And so when you did that, I guess that -- that's so that you get a little bit more of a -- a -- you're looking at multiple sources instead of just one, not putting everything on one source?

A That's right.

Q But -- but the only way that you looked at the growth was to measure the growth in earnings. Well, at least -- I don't know. You have a retention growth estimate. Is that also related to earnings?

A It's -- it's a slightly different measure, but it's -- it's intended to measure the extent to which the company can grow by reinvesting its earnings and by issuing stock.

Q Okay. And when you did these -- before I leave this sheet and look at something else for a minute, the -- the high ROE column that you've done takes that same expected dividend -- excuse me -- the dividend yield in column 3, but instead of using an average growth, you look at the high of those different measures of growth and increase the dividend for the high, and then you use the high estimate.

A Correct. And we do the same thing --

Q So it's the highest it could be of those.

A I'm sorry. That's correct, and the same for the low.

Q The low is the lowest of those numbers.

A Correct.

Q So you're kind of showing the mean and then the out--- sort of the outliers. Sometimes maybe they're not so far off and sometimes they take the numbers that are quite different --

A Well, I -- I --

Q -- is that right?

A -- I don't look at it as -- I -- I use this method to really help establish a range, but the way you've described it is -- is correct.

Q So, for instance, that number kind of jumps out in column 7, the second number, so that's for that Spire -- Laclede, now called Spire, is 10 percent and -- well, anyway, the -- but you're taking a bunch -- multiple numbers to get to your result.

A Right. And it's -- that's a good observation. It's 10 percent from Value Line, which is higher than the others, but for First Call it's 4.78 percent, which is the third lowest. So that's -- that's the point of having a -- a diversity of estimates.

Q So that you get the range. Now, if we look back at the Value Line page, that Value Line earnings growth that you have in column 7 comes right off of this Value Line report that I passed out earlier that was Cross Exhibit 3, right?

A Yes. This is the -- the source of the Value Line data.

Q So if we look in that block -- now, we're going to have to look way over to the left of that Value Line for -- and look down for Atmos to just beyond the halfway point, it says, "Annual rates of change per share." That's where it comes from, right, in that block?

A It does, yes.

Q So that block has a whole bunch of different ways of looking at annual rates of growth -- of change. It's not necessarily growth. I guess sometimes for Atmos their revenues were decreased. Well, I guess one time. But the earnings number is -- is the one that appears opposite earnings, and it's the projected earnings.

A Correct. All -- all of these are --

Q Seven percent.

A Yes. All of these are projected. When I say all of these, revenues, cash flow, earnings, all the numbers in the box that you've pointed out are projected numbers.

Q Well, now, if we look at in annual rates of change, they also show past 10 years, don't they?

A They do.

Q But you didn't use that, I mean, but that's available to an investor. That's not a projection, is it?

A No. I'm sorry. And I should have been more clear. I apologize. The right-hand column where it says estimated 12 to 14 to 18, 20, those are all projected numbers.

Q Those were all projected numbers. And so when you look at the projected numbers, you could have used projected dividends or projected book value?

A I could have, but I would not have.

Q You would use the projected earnings?

A Yes.

Q But now this is comparing the dividends that are -- were earned now to future growth, but you think it's better to use earnings than dividends.

A I do. I do, simply because the earnings -- the dividends are derived from earnings. You cannot pay dividends unless you have earnings. The dividend growth rate can be slower, it can increase, depending upon earnings. It can change depending upon your capital investment assumptions. There are lots of theories as to why dividends can change. But at the end of the day you cannot pay dividends unless you have earnings, so that's what I focus on.

Now, not to get too technical, but this model also requires that the payout ratio will stay constant, so if we assume a constant payout ratio, there's really nothing wrong with looking at earnings as the measure of growth. Keep in mind that in this model, the rate of growth is the rate of capital appreciation; it's how much your stock will gain in value when you own it. So looking at earnings growth has a direct connection to the price earnings ratios we were talking about a minute ago, and it is what drives any dividend decision. So in my view, earnings is the proper measure of growth.

Q But if you were an investor and subscribed to Value Line, you would have a whole range of numbers that you -- you could look at, and those numbers don't all -- I mean, some of them are -- some of -- for Atmos some of them are pretty different. Turn to the next page for Laclede Group. There was that 10 percent number I talked -- I mentioned to you before that kind of jumped out. That's the estimated earnings growth projected, right? If you look at the past five years, they had two-year decline in growth, so wouldn't you think that that 10 percent number that reflects earnings and growth might have some relationship to that past five years of decreased growth?

A Well, I -- I think I understand your question, so let me -- let me try this. To the extent the projected earnings growth look at historical growth rates, that information is already reflected in that 10 percent number, for example. So if -- if your question is why wouldn't I give historical growth rates any weight, in part it's because a lot of analysts will already look at historical earnings growth and they would be reflected in the earnings projected.

If your question is that negative 2 percent growth rate, does that mean that you're starting from a lower base, perhaps, but again, that's one reason why I use multiple sources.

The -- the only other thing I would say is that we're looking at this sheet where we've got dividends and book value growth. The other sources that I use, Zacks, First Call, provide earnings growth. They don't provide dividend growth projections. They don't provide book value growth projections, and I can only conclude that it's because they don't see the commercial demand for that type of information.

Q The -- are those -- I guess it looks like five- or six-year growth estimates that are provided in those other sources and -- and here?

A Generally in the five-year range, yes, I agree.

Q And so perhaps that's one of the things that you were talking about, the constant growth method uses what's really a five- or six-year growth projection and looks at that for -- as a long-term number.

A Correct. And --

Q So that's --

A Oh, I'm sorry. I didn't mean to speak over you.

Q Go ahead.

A There has been research that -- that shows that what stock prices are most likely to react to are changes in earnings growth rates, and by earnings growth rates, we mean analysts' earnings growth rates, which typically are, as you say, three- to five-year projections. So we know that as a practical matter this is how the market values stocks. This is how they look at growth, based on those projections. But if your question is are they three- to five-year growth rates, yes, they are.

Q When we look at your table that I -- I think it was the Cross Exhibit -- well, no, I didn't give it a cross exhibit number. Sorry. Your -- your table, I think it's Table 2 in your testimony, is that your summary of that constant growth DCF?

A Just one second.

Q Page 30 --

A Oh.

Q Well, no, that's not it. Sorry. You have a few tables.

A I do. Table 2 is on page 25.

Q Now, looking at that table, if we were to take the average of your 30-day, 90-day, 180-day average, would you agree that comes out to 9.48?

A I would agree with that, yes.

Q Okay. And something else, looking at this, it looks to me like 180 days means that you're going back farther, and so as we come closer in time to the time you did your study, then, it looks like the average was going down.

A Right. And this goes back to the point we were discussing with Cross Exhibit 4, which is as the utility sector gained in value, the -- the price went up and, therefore, the dividend yield went down, and so you would see that measured over a shorter period of time. When the utility sector started going up in value in late 2015, early 2016, you would expect to see the numbers lower for the shorter average because it really sort of isolated the effect of the valuation during that time. The longer averaging period had periods of lower valuations.

The problem that I see with this model, again, goes back to this article. One of the fundamental valua--- excuse me -- assumptions of this model is that the price-to-earnings ratio will stay constant forever. And so at this point, if the utility sector, if these companies were being valued at, say, let's look at what -- we'll look at what Value Line said for Atmos, 20 times earnings, which would be well over the -- the market P/E ratio, you would have to be saying that this -- this company is going to be valued at that level forever. It would run counter to what we have in this article here, which says that it would revert to its long-term mean over time. So that's why I don't think we can give this model as much weight. It's -- it's based on a temporary trading phenomenon that I think we've seen is not likely to hold.

The -- I keep saying it's the only thing I'll say. This is really the only other thing I'll say on this. The other -- the other issue with this model is the fundamental construct, is that if the -- if -- if the dividend yield goes down, it's because the growth rate is going to go up. When the growth rate goes up, the price should go up, the dividend yield should go down, so growth rates and dividend yields should somewhat offset each other. We're not seeing this in this market, so it's just another indication to me that the model's fundamental assumptions simply don't line up with the current market.

Q So you've also used a multi-stage DCF, and as I understand it, the differences that you're using for the first part of your analysis, the same DCF study, but then you do it in three phases?

A Oh, I'm sorry.

Q Well, here. let me -- I wrote it down, so maybe I'll say it more clearly. It's --

A Okay.
Q You assume an initial growth rate, a final growth rate, and then you assume there's a transition period in the middle where the first growth rate increases or decreases year by year to the final growth; is that fair?
A Yes. That's right.
Q So there are multiple stages, and you're doing a little bit -- you're using different assumptions about what the growth or what the return will be during that time, right, or is it cash flow?
A It's -- there -- there are assumptions as to what the -- the growth rate would be over that time, and there are assumptions as to what the payout ratio would be. And when I say growth rate, I mean earnings growth rate.
Q Okay. And so in the first part of it, it's the same model, isn't it --
A Essentially the same model --
Q -- that we were just talking about?
A -- yes.
Q At the end -- let's go to the end because there's the third one and then there's a phase-in to the third one. You've evaluated that third stage using the

growth rate in the gross domestic product; is that right?

A That's right.

Q So in between, that middle stage is shifting from your constant growth -- well, from your DCF model, the first one, and then you've come up with the rate for the gross domestic product, and then we're shifting from one to the other in that middle stage; is that right?

A Right. So we're -- that's right. We're using the same growth rates as the Constant Growth Model in the first stage, the GDP growth in the last stage, and transitioning from the first to the last sort of ratably over time.

Q So I'm not going to hand out that one. It's hard to -- to figure out by looking at the model that you used in your exhibits, but in that -- for the growth rate, did you use a 5.31 GDP growth rate as the last stage?

A Yes. That's correct.

Q So explain how that relates to the average GDP growth rate from historically. It's a little bit more than that, right?

A No. It's quite a bit lower.

Q Oh.

A The historical GDP growth has been around 6 percent when you include the effect of inflation. The -- mine is based -- my estimate is based on a real GDP growth rate of about 3.2 percent, which is the long-term historical average, but I use an inflation estimate of about 2 percent which is considerably below the long-term historical average.

Q We talked earlier about the testimony that you gave in -- that you submitted in -- in Missouri. I don't know -- they haven't had the hearing yet, I assume, or maybe they have.

A No. We're -- we're -- we're still in the process there.

Q Okay. In that you did a multi-stage analysis in that one, too, DCF analysis, didn't you?

A That's right.

Q You mentioned there that there are other ways of measuring and projecting GDP that are available. One of them is from the Energy Information Administration?

A Uh-huh.

Q And another is from the Social Security Administration.

A Right.

Q Those are both lower than your 5.31 percent, aren't they?

A Not necessarily. The -- when you look at the Social Security Administration, their -- their reference case, their base case is lower, but they also produce what they refer to as a high and a low cost scenario. My estimate is well within the range of their -- their low cost scenario. It's higher than their base case, but it is well within the range of the estimates that they provide.

Q So I think you mentioned the -- what you're calling the base case as well now that was 4.35 percent; is that right?

A That -- that's probably about right.

Q And the EIA, Energy Information Administration, used 4.24 percent --

A Again --

Q -- as their --

A I'm sorry. Again, in their reference case.

Q Okay. But if those were the numbers that we were using to estimate growth in that third stage, it would make a sizable difference in your multi-stage analysis, wouldn't it?

A It would.

Q Okay. Give me a second. I think I'm going to -- I'm going to switch over, try to speed it up and move over. You also have a CAPM. Would you tell me what that stands for because I -- because I forget. I'm sorry.

A Oh, no. That's okay. It is the Capital Asset Pricing Model.

Q Okay. Now, where one is looking at the cash flows I guess we were talking about, with the discounted cash flow, am I right that the CAPM takes a look at what would be considered a risk free rate, and then it adds to that a premium, and then it uses a multiplier using that beta we were talking about earlier so that you're saying, well, in this company's case it's less risky or more risky than the overall market?

A Yes. I -- I think the -- the CAPM is a risk-premium based approach, so whereas discounted cash flow model says what do I expect the cash flows to be and what does that mean for the expected rate of return, this approach looks at the relative risk of each company, so it's -- it's a different perspective.

Q Sorry. I'm looking for the chart. Let's look at your Exhibit RBH-6, and I have copies I can bring to you and pass out. You see it's the same?

A Yeah. Thank you.

Q So you actually spelled it out on your Exhibit CAPM, right?

A Yes. At -- at the -- the title line, Capital Asset Pricing Model Results.

Q And this is the way you put together the numbers that produced the -- your CAPM results.

A Yes.

Q And they -- those are shown on a table. So I just wanted to go through an example of how that works to understand the -- we mentioned the risk free rate. That's a 30-year Treasury of 2.79, is the first one you give. Current and Projected Mean, that's a little higher --

A Yeah.

Q -- in that column 1?

A The -- the -- the projected is 3.35 percent relative to the current of 2.79 percent, yes.

Q And then I guess you took a mean of those.

A No. I'm sorry. The -- the -- the -- the mean, it --

Q At the end.

A -- goes all the way to the end, right.

Q Okay. And skip over the beta coefficient, the -- you have Bloomberg and Value Line. Those are DCF, so I guess that's a discounted cash flow using Bloomberg numbers; is that right --

A Yes. That's right.
Q -- the Bloomberg bracket? And then that's something that you calculated yourself, is that -- or is that what Bloomberg publishes?
A The -- Bloomberg publishes the dividend yields and the growth rates and the market capitalization numbers. So what -- what we do here is we take each of the companies in the S&P 500, we estimate the expected return based on the Constant Growth DCF Model, and we take a market capitalization weighted average of those numbers to come up with an expected market return.
Q And so you're showing 10.66, and -- and I guess that's what you used all the way through your study. Am I right, then, that that's added to 2.79 to come up with the overall rate that you were saying for the market as a general rule? So, I guess, what would that be?
A Right. So, in fact, you can just look at --
Q A little bit over 13 percent return on -- rate of return?
A Right. Fair enough.
Q Okay. On equity, I guess.
A For the market. That's correct.
Q For the market. So that's what you calculated using Bloomberg and Value Line. Are -- are there any

studies that project what the risk premium is? Does -- are there any resources we can go to for that?

A Sure.

Q And are they as high as 10.66 percent?

A There are -- there are a lot -- first, to your question, there are lots of resources that we can go to. There are historical measures of the market risk premium. Again, the market risk premium is the difference between the return on the market and the Treasury rate. We can look at historical measures. We can look at surveys of expected measures. There are lots of things that people use. I use the expected market return because this is a forward-looking exercise, so that's the method that I've -- that I've consistently employed.

But to your point, yes, there are other -- other resources that sometimes people will use.

Q Sorry. I'm fumbling as I'm listening to you. Here's another one.

A That's okay. I'm fumbling as I'm answering.

Q Are you familiar with Duff & Phelps?

A I am.

Q I'll show you that and we can pass that up.

MS. FORCE: I ask that this -- I think this is Number 5 because we've used some of Mr. Hevert's -- I'd ask that this be marked Attorney General Hevert Cross Examination Exhibit 5.

COMMISSIONER BROWN-BLAND: It will be so identified for the record.

MS. FORCE: Thank you.

(Whereupon, Attorney General Hevert Cross Examination Exhibit Number 5 was marked for identification.)

Q So this is a summary sheet, Mr. Hevert, that indicates that Duff & Phelps put out an increase in its recommended US equity risk premium going from 5 to 5.5 percent. I have a longer -- I think there's a report -- this is -- that you can click on if you were online and get. If you would like to look at that, I've got a big, long copy.

A Oh, that -- that's -- I'm quite familiar with it.

Q But this is a source that is available to investors as well, and it looks to me like this is something that -- they say right in that last paragraph, don't they, "The ERP," I think they're saying equity risk premium, is "used to calculate the cost of equity capital within the context of the Capital Asset Pricing Model (CAPM)." And they say five -- they're increasing from 5

to 5.5 percent --
A Right.
Q -- right? So they just have a different number than you do.
A Well --
Q But isn't --
A I'm sorry. Go ahead.
Q Is that right?
A It -- it's a different number, and in many ways it's used for a different purpose. You'll see in the last paragraph where it says, "The ERP is used as a building block when estimating a company's discount rate." Duff & Phelps has two approaches. One is a Capital Asset Pricing Model and the other is what they refer to as their buildup approach. The equity risk premium is only one portion of it. There are other industry risk factors, size factors that they layer on to come to the eventual what they refer to as discount rate, we would refer to as the cost of equity. So this is just one component of their building block approach.
Q Well, and likewise in your study, you're not just giving an equity risk premium; you're also figuring what's the risk free rate and what other factors in that beta reflect on this particular company; isn't that

right?

A Well, they're -- they're fundamentally different approaches. The building block approach will say, we'll take a -- an equity -- excuse me -- a Treasury yield of call it 2.79 percent, we'll add to that 5.5 percent. Now we'll look at the company's size relative to the market. We'll add something for that. We'll look at the company's industry that -- an industry risk. We'll add something for that. So my point is that under the building block approach, there are pieces beyond just the beta coefficient, just the equity risk premium that Duff & Phelps looks at when they're -- when they're applying that method.

Now, if you were to apply their 5.5 percent equity risk premium and they say here the use a normalized risk free rate of 4 percent, then using the beta coefficient that I have here of .634, that would give you an ROE of 6.27 percent, I think. Let me just check that again real quick. Yes, 6.28 percent. So that would suggest that the -- the cost of equity for a gas utility is 6.28 percent. That -- that simply isn't reasonable.

Q I'm sorry. Say -- tell me that again. Are you -- tell me your math on that because I think I can't --

A Sure. So you said they increased their equity risk premium to 5.5 percent, so let's use that. We'll take 5.5 percent, multiply that by .634, which is the average beta coefficient in column 2, and to that we add 2.79.

Q Oh. So in -- but in their -- wouldn't they add 4 and --

A Right. So -- so right. So even if we were to add 4, that's right, that's a good point. Even if we were to add 4 -- excuse me.

Q 7.49?

A Right, 7.49. So we would go from -- see, the lowest return I'd ever seen authorized for any utility was 8.75 percent, so you'd be -- you'd be 125 basis points below that based on -- based on this.

Q But now we're talking about what the market data is, not the authorized returns in other states, right?

A Sure. But I think if we were to say that the -- if this Commission were to say that the cost of equity is 7.47 percent, I -- I think there -- the market would react very substantially to that. There would be considerable pressure on the Company's cash flows. The view of this Commission as being constructive I think would come under pressure. I think the Company's debt would certainly come under review and -- and I could easily see a downgrade. The Company's SCANA stock price would fall. It -- it -- the reaction of the market to an ROE that would fall out of this Duff & Phelps formula I think would be significant.

Q For purposes of doing the math, since we were saying it out loud, just -- you can take a look at this. This is filling in those numbers, I think, using that 4 percent.

A You did the math for me.

Q About time I came up with that. Actually, my computer did the math, fortunately.

MS. FORCE: I'd ask that this be marked Attorney General Hevert Cross Examination Exhibit Number 6, please.

COMMISSIONER BROWN-BLAND: It will be so identified.

(Whereupon, Attorney General Hevert Cross Examination Exhibit Number 6 was marked for identification.)

Q This is using those same numbers that you had given with that change; is that right? I -- I'm not asking you to agree with what --

A No.

Q -- what they've estimated as the premium or that it would be appropriate for the -- but it is using this average beta coefficient from your numbers, right? That's taking the betas for these comparable groups --

A Yes. That's correct.

Q -- and averaging them?

A That's right.

Q Okay. We're getting there, Mr. Hevert. I -- let me check my notes. There's something else I want to ask you on your third, but that's pretty brief, so let me make sure I've asked all the questions I have on this.

Okay. The third type of study that you did starts on your testimony on page 35, I think, and it's called the Bond Yield Cost Risk Premium Approach, right?

A Yes. That's correct.

Q So in that analysis your risk premium is defined based on the difference between the prevailing level of long-term Treasury yield, so Treasuries, like we used in that CAPM, I think, for the risk free?

A That's right.

Q And authorized rates of return on equity that have been authorized by regulatory bodies like the Utilities Commission, right?

A That's correct.

Q So that second part of it, those authorized returns, they're not market data, are they? They are somebody's estimate that could take into account market data, but also includes other policies and that kind of thing.

A I -- I agree with that. They're -- they're authorized returns and, of course, authorized returns reflect the particular circumstances of each case. What we're doing here is looking at the relationship between authorized returns and interest rates over time, and we're looking at several hundred, in fact, over a thousand cases, and so my thought is that the -- to the extent that there are particular circumstances in one case, they would be averaged out by the use of many, many cases.

Q And the point, though, that I was making you don't disagree with, that it's -- it's not -- it's derivative of somebody's estimate of market conditions as opposed to using the market data itself.

A Well, the way I look at it is just as this Commission would render a decision based on testimony that reflects market data, these decisions likewise would be based on testimony and evidence that reflects market data.

Q Okay.

MS. FORCE: I don’t have any other questions. Appreciate it.

THE WITNESS: Thank you.

MS. FORCE: Oh, you want me to ask --

MR. GRANTMYRE: Your exhibits have not been identified.

MS. FORCE: They’ve been identified, but not admitted. Did you have --

COMMISSIONER BROWN-BLAND: Is there redirect?

MS. GRIGG: Yes, ma'am. Just a few -- very few questions.

REDIRECT EXAMINATION BY MS. GRIGG:

Q Good afternoon, Mr. Hevert.

A Good afternoon.

Q Earlier today you were talking with Ms. Force about the CAP structure of SCANA Corporation, PSNC and the proxy companies that you looked at, and you were looking at the Value Line reports, correct?

A Yes. That’s right.

Q And you looked at a number of different items on these reports and spoke with them -- about them with Ms. Force.

A Yes. That's right.

Q One line item that you did not look at was the common equity ratio for the proxy companies. Would you please tell me what the equity ratios are for the proxy companies?

A Well, these -- if -- if you were to look at these Value Line reports toward the right-hand margin, you've got expected equity ratios going forward and then even some current ratios, and these are based on common equity and long-term debt, but nonetheless, with those we see common equity ratios of 55 percent for Atmos, 58 percent for New Jersey Resources, 56 for Northwest Natural. I skipped one. I'm sorry. Forty-nine (49) for Laclede, which is, I think, the lowest of the group. So we see a number of equity ratios in the range of, say, 49 to as high as 58 percent, whereas SCANA is 46 percent. So my point is that the companies that are fundamentally natural gas distribution companies did have much higher equity ratio expectations from Value Line than SCANA, the holding company.

Q Thank you, Mr. Hevert.

MS. GRIGG: I don't have any additional questions on redirect.

COMMISSIONER BROWN-BLAND: All right. Are there questions from the Commission? Chairman Finley?

EXAMINATION BY CHAIRMAN FINLEY:

Q Mr. Hevert, I think this is the first time you've been here where you have been affiliated with ScottMadden; is that right?

A Yes, sir. It is.

Q Are you still going to be located in Massachusetts or are you going to move to Raleigh?

A I am working very hard to be here in Raleigh as often as I can, especially in January, February.

Q That says a lot about your credibility, Mr. Hevert.

(Laughter.)

Q You use the acronym or the abbreviation ROE like a lot of people do, right?

A Yes, sir.

Q And I think you said at one point in your summary there that that is the cost of equity capital, right?

A Yes. That's right.

Q And that -- that abbreviation can mean different things in different contexts, can't it? For example, what we're talking about here, are we not, is -- is really the rate of return on equity expressed as a percentage, right?

A That's correct.

Q And another way to refer to the return on equity would be the dollars that are actually approved in this case as the return that is given to the equity investor. In other words, if you take the rate base -- let's say hypothetically you take a rate base of a million dollars and you use a 50/50 capital structure, so you've got $500,000 in equity, and you multiply that $500,000 times 9.7 percent, that would give you $48,500, if my calculation is right.

A Correct. And -- and so that would be the -- the dollar amount that the utility would have the opportunity to earn.

Q So you -- you could say that that is the return on equity in terms of dollars that the equity investor gets, right?

A Correct.

Q All right. Now, you made some comments about current economic conditions in North Carolina, right?

A Yes, sir.

Q My assumption is you did that because of some requirements in some North Carolina Supreme Court cases; am I wrong about that or right about that?

A You are correct about that.
Q All right. And I think you testified, and Ms. Force asked you, about four cases, two Duke Energy Carolinas cases, one Progress Energy Carolinas case and one Dominion Resource case, right?
A Yes, sir.
Q And you were the rate-of-return witness in all four of those cases; is that right?
A I was.
Q All right. And I -- am I correct in my understanding that -- that those four cases were appealed to the North Carolina Supreme Court by the North Carolina Attorney General on the theory that the Commission had committed error because it had not taken into account the ability of the customers to pay in determining what the rate of return on equity should be?
A That was my reading, yes.
Q And is it your understanding that those four cases were remanded to the Commission because the court -- the court took into account the theory that the Attorney General had advocated and said that the Commission erred in not taking into account the ability of the customers to pay in establishing a rate of return on equity?

A That's right.

Q All right. That theory didn't make a whole lot of sense to me. Does it make any sense to you as an expert rate of return witness?

A I -- I have consistently held that the -- the cost to equity investors is based on what we talked about earlier, the opportunity cost, the -- the return that you forego by investing in alternative investments. And in utilities, those, of course, would be utilities operating in jurisdictions across the country. So in my view, that's the fundamental basis for the cost of equity and that's how I based my -- my analyses.

Q So the equity investor invests in a market, looks at the -- looks at the risks and determined what those risks are, and if he deemed the risks to be appropriate, he could provide money to the company. If he doesn't -- if he thinks the risks are too high or he's not going to get the appropriate return, he won't invest in that company, right?

A That -- that's correct. And earlier I made the distinction between expected and required returns, and it was exactly that that you just mentioned. If the return that an investor requires is higher than the return they inspect -- they expect, they will not invest their money.

Q All right. Now, let's say hypothetically that you've got a company that operates in a state where the economic conditions are not good, and in fact they're terrible, and it's hypothetically that half the customers are having a hard time paying their bills so that the company has a -- has a large uncollectibles and it's just not collecting the money that it should receive for the services it provides. To me that would cause the risk to increase and the cost of equity that the equity investor would require to be higher rather than lower. Does that make sense to you or not?

A It does.

Q And by the same token, if -- if you were going to base the rate of return on equity on current economic conditions, and if you were going to penalize the investor, give him less rate of return if the economic conditions were poor, if the economic conditions were robust and if the economy was running on all cylinders, then symmetry would -- would say that you give a higher rate of return on equity and -- when the economy is robust. Symmetry would, would it not?

A It would.

Q All right. What -- in comparison to the economic conditions when those prior electric rate cases were decided, the two Duke Energy Carolinas cases, the Progress Energy Carolinas and the Dominion Resource cases, what is the status, in your opinion, of the North Carolina economy today versus what it was when those three cases were decided initially by the Commission?

A It has well improved. The unemployment rate is down considerably. In fact, in -- in North Carolina it is approximately equal to the national rate of unemployment, whereas it had been higher. Both have fallen, but North Carolina has fallen considerably. The state GDP growth has expanded, and the Richmond Federal Reserve has noted its expectations for continued growth in North Carolina. So I think since those cases, the overall economy has improved here in North Carolina.

Q I think you mentioned also in the course of your testimony here today that the investment community looks upon the North Carolina Commission as providing a constructive regulatory environment, did you not?

A Yes. That's right.

Q And a regulatory environment includes not only the Public Service Commission, but it includes the courts and the legislature and the executive branch of the government, right?

A I would agree, yes.

Q All right. Now, those three -- those four cases that we mentioned a moment ago were remanded to the Commission. The Commission, in effect, reapproved the rates that it had initially approved for those companies. It was taken up to the Supreme Court and the Supreme Court ultimately affirmed those remanded cases, right?

A That's right.

Q What opinion -- what is your opinion that if it became a permanent requirement in this state that the Commission change the rate of return on equity based on the ability of the customers to pay, would that not have some sort of a negative impact on the regulatory environment in the state?

A It would, I think, in at least two ways. First, it would be a departure from the Commission's past practice, and a departure from practice that's been well established is often an area of risk for investors. Second, it would be a departure from the practice of other regulatory commissions. Those two things put together would, I think, add a considerable element of risk.

Q So as far as you're concerned, other regulatory commissions do not take into account the ability of the customers to pay when they establish the rate of return on equity capital?

A I think all utilities have the obligation to balance the interests of investors and ratepayers, and they do that to the best of their ability based on the evidence before them. I'm not aware of a commission that will apply increments or decrements of return based on economic conditions. They'll take them into consideration, but I don't know of any commission that will adjust the return on equity by increments or decrements for that purpose.

Q So the -- the commissions will take the economic conditions and revenue requirement or the bottom line as opposed to the increments or decrements to the rate of return on equity?

A That's right. And that's what I say in my testimony. It's an unenviable task that commissions have to -- to balance those interests, but in my experience that's the manner in which those interests are balanced.

CHAIRMAN FINLEY: All right. Those are all the questions I have, Madam Chair.

COMMISSIONER BROWN-BLAND: Any other questions from the Commission?

(No response.)

COMMISSIONER BROWN-BLAND: Questions of

Commission's questions?

MS. GRIGG: No, ma'am.

COMMISSIONER BROWN-BLAND: Ms. Force?

MS. FORCE: No.

COMMISSIONER BROWN-BLAND: All right.

MS. GRIGG: I'd like to move Mr. Hevert's 13 exhibits to his direct testimony as they were premarked for identification into evidence, and his two exhibits to his rebuttal testimony as they were premarked for identification into evidence.

COMMISSIONER BROWN-BLAND: All right. Without objection, witness Hevert's exhibits to his prefiled testimony, his direct and supplemental, the 13 with the direct, the two exhibits with the supplemental, will be received into evidence.

(Whereupon, Exhibits RBH-1 through RBH-13 and Supplemental Exhibits RBH 1 and 2 were admitted into evidence.)

MS. FORCE: And I'd like to move into evidence Attorney General Hevert Cross Examination Exhibits 1 through 6.

COMMISSIONER BROWN-BLAND: All right. They -- Attorney General Hevert Cross Examination Exhibits 1 through 6 will be received into evidence as well.

(Whereupon, Attorney General Hevert Cross Examination Exhibits 1 through 6 were admitted into evidence.)

COMMISSIONER BROWN-BLAND: And Mr. Hevert, I hope you can make your plane.

THE WITNESS: Thank you very much. I --

COMMISSIONER BROWN-BLAND: You're excused.

THE WITNESS: I appreciate your flexibility.

(Witness excused.)

MR. PITTMAN: The Company will call to the stand George Ratchford. Good afternoon, Mr. Ratchford.

COMMISSIONER BROWN-BLAND: Hold on just a second.

MR. PITTMAN: Ma'am?

COMMISSIONER BROWN-BLAND: Sworn in.

MR. PITTMAN: Oh, I'm sorry. Forgive me.

GEORGE B. RATCHFORD; First being duly sworn, testified as follows:

COMMISSIONER BROWN-BLAND: All right. Now Mr. Pittman. Have at it.

MR. PITTMAN: Thank you, Madam Chairman.

DIRECT EXAMINATION BY MR. PITTMAN:

Q Mr. Ratchford, would you please state your name and business address.

A My name is George Ratchford, business address is 800 Gaston Road, Gastonia, North Carolina, 28054.

Q And how are you employed?

A I'm employed as Vice President of Operations for PSNC Energy.

Q Did you cause to be prefiled in this docket on or about March 31st direct testimony in question and answer form consisting of 17 pages and one premarked exhibit?

A I did.

Q Are there any additions or corrections you wish to make to that testimony?

A No.

Q If I asked you the same questions today, would your answers be the same?

A Yes, they would.

MR. PITTMAN: Madam Chairman, I'd ask that Mr. Ratchford's direct testimony be copied into the record as if given orally from the stand.

COMMISSIONER BROWN-BLAND: There being no objection, Mr. Ratchford's prefiled testimony will be received into evidence as if given orally from the witness stand.

(Whereupon, the prefiled direct testimony of George B. Ratchford was copied into the record as if given orally from the stand.)

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND CURRENT POSITION.

A. My name is George B. Ratchford and my business address is 800 Gaston Road, Gastonia, North Carolina. I am Vice President – Gas Operations for Public Service Company of North Carolina, Inc., d/b/a PSNC Energy ("PSNC" or the "Company").

Q. WHAT ARE YOUR RESPONSIBILITIES WITH THE COMPANY?

A. I am responsible for the day-to-day management of PSNC's operations, including the provision of safe and reliable natural gas sales and transportation services to customers located within its franchised service territory in three areas of North Carolina – Raleigh/Durham (Eastern Region), Gastonia/Concord/Statesville (Central Region), and Asheville/Hendersonville (Western Region).

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I graduated from the University of North Carolina at Charlotte in 1987 with a Bachelor of Science degree in Civil Engineering. Following graduation, I began working at PSNC as an Assistant to the Division Engineer. In 1990, I was promoted to Manager of Engineering in the Western Region of the Company and became the Director of Western Region Operations Engineering in 1993. Over the next twenty years I held a variety of management positions in several other areas of the Company, including construction, materials management, and customer service operations. In May

2013, I was promoted from General Manager – Customer Service Operations to my current role of Vice President – Gas Operations for PSNC.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes, I presented testimony in Docket No. G-5, Sub 545.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. My testimony supports the Company's requests for (1) a rider to its rates to recover capital expenses related to the Company's transmission and distribution pipeline integrity management programs; (2) regulatory asset accounting treatment for certain operations and maintenance ("O&M") expenses incurred due to the Company's pipeline integrity management programs; (3) inclusion in the Company's cost of service of $2,000,000 for its distribution integrity management O&M expenses; and (4) an annual investment in the Gas Technology Institute's Operations Technology Development program. I also recommend that the Company's current deferral mechanism related to manufactured gas plants be terminated.

Q. PLEASE BRIEFLY DESCRIBE PSNC'S INTEGRITY MANAGEMENT EFFORTS.

A. PSNC has multiple processes to ensure the safety of its natural gas transmission and distribution systems. These processes include identifying and assessing risks on its transmission and distribution pipelines and remediating conditions that present potential risks to pipeline integrity. PSNC is presently escalating its integrity management efforts as federal pipeline safety regulations evolve.

Q. PLEASE DESCRIBE THE FEDERAL REGULATIONS PERTAINING TO TRANSMISSION PIPELINE INTEGRITY MANAGEMENT.

A. The federal regulations that govern PSNC's transmission integrity management program ("TIMP") are within Subpart O of Part 192, Title 49 of the United States Code of Federal Regulations ("CFR"). In November of 2002 the United States Congress enacted the Pipeline Safety Improvement Act ("PSIA") which required, among other things, that operators of natural gas transmission pipelines implement integrity management programs to conform to regulations promulgated by the United States Department of Transportation ("USDOT"). In December 2003, the USDOT's Research and Special Programs Administration ("RSPA")/Office of Pipeline Safety ("OPS") published the Gas Transmission Rule ("TIMP Rule") to prescribe minimum standards for integrity management programs for natural gas transmission pipelines. The TIMP rule mandated a more structured and systemic approach for the gas industry to manage the safety of natural gas transmission pipelines. RSPA was abolished in 2004 and certain of its powers and duties were transferred to the Pipeline and Hazardous Materials Safety Administration ("PHMSA"), including responsibility for the integrity management programs. The OPS is now part of PHMSA.

Q. PLEASE DESCRIBE THE FEDERAL REGULATIONS PERTAINING TO DISTRIBUTION PIPELINE INTEGRITY MANAGEMENT.

A. The federal regulations that govern PSNC's distribution integrity management program ("DIMP") are within Subpart P of Part 192, Title 49 of the CFR. In 2006 the United States Congress enacted the Pipeline Integrity, Protection, and Safety ("PIPES") Act, which directed PHMSA to prescribe minimum standards for integrity management programs for natural gas distribution systems. In December 2009, PHMSA published the "Pipeline Safety: Integrity Management Program for Gas Distribution Pipelines" Rule ("DIMP Rule").

Q. ARE THE TIMP AND DIMP RULES SIMILAR IN THEIR APPROACH?

A. Yes, like the TIMP Rule, the DIMP Rule provides a framework for a more comprehensive approach to managing pipeline safety. However, although the foundations underlying TIMP and DIMP are similar—know your assets, identify threats and risk to your assets, and proactively mitigate those threats— the TIMP Rule is more prescriptive than the DIMP Rule.

Q. PLEASE EXPLAIN.

A. The TIMP Rule has very specific requirements for how pipeline operators, such as PSNC, must identify, prioritize, assess, evaluate, repair and validate the integrity of gas transmission pipelines that could, in the event of a leak or failure, affect High Consequence Areas ("HCAs"), which are certain populated and occupied areas. In total, the TIMP Rule comprises just over 19 pages in the current version of the CFR.

In contrast, the DIMP Rule comprises just over 3 pages in the current version of the CFR because PHMSA concluded that more general requirements were necessary for distribution systems given their diversity and the unique threats which they may face. The DIMP Rule requires that operators of natural gas distribution companies develop, write, and implement a distribution integrity management program which demonstrates the operator's knowledge of the system; identifies threats and risks; evaluates and ranks risks; identifies and implements measures to address those risks; measures performance, monitors results, and evaluates effectiveness of the program; periodically evaluates and improves the program; and reports results.

Q. HAS PSNC COMPLIED WITH THE REQUIREMENTS OF THE TIMP RULE?

A. Yes, PSNC's top priority is safety, and the Company has met the requirements of the TIMP Rule.

Q. PLEASE DISCUSS HOW PSNC HAS MET THE TIMP RULE'S REQUIREMENTS.

A. Some examples of initiatives PSNC has implemented to meet the TIMP Rule are:

- Conducting In-Line Inspections ("ILI") on transmission pipelines; PSNC has completed ILI on its T-1, T-12A and T-15 transmission pipelines;
- Conducting more frequent aerial patrols to mitigate the threat of third party damage;

- Removing casings from transmission pipelines within HCAs;
- Implementing Mechanical Damage Direct Assessment ("MDDA") inspections to address specific threats and risks to transmission pipelines located in road rights-of-way; and
- Enhancing the corrosion inspection program to include (1) conducting close interval surveys over the full length of all transmission pipelines once every seven years; (2) collecting alternating current readings annually during corrosion inspections; and (3) installing current-measuring test stations so coating quality can be monitored.

An additional nineteen employees have been added to administer these and other TIMP processes.

Q. PLEASE DISCUSS PSNC'S INTEGRITY MANAGEMENT ACTIVITY ASSOCIATED WITH ITS T-1 TRANSMISSION PIPELINE.

A. PSNC's T-1 transmission pipeline was installed in the early 1950s to serve its western territory. Consistent with PSNC's TIMP, PSNC performed an ILI on T-1 in 2014. Because of the type of pipe that was installed, the data generated by the ILI was inconclusive as to the integrity of T-1 and since the results of the ILI could not confirm the integrity of the pipeline, PSNC determined it should replace the pipeline. As a result, and due to PSNC's need to increase the pipeline's size and add compression to serve growing demand in its Western Region, PSNC projects that it will spend $369 million over the next three years to replace T-1.

Q. PLEASE EXPAND ON THE MDDA INITIATIVE.

A. After an incident in PSNC's western system involving a transmission pipeline rupture in January 2014, the Company determined that the ruptured pipeline had been damaged during a distribution pipeline installation. The distribution pipeline was being installed at an entranceway to a parking lot by way of directional boring, and the crew engaged in the installation were unaware the existing transmission pipeline had been damaged. As a result of this incident, PSNC developed a process to inspect for similar kinds of damage on transmission pipelines located in road shoulders. This new inspection method utilizes direct current voltage gradient tools to detect damage to a pipeline's protective coating. PSNC piloted the process, which proved to be effective at locating potential mechanical or third party damage. Given the effectiveness of the pilot, PSNC is now performing these or similar inspections on transmission pipelines in road shoulder rights-of-way.

Q. IS PSNC CONSIDERING ADDITIONAL TIMP INITIATIVES?

A. Yes. A key component of integrity management is continuous improvement. Operators such as PSNC must continuously identify and invest in risk control measures, and must implement methods to reduce the risks from threats that may be specific to PSNC's individual pipelines and systems. The Company is developing a number of initiatives that utilize new processes and the additional use of technology. Some examples are:

- Implementing strategies to retrofit pipelines that can feasibly accept ILI tools; transmission pipelines that are currently being retrofitted or where partial ILI has been performed include T-11, T-11B, T-21, T-29, and T-53; ILI on these pipelines (approximately 64 miles) is scheduled to be completed in 2016; 15 additional transmission pipelines are currently identified to be similarly retrofitted;

- Developing risk models using the Geographical Information System ("GIS") to guide decisions about pipeline inspections, risk performance, and adequacy of preventive and mitigation measures;
- Collecting, reporting, housing, integrating and analyzing integrity inspection data;
- Implementing software tools to manage Maximum Allowable Operating Pressure ("MAOP") validation and records processes; and
- Developing reports and measures to validate the overall performance of PSNC's pipeline safety programs.

Q. HAS PSNC MET THE REQUIREMENTS OF THE DIMP RULE?

A. Yes, the Company has evaluated the threats to its distribution system and established its DIMP, which includes the following initiatives:

- Enhancing data collection and analysis to better assess the threats and risks to its distribution system, including a database to track leaks and development of PSNC's distribution risk model;
- Conducting sewer cross-bore pilot inspections across PSNC's system;
- Conducting annual leakage surveys of high-pressure distribution pipelines;
- Conducting accelerated patrols on higher risk distribution pipelines;

- Contracting with third-party pipeline location services to supplement Company personnel who locate pipelines (damage to PSNC's pipelines by contractors excavating near and around its pipelines is the greatest threat to the Company's system); and
- Enhancing inspection and remediation programs for cased crossings and bridge attachments.

Q. IS PSNC CONSIDERING ADDITIONAL DIMP INITIATIVES?

A. Yes. PSNC's DIMP is still relatively new. However, as its program matures the Company continues to learn more about its system and better understand emerging risks. PSNC anticipates that its DIMP will continue to evolve at a relatively fast pace going forward, and that its efforts, practices, and tools related to the implementation of its DIMP will correspondingly change in significant ways. Some examples of future distribution integrity initiatives include:

- Enhancing methods and inspections on PSNC's system to address specific threats; examples include:
  - Establishing a formal cross-bore inspection program;
  - Enhancing the one-call locate program to ensure the Company is able to meet peak request demands;
  - Developing a comprehensive pipeline safety management system framework, requiring integrated processes across information management, stakeholder communications, risk evaluation, procedure

development, materials selection, employee and contractor training, audit, and risk management; and

- Enhancing corrosion control procedures and practices.

- Investing in technologies – specifically, tools and systems to gather, store, and analyze information – that will aid PSNC in understanding the threats and risks to its system; examples include:
    - Mapping service lines and attributes in the Company's GIS;
    - Creating data management solutions for metering, regulating, and valve stations;
    - Developing processes to validate distribution facility records and identify gaps in those records; and
    - Enhancing public safety messaging to improve the overall awareness and education of our customers and the general public.

Q. DOES PSNC FORESEE NEW REGULATIONS?

A. Yes. Currently, several PHMSA rulemakings are in various stages of development which have the potential to significantly impact both PSNC's TIMP and DIMP. For TIMP, these new rulemakings include:

- A Notice of Proposed Rulemaking ("NOPR") entitled "Pipeline Safety: Safety of Gas Transmission and Gathering Pipelines".
- Amendments to Parts 192 and 195 to require Valve installation and Minimum Rupture Detection Standards (Rupture Detection and Valve Rule).

For DIMP, new rulemakings include:

- An "operator qualification" rule that could expand the covered tasks it applies to, as well as incorporate new requirements for performance measures and tracking;
- A "construction inspection" rule that has the potential to impact PSNC's distribution construction inspections and place new requirements for internal performance audits on non-construction functions; and
- A "plastic pipe" rule that proposes new requirements for records, tracking, and traceability of materials.

Q. HAVE NEW STANDARDS BEEN PROPOSED THAT MAY AFFECT PSNC'S TIMP AND DIMP?

A. Yes. The American Petroleum Institute ("API") is developing new Recommended Practices ("RP") and Technical Reports that may affect both programs, including:

- API RP 1162, which proposes to enhance the communications methods and requirements to promote social and digital media channels of communications;
- API RP 1173, which proposes "Pipeline Safety Management Systems" as a framework to culturally integrate pipeline safety into all jobs and functions; and
- API Technical Report 1178, which proposes new standards for data integration to support pipeline safety programs.

Q. HAVE THESE PROPOSED RULES AND STANDARDS ADVANCED TO A POINT TO SUFFICIENTLY QUANTIFY THEIR IMPACTS?

A. No. For example, the NOPR entitled "Pipeline Safety: Safety of Gas Transmission and Gathering Pipelines" was issued in pre-publication form on March 17, 2016; after publication, persons interested in submitting written comments will have 60 days to do so. The final rule will not be issued until sometime after the comment period expires. The balance of the proposed rules and standards are in earlier stages of development and adoption.

Q. DOES THIS NOPR OFFER ANY INSIGHT AS TO THE POTENTIAL LEVEL OF IMPACT TO PSNC'S OPERATIONS, PIPELINE SAFETY PROGRAMS AND LEVEL OF RESOURCES REQUIRED TO COMPLY?

A. Yes. The NOPR as proposed would significantly impact PSNC in a number of ways, including, but not limited to:

- Expanding certain integrity management requirements beyond HCAs by creating new "Moderate Consequence Areas" ("MCAs"). This change would greatly increase the number of transmission pipelines subject to Subpart O.
- Requiring MAOP verification for certain pipelines, including those having MAOPs established by 49 CFR 192.619(c), also known as the Grandfather Clause. The Grandfather Clause allows pipeline segments, without a pressure test in accordance with the requirements 49 CFR 192.619(a)(2) after July 1, 1965, to be operated at the highest actual operating pressure to which the segment was subjected during the five years preceding July 1,

1970. The proposed MAOP verification of grandfathered pipeline segments may require PSNC to pressure test, replace, or reduce pressures, or implement additional inspections on pipelines or portions of pipelines, or it may require rigorous yet currently undefined engineering analyses to predict minimum predicted failure pressures for a pipeline.

- Implementing requirements for operators to establish material verification plans for pipelines and pipeline facilities lacking traceable, verifiable, and complete records, which may result in PSNC implementing new field equipment, processes, and inspections as well as technologies to gather, store, analyze, and report information detailing the mechanical and chemical properties of pipeline facilities.
- Revising the requirements for direct assessment (which has historically served as PSNC's primary inspection method) to allow its use only if a pipeline is not capable of inspection by internal inspection tools and it is not practical to assess the pipeline using the other methods specified.

PSNC – as well as other distribution operators who operate intrastate transmission pipelines – will be subject to these requirements unless the proposed rule is modified prior to the issuance of the final rule being issued. As proposed, the NOPR's additional requirements would greatly increase PSNC's compliance activity, and hence, compliance costs.

Q. IS PSNC SEEKING SPECIFIC REGULATORY TREATMENT FOR CAPITAL EXPENSES RELATED TO ITS TIMP AND DIMP, TO INCLUDE EXPENSES INCURRED AS A RESULT OF FUTURE REGULATIONS?

A. Yes. PSNC proposes to implement an integrity management rider to its rates to track and provide for the ongoing recovery of capital expenses related to its transmission and distribution integrity management programs.

Q. IS THIS REQUEST CONSISTENT WITH APPLICABLE NORTH CAROLINA GENERAL STATUTES?

A. Yes. The North Carolina General Assembly enacted House Bill 119, Session Law 2013-54, which gives this Commission the authority to adopt the rider PSNC is proposing. The rider is further discussed in Company Witness Paton's testimony.

Q. WHY IS ADOPTION OF THE RIDER APPROPRIATE?

A. PSNC's TIMP and DIMP are required by federal regulations that continue to evolve. While it is not possible to predict the anomalies that PSNC may discover on its pipeline system, when any anomalies are discovered, they must be remediated. It is also not possible to predict the cost of compliance under the current regulations, let alone the regulations that may govern these activities in the future. By their nature these programs are very capital intensive and extremely difficult to plan and budget for. PSNC's proposed rider would allow the capital cost of pipeline integrity activities to be recovered in a timelier manner than they would be if PSNC had to wait for a general rate case. In this manner, PSNC's customers are not subjected to a large, one-time rate increase, and the amount of the increase is reduced by minimizing debt expense on the capital necessary to make integrity management improvements, as well as minimizing general rate cases and their associated expense.

Q. PLEASE DISCUSS THE DEFERRED ACCOUNTING TREATMENT IN EFFECT FOR PSNC'S TIMP O&M EXPENSES.

A. After the PSIA was enacted and Subpart O was issued, PSNC requested and the Commission authorized the deferral of O&M expense associated with TIMP in its January 21, 2005, Order Approving Deferred Accounting Treatment (Docket Number G-5, Sub 459). The Commission subsequently authorized cost recovery of deferred expenses in PSNC's general rate cases in Docket Numbers G-5, Sub 481, and G-5, Sub 495.

Q. IS PSNC REQUESTING TO CONTINUE THIS ACCOUNTING TREATMENT?

A. Yes, this treatment is appropriate for the reasons stated above. In addition, the stipulation approved by the Commission in PSNC's last general rate case states that, "it is appropriate to continue until the resolution of PSNC Energy's next general rate case proceeding the regulatory asset treatment for costs paid to outside contractors and outside consultants incurred as a result of the Pipeline Safety Improvement Act of 2002 and necessary for compliance with current federal regulations, pending the establishment of an appropriate recovery mechanism in a future proceeding." *Order Approving Partial Rate Increase*, Docket No. G-5, Sub 495, October 24, 2008.

Q. IS PSNC SEEKING ADDITIONAL DEFERRED ACCOUNTING TREATMENT IN THIS APPLICATION?

A. Yes. In addition to continuing the deferral of certain O&M expenses associated with its TIMP, PSNC is requesting authority to defer certain O&M expenses associated with its DIMP that are in excess of $2,000,000. PSNC also requests the authority to include $2,000,000 of DIMP O&M expense in its cost of service.

Q. WHY DOES PSNC BELIEVE THIS TREATMENT IS APPROPRIATE?

A. Like the capital expenses PSNC is experiencing in its TIMP and DIMP, the O&M expenses associated with its DIMP program are rapidly growing and are difficult to predict. During the test year ending December 31, 2015, PSNC incurred $480,884 of DIMP O&M expense. However, PSNC is projecting a DIMP O&M expense of $2,143,221 in 2016, and projects it will spend approximately $28,000,000 over the next five years, as presented in Company Witness Spaulding's Exhibit 1. Similar to the O&M deferral associated with its TIMP, PSNC has and will continue to utilize third-party contractors and/or consultants to perform key tasks and projects associated with its DIMP.

Q. WHAT IS PSNC'S PROPOSAL WITH RESPECT TO FUNDING RESEARCH AND DEVELOPMENT ACTIVITY CONDUCTED BY THE GAS TECHNOLOGY INSTITUTE?

A. PSNC is proposing to include an annual contribution of $275,000 to the Gas Technology Institute's Operations Technology Development ("OTD") program in the Company's cost of service. This program is specifically targeted towards developing tools and technologies that will assist local distribution companies such as PSNC in meeting the requirements associated with their TIMP and DIMP. The contribution is further supported by Company Witness Spaulding's testimony, and a brochure describing the OTD program's recent initiatives is attached as Ratchford Exhibit 1.

Q. DO YOU BELIEVE THIS CONTRIBUTION WILL BENEFIT PSNC'S CUSTOMERS?

A. Yes. For instance, new tools being developed, such as one that can locate plastic mains and services, will enhance both the Company's overall pipeline safety efforts, and the efficient implementation of those efforts.

Q. DO YOU HAVE ANY ADDITIONAL PROPOSALS?

A. Yes. As mentioned in the testimony of Company Witness Harris, PSNC will complete the remediation of its manufactured gas plant facilities by the end of June 2016. The Company requests that the deferral mechanism associated with its environmental remediation expenses be terminated, as the only ongoing expense associated with these sites will be monitoring water quality, as discussed more fully in the testimony of Company Witness Boone.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, although I reserve the right to supplement or amend my testimony before or during the Commission's hearing in this proceeding.

Q Mr. Ratchford, have you prepared a summary of your testimony?

A I have.

Q Would you read it to the Commission at this time?

A Yes. Good afternoon, Madam Chairman and fellow Commissioners. My testimony supports PSNC's requests regarding the Company's transmission and distribution pipeline integrity management or "TIMP" and "DIMP" programs. As background to these requests, I describe the current federal regulations pertaining to pipeline integrity management and the new federal standards that have been proposed. I discuss PSNC's pipeline integrity management efforts and how these efforts meet the requirements of the federal rules, as well as additional pipeline integrity initiatives that PSNC is considering.

The programs are in response to federal regulations, regulations that continue to evolve. While it is not possible to predict the anomalies that PSNC may discover on its pipeline system, when any anomalies are discovered, they must be remediated. It is also not possible to predict the cost of compliance under the current regulations, let alone the regulations that may govern these activities in the future. By their nature these programs are very capital intensive and extremely difficult to plan and budget for.

My testimony describes the deferred accounting treatment currently in effect for PSNC's TIMP O&M expenses, and proposes the same treatment for DIMP O&M expenses. I also explain what -- that the Company proposes to implement an integrity management rider to track and provide for the ongoing recovery of capital expenses related to its TIMP and DIMP programs. PSNC's proposed rider would allow the capital cost of pipeline integrity activities to be recovered in a timelier manner than they would be if PSNC had to wait for a general rate case. In this manner, PSNC's customers are not subjected to a large, one-time rate increase.

Finally, my direct testimony describes and supports PSNC's proposal to include an annual contribution to the Gas Technology Institute's Operations Technology Development program and also discussed the Company's request that the federal -- that the -- excuse me -- that the deferral mechanism associated with its manufactured gas plant environmental remediation expenses be terminated, as these mediation efforts are now complete.

This concludes my summary.

MR. PITTMAN: Madam Chairman, Mr. Ratchford is available for cross examination.

COMMISSIONER BROWN-BLAND: Thank you. Ms. Force?

CROSS EXAMINATION BY MS. FORCE:

Q Good afternoon, Mr. Ratchford.

A Good afternoon, Ms. Force.

Q I'll keep it pretty brief. I -- I'm curious -- I asked some questions of Mr. Addison that he couldn't answer. Would you be able -- you said it's hard to predict costs associated with the costs that would go into this tracker, and you were talking about several mechanisms, I think, there, but you also spoke about the IM tracker; am I right --

A Yes.

Q -- in your testimony?

A Yes.

Q And -- and said that --

A The TIMP and DIMP programs.

Q And it's hard to predict the costs that would be involved, but can you give an idea of about what impact this might have on rates in the next three years or four years? And by that, I mean you would increase rates to collect revenue from qualifying costs. What --

what are we looking at in terms of the impact on consumers?

A The -- the proposal that we have in hand for the tracker is spelled out in the proposed Rider E on the way that it will be handled and the way that the deferral accounting and that treatment would be handled.

Q Does it identify any costs that you're projecting in that, too?

A Now, Ms. Paton could have some projected costs with -- with regard to that as far as rates go.

Q I see. Yeah. Part of my question I think for Mr. Addison was that there isn't anything in the rider that caps the amount that could be passed through to customers; is that right?

A Not that I'm aware of, no.

Q Okay.

MS. FORCE: I don't have any other questions.

MR. PITTMAN: No redirect.

COMMISSIONER BROWN-BLAND: Questions from the Commission?

EXAMINATION BY COMMISSIONER BROWN-BLAND:

Q I have just a couple for you, Mr. Ratchford.

A Okay.

Q Don't ease away too quickly.

A I'm not.

Q Rider E, which is the Company's proposed Integrity Management Tracker, quotes from the statute and makes reference to prudently incurred capital investment and associated cost of complying with federal gas pipeline safety requirements. And paragraph 10 of the Stipulation addresses adoption of the -- of the tracker and makes reference to capital expenses that are, quote, "related to the Company's transmission and distribution pipeline integrity management programs." Now, as you know, subpart (o) of the applicable federal regulation deals with transmission.

A Yes.

Q And subpart (p) deals with distribution.

A Yes.

Q Is it the intent of the Stipulation to limit the capital projects to those that are responsive to subparts (o) and (p) or all capital expenditures and associated expenses made to comply with all federal pipeline safety requirements eligible?

A No. The -- the -- the tracker, the DIMP -- the TIMP and DIMP Tracker that -- that we are referring to is -- is to address the -- the items and subparts (o) and (p).

Q Okay. And so the others that don't fit within (o) and (p) are not eligible?

A They'll be -- they'll be handled at the next general rate case.

Q All right. And are you able to discuss with me a little bit about the Company's role in economic development and what's happening right now in the Asheville/Hendersonville area?

A Well, I'll try.

Q Okay. Do you understand what's driving that right now in the moment?

A The -- the overall economic development situation?

Q In that area.

A Yes. I -- I know that the -- I -- I know the -- the -- I do know the downtown Asheville area has -- I would classify has been fairly robust the past couple years with a lot of commercial development going on. We have had some adequate residential growth with regard to the Asheville/Hendersonville region. I would -- I would -- we -- we have seen that growth, given that particular region as well lately, yes.

Q And is there -- do you see as well effects of the automotive industry in the area?

A We have seen some -- some manufacturing with respect to that in -- in the aerospace and automotive manufacturing area in the -- in the Hendersonville/Asheville regions, yes, we have.

Q Well, the question that we have is on the SCANA's website or webpage that's entitled Economic Development, it mentions there expressly that the Company is helping grow businesses and jobs in South Carolina, and it also has a link to developing the South Carolina economy. So our question is if a business is looking to locate in either North or South Carolina and they would also be a taker of both gas and electric service, what assurances does North Carolina have that it would be treated fairly by SCANA in the competition for that business and that economic development?

A I feel like all of our customers are treated fairly. You know, we have -- we have a -- a new business model that -- that we run through that, and that is subject to be reviewed. And so I can't speak on behalf of electric; I can only speak on behalf of PSNC Energy, but -- but that model and judgment is used to exercise to help -- to help in the discussions for -- for new manufacturing and economic development.

Q Well, in -- in terms of the Company's role in

-- in helping either state kind of land that business, if -- if -- should -- should this state or this Commission be concerned that because there might be additional sales, i.e., electric sales on the South Carolina side, that somehow you might weigh in more favorably or -- or more actively on one side of that equation than the other?

A That has not been my experience. I know that we go by the Code of Conduct that -- that's been issued by this body, and that's looked at, and that -- that has not been looked at favorably one side or the other. No. I -- I would say we pretty much stay in our lane, so to speak, Madam Chair.

COMMISSIONER BROWN-BLAND: All right. Follow-up questions to the Commission's questions?

MR. PITTMAN: No, ma'am.

COMMISSIONER BROWN-BLAND: All right. Do you have an exhibit, Mr. Pittman?

MR. PITTMAN: Mr. -- we would move Mr. Ratchford's one exhibit into evidence that's attached to his testimony.

COMMISSIONER BROWN-BLAND: There being no objection, Mr. Ratchford's Exhibit 1 that was prefiled with his prefiled testimony will be received into evidence and identified as it was marked.

(Whereupon, Ratchford Exhibit 1 was identified as premarked and admitted into evidence.)

COMMISSIONER BROWN-BLAND: Mr. Ratchford, I didn't spend nearly as much time as Mr. Addison, but you're free to go.

THE WITNESS: Thank you.

(Witness excused.)

MR. COLLINS: Madam Chair, PSNC would call as its next witness Candace Paton.

CANDACE PATON; First being duly sworn, testified as follows:

COMMISSIONER BROWN-BLAND: You may be seated. Mr. Collins, she's your witness.

DIRECT EXAMINATION BY MR. COLLINS:

Q Good afternoon, Ms. Paton.

A Good afternoon.

Q Would you please state your name and business address for the record.

A My name is Candace Paton. My business address is 800 Gaston Road, Gastonia, North Carolina.

Q Where are you employed and in what capacity?

A I'm employed by SCANA Services as Rates and

Regulatory Manager for PSNC Energy.

Q Did you cause to be prepared and prefiled in this proceeding on March 31st, 2016, direct testimony consisting of 12 pages and Appendix A and 13 other exhibits premarked as Exhibits 1 through 13, Paton --

A Yes.

Q -- Exhibits 1 through 13?

A Yes, I did.

Q Do you have any corrections or changes to the direct testimony or exhibits?

A I have one correction on my Exhibit 13. The Docket Number should be Sub 565 rather than Sub 495.

Q And did you cause to be prepared and prefiled on August the 29th, 2016, supplemental testimony consisting of three pages?

A Four pages?

Q Four pages? Consisting of four pages?

A My copy has four.

Q Okay. And did that supplemental testimony replace that which was previously filed with the Commission on, I believe, August the 25th, 2016?

A Yes, it did.

Q Okay. Do you have any changes or corrections to that later testimony?

A No, I do not.

Q So if I were to ask you the questions set forth in your prefiled testimony in this proceeding, would your answers be the same as they are written?

A Yes, they would.

MR. COLLINS: Madam Chair, I'd move that Ms. Paton's prefiled direct and supplemental testimony be copied into the record as if given orally from the stand.

COMMISSIONER BROWN-BLAND: Very well. Ms. Paton's prefiled testimony, supplemental and direct, will be received into evidence and treated as if given orally from the witness stand.

(Whereupon, the prefiled direct testimony and prefiled supplemental testimony of Candace A. Paton was copied into the record as if given orally from the stand.)

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND CURRENT POSITION WITH PUBLIC SERVICE COMPANY OF NORTH CAROLINA, INC.

A. My name is Candace A. Paton. I am employed by SCANA Services, Inc. as Rates & Regulatory Manager for Public Service Company of North Carolina, Inc., d/b/a PSNC Energy ("PSNC Energy" or the "Company"). My business address is 800 Gaston Road, Gastonia, North Carolina 28056.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND, WORK EXPERIENCE AND OTHER QUALIFICATIONS.

A. My qualifications and work experience are set forth in Appendix A immediately following this testimony.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to present the following:

1. Adjustments to test period revenues and cost of gas related to quantities of gas sold and transported during the test period;
2. The cost of service study used to support the proposed rate design;
3. The Company's proposed rate design;
4. The Company's proposed Medium General Service Rate 140;
5. Proposed changes in PSNC Energy's Rates, Rate Schedules, Riders and Rules and Regulations;
6. Factors to be used in the Company's Customer Usage Tracker adjustment mechanism ("CUT"); and

7. The Company's proposed Integrity Management Rider.

Q. PLEASE DISCUSS THE PROPOSED ADJUSTMENTS TO TEST PERIOD REVENUES AND QUANTITIES OF GAS SOLD AND TRANSPORTED.

A. Test period sales and transportation volumes have been adjusted to reflect normal weather and to reflect customer growth. Adjusted volumes were then priced at the current Tariff rates, exclusive of the current temporary CUT increments and decrements. These adjustments are set forth in Paton Exhibit 8. Detailed workpapers supporting the adjustments are contained in Item 4 of Form G-1.

Q. PLEASE DISCUSS THE ADJUSTMENT TO TEST PERIOD VOLUMES TO REFLECT NORMAL WEATHER.

A. Test period sales for residential and general service customers were adjusted using 15-year normalized weather. This was done by using a heat sensitivity factor ("HSF") determined through statistical regression analysis of therm use per customer for each rate. The HSF equals the change in therm use per customer for a change of one heating degree day ("HDD"). In this proceeding the Company has used HDDs with a base temperature of 65 degrees. New base load and heat sensitive factors to be used in the Customer Usage Tracker are set forth in Paton Exhibit 9.

Q. PLEASE DISCUSS HOW THE TEST PERIOD VOLUMES WERE ADJUSTED FOR CUSTOMER GROWTH.

A. Based on average customer growth for 2014 and 2015, test period volumes for residential customers on Residential Service Rate 101 were adjusted to reflect a growth rate of 2.59% and residential customers on High Efficiency Residential Service Rate 102 were adjusted to reflect a growth rate of 14.51%. A growth rate of 1.63% was applied to customers on Small General Service Rate 125. Although customers on High-Efficiency Small General Service Rate 127 grew 3.76% from 2014 to 2015 no growth adjustment was applied to this rate because the number of customers has remained the same for thirteen months.

Q. PLEASE DISCUSS THE PROPOSED ADJUSTMENTS TO TEST PERIOD COST OF GAS.

A. The determination of adjusted cost of gas is set forth in Paton Exhibit 10. Fixed transportation and storage charges were priced at current tariff rates. The commodity cost of gas was determined by applying the current commodity cost of gas of $0.225 per therm to the adjusted sales volumes on Paton Exhibit 8. In addition, Company Use and Lost and Unaccounted For ("LAUF") volumes were also priced at $0.225 per therm. The LAUF volumes reflect losses of 85.23 dekatherms ("DTs") per HDD and a non-weather sensitive loss level of 34,635 DTs per month. Gas cost was then decreased by $24,261,652 to recognize the level of fixed gas cost, Company Use and LAUF amounts reflected in adjusted revenues based on current rates. The proposed Company Use and LAUF recovery rates are set forth on Paton Exhibit 11.

Q. IS THE COMPANY PROPOSING NEW FIXED GAS COST RECOVERY RATES?

A. Not at this time. Paton Exhibit 12 shows how much the Company would expect to recover from customers based on normalized volumes and today's current rates. Using these amounts and adjusted sales volumes the Company calculated new fixed gas apportionment rates that PSNC would propose to use in any future changes to fixed gas rates or the determination of any All Customers Deferred Account temporary increments or decrements.

Q. HAVE YOU PREPARED A COST OF SERVICE STUDY FOR USE IN THIS PROCEEDING?

A. Yes. The per-books cost of service study summary is set forth in Paton Exhibit 5. An adjusted, or pro-forma, cost of service study summary under present rates is set forth in Paton Exhibit 6 and a pro-forma cost of service study summary under proposed rates is set forth in Paton Exhibit 7. Detailed workpapers supporting the pro-forma cost of service studies are included in Item 3 of the Form G-1 filed in this proceeding.

Q. PLEASE DISCUSS THE PURPOSE OF A COST OF SERVICE STUDY.

A. A cost of service study is used to determine the cost of providing service to the Company's various customer classes. The basic premise is to assign or apportion all of the Company's expenses and investments to the various customer classes that cause those investments to be made or costs to be incurred. The results of the study indicate the rates of return for those customer classes.

Q. PLEASE DESCRIBE THE STEPS USED TO DEVELOP THE COMPANY'S COST OF SERVICE STUDY.

A. The first step in any cost of service study is to separate the Company's expenses and rate base into one of the following functional categories: storage, transmission, distribution, general, intangible, and customer-related. Expenses and net plant were assigned directly to the functional classifications based on the Company's books and records. Revenues, expenses and rate base were then assigned to the various customer classes by direct assignment, and where direct assignment was not possible, by allocation.

Q. DID YOU MAKE ANY CHANGES TO THE COST OF SERVICE STUDY IN THIS PROCEEDING COMPARED TO THE COMPANY'S LAST GENERAL RATE CASE?

A. Yes. In this case the Company is proposing to treat revenues from PSNC's special contract customers and Rate 135 customers as reductions in revenue requirement to be collected from the remaining classes of customers. Rate base investment and revenues associated with these customers have been allocated to classes in the same manner as general plant is allocated. PSNC's compressed natural gas fueling facilities are classified as general plant. Because these facilities serve both public sales and company use gas this treatment ensures that all customer classes are allocated an appropriate share of company use costs.

Q. PLEASE GENERALLY DESCRIBE THE RESULTS OF THE COST OF SERVICE STUDY.

A. The per-books cost of service study showed that the Company earned an overall rate of return of 7.84% for the test period. After adjustments to update plant investment and recognize known and measurable changes in the Company's revenue and expense levels, the pro-forma cost of service study under present rates showed an overall return of 5.43%. The impacts of the proposed rate changes on customer class rates of return are shown in Paton Exhibit 7.

Q. PLEASE DESCRIBE THE COMPANY'S RATE DESIGN OBJECTIVES IN THIS PROCEEDING.

A. The Company's primary objective is to design rates that reflect appropriate ratemaking principles, are fair to the various customer classes, and are sufficient to produce the revenue requirement found appropriate by the Commission. There are numerous other economic, supply, and policy principles to be considered in designing rates for specific customer groups. Among these are the following:

- Cost of service;
- Value of service and competitive conditions in the marketplace;
- Consumption characteristics of different customer classes;
- Simplicity and administrative ease;
- Margin stability.

Q. PLEASE SUMMARIZE THE COMPANY'S PROPOSED RATE DESIGN RECOMMENDATIONS IN THIS PROCEEDING.

A. Other than changes to the per-therm billing rates themselves, the Company is proposing to maintain the Company's present rate structure with the exception of adding a new Medium General Service Rate 140.

Q. PLEASE DISCUSS THE PROPOSED MEDIUM GENERAL SERVICE RATE 140.

A. PSNC is proposing a new medium general service rate applicable to commercial and small industrial customers who use more than 25,000 but less than 60,000 therms per year. PSNC analyzed various levels of annual consumption for this proposed rate schedule and determined that annual usage of at least 25,000 therms was a reasonable level. There are 887 customers currently on Small General Service ("SGS") Rate 125 who meet this criterion. On average, these customers used 36,371 therms in 2015. This compares to average annual usage of 3,472 therms for all of SGS Rate 125, including these customers. When the 887 customers using in excess of 25,000 therms were removed the average annual consumption of the remaining SGS Rate 125 customers decreased to 2,777 therms per year. These larger customers were clearly distorting the average usage levels for SGS Rate 125.

Q. IS THE COMPANY PROPOSING TO INCREASE THE BASIC FACILITIES CHARGE FOR ANY RATES?

A. Yes. The Company is proposing to increase the basic facilities charge ("BFC") for Residential Service Rate 101 and for High Efficiency Residential Service Rate 102, from $10.00 to $12.00 per month and for SGS Rate 125 and High-Efficiency SGS Rate 127 from $17.50 to $25.00 per month.

Q. WHAT IS THE COMPANY'S REASON FOR THE PROPOSED BFC INCREASES?

A. One goal of rate design is for the rates charged to reflect the costs incurred to provide service. The ideal rate structure for a gas local distribution company ("LDC") would be "straight fixed-variable". This type of structure recognizes that the vast majority of an LDC's costs are fixed and are not dependent on the quantity of gas consumed. However, to fully implement such a structure would require a much higher BFC. In fact, the cost of service study would support higher BFCs than the Company is proposing. This approach, although a valid rate design structure, would be difficult to implement due to lack of customer understanding and acceptance, and may not further the Company's goal of promoting conservation. We believe that the proposed BFC increases strike an appropriate balance of the customers' and Company's needs.

Q. IS THE COMPANY PROPOSING ANY CHANGES TO MISCELLANEOUS FEES?

A. Yes. The Company proposes to increase reconnection fees to bring them more in line with the current cost of providing these services.

Q. ARE THERE ANY OTHER PROPOSED RATE CHANGES?

A. As discussed in Company Witness Boone's testimony the Company is proposing to refund excess accumulated deferred income taxes resulting from recent reductions in the state income tax rate through a temporary rate decrement. The calculation of the proposed temporary decrements is set forth on Paton Exhibit 13.

Q. DO YOU BELIEVE THAT THE PROPOSED RATES IN THIS PROCEEDING ARE FAIR AND EQUITABLE FOR ALL CLASSES OF SERVICE?

A. Yes, I do.

Q. HAVE YOU PROVIDED EXHIBITS REFLECTING THESE PROPOSED RATE CHANGES?

A. Yes. PSNC's current rates and charges are set forth on Paton Exhibit 1. Paton Exhibit 2 shows the proposed rates and charges and the design of the proposed rates is set forth on Paton Exhibit 3. Proposed Tariff changes are set forth in Paton Exhibit 4.

Q. IS THE COMPANY PROPOSING ANY CHANGES TO ITS VARIOUS RATE SCHEDULES?

A. PSNC is proposing minor changes to various rate schedules. Language is being added to indicate that all rate schedules will be subject to the proposed Integrity Management Tracker. The Company also added language to the Large General Service and transportation rate schedules to indicate that for billing purposes the rates in the Company's Summary of Rates and Charges that are expressed on a per therm basis will be converted to a per DT basis. This change will help these larger customers and their shippers monitor daily usage in order to minimize imbalances. Other minor changes to PSNC's rate schedules are shown as indicated on Paton Exhibit 4.

Q. IS THE COMPANY PROPOSING ANY CHANGES TO ITS SERVICE RULES AND REGULATIONS?

A. Yes, the Company is proposing some minor changes as indicated on Paton Exhibit 4. There are a few proposed changes worth noting. The Company is proposing to delete the current Section 29 which addresses the methodology for determining the proper rate service priority classification pursuant to

Commission Rules R6-12 and R6-19.2 and setting forth this information in a new Rider B to the tariff. PSNC is also adding a provision for reclassification of a customer outside of the annual review period under certain conditions. The Company is proposing additional language in Section 21 to address gas quality and measurement. Finally, a new Section 29 has been added to clarify the customers' responsibility for payment of certain taxes.

Q. DOES THE COMPANY PROPOSE CHANGES TO THE VARIOUS RIDERS APPLICABLE TO THE COMPANY'S RATES?

A. Yes. Company Witness Jackson will discuss PSNC's proposed changes to Rider A, Curtailment of Service Under Commission Rule R6-19.2. As discussed above the Company is are proposing a new Rider B – Methodology for Determining Proper Rate Service Priority Classification Pursuant to Commission Rules R6-12 & R6-19.2. The Company is proposing a minor change to section II of Rider C, Customer Usage Tracker to indicate that the proposed Medium General Service Rate 140 will be subject to the CUT. PSNC is not proposing any significant changes to Rider D, Purchased Gas Adjustment Procedures. The Company is proposing other minor revisions to the Riders for clarification, formatting or grammatical correction.

As discussed by Company Witness Ratchford, PSNC is requesting an Integrity Management Tracker pursuant to North Carolina General Statute § 62-133.7A. PSNC is proposing a new Rider E, Integrity Management Tracker ("IMT") that sets forth how the proposed tracker will work.

Q. PLEASE EXPLAIN HOW THE TRACKER WILL WORK.

A. PSNC's proposed Rider E is set forth in Paton Exhibit 4. In broad terms, the IMT provides for PSNC to adjust its rates biannually in order to recover the revenue requirement associated with Integrity Management Plant Investment ("IMPI") and associated costs incurred by PSNC resulting from prevailing federal standards for pipeline integrity and safety that are not otherwise included in current base rates.

The calculation of this revenue requirement or Integrity Management Revenue Requirement ("IMRR") will be filed with the Commission each January 31st and July 31st based on plant investment for the previous six-month periods ending December 31st and June 30th. The formula to be used for this calculation is set forth in section III. (b) of Rider E. Details of the IMPI underlying the IMRR will be filed with the Commission on a monthly basis within 45 days after the end of the applicable month. Additionally, an annual report summarizing PSNC's IMPI for the previous 12-month period ending December 31st will be filed each January 31st.

After the IMRR is filed each January 31st and July 31st, PSNC will file for an Integrity Management Adjustment ("IMA") by February 15th and August 15th for biannual rate adjustments to be effective March 1st and September 1st respectively.

PSNC will maintain an Integrity Management Deferred Account ("IMDA") which will track the monthly IMRR expense and the monthly IMRR amounts collected from customers pursuant to the biannual rate adjustments.

Monthly reports detailing the activity in the IMDA will be filed monthly within 45 days after the end of the applicable month.

Rider E provides for PSNC to file for an annual Integrity Management Deferred Account True-Up Adjustment ("IMDATA") in order to recover the balance in the IMDA as of January 31st. The Company also requests authority, at its discretion, to file for further IMDATAs on 14-days' notice to the Commission if the balance in the IMDA warrants.

Finally, Rider E provides for PSNC to file annually by January 31st its projected plan of IMPI for the next three fiscal years.

Q. DOES THIS COMPLETE YOUR PREFILED DIRECT TESTIMONY?

A. Yes, although I reserve the right to supplement or amend my testimony before or during the Commission's hearing on this Application.

APPENDIX A

CANDACE A. PATON
QUALIFICATIONS & EXPERIENCE

EDUCATION:

1979	Bachelor of Arts in Accounting North Carolina State University

PROFESSIONAL LICENSURE:

1983	Certified Public Accountant, State of North Carolina

MEMBER:	American Institute of Certified Public Accountants North Carolina Association of Certified Public Accountants

PROFESSIONAL UTILITY REGULATORY EXPERIENCE:

August 2002 to Present	Rates & Regulatory Manager, PSNC Energy *Presented testimony before the NCUC in annual prudence reviews, general rate cases, and expansion fund filing*
July 2001 to August 2002	Independent Consultant
April 1999 to March 2001	Supervisor, Regulatory Accounting Carolina Power & Light Company
January 1991 to April 1999	Manager, Regulatory Accounting Duke Power Company *Presented testimony before the NCUC in various fuel clause proceedings and an Integrated Resource Planning proceeding*
August 1987 to December 1990	Project Manager & Manager, Revenue Requirements Potomac Electric Power Company
January 1987 to August 1987 and October 1979 to July 1985	Public Staff of the North Carolina Utilities Commission Public Utilities Accountant II *Presented testimony before the NCUC in various telephone, electric and water & sewer general rate case proceedings*
April 1986 to December 1986	Texas Office of Public Utility Counsel Chief Accountant *Presented testimony before the Texas Public Utility Commission in telephone & electric rate case proceedings*
July 1985 to March 1986	Telecommunications Specialist North Carolina Utilities Commission

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND CURRENT POSITION WITH PUBLIC SERVICE COMPANY OF NORTH CAROLINA, INC.

A. My name is Candace A. Paton. I am employed by SCANA Services, Inc. as Rates & Regulatory Manager for Public Service Company of North Carolina, Inc., d/b/a PSNC Energy ("PSNC" or "the Company"). My business address is 800 Gaston Road, Gastonia, North Carolina 28056.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. Yes. I pre-filed direct testimony in this proceeding on March 31, 2016.

Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?

A. The purpose of my supplemental testimony is to support the Stipulation filed in this proceeding on August 29, 2016.

Q. PLEASE DESCRIBE THE EVENTS WHICH LEAD TO THE FILING OF A STIPULATION IN THIS PROCEEDING.

A. Subsequent to the filing of the Company's Application in this docket, PSNC, the Public Staff, Carolina Utility Customers Association, Inc., and Blue Ridge Paper Products Inc. d/b/a Evergreen Packaging (collectively, "the Stipulating Parties") engaged in substantial discovery regarding the matters contained therein. Additionally, the Public Staff spent several days in both Gastonia and SCANA's corporate office in Cayce, South Carolina, performing on-site audits and interviewing various Company personnel. After lengthy negotiations in multiple meetings and conference calls, the Stipulating Parties were able to arrive at a partial settlement of all but one issue in the case. The Stipulating

Parties were ultimately able to resolve the final issue, which resulted in the filing of the Stipulation on August 29, 2016.

Q. WHAT WAS THE OUTCOME OF THE NEGOTIATIONS AMONG THE STIPULATING PARTIES?

A. The agreement reflected in the Stipulation was the result of the give-and-take negotiations in which each party made substantial compromises on individual issues in order to obtain a compromise from the other parties on other issues. In the end, each party believes that the results reached, in the aggregate, are fair to the Company and its customers.

Q. PLEASE SUMMARIZE THE EFFECT OF THE STIPULATION ON PSNC'S REQUESTED REVENUE INCREASE.

A. This effect is shown on Paton Supplemental Exhibits 1 and 2. The recommended change in margin on Paton Supplemental Exhibit 1 reflects the amortization of MGP, PIM and DIMP costs as set forth on Supplemental Paton Exhibit 2. In addition, the recommended change in margin reflects a further decrease in advertising expenses of $159,027.

Q. DOES THE STIPULATION MAKE CHANGES TO ANY OF PSNC'S RATE SCHEDULES?

A. Yes. The Stipulation adds a sixth step to Rate Schedules 145 and 175.

Q. DO YOU HAVE A SCHEDULE THAT SHOWS THE EFFECT OF THE STIPULATION ON PSNC'S RATES AND CHARGES?

A. Not at this time. The Parties have agreed to the rate design principles and the revenue requirement and will work together to file revised rates by close of business this Wednesday, August 31, 2016.

Q. ARE THERE ANY OTHER ITEMS IN THE STIPULATION THAT REQUIRE FURTHER ACTION?

A. Yes. Paragraph 10 of the Stipulation addresses the adoption of an Integrity Management Tracker ("IMT"). That paragraph provides for the Company and the Public Staff to work together to determine the appropriate level of costs associated with the planned Highway 751 transmission integrity management project as well as other projects which may have significant non-integrity management components. Working together to resolve such issues before the fact will improve the accounting, reporting, and auditing process of the IMT for all parties.

As discussed in paragraph 8 of the Stipulation, the Company and the Public Staff have agreed to work together to determine the appropriate rate adjustment needed to reflect the decrease in the state income tax rate from 4% to 3% effective January 1, 2017. Additionally, as discussed in the testimony of Public Staff witness Boswell the Company and the Public Staff have agreed to determine the appropriate amount of excess accumulated deferred income taxes to be refunded resulting from the decrease in the state income tax rate from 4% to 3%.

Q. IN YOUR OPINION DOES THE STIPULATION REFLECT A FAIR, JUST, AND REASONABLE RESOLUTION OF THE ISSUES IT COVERS?

A. Yes. The Stipulation is the result of negotiations between the Stipulating Parties who, collectively, represent all segments of PSNC's customer base impacted by this rate case. It resolves all the issues in the case without the necessity of contentious litigation. In summary, I respectfully request that the Commission approve the Stipulation in its entirety.

Q. DOES THIS COMPLETE YOUR SUPPLEMENTAL TESTIMONY?

A. Yes, it does.

MR. COLLINS: And I would ask that her exhibits, as amended from the stand, be marked for identification.

COMMISSIONER BROWN-BLAND: That will also be allowed, so marked.

(Whereupon, Paton Exhibits 1 through 12, Paton Exhibit 13, as amended from the stand, and Paton Supplemental Exhibits 1 and 2 were identified as premarked.)

Q Ms. Paton, have you prepared a summary of your direct and supplemental testimony?

A Yes, I have. My direct testimony presents adjustments to test period revenues and cost of gas related to quantities of gas sold and transported during the test period ended December 31st, 2015. These adjustments included adjustments to reflect normal weather and to reflect customer growth, and to adjust the test period cost of gas. My direct testimony also discusses the cost of service study for use in this case -- how it was developed and the results of the study -- as well as PSNC's proposed rate design for this case. The per-books cost of service study showed that the Company earned an overall rate of return of 7.84 percent for the test period. After adjustments to update plant investment and recognize known and measurable changes in the Company's revenue and expense levels, the pro forma cost of service study under present rates showed an overall return of 5.43 percent.

Other than changes to the per-therm billing rates themselves, the Company is proposing to maintain PSNC's present rate structure with the exception of adding a new Medium General Service Rate 140 that will apply to commercial and small industrial customers who will use more than 25,000 but less than 60,000 therms per year.

In my direct testimony I also discuss changes to the Company's rates that PSNC has proposed, including an increase to the reconnection fees to bring them more in line with PSNC's current cost to provide this service, as well as a proposed refund, through a temporary rate decrement, of excess accumulated deferred income taxes resulting from recent reductions in the state income tax rate. In addition, I discuss proposed minor changes to PSNC's rate schedules and its service rules and regulations.

Further, my direct testimony addresses the proposed Integrity Management Tracker or "IMT" that will be implemented through new Rider E. The IMT will allow for PSNC to adjust its rates biannually in order to recover the revenue requirement associated with Integrity Management Plant Investment resulting from federal standards for pipeline integrity and safety that are not otherwise included in current base rates.

The purpose of my supplemental testimony is to present and support the Stipulation filed on August 29th, 2016, entered into by PSNC, the Public Staff, Carolina Utility Customers Association and Evergreen Packaging. The parties reached agreement on all issues.

Among other things, the Stipulation addresses the adoption of an IMT and provides for the Company and the Public Staff to work together to determine the appropriate level of costs associated with the planned Highway 751 transmission integrity management project as well as other projects which may have significant non-integrity management components.

The parties also agreed to a sixth step for Rates 145 and 175.

The Company and the Public Staff have agreed to work together to determine the appropriate rate adjustment needed to reflect the decrease in the state income tax rate effective January 1st, 2017 and the appropriate amount of excess accumulated deferred income taxes to be refunded.

Finally, the Stipulation resolves the dis--- the disagreement between the Company and the Public Staff regarding the appropriate treatment of deferred MGP and PIM costs. It is my opinion that the Stipulation is fair and reasonable and should be approved in its entirety.

Q Does that conclude your summary?

A Yes, it does.

MR. COLLINS: Ms. Paton is available for cross examination and questions from the Commissioners.

COMMISSIONER BROWN-BLAND: All right. Ms. Force, you have questions for Ms. Paton?

CROSS EXAMINATION BY MS. FORCE:

Q I'm trying to find -- I'm sorry. Ms. Paton?

A Yes.

Q Good afternoon.

A Good afternoon.

Q We've had a few changes in the -- the numbers in -- in the last couple days, haven't we?

A Yes, we have.

Q I'm going to ask your indulgence, because the number that I thought I saw earlier for the rate base may have changed or I misread it. I came up -- I have a number 946,722,235.

A Bear with me -- 946,722,235, that's what I show as attached to the Stipulation that I believe was filed this morning.

Q All right. That's what I thought, but I just turned to a page that has a different number in it. Well, good. Then we're in agreement. I can't find it in my notes, so I'm glad that you have the same number.

I have some questions for you. Did you hear me earlier? I -- I had questions of Mr. Addison about what the rate of return is in the settlement --

A Yes.

Q -- and the capital structure and the weighted rate of return, and then also looking at the effect of income taxes on that, plus other factors that are used to gross up --

A Gross up, yes.

Q -- for the revenue that's required. And that earlier exhibit that we used showed that for equity, the rate of return would gross up percent -- if you use it as a percentage is 15.61 percent compared to long-term debt at 5.54 percent.

A That's --

Q So those are rates.

A That's correct.

Q Those percentages then apply back to the net rate base to come up with a revenue requirement. Let me pass out an exhibit I'd like to ask you to take a look at that illustrates it. I'm glad -- I -- I can't find that number now.

A Okay.

Q I don't know if it's changed. And earlier that exhibit was attached to this showing the percentages, but looking here on the first page --

COMMISSIONER BROWN-BLAND: Ms. Force, do we need to get this one identified?

MS. FORCE: Yeah. I -- I'd ask that this be Attorney General Paton Cross Examination Exhibit Number 1.

COMMISSIONER BROWN-BLAND: All right. It will be identified as Attorney General Paton Cross Examination Exhibit Number 1.

(Whereupon, Attorney General Paton Cross Examination Exhibit Number 1 was marked for identification.)

Q So I think some of these numbers may not be precise when you look up from -- in terms of dollar for dollar, but they should be almost identical to numbers that would appear in your schedules and that you would calculate that shows the -- for long-term debt, using that capital structure and a rate base of 946.7 million, the net operating income for long-term debt that shows up in the revenue requirement is about 23.3 million and equity is about 47.8 million; is that --

A That's correct.

Q Does that look right?

A Yes.

Q And if you turn the page, then, page 2, and look at that chart, it shows, again, the rate of return for the various types of investment, and looking over I've added the column for gross up for taxes and other items, and when you look at the revenue requirement then, there's not too much of a difference for long-term debt and short-term debt --

A That's correct --

Q -- is that right?

A -- because you deduct your interest expense for tax purposes.

Q Right. So there's not the income tax effect. But it's a noticeable impact. I guess nobody likes taxes, do they? And it shows up in rates as substantially more once you include those factors, am I right, so it goes in total from 71,317,059 to a hundred, little bit over 100 million, almost 100.5?

A That's correct.

Q Now, I have one more that I want to show you, and then I just have a couple questions follow up on other witnesses.

MS. FORCE: Okay. I -- I apologize. My coffee evidently spilled. It doesn't look very nice on a few of these copies. I'll try to give clean ones to the Commissioners.

COMMISSIONER BROWN-BLAND: We'll mark -- mark this one for identification --

MS. FORCE: Yes, please.

COMMISSIONER BROWN-BLAND: -- as Attorney General Paton Cross Examination Exhibit 2?

MS. FORCE: Yes.

(Whereupon, Attorney General Paton Cross Examination Exhibit Number 2 was marked for identification.)

Q Now, Ms. Paton, if you look at this, I'll submit to you that I think it looks a lot like the last exhibit we looked at, but it adds another identical exhibit, and the change in it is to change the equity percentage to 45 percent from 52 percent. And accordingly, there's a -- an increase in long-term debt.

A I see that.

Q Now, this is all mathematical. I'm not asking you to agree. But would you, subject to check, agree that the numbers work out or appear to work out showing the total gross up -- revenue requirement with gross up goes from 100.482 million down so that there's a difference of 6 point -- well, 6,669,526?

A Assuming the math is correct, yes.

Q It's right.

A The -- the reduction of the equity ratio and the increase of the long-term debt would cause the total overall to go down.

Q And the point of it is that it makes a significant difference even using the same rate of return on equity when there's more or less equity ratio --

A That --

Q -- in the capital structure?

A That is true. That assumes that -- that the cost rates would not change with the change in the capital structure, though.

Q Okay. That's -- that's a good point. Now, I also want to ask you, you were referred to a couple of times. I had some questions about the IM Tracker.

A Yes.

Q And I'm curious if you have -- you would agree, wouldn't you -- I think you're the one that talked about the tracker itself -- that there's not a cap in that tracker at this point that says beyond this point we're not going to put any more into rates?

A No. There was no tracker. There's a four-year review period.

Q Okay. That's right. Okay. And do you have an estimate of about how much this impact could have on rates? We've heard -- Mr. Addison said that the plan right now is to spend 230 million per year for the next three years. I don't know that that would be --

A I believe that was the total capital budget, not just integrity management plant.

Q Uh-huh.

A Exhibit F to the Stipulation has some estimates of some current projects that we have planned. It's not -- it's not the total amount. This was --

Q Oh, right.

A I believe the Stipulation speaks to the current replacement of the T1 transmission line up in the Asheville area, and that was -- I believe the total amount of that that we would include in the tracker would be about 117 million. And then these were other projects that were of a different nature, so we showed them separately with the percentages that would be applied to those programs. To use the word of the day, lumpy, we will be doing projects that come into service sort of in a lumpy fashion, so the revenue requirement impact in any one biannual adjustment is going to vary, but over the next five years a rough approximation would be about five million a year. Some -- some years it may be higher; some years quite a bit lower.

Q Okay. So -- and I think you mentioned that the lumpy that's coming in, this -- does -- these costs do not come into rates until after the projects are completed?

A Until they're completed, yes. We've actually already replaced the first portion of that transmission line from the Kings Mountain area up to Asheville. We've replaced the first portion, and that went into rate base in June of this year.

Q Uh-huh. Because of the rate case?

A Because that's the way the schedule was planned, but yes, because of the rate case. It's already in rate base.

Q Uh-huh. Okay.

MS. FORCE: Okay. I don't have any other questions. Thank you.

COMMISSIONER BROWN-BLAND: Mr. Collins, any redirect?

MR. COLLINS: No questions.

COMMISSIONER BROWN-BLAND: All right. Any questions from the Commission? Commissioner Bailey?

EXAMINATION BY COMMISSIONER BAILEY:

Q Good afternoon, Ms. Paton.

A Good afternoon.

Q Just a curiosity question on my part.

A Okay.

Q The new rate schedule for Medium General Service 140 --

A Yes.

Q -- did that come from internal or did that come from your customers requesting a different rate schedule?

A That was an internal. We -- a year or a year or two ago we sort of took a look at the current rate structure and we realized that there were quite a few of the customers that are currently on the Small General Service rate who are significantly larger than the norm in that group, so we pulled them out into a separate rate schedule.

Q How many customers is that going to be?

A At the point in time that we did it earlier this year it would affect about 887 customers. And for -- the other thing it will do, right now we do an annual review of all of our customers to see if their usage has changed enough to move them, and right now if the usage has dropped and they're a current Rate 145 customer, they would fall all the way back to Rate 125, and this will -- this will be, you know, a halfway stopping point.

COMMISSIONER BAILEY: Thank you, ma'am.

COMMISSIONER BROWN-BLAND: Any other questions?

EXAMINATION BY COMMISSIONER BROWN-BLAND:

Q Ms. Paton, I have a few --

A All right.

Q -- for you. With regard to what we understand was the last matter resolved --

A Yes.

Q -- in your negotiations with the Stipulating Parties, could you explain to the Commission how the matter of handling deferred accounts, particularly when the deferred account amortizations have been fully recovered, how that matter -- how that was resolved for going forward on a prospective basis?

A What we have agreed to on a go-forward basis is that we will continue the amortizations on our books until the next general rate case, so if we stayed out six years rather -- because we have five-year amortizations built in, we would still record an amortization expense that would then be applied against the dollars that we are continuing to defer. Does that make --

Q Right. To cover costs that you -- that will continue?

A Yes. Right.

Q And is that -- that is in line with what the Public Staff initially requested, is that -- in terms of that process?

A For that particular piece of it, yes. The other -- the other piece of that was the rate base treatment of those balances.

Q All right. Could you speak to the rate base treatment at all?

A The -- we have not been including the unamortized balance in rate base. And I'll take MGP just as the example because that's been going on longer. I believe in '93, when we filed for deferral treatment, we were allowed to -- I can't remember when the next rate case was; it probably was '93 or '94 -- and we deferred -- we had deferred the dollars and then we got a, I believe at that point, either a two- or three-year amortization, but the balance that we still had to amortize during that time period was not included in a rate base, so we were not earning the cost of money while we were recovering it. Each rate case since then we have, again, put an annual amortization into the cost of service, but did not include that unamortized balance in rate base. It's my understanding that in other cases for other companies they have done it the other way, they've put it in rate base and continued an amortization expense. And we've agreed going forward that that's what we would do.

Q So you would include --

A We have not -- in this settlement we did not include that unamortized balance in rate case for this proceeding.

Q All right.

A I would anticipate the next time that PSNC is here, not me, next time PSNC is here, they will --

(Laughter.)

COMMISSIONER BROWN-BLAND: I think she's making an announcement of some sort.

THE WITNESS: For those of us with gray hair, yes.

A So the next time the Company would propose to have an unamortized balance in rate base --

Q All right.

A -- and to continue the amortizations.

Q All right. But for now in this -- in this Stipulation as well there's the commitment that going forward, the monies that continue to be collected past full recovery of that amortized amount will be applied against any --

A Future deferrals (simultaneous speaking).

Q -- future --

A Yes, yes.

Q Thank you.

A I do suspect there would be a rate case again before that five years, but...

Q All right. On page 10, beginning on line 3 of your testimony, and I believe this is the direct, you discuss the additional language in Section 21 to address gas quality and measurement, and PSNC's proposed changes to its service regulations reject any responsibility for the quality of the gas and call for a conversion from volumetric measurement to dekatherms based on the system average heat content.

First, with regard to the gas quality, PSNC's new regulation in Section 21 assumes that all gas is delivered by a FERC-regulated interstate supplier. What happens if the gas is produced in North Carolina and put into PSNC's system?

A That's a good question. I imagine we might be back here with a change. I honest to goodness don't know that we contemplated anything above and beyond what's coming off the interstate now.

Q Do you think about -- ahead to buy gas? What if it has a distinctly different heat content and different gas quality characteristics?

A Bear with me. I am going to jump to that exhibit.

MR. COLLINS: Madam Chair, while she's looking, I believe that Ms. Jackson --

THE WITNESS: Yes.

MR. COLLINS: -- can probably address your questions, and she'll be testifying later in the day.

COMMISSIONER BROWN-BLAND: She is going to --

THE WITNESS: (Simultaneous speaking.) That was going to be my next answer.

Q Having experienced that kind of reference earlier?

A Yes, yes. I don't know that we had thought far enough ahead for any gas other than coming off of Transco or Atlantic Coast Pipeline.

Q All right. Well, the reference to Transco leads me to the next question, so with regard to using the system-average heat content in the past, all of the gas supply was flowing up from the south from Transco, right?

A Correct.

Q And where is the gas being delivered to PSNC? Where is that coming from now?

A I -- Ms. Jackson, again, can probably better tell you, but in the past we've just used the one BTU rating, and now that we do have gas coming from different directions we're taking a weighted average of the gas as we take it off at our different take-off stations, so it will be weighted by how many DTs we pull off at what BTU content.

Q All right. So I'm assuming there is a difference in the heat content and the gas quality between the different supply sources?

A There is. It has not been significant. We've talked about that internally and have not seen a significant change due to gas coming in the other direction.

Q Have you thought ahead to how much variance would be acceptable while -- you know, given that you'd still be billing the customers on the system-wide average?

A I believe that the system-wide average BTU factor would balance out any of the pricing concerns. As far as what the system can tolerate for variance, I'm going to hope that Ms. Jackson would be able to better answer that. If not, we can pull Mr. Ratchford back up.

Q All right. And moving on to the next question, with regard to Company Service Rules and Regulations, beginning on line 20 of page 9 is where we're looking at, you testified that the Company is proposing to delete the current Section 29 which addresses the methodology for determining the proper rate service priority classification pursuant to Commission Rules R6-12 and R6-19.2 --

A Correct.

Q -- and setting forth this information in the new Rider B to the tariff. PSNC is also adding a provision for reclassification of customer -- of a customer outside of the annual review period under certain conditions. So reclassifying customers impacts the Company's recovery of the annual revenue requirement established in this docket, won't it?

A Yes, it would.

Q And do you see that reclassification as having a material impact on the revenue that's collected?

A I would not think so just because I don't think we would see a lot of movement. If there was wholesale movement, yes, we could, but it's -- this is just the two-year review and, again, it tends to be if a commercial customer has either grown such that they can move into one of the other rate schedules or if they drop off their consumption, but it's not been a huge impact.

Q All right. And the last question area that I have concerns the -- in the Stipulation there's been an agreement that the interest rates that will be charged on the overcollections and the undercollected in the Sales Customer Only All Customers and Hedging Deferred Gas Accounts -- Gas Cost accounts will be 6.6 -- fixed at 6.6 percent, correct?

A Correct. That would be -- and we would review that annually.

Q But Rider C and E, the Customer Utilization Tracker and the Integrity Management Tracker, they also will use that 6.6 percent --

A Correct.

Q -- interest rate?

A For all of the deferred accounts we would use the 6.6.

Q And those two riders specifically state that that rate will be reviewed annually. Is that also true with regard to the Sales Customer Only All Customers and Hedging Deferred Gas Cost accounts?

A Yes. We would review all those.

Q And that will be reviewed in the annual review docket?

A We would most likely review it prior to each year starting up, like it will be 6.6 now. We would actually review it before 2017.

Q Okay.

COMMISSIONER BROWN-BLAND: Any further questions from the Commission? Chairman Finley?

EXAMINATION BY CHAIRMAN FINLEY:

Q Ms. Paton, going back to this recovery of the transmission distribution improvement cost and the deferrals and the amortization and the rate base treatment and so forth --

A Yes, sir.

Q -- you said you probably expected to be back in before five years.

A Based on the construction budget, I would think that we would be.

Q So when between now and five years?

A Maybe four.

Q Okay. The last general rate case before this one was in 2008; is that right?

A Eight (8). That's correct.

Q Back in 2008 did you think you'd be out for --

A No, we did not.

Q -- a few years?

A We did not.

Q Yeah.

A I mean, the plan would be barring any economic conditions that we can't foresee now, we would be back in.

Q Now, with respect to the manufactured gas costs, in years past one of the disputes between the Company and the Public Staff was whether or not those costs would be addressed in a general rate case or through a tracker or a rider; is that not right?

A Correct. The first proposal the Company made was to have a tracker.

Q Did you and the Public Staff or any of the other Stipulating Parties discuss the advisability of using a tracker or a rider for these distribution or transmission costs rather than in the general rate case?

A Not specifically, I wouldn't say. I think we probably had discussions over the years, and trackers are, in general, not something that all the parties can agree on.

Q Some see merit in trackers and some don't.

A Correct.

CHAIRMAN FINLEY: All right. I'll leave it at that.

COMMISSIONER BROWN-BLAND: Is there follow up to the Commission's questions?

MR. COLLINS: No questions.

COMMISSIONER BROWN-BLAND: All right. Any -- all right. Then do we have exhibits -- I thought we had exhibits for Ms. Paton.

MR. COLLINS: Yes, ma'am. I would move that Ms. Paton's exhibits be moved into evidence -- be admitted into evidence at this time.

COMMISSIONER BROWN-BLAND: All right. That is her 13 exhibits?

MR. COLLINS: Yes, ma'am.

THE WITNESS: And supplemental exhibits. Never mind. That was the earlier supplemental.

COMMISSIONER BROWN-BLAND: All right. So the 13 exhibits attached to witness Paton's direct testimony, prefiled testimony, will be received into evidence at this time, and they will be marked as they were identified when prefiled.

(Whereupon, Paton Exhibits 1 through 13 were admitted into evidence.)

COMMISSIONER BROWN-BLAND: There being no further questions for Ms. Paton, you're excused.

THE WITNESS: Thank you.

COMMISSIONER BROWN-BLAND: I do hope you will come back, though. You indicated you might not.

THE WITNESS: I will.

(Witness excused.)

MR. COLLINS: We would next call to testify Sharon Boone.

COMMISSIONER BROWN-BLAND: Excuse -- I'm sorry?

MR. COLLINS: Sharon Boone.

COMMISSIONER BROWN-BLAND: All right. Ms. Boone, we'll get you sworn in, and I'm being asked for a break, so right after that -- after we swear her in we'll take a break.

SHARON D. BOONE; Being first duly sworn, testified as follows:

COMMISSIONER BROWN-BLAND: All right. You're already sworn in, and we'll come back and you'll be Mr. Collins' witness, and we will take a -- we'll be back on the record at 3:40.

(Recess taken from 3:26 p.m. to 3:42 p.m.)

COMMISSIONER BROWN-BLAND: All right. Let's come back to order. Mr. Collins, I believe you had a matter to take care of before we proceed with Ms. Boone?

MR. COLLINS: Yes, ma'am. Ms. Paton did have two supplemental exhibits to her supplemental testimony that were premarked, Paton Supplemental Exhibits 1 and 2, and we would move those into the record -- into evidence at this time.

COMMISSIONER BROWN-BLAND: All right. There being no objection, Ms. Paton's Supplemental Exhibit Number 2 will also be received into evidence --

MR. COLLINS: Thank you.

COMMISSIONER BROWN-BLAND: -- and will be marked as it was when it was prefiled. Exhibit Number 1 has already been received.

(Whereupon, Paton Supplemental Exhibits 1 and 2 were admitted into evidence.)

COMMISSIONER BROWN-BLAND: All right. Mr.

Collins, you may proceed.

DIRECT EXAMINATION BY MR. COLLINS:

Q Good afternoon, Ms. Boone.

A Hello.

Q Please state your name and business address for the record.

A My name is Sharon D. Boone, and my business address is 800 Gaston Road, Gastonia, North Carolina.

Q Where are you employed and in what capacity?

A I'm employed by SCANA Services and serve as the Business Unit Controller for PSNC Energy.

Q Did you cause to be prepared and prefiled in this proceeding on March 31st, 2016 direct testimony consisting of 12 pages and seven exhibits premarked Boone Exhibits 1 through 7?

A Yes, I did.

Q Do you have any corrections or changes to your testimony or exhibits?

A Yes. There was an error in the presentation of some of the numbers on page 1 of Boone Exhibit 6, and a revised page is being provided.

Q So if I were to ask you the questions that are set forth in your prefiled testimony, would your answers be the same as they are written?

A Yes.

MR. COLLINS: Madam Chair, I would move Ms. Boone's prefiled direct testimony be copied into the record as if given orally from the stand.

COMMISSIONER BROWN-BLAND: All right. That will be allowed, and Ms. Boone's prefiled testimony will be received into the record and treated as if given orally from the witness stand.

(Whereupon, the prefiled direct testimony of Sharon D. Boone was copied into the record as if given orally from the stand.)

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Sharon D. Boone. My business address is 800 Gaston Road, Gastonia, North Carolina 28056.

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

A. I am employed by SCANA Services, Inc. ("SCANA Services"), a subsidiary of SCANA Corporation ("SCANA"), and serve as the Public Service Company of North Carolina, Inc. ("PSNC" or the "Company") business unit controller.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND, WORK EXPERIENCE AND OTHER QUALIFICATIONS.

A. I graduated cum laude from Appalachian State University in 1975 with a Bachelor of Science Degree in Business Administration. In July 1980, I became a Certified Public Accountant. I was employed in 1975 by Piedmont Natural Gas Company in Charlotte and, for the next seven years, worked in its subsidiary accounting, staff accounting, and tax departments. I joined PSNC in 1982 as a Staff Accountant and was promoted to Assistant Manager-Plant Accounting in 1983; Manager-Plant Accounting in 1984; Manager-Plant Accounting and Tax Services in 1990; Director-Corporate Accounting in 1992, and Controller and Assistant Secretary in 1995. As an employee of SCANA Services since 2000, I have continued in my role as controller of the PSNC business unit.

Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE THIS COMMISSION?

A. Yes, in Docket No. G-5, Sub 337, Docket No. G-5, Sub 356, Docket No. G-5, Sub 386, Docket No. G-5, Sub 481 and Docket No. G-5, Sub 495.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. My testimony presents accounting exhibits supporting PSNC's proposed revenue increase. It specifically addresses adjustments to rate base, depreciation and income tax expense. Other cost of service adjustments are supported in the testimonies of Company Witnesses Spaulding and Paton. The following exhibits are included with my testimony.

Exhibit 1	End of Period Net Investment
Exhibit 2	Accumulated Depreciation and Amortization
Exhibit 3	Materials and Supplies
Exhibit 4	Working Capital
Exhibit 5	Statement of Net Operating Income
Exhibit 6	Net Operating Income and Rates of Return
Exhibit 7	Balance Sheet and Income Statement

Q. PLEASE EXPLAIN EXHIBIT 1.

A. Page 1 of Exhibit 1 is a summary of PSNC's total end-of-period net investment as of December 31, 2015, in the amount of $842,634,601. Gross utility plant in service as of December 31, 2015, is presented on pages 2 and 3, and the total amount at the end of the test year was $1,713,468,230.

Q. PLEASE EXPLAIN EXHIBIT 2.

A. Exhibit 2 is a schedule of PSNC's Accumulated Provision for Depreciation and Amortization on Utility Plant in Service as of December 31, 2015, in the amount of $646,571,744. The schedule is presented by plant account and current depreciation rates are presented for each account. The current depreciation rates are those from the study prepared by Gannett Fleming Valuation and Rate Consultants, LLC ("Gannett Fleming") based on plant in service as of December 31, 2005. These depreciation rates were approved by the Commission in Docket No. G-5, Sub 481.

Q. HAS PSNC FILED A DEPRECIATION STUDY WITH THE COMMSSION SUBSEQUENT TO THE STUDY APPROVED BY THE COMMSSION IN DOCKET NO. G-5, SUB 481?

A. Yes. Pursuant to Commission Rule R6-80, PSNC filed a 5-year depreciation study with the Commission on March 10, 2011 related to Gas Plant at December 31, 2010. PSNC requested that the results of this study or an updated study be considered in its next general rate case proceeding or other appropriate proceeding as determined by the Commission. At the Commission's regular Staff Conference on May 16, 2011 the Public Staff recommended that the study be accepted by the Commission as in compliance and that it be considered in PSNC's next general rate case. The Commission's order dated May 17, 2011 accepted this study as being in compliance with the Commission Rule R6-80.

Q. IS PSNC PROPOSING NEW DEPRECIATION RATES IN THIS PROCEEDING?

A. Yes. In compliance with Commission Rule R6-80, Gannett Fleming, prepared a depreciation study based on utility plant in service as of December 31, 2015. The details and results of this study are found in the direct testimony of Company Witness Spanos. PSNC is requesting that this study be accepted by the Commission as in compliance with Rule R6-80.

Q. WHAT IS THE IMPACT OF THE PROPOSED DEPRECIATION RATES ON THIS PROCEEDING?

A. PSNC prepared an adjustment to depreciation expense on the estimated plant in service as of June 30, 2016. The adjustment using the proposed rates increases annual depreciation expense by $2,050,689. The calculation of this adjustment is found in the G-1, Item 4a, Workpaper 4-D.

Q. PLEASE EXPLAIN EXHIBIT 3.

A. Exhibit 3 presents both the end-of-period and 13-month average balances of materials and supplies for the test year ended December 31, 2015. The average balance of $47,533,255 is used in the computation of working capital on page 1 of Exhibit 4.

Q. PLEASE EXPLAIN EXHIBIT 4.

A. Exhibit 4 presents PSNC's calculated working capital allowance of $9,589,070 included in net investment on Exhibit 1. The first component of $12,042,294 is the result of PSNC's lead-lag analysis found in Form G-1, Item 26. Gannett Fleming updated the lead and lag days for PSNC based on 2014 cost of service activity. The resulting lead and lag days were applied to the 2015 cost of service to determine the level of investor supplied funds to be included in rate base. Other additions to working capital include average materials and supplies and average gas inventories (as shown in Exhibit 3) and average prepayments. The working capital allowance has been reduced by the 13-month average for the test year of customer deposits, interest accrued on customer deposits, accrued vacation liability, state sales taxes, the deferred credit Treasury A account (tracks the clearing of customer refund checks) and for several cost-free capital items.

Q. PLEASE EXPLAIN EXHIBIT 5.

A. Exhibit 5 is a statement of net operating income per books for the year ending December 31, 2015, in the amount of $66,098,476.

Q. PLEASE EXPLAIN EXHIBIT 6.

A. Page 1 of Exhibit 6 summarizes PSNC's operating income and end-of-period rate of return on three bases – per books (column 1), after adjustments (column 3), and after the proposed rate increase (column 5). Column 2 includes the accounting and pro forma adjustments necessary to state expenses and utility plant on a going-level basis; and column 4 shows the adjustments for the proposed rate increase. Corresponding capitalization statements for columns 1, 3, and 5 are presented on page 2 of the Exhibit, and the proposed adjustments from columns 2 and 4 are listed on pages 3 through 5.

Q. PLEASE EXPLAIN THE ADJUSTMENTS, BEGINNING WITH ADJUSTMENT 1 IN COLUMN 2 OF EXHIBIT 6, PAGE 1.

A. Adjustment 1 decreases gas sales and transportation revenues by $8,763,654. This adjustment is discussed in the testimony of Company Witness Paton and the computation can be found in Form G-1, Item 4, Workpaper 1.

Adjustment 2 annualizes the cost of gas at PSNC's present $2.25 per dekatherm "benchmark" commodity price. This adjustment also includes the fixed gas costs. All of PSNC's gas costs are subject to an annual prudence review pursuant to the Commission's Order in Docket No. G-100, Sub 58, dated April 9, 1992. The computation of pro forma cost of gas can be found in Form G-1, Item 4, Workpaper 2 and is discussed further in Company Witness Paton's testimony.

Adjustment 3 increases operation and maintenance expenses by $20,134,370. This adjustment reflects 24 separate adjustments that are discussed in the testimony of James Spaulding.

Adjustment 4 is a net increase to test year depreciation expense due largely to the estimated additions to net plant through June 30, 2016. Also contributing to this adjustment is an increase for the use of the proposed depreciation rates discussed in the testimony of Company Witness Spanos and anticipated additional depreciation expense allocated to PSNC from SCANA Services based on estimated June 30, 2016 plant. The depreciation adjustment also includes a reduction for an allocation to non-utility operations.

Adjustment 5 increases general taxes by $3,026,690. This adjustment is discussed in the testimony of Company Witness Spaulding.

Adjustments 6 and 7 record state and federal income taxes, respectively, related to all of the other adjustments, net of the adjustments to the deferred income tax provision, which are separately shown in Adjustments 6.1 and 7.1. The adjustments also reflect a reduction in the state income tax rate. The statutory state income tax rate in the test year was 5%. Effective January 1, 2016, the state income tax rate is reduced to 4%. In addition, the adjustments include a savings from interest expense on the projected June 30, 2016 long-term and short-term debt.

Adjustments 6.1 and 7.1 reflect the estimated federal and state deferred income tax provision to be recorded between January 1, 2016 and June 30, 2016.

Adjustment 8 increases utility plant for estimated net additions through June 30, 2016, and decreases utility plant for an allocation to non-utility plant.
Adjustment 9 increases the reserve for depreciation and amortization of utility plant for the anticipated change between the end of the test year and June 30, 2016, net of an allocation to non-utility plant.
Adjustment 10 is an increase to working capital for the projected decrease in the other postemployment benefits accrual and for an increase to prepayments related to the NC franchise tax. Both of these adjustments are discussed in Company Witness Spaulding's testimony.

Adjustment 10.1 is an increase in the lead-lag portion of working capital after proforma adjustments. Refer to Adjustment 16 for further explanation.

Adjustment 11 is an increase in accumulated deferred income taxes ("ADIT") for the anticipated change between the end of the test year and June 30, 2016, net of an allocation to non-utility operations.

Adjustments 12 through 15 in column 4 on page 1 of Exhibit 6 reflect the proposed increase from total operating revenues of $41,583,020, which is the increase required to give PSNC the opportunity to earn the rate of return requested in this proceeding. Per Adjustment 12, it is proposed that $41,306,444 of the revenue adjustment come from Gas Sales and Transportation, and per Adjustment 12.1, $276,576 from an increase to Other Operating Revenues, more specifically reconnect fees. Adjustments 13 through 15 reflect changes in regulatory fees, uncollectibles expense, and state and federal income taxes resulting from the proposed revenue increase. These adjustments increase net operating income by $25,844,628 and will produce a return on investment of 8.14% and a return on common equity of 10.6%.

Adjustment 16 in column 4 on page 1 reflects the adjustment to the lead-lag component of cash working capital ("CWC") resulting from the proposed adjustment to revenues and its impact on cost of service in adjustments 12-15. The Commission in its May 5, 2015 order on Lead-Lag Study Procedure in Docket No. M-100, Sub 137 concluded that as a general rule, in future determinations of CWC for major electric and natural gas utilities, lead-lag studies would be based upon fully-adjusted, pro-forma, test-period levels of revenues and costs, including the full effects of any approved rate increases or decreases.

Q. PLEASE EXPLAIN EXHIBIT 7.

A. Page 1 of Exhibit 7 is PSNC's balance sheet as of December 31, 2015, and page 2 is its income statement for the twelve months ended December 31, 2015.

Q. EXPLAIN HOW PSNC HAS TREATED THE BOOK ACCOUNTING ADJUSTMENTS RELATED TO SFAS NO. 158.

A. In September 2006, the Financial Accounting Standards Board ("FASB") issued its Statement of Financial Accounting Standards ("SFAS") No. 158, entitled "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." It requires an employer to recognize the overfunded or underfunded status of a defined benefit pension or other postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year which changes occur through accumulated other comprehensive income. In 2006, PSNC filed a request in Docket No. G-5, Sub 485 seeking the Commission's approval to "place all impacts to its other comprehensive income caused by adoption of SFAS No. 158 in regulatory deferred accounts". The Commission's order dated January 5, 2007 approved this request. It also stated "adoption of SFAS 158 and approval of the deferred accounting treatment proposed by PSNC Energy shall have no impact on PSNC Energy's operating results or return on rate base for regulatory purposes and that the net effect of the deferred accounting allowed shall be to reset PSNC

Energy's rate base, net operating income for return, and regulatory return on common equity to the same levels as would have existed had SFAS 158 not been implemented." As of December 31, 2015, PSNC had recorded a regulatory asset of $30,315,128 related to SFAS No. 158. Offsets were posted to pension assets, postretirement liabilities and ADIT. The impact of SFAS No. 158 was removed from all accounts before computing PSNC's rate base, net operating income and common equity.

Q. HAS PSNC RECORDED ANY OTHER ACCOUNTING ADJUSTMENTS RELATED TO THE ADOPTION OF ACCOUNTING PRONOUNCEMENTS THAT YOU WOULD LIKE TO DISCUSS?

A. Yes. PSNC has ignored the book accounting impact of FASB's Interpretation No. 47 entitled "Accounting for Conditional Asset Retirement Obligations" ("FIN 47") as of December 31, 2007 in the computation of rate base, net operating income for return and regulatory return on common equity in accordance with the Commission's order in Docket No. G-5, Sub 474, dated January 11, 2006. This order authorized PSNC "to place in regulatory deferred accounts any differences in its income statement caused by the adoption of FIN 47". It also states that "adoption of FIN 47 and approval of the deferred accounting treatment proposed by PSNC Energy shall have no impact on PSNC Energy's operating results or return on rate base for regulatory purposes and that the net effect of the deferred accounting allowed shall be to reset PSNC Energy's rate base, net operating income for return, and regulatory return on common equity to the same levels as would have existed had FIN 47 not been implemented". As of December 31, 2015, PSNC had recorded an asset retirement obligation of $31,832,832 and a regulatory deferred asset of $20,318,053, with the difference booked in utility plant and accumulated depreciation.

Q. DOES YOUR TESTIMONY ADDRESS ANY OTHER MATTERS?

A. Yes. My testimony addresses the reimbursement to customers of excess ADIT that PSNC has deferred as a regulatory liability under the Commission's order in Docket No. M-100, Sub 138 dated May 13, 2014. The order states that the excess deferred income taxes "shall be held in a deferred tax regulatory liability account until they can be amortized as credits (i.e., reductions) to income tax expense for ratemaking purposes in each utility's next general rate case proceeding."

PSNC proposes that a rate decrement be implemented to refund to its customers the excess ADIT balance of $7,305,529 as of December 31, 2015. PSNC proposes that the decrement be in place for 12 months or until the excess ADIT balance is substantially refunded. Any balance remaining in the excess ADIT account(s) will be transferred to PSNC's all customer Rider D account. PSNC proposes that any adjustments to its ADIT resulting from future federal or state income tax rate changes, whether increases or decreases, should be deferred. The excess/deficient ADIT would then be returned to or received from customers by implementing a rate decrement or increment over a period approved by the Commission.

Q. DOES THIS COMPLETE YOUR PREFILED DIRECT TESTIMONY?

A. Yes, however, I plan to offer information pertaining to relevant changes in costs, revenues, property, returns or any other matter relevant to the Commission's determination of the matters raised in this Application that occur after the filing of my testimony. Also, I reserve the right to supplement or amend my testimony before or during the Commission's hearing in this proceeding.

MR. COLLINS: And I would ask that her exhibits be marked for identification.

COMMISSIONER BROWN-BLAND: All right. They'll be so marked.

(Whereupon, Boone Exhibits 1 through 7 were identified as premarked.)

Q Ms. Boone, have you prepared a summary of your testimony?

A Yes, I have.

Q Please provide that at this time.

A My direct testimony presents the accounting exhibits that support PSNC's proposed revenue increase, specifically the Company's adjustment to rate base, depreciation, and income tax expense. These adjustments include the adjustment to the lead-lag component of cash working capital resulting from the requested increase in revenues.

In addition, I explain PSNC's request that the depreciation study prepared by Gannett Fleming based on utility plant in service as of December 31st, 2015 be accepted by the Commission and testify that the Company prepared an adjustment to depreciation expense on estimated plant in service as of June 30th, 2016 using the proposed new depreciation rates. I also explain how

PSNC has treated certain adjustments in light of related Financial Accounting Standards Board guidance. Finally, I address the reimbursement to customers of excess accumulated deferred income tax or ADIT that PSNC has proposed in this case and discuss the Company's proposal for deferred accounting treatment of any adjustments to ADIT resulting from future federal or state income tax rate changes.

Q Does that conclude your summary?

A It does.

MR. COLLINS: Madam Chair, the witness is available for questions.

COMMISSIONER BROWN-BLAND: All right. Thank you, Mr. Collins. Is there any cross examination?

MS. FORCE: No.

COMMISSIONER BROWN-BLAND: The Commission has a few questions for you, Ms. Boone.

EXAMINATION BY COMMISSIONER BROWN-BLAND:

Q In PSNC's prefiled testimony and exhibits, the Company included a cash working capital amount of $13,005,488. This was on Exhibit 6, unless this is one of your numbers that has changed and you can explain that in a minute, but -- and I believe that included pro forma adjustments and the Company's requested ROE of 10.6

percent.

A That's correct.

Q That's still correct?

A Uh-huh.

Q And the Public Staff's prefiled testimony and exhibits used a -- recommended a cash working capital amount of $13,700---722,244, and that was -- it included the recommended pro forma adjustments and the recommended ROE of 9.7; is that --

A That's correct.

Q So can you explain why the Public Staff's amount is higher than the amount that was requested by the Company even though it reflects the inclusion of a substantially lower ROE than that proposed by the Company?

A Yes, I believe so. The Public Staff made really a substantial amount of decreases to PSNC's operating expenses, and when you do that, that tends to increase your lead-lag adjustment. They also made some adjustments to our adjusted test year for revenues and increased those, and that also increased the lead-lag adjustment. Now, their -- their use of the 9.7 percent ROE did decrease PSNC's working capital, but it did not -- it was not large enough to override the other adjustments that they made. It still had a net increase.

Q All right. I see. And in Public Staff witness Boswell's Exhibit 1, Schedule 2, column (a), line 5, there reflects a per-company adjusted number for cash working capital at $10,006,617. Can you explain how that number was derived and why it was adjusted by the Company?

A Well, the Revised Exhibit 6 that was provided, that was the presentation mistake that was in my original Boone Exhibit 6.

Q Uh-huh.

A I had put in column 3 of my Exhibit 6 that interest synchronization adjustment that comes from the lead-lag increase due to the increased in proposed revenues, so those dollars were reflected incorrectly in my column 3 on my original Exhibit 6. Now I do believe that my column 3 would agree with the Public Staff's lead-lag amount at that point in time before their adjustments. That presentation error did not change PSNC's overall requested increase in revenues or its after adjustments for proposed changes, the overall revenue requirement. It was just a presentation difference in where some dollars were put on that Exhibit 6.

Q So that 10,000,000 figure that the Public Staff used, that's the correct starting point?

A It is. It is.

Q And that's now accounted for in the changes that you've made in Exhibit 6?

A That's correct.

Q All right. Do you agree that if the Commission were to make any other adjustments to the Stipulation, the cash working capital amount included in rate base by either the Company or the Public Staff will need to be recalculated?

A I do.

Q And I think that calculation is something that's pretty complex and it's an iterative process, so our staff isn't certain that one party's model would produce the same result as another party's, so once the Commission makes its final decisions, would you be amenable to providing the Commission with a revised cash working capital amount based on the Commission's decision?

A Yes.

Q And how much time would you expect you would need to do that?

A I guess it depends on the number of changes that were required, but, you know, time to enter the changes and have it reviewed, a couple days.

Q All right. All right. And as a late-filed exhibit, could you provide the workpapers supporting the calculation of the lead-lag working capital amounts that include the manufactured gas and the pipeline integrity management numbers?

A Yes.

Q And we would like these details to contain the lead and lag days agreed to in the Stipulation by the parties, as well as break each of the revenue and expense items included in the study, break those -- broken down on a cost of service level for the pro forma levels included in your final proposed amount of the cash working capital. And if you could provide that electronically, that would also be appreciated.

A Okay. Can I get you to repeat that once more?

(Laughter.)

A That's going to be hard.

Q We just ask that the details contain the lead and lag days agreed to in the Stipulation by the parties, as well as break down each of the revenue and expense items included in the study.

A Okay. So you're looking for basically our lead-lag study maybe that's in the G-1 already? We have a -- the details of all the lead-lag days for the different types of operating expenses and the revenues is contained in G-1, I believe it's item 26. Now, that lead-lag was on our test year -- that was our test year model and -- I take that back. It was test year and adjustments, I believe, were in that G-1, item 26.

Q All right.

CHAIRMAN FINLEY: I think what we want is after all the adjustments that you've gotten with the Stipulation --

THE WITNESS: Okay.

CHAIRMAN FINLEY: -- the latest number that -- the latest revenue requirement number you've got and all the leads and lags in that as opposed to what you filed in your...

THE WITNESS: Okay.

Q And we would like it broken down on a cost of service level for the pro forma levels included in that -- in that final proposed amount.

A Okay. All right.

COMMISSIONER BROWN-BLAND: All right. Any other questions from the Commission?

(No response.)

COMMISSIONER BROWN-BLAND: I think that's all I have. Any follow up?

MR. COLLINS: No questions.

COMMISSIONER BROWN-BLAND: All right, Ms. Boone. Thank you very much.

THE WITNESS: Thank you.

MR. COLLINS: We'd asked Ms. Boone to be excused and that her exhibits be admitted into evidence at this time.

COMMISSIONER BROWN-BLAND: She is excused.

(Witness excused.)

COMMISSIONER BROWN-BLAND: And her -- how many exhibits, Mr. Collins?

MR. COLLINS: I believe it's seven.

COMMISSIONER BROWN-BLAND: I'm losing track of my own paper. Anyway, the exhibits that were prefiled with Ms. Boone's prefiled testimony will be received into evidence and marked -- identified as they were marked when prefiled.

(Whereupon, Boone Exhibit Numbers 1 through 7 were admitted into evidence.)

MR. COLLINS: All right. And we would call Rose M. Jackson to the stand.

ROSE M. JACKSON; Being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. COLLINS:

Q Good afternoon, Ms. Jackson.
A Good afternoon.
Q Please state your name and business address for the record.
A My name is Rose M. Jackson, and my business address is 1300 12th Street, Suite F, Cayce, South Carolina.
Q Where are you employed and in what capacity?
A I'm employed by SCANA Services Incorporated as the General Manager of Supply and Asset Management.
Q Did you cause to be prepared and prefiled in this proceeding on March 31st, 2016 direct testimony consisting of 10 pages in question and answer form?
A Yes, sir.
Q And you have no exhibits?
A No, sir.
Q Are there any changes or corrections to your testimony?
A No, sir.
Q If I were to ask you the questions set forth in your prefiled testimony, would your answers be the same

as they are written?

A Yes, sir.

MR. COLLINS: Madam Chair, I'd move Mrs. -- Ms. Jackson's prefiled direct testimony be copied into the record as if given orally from the stand.

COMMISSIONER BROWN-BLAND: All right. That will be allowed, and Ms. Jackson's prefiled testimony will be received into evidence and treated as if given orally from the witness stand.

(Whereupon, the prefiled direct testimony of Rose M. Jackson was copied into the record as if given orally from the stand.

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, BY WHOM YOU ARE EMPLOYED, AND IN WHAT CAPACITY.

A. My name is Rose M. Jackson and my business address is 1300 12th Street, Suite F, Cayce, South Carolina. I am employed by SCANA Services, Inc. ("SCANA Services") as General Manager – Supply & Asset Management.

Q. WHAT ARE YOUR RESPONSIBILITIES?

A. I am responsible for managing the Gas Supply Group ("Gas Supply") which supports the gas supply and capacity management functions for Public Service Company of North Carolina, Incorporated, d/b/a PSNC Energy ("PSNC" or the "Company"), and South Carolina Electric and Gas Company, the two regulated local distribution subsidiaries of SCANA Corporation ("SCANA"). Gas Supply's specific responsibilities include planning and procurement of gas supply and pipeline capacity, nominations and scheduling related to natural gas transportation and storage services on interstate pipelines and PSNC's system, gas cost accounting, state and federal regulatory issues concerning supply and capacity, asset and risk management, and transportation administration.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I graduated from the University of South Carolina in 1988 with a Bachelor of Science degree in Accounting. Following graduation, I worked as an accountant for a national security services firm. In 1992, I began my employment with SCANA as an accountant. Over the years, I have held varying positions of increasing responsibility related to gas procurement, interstate pipeline and local distribution company scheduling, and preparation of gas accounting information. In May 2002, I became Manager of Operations and Gas Accounting with SCANA Services where I was responsible for gas scheduling on interstate pipelines and gas accounting for all SCANA subsidiaries. In November 2003, I became Fuels Planning Manager where I assisted all SCANA subsidiaries with strategic planning and special projects associated with natural gas. I held this position until promoted to my current position in December 2005.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes. I presented testimony on behalf of PSNC in Docket No. G-5, Subs 482, 516, 540, 545, 548, and 558.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to discuss a review PSNC performed of all tariff provisions related to its interruptible services and pooling and to support modifications it is proposing based upon that review. Specifically, PSNC is proposing modifications to (1) Rider A (Curtailment of Services Under NCUC Rule R6-19.2 and Emergency Services); (2) the four interruptible rate schedules, Rate Schedule No. 150 – Large-Quantity Interruptible Commercial and Industrial Service, Rate Schedule No. 160 – Special Sales Rate, Rate Schedule No. 165 – Special Transportation Rate, and Rate Schedule No. 180 – Interruptible Transportation Service for Customers Qualifying for Service on

Rate Schedule No. 150; and (3) the form Transportation Pooling Agreement that is entered into with poolers who act as agents for large customers receiving service under a transportation rate schedule.

Q. WHY DID PSNC PERFORM ITS REVIEW OF ITS INTERRUPTIBLE SERVICES?

A. In Docket No. G-5, Sub 545, PSNC filed a request with the Commission to temporarily adjust the cost of gas for emergency service and unauthorized gas used by interruptible customers that did not fully curtail their usage when directed during an unusually cold period in January 2014. PSNC also requested changes to its Rider A, the interruptible rate schedules, and the Transportation Pooling Agreement.

The Commission denied PSNC's request to adjust the cost of gas and stated that "any changes to PSNC's tariffs should be considered in a docket that provides the Commission with full information and allows the Commission adequate time to review the effects of proposed changes on all of PSNC's ratepayers, not just its interruptible customers." *Order on Petition For Limited Modification of Rider A*, Docket No. G-5, Sub 545, Sept.8, 2014.

Since that order, PSNC has further reviewed its interruptible services, pooling agreement, and curtailment procedures and contends that the changes proposed in my testimony will improve the Company's ability to ensure service to its firm customers, efficiency of transportation service, and the customer and pooler notification process in the event of curtailment.

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED CHANGES TO RIDER A.

A. First, the Company proposes to eliminate On-Peak Emergency Service. Rider A gives PSNC the discretion to grant a curtailed customer's request for Emergency Service pursuant to advance arrangements. Currently, the tariff provides different assessment rates for Emergency Service depending upon whether the Company uses its liquefied natural gas peak-shaving capability on the day that Emergency Service is arranged. If such a capability is used (On-Peak Emergency Service), the assessment rate is $1.50 per therm and, if not (Limited Emergency Service), the assessment rate is $1.00 per therm.

PSNC proposes to have one Emergency Service with a single assessment rate of $2.00 per therm, or $20 per dekatherm. By removing the need to track whether a peak-shaving asset was used, this change will provide the customer with a simple and transparent calculation of costs being incurred and will ease the administrative burden on PSNC.

Second, PSNC proposes an increase in the assessment rate for Unauthorized Gas from $2.50 per therm to $5.00 per therm, or $50.00 per dekatherm. The $50.00 per dekatherm is based on the current unauthorized overrun penalty in the Transcontinental Pipeline LLC ("Transco") tariff. The Company's experience during the January 2014 curtailments indicated that for a number of its interruptible customers the current assessment rate was not a sufficient deterrent to prevent them from using gas during a curtailment. PSNC is therefore proposing to double the assessment rate. This assessment rate should be high enough to cause curtailed interruptible customers to convert to their alternate fuel or, if they have no alternate fuel, to cease operations that utilize natural gas.

Third, PSNC proposes to remove the allowance of 10 therms per day for pilot usage in its Rate Schedules 150 and 180 and modify its Rider A to allow customers to receive a maximum of 10 dekatherms per day in Emergency Service without prior authorization from the Company. These changes better reflect the interruptible nature of Rate Schedules 150 and 180 and still give those customers some protection during a curtailment, at a reasonable cost.

Q. IS PSNC ABLE TO PROVIDE THIS 10 DEKATHERMS EMERGENCY GAS PER DAY WITHOUT COMPROMISING ITS SYSTEM AND SERVICE TO ITS FIRM CUSTOMERS?

A. Yes, consistent with other applicable provisions of our tariff, such as force majeure.

Q. WHY IS PSNC PROPOSING THESE CHANGES TO RIDER A?

A. PSNC submits that its proposed changes to Rider A and assessment rates will more effectively deter noncompliance with curtailments and will be more efficient for the Company to administer.

Q. WHAT CHANGES IS PSNC PROPOSING TO MAKE TO ITS INTERRUPTIBLE RATE SCHEDULES?

A. PSNC proposes several changes to its interruptible rate schedules – Rate Schedules 150, 160, 165, and 180. First, PSNC proposes adding a specific requirement that the customer is responsible for providing and updating contact information, including at least two authorized representatives' telephone numbers and email addresses. Additionally, the Company is proposing to add language clarifying that a curtailment notice is effective when issued and posted on the Company's electronic bulletin board ("EBB"). These revisions will allow PSNC to enhance the curtailment notification process by utilizing three means of notice – immediate notification electronically, emails to customers, and subsequent personal contact with the customers by telephone.

Second, the Company also proposes adding language to all of its interruptible rate schedules that describes some of the costs, not addressed in Rider A, for which an interruptible customer taking Unauthorized Gas may be required to reimburse PSNC. Currently, these rate schedules provide that such a customer "shall reimburse PSNC for any expenses and liabilities imposed on PSNC that are caused by Customer's failure to discontinue use of Gas." The proposed addition provides examples of the types of cost contemplated by this provision such as penalties and assessments that might be imposed by an upstream pipeline and costs in excess of those recovered through Rider A that are associated with using system supply or acquiring delivered gas supplies during a curtailment. Although not exhaustive, these examples should give customers a better understanding of the potential consequences that can result from their using Unauthorized Gas.

Finally, PSNC proposes to add language to Rate Schedule 180 to clarify that, in the case of non-compliance with a curtailment order, PSNC may valve off service when deemed necessary to protect service to higher priority customers. This language, which is already contained in Rate Schedules 150, 160, and 165, will confirm that all interruptible customers are subject to having their service physically terminated if their failure to curtail threatens to impair service to PSNC's firm customers.

Q. IS PSNC PROPOSING TO REQUIRE THAT INTERRUPTIBLE CUSTOMERS HAVE ALTERNATE FUEL CAPABILITY?

A. No. The Company is not proposing to require that customers receiving service under an interruptible rate schedule must have alternate fuel capability. Many customers without alternate fuel capability routinely comply with curtailment notices. PSNC has proposed additional deterrents to cause its other interruptible customers to comply.

Q. WHY IS PSNC PROPOSING THESE CHANGES?

A. The proposed revisions to the interruptible rate schedules will allow for a more effective and efficient curtailment process and are compatible with the proposed changes to Rider A and the associated assessment rates.

Q. WHAT CHANGES IS PSNC PROPOSING TO MAKE TO ITS TRANSPORTATION POOLING AGREEMENT?

A. PSNC proposes revisions to its Transportation Pooling Agreement that are designed to improve the transportation nomination process and encourage poolers to stay in balance on a monthly basis, and more importantly, on days when the Company anticipates that a demand or supply mismatch could threaten the integrity of its system. First, PSNC proposes to add definitions for "Gas Day," and "Operational Order" to Article I of the agreement for use in revised Article V dealing with pooling procedures.

Second, PSNC proposes to make revisions to Article IV, which addresses nomination procedures, to provide that nominations will be submitted through the EBB and to allow for nomination changes during the month on the day before gas flow rather than two days before as the agreement currently provides. These changes will make the nomination process more efficient for both the pooler and the Company.

Third, PSNC proposes to add provisions to Article V that will allow the Company to issue an Operational Order, at least four hours before it is to become effective, which places restrictions on a pooler's delivery of gas to PSNC's system. These restrictions will be designed to address potential problems caused by daily imbalances, either short or long, in a pooler's gas deliveries to the PSNC system. In the event a pooler fails to comply with an Operational Order, penalties will be imposed based upon the extent that the pooler under-delivers or over-delivers gas to the PSNC system, depending upon the type of restrictions that were in place. Poolers in violation of an Operational Order will pay a penalty of $25 for each dekatherm that the pooler's imbalance is greater than 2% but less than 10% of the pooler's approved nomination and $50 for each dekatherm that the pooler's imbalance is greater than 10% of the pooler's approved nomination, plus the absolute high price of gas for the day.

Fourth, PSNC proposes to modify the monthly balancing tolerance levels in Article VIII. A pooler should be able to comply with this modification due to the availability of daily measurement data on the EBB coupled with the changes in the nomination procedures described above.

Q. WHAT ARE THE BENEFITS OF PSNC'S ABILITY TO ISSUE OPERATIONAL ORDERS?

A. The ability to issue Operational Orders should improve system reliability and better enable the Company to manage the operation of its system on critical days, such as when cold weather is forecasted and high natural gas demand is expected. The Operational Order will provide PSNC with another tool in addition to curtailment to manage daily imbalances that threaten system integrity. This should provide a deterrent for poolers who might otherwise divert gas from PSNC's system to other, more lucrative locations.

Q. YOU MENTIONED THAT PSNC IMPLEMENTED AN EBB RECENTLY. PLEASE DISCUSS.

A. PSNC's EBB provides a number of benefits. Under the modified Transportation Pooling Agreement poolers will submit nominations via the EBB and any of poolers' daily imbalances will be available on the EBB. Curtailment notices will be posted on the EBB with the effective date and time of the curtailments, and the EBB will distribute these notices via email to both poolers and customers. Currently, the EBB is operational for customers and poolers to view daily usage data. Upon Commission approval of the changes to the Transportation Pooling Agreement, customers will be required to use the EBB to submit nominations. PSNC intends to conduct training sessions for customers, poolers, and other interested parties for the purpose of facilitating a smooth implementation of the new nomination process.

Q. WHAT ARE THE BENEFITS TO PROPOSED MODIFICATIONS TO THE TRANSPORTATION POOLING AGREEMENT?

A. The proposed changes to its Transportation Pooling Agreement will enhance PSNC's ability to manage its system, particularly during times of extreme or unexpected weather conditions, will simplify the process of scheduling transportation services, and will strengthen nomination procedures.

Q. DOES PSNC PROPOSE ANY OTHER CHANGES TO THE RATE SCHEDULES YOU DISCUSS AND THE TRANSPORTATION POOLING AGREEMENT?

A. Yes. PSNC is proposing other minor revisions to the Transportation Pooling Agreement and its Rate Schedules for clarification or grammatical correction.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, although I reserve the right to supplement or amend my testimony before or during the Commission's hearing in this proceeding.

MR. COLLINS: Thank you.

Q Ms. Jackson, have you prepared a summary of your testimony?

A Yes, sir. I have. Good afternoon, Madam Chair and Commissioners. My direct testimony supports modifications to PSNC's tariff provisions related to interruptible services and pooling that the Company has proposed to make in this case. I explain the reason for PSNC's review of these provisions and the timing of these proposals which were based on the Commission's decision in its 2014 Order on Petition in Docket Number G-5, Sub 545 that made -- any changes to PSNC's tariffs should be considered in a docket that allows for the time and information to fully assess such proposals.

First, PSNC proposes several modifications to Rider A, Curtailment of Services under NCUC Rule R6-19.2 and Emergency Services, eliminating on-peak emergency service in favor of having one emergency service with a single assessment rate of $2.00 per therm, increasing the rate of unauthorized gas to $5.00 per therm, and removing the allowance of 10 therms per day for pilot usage in Rate Schedules 150 and 180, and modifying Rider A to allow customers to receive a maximum of 10 dekatherms per day in emergency service without prior Company authorization. These changes to Rider A and assessment rates will more effectively deter noncompliance with curtailments and be more efficient for PSNC to administer.

Next, PSNC proposes several revisions to its interruptible rate schedules to allow for a more efficient curtailment process and to complement the proposed changes to Rider A and the associated assessment rates.

Finally, PSNC has proposed several revisions to its transportation pooling agreement designed to enhance the Company's ability to manage its system, particularly during extreme or unexpected weather conditions, improve the transportation nomination process and encourage poolers to stay in balance. These revisions include changes to improve the efficiency of the nomination process through PSNC's electronic bulletin board and to allow the Company to issue an Operational Order that requires daily balancing during critical times.

Q Does that conclude your testimony?

A Yes, it does.

MR. COLLINS: Madam Chair, Ms. Jackson is available for cross examination or questions from the Commissioners.

COMMISSIONER BROWN-BLAND: All right. Is there any cross examination for this witness?

MS. FORCE: (Shakes head negatively.)

COMMISSIONER BROWN-BLAND: Anybody up here have any questions? Just a few for you, and you heard them because they got punted to you earlier, so I'll start with that one.

EXAMINATION BY COMMISSIONER BROWN-BLAND:

Q And that was the question about what happens if gas is produced in North Carolina and put into PSNC's system, and what if that's biogas?

A The Company has been contacted about biogas projects over the last few years, and what we have contemplated doing is to install a chromatograph at the site where that supply source would come into our system, and we have requested that that producer located on our system would meet the gas quality standards that we currently have.

Q And so if -- if that biogas comes in, does PSNC then have responsibility for the quality of the gas it accepts?

A The producer is required to meet the gas quality standard so that our customers will not be impacted.

Q Okay. With regard to using the system average heat content, as we have learned from Ms. Paton, the gas has been flowing from the south -- that Transco delivers is coming from the south, and is there a difference in the heat content and gas quality between the different gas supply areas that we heard from Ms. Paton?

A We haven't seen a significant difference in the BTUs between the traditional south to north or on Transco's system for north to south, which has been predominantly the Marcellus shale gas. Much of that gas, when produced, is produced at gas quality standards. The only concern that we've had in the past was several years ago back in 2003 for a timeline when Elba Island was reactivated, we had some concerns about the potential of that imported LNG, which was a much higher BTU, could potentially make it into PSNC's system, however, that never materialized.

Q Okay. With the different sources or different supply areas now, has the Company considered how much of a percentage variance in the heat content in different parts of the system it would consider acceptable while billing on the system average or system-wide average?

A That is one reason why we have moved from that one system-wide point where we were determining the BTU on a daily basis to a weighted average at multiple points on our system. Until such supply creates a significant difference, we'll continue to do the weighted average to see if that's going to have any major impact to the customer's conversion factor.

Q All right. Appreciate that. And I'd also like -- your testimony deals with the review of -- that PSNC performed of all tariff provisions related to its interruptible service and Transportation Pooling Agreement, correct?

A Yes, ma'am.

Q And you mentioned the events of January 2014, when some of the Company's interruptible customers failed to fully curtail when they were directed to do so. In the Commission's September 8th, 2014 Order in the Docket G-5, Sub 545, PSNC was ordered to conduct an investigation to determine whether their interruptible customers receiving gas on a firm basis for space heating and other uses that should be provided under a firm service tariff and to file a report within 60 days. In that report, the Company stated that it believed the appropriate steps have been taken or are being taken for its large customers to receive service under a suitable rate schedule. Is the Company now satisfied that those customers who were in the process of taking those appropriate steps have completed that process?

A Yes, ma'am. I do believe after -- during that 60-day period, we were -- we -- our large account reps contacted and met with all of our industrial uninterruptible customers, and we -- the sales reps sat down with all the customers to provide them with options based on their usage. One change that we did make in this case was to eliminate the pilot -- the 10 therms of pilot use which was being billed at the base rate of gas, and instead we've implemented 10 dekatherms of emergency gas which would be charged to those customers at a higher rate. It avoids the necessity for a separate meter for such a small volume, but in the event that a customer has to use that small amount of gas to keep their pilots lit, then they will pay a higher price of gas which will be credited back.

Q All right. And is the Company satisfied that all the customers are on the correct rate schedule at this time?

A Based on the needs that were -- based on the needs and the requirements that each customer shared with our large account sales department, yes, ma'am, we are.

Q All right. So that work has been completed.

A Yes, ma'am.

Q And what's the Company's thoughts about whether the changes to Rider A and the Transportation Pooling Agreement, as agreed to in the Stipulation, are adequate to avoid the recurrence of what we saw in 2014?

A Madam Chair, I think one thing that we were faced with in 2014 that we're trying to correct here is that we were one of the very few, if the only, utility -- gas utility that did not have operational orders or operational flow orders in our tariff, so the only provision that we had in our tariff to ensure that our interruptible customers were going to deliver the amount of gas that they planned to use was to curtail those customers.

So what we're asking for in this case is to also provide for operational orders because we heard from a number of our customers I had negotiated a contract with my then pooler to deliver gas to your system every day of the month, but when you curtailed me, they didn't deliver that gas or I didn't realize they didn't deliver enough gas. So what this does is it puts the requirement on the pooler who is in the marketplace every day, knows what the price of gas is going to be, to deliver that gas to match the customers and their pool. It also gives them the flexibility to manage all those customers in one pool so that if one is longer and one is short, we knit it together. But in the event the pooler does not to deliver -- does not deliver sufficient gas to serve their pool of customers, then that penalty will be assessed to the pooler itself.

Q Okay.

COMMISSIONER BROWN-BLAND: Any other questions from up here, the Commission?

(No response.)

COMMISSIONER BROWN-BLAND: Any follow up?

MR. COLLINS: No questions, Madam Chair.

COMMISSIONER BROWN-BLAND: All right. Ms. Jackson, as I understand it, though you had provided testimony, you learned only yesterday that you'd be required to be here so we thank you for being here --

THE WITNESS: Thank you.

COMMISSIONER BROWN-BLAND: -- and we don't have any further questions for this witness.

THE WITNESS: Thank you.

COMMISSIONER BROWN-BLAND: You're excused.

(Witness excused.)

MS. GRIGG: Thank you, Madam Chair. I believe that concludes PSNC's case. At this time we'd like to move into evidence the Company's Application that was filed on March 31st, 2016, along with the Company's testimony.

COMMISSIONER BROWN-BLAND: All right. The Company's Application will be received into evidence along with that testimony, to the extent it hasn't already been moved in.

MS. GRIGG: Thank you.

(Whereupon, the Application of Public Service Company of North Carolina, Inc. was admitted into evidence.)

COMMISSIONER BROWN-BLAND: All right.

MS. GRIGG: That concludes our case.

COMMISSIONER BROWN-BLAND: All right. Ms. Holt, I think that moves us to your end of the case.

MS. HOLT: Madam Chair, first, it's my understanding that none of the parties nor the Commission intends to call --intends to question our witness Julie Perry?

COMMISSIONER BROWN-BLAND: That's correct.

MS. HOLT: And we would move at this time that her testimony be copied into the record as if given orally from the stand and that she be excused.

COMMISSIONER BROWN-BLAND: All right. There being no objections, the prefiled testimony of witness Julie Perry will be received into evidence as if given orally from the witness stand.

MS. HOLT: Thank you.

(Whereupon, the prefiled testimony of Julie G. Perry was copied into the record as if given orally from the stand.)

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PUBLIC SERVICE COMPANY OF NORTH CAROLINA, INC.
DOCKET NO. G-5, SUB 565
TESTIMONY OF JULIE G. PERRY
ON BEHALF OF THE PUBLIC STAFF
NORTH CAROLINA UTILITIES COMMISSION
AUGUST 18, 2016

Q. WILL YOU STATE FOR THE RECORD YOUR NAME, ADDRESS, AND PRESENT POSITION?

A. My name is Julie G. Perry. My business address is 430 North Salisbury Street, Raleigh, North Carolina. I am the Supervisor of the Natural Gas Section of the Accounting Division of the Public Staff. My experience and qualifications are provided in Appendix A.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to (1) explain the level of fixed gas costs contained in the cost of service reflected in the Partial Stipulation between PSNC and the Public Staff filed in this proceeding, (2) provide testimony on the proposed Rider E - Integrity Management Tracker agreed to by the parties in this proceeding, and (3) address changes in reporting requirements.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO FIXED GAS COSTS.

A. The Company's filing included an adjusted level of fixed gas costs of $67,431,969 that was determined by multiplying its proposed sales and transportation volumes by the corresponding fixed gas cost collection rates approved by the Commission in Docket No. G-5, Sub 524, the Company's 2011 Annual Review of Gas Costs proceeding. These fixed gas costs collection rates were calculated on Paton Exhibit 1, Schedule 13, filed in Sub 524, based on total fixed gas costs of $62,769,162 and the Company's proposed level of volumes of 797,002,022 therms in this case.

The Partial Stipulation incorporates fixed gas costs at current level of charges pursuant to pipeline and storage facility tariffs or contacts as of May 31, 2016, of $91,412,650, while also reflecting secondary market credits of $23,484,031 in the determination of the annual fixed gas costs in this proceeding. The calculation of the new fixed gas cost collection rates is based on annual fixed gas costs of $67,928,619 and sales and transportation volumes of 808,586,562 therms as recommended by Public Staff witness Larsen.

Q. PLEASE EXPLAN THE INTEGRITY MANAGEMENT TRACKER FILED BY THE COMPANY.

A. PSNC filed for approval of an Integrity Management Tacker (IMT) pursuant to G.S. § 62-133.7:

> In setting rates for a natural gas local distribution company in a general rate case proceeding under G.S. 62-133, the Commission may adopt, implement, modify, or eliminate a rate adjustment mechanism for one or more of the company's rate schedules, excluding industrial rate schedules, to track and true-up variations in average per customer usage from levels approved in the general rate case proceeding. The Commission may adopt a rate adjustment mechanism only upon a finding by the Commission that the mechanism is appropriate to track and true-up variations in average

per customer usage by rate schedule from levels adopted in the general rate case proceeding and that the mechanism is in the public interest.

PSNC's proposed Rider E was filed in Paton Exhibit 4. In broad terms, the IMT provides for PSNC to adjust its rates biannually in order to recover the revenue requirement associated with Integrity Management Plant Investment and associated costs incurred by PSNC resulting from prevailing federal standards for pipeline integrity and safety that are not otherwise included in current base rates.

Q. PLEASE EXPLAIN THE SETTLED IMT PROPOSAL?

A. After several months of discussions, PSNC and the Public Staff agreed to a modified form of the IMT mechanism filed by the Company. The IMT mechanism will assist PSNC in the implementation and timely recovery of costs associated with its investment of capital in compliance with the requirements of federal and state laws and regulations regarding pipeline integrity (including both transmission and distribution integrity), reliability and safety.

The Public Staff has had approximately 2 ½ years of experience auditing the Piedmont IMR mechanism[1], which was very helpful in our discussions with PSNC regarding its proposed IMT. The Partial Stipulation includes a revised proposal that both parties have agreed

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[1] See *Order Approving Partial Rate Increase and Allowing Integrity Management Rider* (G-9, Sub 631, December 17, 2013); and *Order Approving Stipulation* (G-9, Sub 631, November 23, 2015)

to that sets out how to determine excluded costs from the Company's Integrity Management Plant Investment using both the exclusion percentages determined using PSNC's budgeted IMT projects, as well as the direct assignment approach for specific IMT projects that may not be eligible for the exclusion percentages set out in the Partial Stipulation. The Public Staff and PSNC have agreed that the excluded reasonable and prudent costs shall be eligible for inclusion in recoverable rate base in PSNC's next general rate case proceeding.

The Public Staff and PSNC further agreed that costs incurred for system expansion/improvement or routine maintenance, repair and replacement of system components that are not required to comply with federal gas pipeline safety requirements shall not be included in amounts recovered under the IMT mechanism.

The Public Staff and PSNC have worked hard to determine a fair and reasonable approach to enable the Company to recover its prudently incurred capital investment and associated costs of complying with federal gas pipeline safety requirements, and we recognize that an agreement to implement this mechanism was an important part of the Partial Stipulation in this proceeding.

Q. PLEASE PROVIDE THE AREAS IN THE PARTIAL STIPULATION THAT ADDRESS CHANGES IN REPORTING REQUIREMENTS.

A. The Stipulating Parties have agreed to changes in certain PSNC reporting requirements that include (1) using the net-of-tax overall rate of return from the most recent general rate case as the applicable interest rate on all amounts over-collected or under-collected from customers reflected in its Sales Customers Only, All Customers, and Hedging Deferred Gas Cost Accounts, (2) filing the GS-1 Report in a format similar to the ES-1 filed by the electric utilities effective with filings after January 1, 2017, and (3) recognizing the state corporate income tax rate change from 4% to 3% beginning January 1, 2017, and working together to determine the appropriate revenue requirement reduction and effectuating such reductions.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes.

Appendix A

JULIE G. PERRY

Qualifications and Experience

I graduated from North Carolina State University in 1989 with a Bachelor of Arts degree in Accounting and I am a Certified Public Accountant.

Prior to joining the Public Staff, I was employed by the North Carolina State Auditor's Office. My duties there involved the performance of financial and operational audits of various state agencies, community colleges, and Clerks of Court.

I joined the Public Staff in September 1990, and was promoted to Supervisor of the Natural Gas Section in the Accounting Division in September 2000. I have performed numerous audits and/or presented testimony and exhibits before the Commission addressing a wide range of natural gas topics.

Additionally, I have filed testimony and exhibits in numerous water rate cases and performed investigations addressing a wide range of topics and issues related to the water, electric, and telephone industries.

MS. HOLT: The Public Staff calls witness Michelle Boswell.

MICHELLE M. BOSWELL; Being first duly sworn,
testified as follows:

DIRECT EXAMINATION BY MS.HOLT:

Q Would you please state your name and business address for the record.

A Michelle Boswell, 430 North Salisbury Street, Raleigh, North Carolina.

Q By whom are you employed and in what capacity?

A I'm a Staff Accountant with the Public Staff - Utilities Commission Accounting Division.

Q And Ms. Boswell, did you cause to be prefiled in this docket on or about August 18th, 2016 testimony in question and answer form consisting of 23 pages, one appendix and one exhibit and schedules?

A Yes, ma'am.

Q And also on August 29, did you also revise -- submit a revised Exhibit 1, Schedule 1 --

A Yes, ma'am.

Q -- that was attached to your testimony? Do you have any additions or corrections?

A No, ma'am.

Q If you were asked the same questions today, would your answers be the same?

A Yes, ma'am.

MS. HOLT: Madam Chairman, I request that the testimony of Ms. Boswell be copied into the record as if given orally from the stand, and that her appendix and exhibits be identified as premarked.

COMMISSIONER BROWN-BLAND: There being no objection, the prefiled testimony of witness Michelle Boswell will be received into evidence as if given orally from the witness stand, and her exhibits filed with that testimony will be marked as they were when prefiled.

MS. HOLT: Thank you.

(Whereupon, the prefiled testimony of Michelle M. Boswell was copied into the record as if given orally from the stand.)

PUBLIC SERVICE COMPANY OF NORTH CAROLINA, INC.
DOCKET NO. G-5, SUB 565

TESTIMONY OF MICHELLE M BOSWELL
ON BEHALF OF THE PUBLIC STAFF
NORTH CAROLINA UTILITIES COMMISSION

AUGUST 18, 2016

Q. WILL YOU STATE FOR THE RECORD YOUR NAME, ADDRESS, AND PRESENT POSITION?

A. My name is Michelle M. Boswell. My business address is 430 North Salisbury Street, Raleigh, North Carolina. I am an Accountant in the Accounting Division of the Public Staff. My experience and qualifications are provided in Appendix A.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to support the Partial Stipulation between Public Service Company of North Carolina, Inc. (PSNC or the Company), the Public Staff, Carolina Utility Customers Association, Inc., and Blue Ridge Paper Products, Inc. d/b/a Evergreen Packaging (Collectively, "Stipulating Parties") regarding certain issues related to the Company's pending application for a general rate increase. Specifically, I discuss the accounting and ratemaking adjustments to which PSNC and the Public Staff have agreed as set forth on Schedule 1 of Boswell Exhibit I attached to my testimony.

Q. PLEASE DISCUSS THE COMPANY'S APPLICATION FOR A RATE INCREASE.

A. In its application filed on March 31, 2016, PSNC requested $41,583,020 in additional revenue requirement.

Q. PLEASE DESCRIBE THE SCOPE OF THE PUBLIC STAFF'S INVESTIGATION INTO THE COMPANY'S FILING.

A. The Public Staff's investigation included a review of the application, testimony, exhibits and other data filed by the Company, an examination of the books and records for the test year, and a review of the Company's accounting, end-of-period, other data, and after period adjustments to test year revenue, expenses, and rate base. It also included a review of the Company's responses to the Public Staff's data requests. At the conclusion of this investigation, PSNC and the Public Staff entered into settlement negotiations and have reached settlement of certain of the issues in this proceeding, including the revenue requirement. The Partial Stipulation between the Stipulating Parties is being filed contemporaneously with my testimony.

Q. WHAT BENEFITS DOES THE PARTIAL STIPULATION PROVIDE FOR RATEPAYERS?

A. From the perspective of the Public Staff, among the most important benefits provided by the Partial Stipulation are as follows:

(a) A significant reduction in the Company's proposed revenue increase in this proceeding.

(b) The avoidance of protracted litigation by the Stipulating Parties before the Commission and possibly the appellate courts.

Based on these ratepayer benefits, as well as the other provisions of the Partial Stipulation, the Public Staff believes the Partial Stipulation is in the public interest and should be approved.

Q. ARE THERE ANY AREAS ABOUT WHICH THE PUBLIC STAFF AND PSNC DID NOT REACH AGREEMENT?

A. Yes. The Public Staff and PSNC did not reach agreement regarding two Public Staff revenue requirement adjustments: (1) the Pipeline Integrity Management (PIM) amortization, and (2) the Manufactured Gas Plant (MGP) amortization. Public Staff witness Hoard presents the Public Staff's position on those issues. If the Commission approves the Company's requests related to the items above, the stipulated revenue requirement would be adjusted pursuant to Commission Order.

Q. WOULD YOU PLEASE BRIEFLY DESCRIBE THE STIPULATED REVENUE REQUIREMENT?

A. Yes. Schedule 1 of Boswell Exhibit I sets forth the rate base, net operating income, return, and revenue increase amounts agreed to by the Stipulating Parties, excluding the effect of the MGP and PIM, which are addressed by Public Staff witness Hoard.

Based on the level of rate base, revenue, and expenses annualized and updated through June 30, 2016, the stipulated increase in revenue requirement is currently $19,377,942, effective November 1, 2016.

Q. PLEASE DESCRIBE THE ORGANIZATION OF YOUR EXHIBITS.

A. Schedule 1 of Exhibit I presents a reconciliation of the difference between the Company's requested increase of $41,583,020, including the effect of supplemental adjustments, and the stipulated increase as well as the Public Staff's recommended amounts on two non-stipulated items, of $19,377,942. The revenue requirement effect of the non-stipulated amounts total $2,986,064, excluding any cash working capital impacts. Boswell Exhibit I, Schedule 1-1 shows the supporting calculation of certain items, which are used to determine the amounts presented on Boswell Exhibit I, Schedule 1.

Schedule 1 also sets forth the revenue requirements impact, based on adjusted fixed gas costs, net of secondary market credits, and lost and unaccounted for (LAUF) gas costs. Public Staff witness Perry addresses the fixed gas costs item in her testimony, and Public Staff witness Larsen addresses the LAUF item in his testimony. I have set out the fixed gas cost and LAUF items separately from the impact of the other Public Staff revenue requirement adjustments, because these items are trued-up in the Company's Deferred Gas Cost Accounts to the actual amounts incurred by the Company and thus do affect the Company's margin (revenue less gas costs).

Schedule 2 presents the adjusted original cost rate base as recommended by the Public Staff. The adjustments made to the Company's proposed level of rate base are summarized on Schedules 2(a), 2-1, and 2-2, and detailed on backup schedules.

Schedule 3 presents a statement of net operating income for return under present rates as adjusted by the Public Staff. Schedule 3 summarizes the stipulated adjustments as well as the Public Staff's adjustments for the two non-stipulated items, all of which are detailed on backup schedules.

Schedule 4 presents the calculation of required net operating income, based on the Public Staff recommended rate base and stipulated cost of capital.

Schedule 5 presents the calculation of the required increase in operating revenue necessary to achieve the required net operating income.

Q. DOES BOSWELL EXHIBIT I, SCHEDULE 1, REFLECT ADJUSTMENTS SUPPORTED BY OTHER PUBLIC STAFF WITNESSES?

A. Yes. These adjustments are as follows:

1) The recommendations of Public Staff witness Larsen regarding end of period revenues adjusted for weather and growth and LAUF.

2) The recommendations of Public Staff witness Perry regarding the stipulated Integrity Management Tracker, the stipulated fixed gas costs, and the various reporting requirement changes reflected in the Partial Stipulation.

3) The recommendations of Public Staff witness Hoard regarding the non-stipulated PIM and MGP amortizations and related rate base amounts.

Q. PLEASE DESCRIBE THE ADJUSTMENTS SHOWN ON BOSWELL EXHIBIT 1, SCHEDULE 1.

A. These adjustments are described below.

<u>PLANT IN SERVICE AND RELATED ITEMS</u>

Q. PLEASE EXPLAIN THE ADJUSTMENT TO PLANT IN SERVICE AND RELATED ITEMS.

A. The Company's exhibits reflect the actual December 31, 2015 plant and accumulated depreciation as well as an estimated June 30, 2016 amounts for these items. I have reviewed PSNC's process of booking plant and depreciation as well as audited several projects, and located no deficiencies. Boswell Exhibit I, Schedule 1 reflects an adjustment to update plant and accumulated depreciation, and related depreciation expense and property taxes, for actual plant additions through June 30, 2016. Depreciation expense reflects the depreciation rates PSNC filed in the depreciation study as part of this rate case. The Public Staff reviewed the depreciation study, found no issues with the new depreciation rates, and recommends approval of the proposed depreciation rates.

WORKING CAPITAL

Q. PLEASE EXPLAIN THE ADJUSTMENT TO WORKING CAPITAL.

A. The Partial Stipulation includes three adjustments to working capital. First, PSNC included three deferred/prepaid items which were all due to be fully amortized within the next 12 months. Since these three items were current, they were removed from the calculation of working capital. Working capital was also updated to reflect the actual June 30, 2016 balances. Finally, I included the unamortized balances for MGP, PIM, and Distribution Integrity Management Plan (DIMP). As stated earlier the treatment of MGP and PIM is addressed by Public Staff witness Hoard, and I address the treatment of DIMP later in my testimony.

GAS IN STORAGE AND MATERIALS AND SUPPLIES

Q. WHAT ADJUSTMENTS HAVE BEEN MADE TO GAS IN STORAGE AND MATERIALS AND SUPPLIES?

A. Gas in Storage, as well as Materials and Supplies, were updated to reflect a 13-month average through June 30, 2016, as shown on Boswell Exhibit I, Schedule 2-2(a).

ACCUMULATED DEFERRED INCOME TAXES

Q. PLEASE EXPLAIN THE ADJUSTMENTS TO ACCUMULATED DEFERRED INCOME TAXES.

A. The Partial Stipulation includes two adjustments to accumulated deferred income taxes (ADIT). First, PSNC included an estimate for ADIT in its filing, which has been updated to reflect the actual balance of ADIT as of June 30, 2016. Additionally, the Partial Stipulation includes $1,897,985 of ADIT related to the special contracts adjustment described below.

CASH WORKING CAPITAL FOR PRESENT RATES

Q. PLEASE EXPLAIN THE ADJUSTMENT TO CASH WORKING CAPITAL FOR PRESENT RATES.

A. Cash working capital (CWC) has been computed by the Company using the lead-lag study method and the Company has adjusted CWC to fully reflect its proposed adjustments, before the amount of its proposed rate increase. The Public Staff has adjusted CWC to reflect all the stipulated adjustments, as well as the two non-stipulated Public Staff adjustments in accordance with the Commission's Order in Docket No. M-100, Sub 137. This $1,903,594 working capital adjustment, which is reflected on Schedules 2-3, incorporates the effect on lead-lag study cash working capital of the Public Staff adjustments, before the rate increase.

SPECIAL CONTRACTS

Q. WHAT ADJUSTMENTS HAVE BEEN MADE TO SPECIAL CONTRACTS?

A. The Company provides natural gas transportation service to a power plant located near Asheville, North Carolina, pursuant to a contract dated March 10, 2000. Though the contract has a 25-year term, the customer paid demand charges over the initial five years of the contract for the actual cost of the facilities installed by PSNC pursuant to the contract. The contract also requires the customer to pay PSNC separate charges related to PSNC's ongoing fuel, O&M expenses, and property taxes. No demand charge payments from the customer related to the plant have been reflected in the Company's revenues in the current rate case filing. The Partial Stipulation adjustment removes from the cost of service the amounts included by the Company for plant, accumulated depreciation, accumulated deferred income taxes, depreciation expense, and property taxes associated with the facilities installed by PSNC.

PAYROLL AND RELATED EXPENSES

Q. WHAT ADJUSTMENTS HAVE BEEN MADE TO PAYROLL AND RELATED EXPENSES?

A. The Company's payroll and related expenses have been adjusted to reflect the following items: (a) annualized actual PSNC payroll costs (both union and non-union) as of June 30, 2016, (b) updated information regarding union progression pay increases scheduled to become effective after June 30, 2016, but before the December 31, 2016, end of the current union contract, (c) PSNC overtime pay based on the average number of overtime hours for the last three years, (d) the removal of the Company's proposed 2.5% increase to overtime dollars, (e) the O&M portion of payroll for three positions hired subsequent to June 30, 2016 that will start employment by the hearing date in this case, and (f) the SCANA services payroll allocated to PSNC through June 30, 2016.

BONUS ACCRUALS

Q. PLEASE EXPLAIN THE ADJUSTMENT TO BONUS ACCRUALS.

A. PSNC included an estimate as of February 2016 for six incentive pay plans to calculate its adjustment to bonus accruals. Bonus accruals have been updated to reflect the actual accruals for the six incentive pay plans as of June 30, 2016. The decrease of $1,178,457 to the bonus accrual adjustment is reflected in Boswell Exhibit I, Schedule 3-2.

PAYROLL BENEFITS

Q. WHAT ADJUSTMENT HAS BEEN MADE TO PAYROLL BENEFITS?

A. The Company used the actual test year relationship of total SCANA payroll benefits to total SCANA payroll in computing the payroll benefits factor, and applied it to direct and allocated PSNC payroll.

The payroll benefits include 401K, long-term disability, and short-term disability. The payroll benefits factor was updated to reflect the actual ratio for the 12-months ended June 30, 2016, and it was applied to updated payroll to determine the updated amount of payroll benefits, as reflected on Boswell Exhibit I, Schedule 3-3.

INCENTIVE PAY FOR EXECUTIVES

Q. PLEASE EXPLAIN THE ADJUSTMENT TO INCENTIVE PAY FOR EXECUTIVES.

A. PSNC's O&M expenses reflect the allocation of $2,229,159 of the salaries and bonus pay (short-term and long-term incentive plans) for nine SCANA senior staff persons. The percentage of bonus pay allocated to PSNC from SCANA was, however, significantly higher than the percentage of senior staff salaries allocated to PSNC. The stipulated adjustment reallocated the SCANA bonus pay for the nine SCANA senior staff persons to PSNC consistent with the allocation of senior staff salaries, calculating a decrease to O&M expenses of $869,580, as depicted on Boswell Exhibit I, Schedule 3-4.

EXECUTIVE COMPENSATION

Q. WHAT ADJUSTMENT HAS BEEN MADE TO EXECUTIVE COMPENSATION?

A. As reflected on Boswell Exhibit I, Schedule 3-5, the stipulated adjustment assigned 50% of the compensation charged to PSNC for the five top SCANA executives, as listed in its 2016 proxy statement, to non-utility operations. Compensation for each executive is composed of the annual salary, long-term incentive pay, short-term incentive pay, and other compensation, as described in the 2016 SCANA proxy statement.

RETIRED EXECUTIVE COMPENSATION

Q. WHAT ADJUSTMENT HAS BEEN MADE TO RETIRED EXECUTIVE COMPENSATION?

A. The Company included $139,250 in salary and bonus pay for a retired executive in its O&M expenses. These dollars were removed as the executive compensation for his replacement has been included in the executive compensation describe early in my testimony.

NON-UTILITY O&M EXPENSES

Q. PLEASE EXPLAIN THE ADJUSTMENT TO NON-UTILITY O&M EXPENSES.

A. PSNC applied its non-utility allocation factor to Administration & General Salaries, Copier Paper & Supplies, Building Services, Property Insurance, and some Miscellaneous General Expenses. I reviewed PSNCs non-utility allocation factors for both merchandising, jobbing, and CNG as well as non-utility equity investments, and found no errors within the calculations. The stipulated adjustment includes several additional accounts in the adjustment to non-utility O&M expenses based upon the Public

Staff's general knowledge of PSNC's non-utility operations and consistent with adjustments made in previous rate cases. The additional accounts and amounts included, as well as the total adjustment to non-utility O&M expenses are depicted on Boswell Exhibit I, Schedule 3-11.

NON-UTILITY PLANT

Q. WHAT ADJUSTMENT HAS BEEN MADE TO NON-UTILITY PLANT?

A. Non-utility plant was updated to reflect the updated plant and accumulated depreciation balances as of June 30, 2016.

DISTRIBUTION INTEGRITY MANAGEMENT PLAN

Q. PLEASE EXPLAIN THE ADJUSTMENTS TO DISTRIBUTION INTEGRITY MANAGEMENT PLAN.

A. PSNC adjusted O&M expenses by $1,519,116 to reflect an increase in ongoing distribution integrity costs to $2,000,000, as the result of the US Department of Transportation Pipeline and Hazardous Materials Safety Administration (PHMSA) distribution pipeline safety requirements. The Public Staff fully supports PSNC as it works to improve the safety across its system but proposes that the Company's distribution integrity management plan (DIMP) costs be treated in a manner similar to the transmission-related PIM program. Like PIM costs, which have been deferred and amortized, after review by the Public Staff and Commission, DIMP costs will vary from year-to-year, depending on the type of work performed. Due to the similarities to the PIM, which is a similar program that is targeted towards transmission facilities, the stipulated adjustment reflects DIMP costs as a regulatory asset that would be amortized over a period of years. The Stipulation reflects the inclusion of the unamortized portion in rate base.

There are three adjustments to PSNC's proposed DIMP adjustment. First, the adjustment has been updated to reflect the Company's actual DIMP costs at June 30, 2016 of $1,501,093. Next, the $1,501,093 balance is amortized over 5 years to reflect an ongoing recoverable level of expenses for the distribution safety plans. Finally, the unamortized balance of $1,200,875 was included in rate base as a component of working capital to reflect the regulatory asset treatment of the item.

INFLATION

Q. PLEASE EXPLAIN THE ADJUSTMENT TO INFLATION.

A. This adjustment reflects the effects of inflation on O&M expenses not otherwise updated or brought to an end-of-period level. The Company reflected an inflation adjustment by applying an inflation factor of 2.39% to test year O&M expenses not specifically adjusted elsewhere. The Partial Stipulation reflects use of an inflation factor of 2.2% based upon updated CPI indices. O&M expenses, such as payroll, that were adjusted elsewhere were deducted before applying the inflation factor. The inflation adjustment was modified to deduct the additional adjustments recommended to non-utility O&M expenses, the Company's non-utility O&M adjustment, advertising expenses, SalesForce, and lobbying/political expenses. The stipulated adjustment also removed contributions and donations as well as expenses related to entertainment and gifts. The non-utility O&M, SalesForce, and advertising costs were deducted because those items are specifically adjusted elsewhere to an ongoing level.

In its filing, the Company adjusted O&M expenses for SCANA Services chargebacks. The Partial Stipulation reflects the removal of that adjustment. Because the SCANA chargebacks, minus payroll and employee benefits, have not been adjusted to an end-of-period level, the SCANA chargebacks should be added to the base amount used to determine the amount of the inflation adjustment. The adjustment to the SCANA Services chargebacks is discussed later in my testimony. These adjustments resulted in an increase for inflation of $449,153, as shown on Boswell Exhibit I, Schedule 3-10.

RATE CASE EXPENSE

Q. WHAT ADJUSTMENT HAS BEEN MADE TO RATE CASE EXPENSES?

A. The Company proposed that estimated rate case expenses of $418,300 be amortized over three years. The Partial Stipulation reflects the amortization of $312,036 of rate case expenses, including the cost of the Public Staff rate-of-return consultant, over a 5-year period.

POSTAGE

Q. PLEASE EXPLAIN THE ADJUSTMENT TO POSTAGE.

A. The Company computed its postage adjustment by first applying a customer growth factor to actual test year postage expense, and then decreasing that amount by the percentage decrease in the postage rate. This new lower level of postage was then compared to the actual postage expense to compute a decrease in postage expense adjustment of $32,366. The Company's growth adjustment was removed, as it was included in the adjustment to customer accounts. In addition, the amount includes a corresponding adjustment to remove postage related to disallowed advertising expense for account 913. I removed the same percentage of excluded direct mailing advertising from postage included in account 913 associated with these mailings. These adjustments decreased postage expense by $144,717, as reflected in Boswell Exhibit I, Schedule 3-8.

UNCOLLECTIBLES EXPENSE

Q. PLEASE EXPLAIN THE ADJUSTMENT TO UNCOLLECTIBLES EXPENSE.

A. PSNC calculated a 0.25% uncollectibles factor based upon the uncollectibles and revenues for 2015. This rate is utilized for the stipulated calculation of updated revenues from sales and transportation of gas recommended by Public Staff witness Larsen, net of gas costs to derive the recommended level of uncollectibles expense. This resulted in a decrease of $22,445 in uncollectibles expense, as shown on Boswell Exhibit I, Schedule 3-9.

REGULATORY FEE

Q. WHAT ADJUSTMENT HAS BEEN MADE TO THE REGULATORY FEE?

A. As detailed later in my testimony, the regulatory fee decreased to 0.14% effective July 11, 2016. As shown on Boswell Exhibit I, Schedule 3-15, we updated PSNC's adjustment to regulatory fee to reflect this change, resulting in a decrease of $34,304.

SALESFORCE LICENSE AMORTIZATION

Q. PLEASE EXPLAIN THE ADJUSTMENT TO SALESFORCE LICENSE AMORTIZATION EXPENSE.

A. SalesForce is a subscription-based cloud computing customer relationship management tool that PSNC utilizes to streamline its engagement with customers from initial contact through meter and/or appliance installation. PSNC calculated its SalesForce License Amortization expense adjustment based upon the remaining amortization of the contract set-up, and implementation costs through the contract's current March 31, 2017, expiration date. PSNC has indicated that the contract will be extended. Boswell

Exhibit I reflects an adjustment to decrease O&M expenses by $37,385, to include an ongoing level for SalesForce of $123,420, as compared to the Company's $160,805 amortization. The adjustment is computed based upon current contract costs of $370,260, amortized over a 3-year contract period. Finally, the SalesForce adjustment was included as part of the non-utility O&M expense described above, because the Company also utilizes the system for non-utility appliance installations.

ADVERTISING

Q. PLEASE SUMMARIZE THE RECOMMENDED ADJUSTMENT TO ADVERTISING EXPENSE.

A. The Company proposed to include $1,034,103 of advertising expense in O&M expense in this proceeding. Based on Commission Rule R12-13 and prior Commission orders, the Stipulating Parties have agreed on an adjustment that reduces test year advertising expenses by $516,898 to exclude image, promotional, and competitive advertising.

CUSTOMER DEPOSITS AND THE RELATED INTEREST EXPENSE

Q. WHAT ADJUSTMENT HAS BEEN MADE TO CUSTOMER DEPOSITS AND THE RELATED INTEREST EXPENSE?

A. PSNC reflected interest on customer deposits as a reclassification to O&M expenses based on the 13-month average of customer deposits for the period ending December 2015. Boswell Exhibit I reflects an adjustment that updates both the amount of customer deposits and interest on customer deposits to reflect the 13-month average for the period ending June 30, 2016.

SERVICE COMPANY CHARGES

Q. PLEASE EXPLAIN THE ADJUSTMENT TO SERVICE COMPANY CHARGES.

A. As shown on Boswell Exhibit I, Schedule 3-19, PSNC has proposed an adjustment that increases O&M expenses for $3,216,283 in Service Company charges. An adjustment was made to remove these unsupported 2016 SCANA Services budgeted amounts.

GAS TECHNOLOGY INSTITUTE FUNDING

Q. WHAT ADJUSTMENTS HAVE BEEN MADE TO GAS TECHNOLOGY INSTITUTE FUNDING?

A. PSNC has proposed an adjustment that includes funding for the Gas Technology Institute (GTI) as an O&M expense. GTI is a not-for-profit research and development laboratory created to benefit natural gas consumers and to support the gas industry. Member utilities are able to direct research efforts and funding through GTI's Operations Technology Development (OTD) program, as PSNC proposes. The Company determined the ongoing expense level based on an estimate of the number of meters as of December 31, 2016, multiplied by $0.50 per meter. Boswell Exhibit I reflects an update to include the Company's actual number of meters at June 30, 2016. This results in a decrease of $6,369 to GTI charges, as shown on Boswell Exhibit I, Schedule 3-20.

FUEL COSTS

Q. PLEASE EXPLAIN THE ADJUSTMENT TO FUEL COSTS.

A. The Company made an adjustment to the test period level of gasoline and diesel fuel costs using a historical three-year average. Boswell Exhibit I reflects an adjustment that utilizes a historical two-year average, and excludes a year that included fuel prices at an all-time record high price. The adjustment is a decrease of O&M expenses of $117,012, as shown on Boswell Exhibit I, Schedule 3-21.

LOBBYING EXPENSES

Q. PLEASE DESCRIBE THE ADJUSTMENT TO LOBBYING EXPENSES.

A. Stipulated O&M expenses have been adjusted to remove lobbying costs incurred by the Company during the test year. The costs to be removed were determined by applying the "but for" test for reporting lobbying costs as used in a Formal Advisory Opinion of the State Ethics Commission dated February 12, 2010, and recognizing that lobbying includes not only employees' direct contact with legislators, but also other activities that would not have been conducted but for the lobbying itself. Applying this test resulted in the removal of a portion of the payroll and related costs of the Economic Development and Government Affairs Department of SCANA. The total amount of the adjustment is to remove $167,760 from the O&M expenses, as shown on Boswell Exhibit I, Schedule 3-22.

CHANGE IN RETENTION FACTOR

Q. PLEASE EXPLAIN THE ADJUSTMENT TO THE RETENTION FACTOR.

A. The stipulated calculations utilize the 0.014% regulatory fee, which took effect on July 11, 2016, in my computation. PSNC utilized the previously approved 0.148% regulatory fee in calculating the retention factor.

CASH WORKING CAPITAL EFFECT OF RATE INCREASE

Q. PLEASE EXPLAIN THE ADJUSTMENT TO CASH WORKING CAPITAL FOR THE PROPOSED INCREASE.

A. The CWC lead-lag effect of the proposed revenue increase as recommended by the Public Staff has been calculated on Boswell Exhibit I, Schedule 2-4. Boswell Exhibit I, Schedule 3A, reflects the income tax effects related to the interest synchronization impact of the Company's proposed rate increase, so as to properly separate the effects of the CWC adjustment of the rate increase from the other effects of the rate increase.

EXCESS DEFERRED INCOME TAXES

Q. PLEASE EXPLAIN THE ADJUSTMENT TO EXCESS DEFERRED INCOME TAXES.

A. PSNC's filing originally proposed a refund of EDIT in the amount of $7.3 million over a one year to reflect the effect of a decrease in the state income tax rate to 4%.

On August 4, 2016, the North Carolina Department of Revenue issued a statement reflecting a decrease in the state income tax rate from 4% to 3%, effective January 1, 2017.

PSNC and the Public Staff agree to work together to determine the appropriate amounts to be refunded related to the change in state income tax rate from 4% to 3%.

TAXES ON CONTRIBUTIONS IN AID OF CONSTRUCTION

Q. PLEASE EXPLAIN THE PUBLIC STAFF'S POSTION REGARDING TAXES ON CONTRIBUTIONS IN AID OF CONSTRUCTION.

A. On September 3, 2013, the Commission issued an *Order on Motion for Clarification* in Docket No. M-100, Sub 113A ("M-100, Sub 113A Order"). The Public Staff has not completed its investigation required by the M-100, Sub 113A Order. The Public Staff found that PSNC is currently recording Contributions in Aid of Construction above the line but proposes to file a report by the end of the 2016, regarding the treatment of gross-up amounts for the 2008-2012 time period consistent with the Commission's order..

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes, it does.

Appendix A

MICHELLE M. BOSWELL

Qualifications and Experience

I graduated from North Carolina State University in 2000 with a Bachelor of Science degree in Accounting and I am a Certified Public Accountant.

I joined the Public Staff in September 2000. I have performed numerous audits and/or presented testimony and exhibits before the Commission addressing a wide range of electric, natural gas, and water topics. I have performed audits and/or presented testimony in Duke Energy's 2010 REPS Cost Recovery Rider; the 2008 REPS Compliance Reports for North Carolina Municipal Power Agency 1, North Carolina Eastern Municipal Power Agency, GreenCo Solutions, Inc., and EnergyUnited Electric Membership; four recent Piedmont rate cases; several Piedmont, NUI, and Toccoa annual gas cost reviews; Piedmont and NUI's merger; and Piedmont and NCNG's merger.

Additionally, I have filed testimony and exhibits in numerous water rate cases and performed investigations addressing a wide range of topics and issues related to the water, electric, and telephone industries.

(Whereupon, Revised Boswell Exhibit Number 1 was identified as premarked.)

Q Do you have a summary of your testimony?

A Yes, ma'am.

Q Please read it.

A I filed testimony and an exhibit in support of a Partial Stipulation between the Public Staff, Carolina Utility Customers Association, Inc., Blue Ridge Paper Products, Inc., doing business as Evergreen Packaging, and PSNC on August 18th, 2016, which resulted in substantial adjustments to the Company's filed case and resolved all but one issue.

On August 29, 2016, the Stipulating Parties were ultimately able to arrive at a complete settlement of all issues, the terms of which are reflected in my revised Boswell Exhibit 1 and the testimony of Company witness Paton.

This concludes my summary.

MS. HOLT: Thank you. Ms. Boswell is available for cross examination.

COMMISSIONER BROWN-BLAND: All right. I don't believe anyone has any cross examination. The Commission had just a few, but I believe that witness Boone may have taken care of most of the questions we had for you.

EXAMINATION BY COMMISSIONER BROWN-BLAND:

Q You heard me, did you not, ask Ms. Boone about the differences in the cash working capital amounts that were in your two exhibits based on the lower or the higher ROEs?

A Yes, ma'am.

Q Did you agree with her answers or did you have anything else to add?

A No, ma'am. Her answer was accurate.

Q And as well, the $10,000,000 figure that was in your exhibit and her explanation of the change there, you are in agreement with that?

A Yes, ma'am.

Q The only other thing is you also heard me ask if she would -- if the Commission were to make changes in the cash working capital from what has been stipulated to, would the Public Staff also be amenable to provide the revised amount that they were --

A Yes, ma'am.

Q -- that those numbers were themselves? And would it take you also likewise about a couple of days --

A Yes, ma'am.

Q -- to do that? Okay. And I believe that the

Commission staff has already received the workpapers, do you have that knowledge, with regard to the calculations for your lead-lag?

A I believe they received the ones on my testimony. I don't believe that there are -- the ones regarding the final settlement.

Q All right. Could you provide that --

A Yes, ma'am.

Q -- as a late-filed exhibit? And you heard my long explanation of what we were looking for?

A Yes, ma'am.

Q Could you provide all of that, too? And if you forget, you can look back in the record and remember.

A (Nods affirmatively.)

COMMISSIONER BROWN-BLAND: Okay. I don't have any further questions for this witness. Does anyone else?

(No response.)

COMMISSIONER BROWN-BLAND: All right. Then you may be the quickest witness we had today, but you --

THE WITNESS: I was trying. Thank you.

COMMISSIONER BROWN-BLAND: All right. Thank you.

MS. HOLT: The Public Staff calls Jan Larsen.

JAN A. LARSEN; Being first duly sworn,
testified as follows:

COMMISSIONER BROWN-BLAND: All right. Please be seated.

DIRECT EXAMINATION BY MS. HOLT:

Q Please state your name and business address for the record.

A My name is Jan Larsen. My business address is 430 North Salisbury Street in Raleigh.

Q By whom are you employed and what capacity?

A I'm with the Public Staff Natural Gas Division. I'm the Director of the Division.

Q Mr. Larsen, did you prefile in this docket on about August 18, 2016 testimony in question and answer form consisting of 11 pages and three exhibits?

A Yes, I did.

Q And did you file a corrected exhibit on August 25, 2016?

A Yes, I did.

Q Do you have any additions or additional corrections to your testimony or exhibits?

A Yes. Due to the settlement that was filed yesterday or this morning, the revenue requirement has changed. Revised Larson Exhibit C will be superseded by

Exhibit B to the Stipulation that we will be filing by the end of business tomorrow. The new rate design will be very similar to the Revised Larsen Exhibit C, however.

Q Thank you. Mr. Larsen, with respect to the testimony that you filed, if you -- if you were to be asked those same questions, would your answers be the same?

A Yes, they would.

MS. HOLT: I request that the testimony of Mr. Larsen be copied into the record as if given orally from the stand, and that the remaining exhibits be identified as premarked, Exhibit A and B.

COMMISSIONER BROWN-BLAND: That motion will be allowed.

(Whereupon, the prefiled testimony of Jan A. Larsen was copied into the record as if given orally from the stand.)

PUBLIC STAFF – NORTH CAROLINA UTILITIES COMMISSION
DIRECT TESTIMONY OF
JAN A. LARSEN
BEFORE THE NORTH CAROLINA UTILITIES COMMISSION
DOCKET NO. G-5, SUB 565
AUGUST 18, 2016

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND PRESENT POSITION.

A. My name is Jan A. Larsen and my business address is 430 North Salisbury Street, Raleigh, North Carolina. I am the Director of the Public Staff's Natural Gas Division. My qualifications and experience are provided in Appendix A.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to present the Public Staff's recommendations regarding several aspects of the application by Public Service Company of North Carolina, Inc. (PSNC or Company) for a General Rate Increase. The recommendations pertain to: (1) the appropriate calculation of Company Use and Lost and Unaccounted For Gas (CU & LUAF), (2) the appropriate End of Period adjustments for weather normalization and customer growth, (3) a reasonable and appropriate rate design, and (4) the Company's tariffs.

COMPANY USE AND LOST AND UNACCOUNTED FOR GAS

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO COMPANY USE AND LOST AND UNACCOUNTED FOR GAS.

A. The Company calculated $1,754,426 of CU&LUAF gas costs by multiplying its proposed sales and transportation volumes by the prior rate case Commission-approved CU&LUAF collection rate of $.00202 per therm. PSNC did not update its CU&LUAF rates in the current rate case.

The Public Staff accepted the Company's company use volume level and then computed a ratio of PSNC's proposed LUAF volumes relative to its sales and transportation therms which was based on PSNC's evaluation of recent operating experience. Using the updated CU&LUAF volume level, the Public Staff applied a CU&LUAF ratio of 0.977% to its recommended sales and transportation volumes to determine the recommended CU&LUAF volumes and then multiplied that CU&LUAF volume level by the $0.225 per benchmark to determine the dollar amount of gas costs associated with CU&LUAF gas of $1,777,080. It is our understanding that PSNC agrees with our methodology for determining the CU&LUAF ratio but not the sales and transportation volumes recommended by the Public Staff that we applied the CU&LUAF ratio to.

END-OF-PERIOD VOLUMES AND CUSTOMER DETERMINATION

Q. WHAT ARE THE TOTAL SALES AND TRANSPORTATION VOLUMES AND CUSTOMER NUMBERS THAT YOU HAVE USED IN CALCULATING THE END-OF-PERIOD RATES?

A. I have evaluated PSNC's test year volumes and customer levels and the Public Staff's adjustment for the addition of a new rate class – Rate Schedule 140 – Medium General Service, weather normalization and customer growth. I will discuss each adjustment below.

NEW RATE SCHEDULE

PSNC is proposing a new Rate Schedule 140 – Medium General Service that is designed for commercial customers who use more than 25,000 but less than 60,000 (the threshold for Rate Schedules 145 and 175) therms per year. As PSNC has stated, there are 887 customers of the nearly 43,000 current Rate Schedule 125 – Small General Service customers who would qualify for this new rate schedule. I agree with the Company's reasoning for creating this new Rate 140, and recommend this be approved.

WEATHER NORMALIZATION – HEATING DEGREE DAYS

When evaluating a general rate case, the Public Staff runs its own weather normalization model and compares the results to those produced by the PSNC model. Typically in the past, the results of the models used by the Public Staff and PSNC (as well as other

Local Distribution Companies (LDCs)) have been very close, and we have accepted the results of the LDCs' models for determining the appropriate weather normalization adjustment. However, in this current docket, our results are significantly different.

Q. WHAT DID THE PULBIC STAFF'S WEATHER NORMALIZATION ADJUSTMENT SHOW?

A. The Public Staff's weather normalization shows an increase in heat sensitive volume of approximately 9.3 million therms. That calculation is shown on Larsen Exhibit A. Increasing volumes due to warmer than normal weather makes logical sense because heat sensitive customers did not use as much gas as they would have had weather been normal.

Q. PLEASE EXPLAIN HOW YOU CALCULATED THIS WEATHER NORMALIZATION ADJUSTMENT.

A. The Public Staff's method of calculating the weather normalization is to take the test year customer data (number of bills and consumption by month) and compare that with the monthly Actual Heating Degree Days (HDDs) and develop a mathematical model that computes a Base Load and Heat Sensitive Factor (HSF.) This Base Load and HSF components are then applied to the test year's Normal HDDs and the result is a volume level that would have been expected if the weather had been normal during the test year.

Q. PLEASE EXPLAIN HEATING DEGREE DAYS AND HOW THEY

ARE UTILIZED IN YOUR MATHMATICAL MODEL.

A. HDDs are calculated by taking the average daily temperature and subtracting that from a base or standard temperature of 65 degrees. For example, a low of 20 degrees and a high of 40 degrees would yield an average of 30 degrees and a HDD of 35 degrees (65 – (20+40)/2.) The Normal HDDs are based on a 15-year average (the years 2000 – 2015 in this docket.) PSNC used to use a 30-year Normal HDDs but moved to a 15-year normalization in its last general rate case in Docket No. G-5, Sub 495.

A mathematical model in the form of a linear regression compares the average usage to the Actual HDD. The accuracy of this model can be determined by examining the R^2 ("R Squared") that the model produces. The closer the R Squared is to 1.000, the more accurate the model. The Public Staff's models resulted in an R Squared value of .992 which indicates a very accurate regression.

I performed this regression by grouping all residential customers (Rates 101 and 102) and all small commercial customers (Rates 125 and 127) and doing three regressions by region – Raleigh/Durham, Gastonia/Charlotte, and Asheville, which are PSNC's three customer base regions. This is the method we use when determining peak day demand in PSNC's Annual Review of Gas Costs each year. Updated customer usage patterns using the review or test period customer data and computing normalized usage is an important computation that allows LDCs to accurately project customer usage during peak or the coldest days.

END OF PERIOD REVENUES

Q. HOW DOES THE DIFFERENCE IN VOLUME AFFECT REVENUES?

A. In order to get to an End of Period revenue level, the proper levels of customer bills are multiplied by the facilities charges and the proper levels of volumes are multiplied by the energy charges. Simply put, if the customer or volume level is lower, the End of Period revenues are less, and a greater increase in rates must occur in order to satisfy the revenue requirement. The Public Staff's End of Period Revenues with the Public Staff's recommended volume level from our weather normalization adjustment under existing rates is $4,177,588 more than that calculated by the Company. There is a corresponding increase in commodity cost of gas expense associated with this revenue increase of $2,606,522, for a net revenue increase of $1,457,278. Larsen Exhibit B shows my calculations. This is the "starting point" for the rate case.

In addition, the Public Staff's recommended level of Other Operating Revenues is $3,526,964, which represents an increase of $113,788 over PSNC's level of $3,413,176. This increase is due to a customer growth adjustment that I have recommended to Public Staff witness Boswell, which she has made to various items in Other Operating Revenues.

Therefore, the total Public Staff recommended end-of-period revenues is $434,445,667.

RATE DESIGN

Q. HOW DO YOU RECOMMEND THAT THE COMPANY RECOVER THE PUBLIC STAFF'S RECOMMENDED REVENUE REQUIREMENT?

A. The Staff is recommending an increase of $18,711,557 for an overall annual revenue requirement of $453,157,224. I recommend that many factors be considered in designing rates to allow the Company to recover the annual level of revenues. Among these are (1) value of service, (2) type of service, (3) quantity of use, (4) time of use, (5) manner of service, (6) competitive conditions relating to the acquisition of new customers, (7) historical rate design, (8) revenue stability of the Company, (9) economic policy, (10) administrative ease, and (11) allocated cost of service studies.

Value of service is an important consideration since it recognizes that the price paid for natural gas service cannot be significantly greater than a satisfactory alternative. The fact that natural gas is cleaner burning (producing less emissions) and easier to use also affects its value for some customers. Value of service consideration is the reason why rates for some rate classes are designed to allow for negotiations based on alternative fuel pricing and also transportation of gas procured by end-users.

The type of service, quantity of use, time of use, and manner of service are considered by reviewing customer characteristics. Different types of customers have different needs. For example, heat sensitive residential and commercial customers need more security of service during peak (cold) winter days than do non-heat sensitive customers, and they pay for this enhanced service by contributing more margin in the form of higher rates. Within the industrial class, some customers require a firm gas supply in their manufacturing process whereas others use gas only as boiler fuel. Some may choose to have an alternate fuel available, and some may not. Rate design should reflect all these differences among customers.

Rates should be attractive to new customers. Some industrial customers are energy intensive and are very conscious of their choice of fuels. Residential and small commercial customers are also concerned with their long-term commitment to their energy choice. Rates should be set in a manner to be appealing to all classes of customers so as to contribute both to the financial health of the utility and the welfare of its customers.

Historical rate design is also considered both in evaluating the results of past rate design and in anticipating the response to the recommended rate design.

In reviewing the revenue stability of the utility, I considered whether rates would enable the Company to attract new customers and keep the customers it currently has. Dramatic changes in rate design can result in unpredictable revenue shifts and should generally be avoided.

Economic policy includes rate design that encourages economic growth in the Company's territory for all rate classes. Proper rate design can facilitate growth by enabling the Company to add new load in a cost-effective manner.

Administrative ease involves the reasonable classification of customers into various groups or classes where they share similarities. If customers are separated into too many rate categories, the utility incurs excessive administrative costs that provide little benefit to customers.

Finally, rates of return resulting from cost of service studies are considered in determining rate design and are used as a guide in determining the direction of rate changes for the various customer classes.

Q DO YOU AGREE WITH PSNC'S INCREASE IN FACILITIES CHARGES IT IS PROPOSING?

A. No, I do not. Since the Company is already recovering the margin that was determined in the rate case through the Customer Utilization Tracker (CUT), there is no need from a cost recovery standpoint for raising the facilities charges. Facilities charges are very unpopular with customers, and the Company can recover its margin through the energy charges that are trued up by the CUT.

Q. HOW HAVE YOU TAKEN COST OF SERVICE INTO CONSIDERATION IN ARRIVING AT YOUR RECOMMENDATIONS?

A. The Public Staff has prepared a fully allocated cost of service study under PSNC's existing rates with pro forma adjustments (end-of-period). I have evaluated that study and have used it as a guide in this proceeding. The Public Staff has worked with PSNC and Carolina Utility Customers Association, Inc. (CUCA) and Blue Ridge Paper Products Inc. d/b/a Evergreen Packaging (Evergreen), the two intervenors representing industrial customers in this docket. Through a series of analysis and discussion, we have come to an agreement regarding rate design, and my recommended rate design takes into account this understanding. My recommended rates are shown in Larsen Exhibit C.

Q. WHAT IS THE EFFECT ON CUSTOMERS' BILLS FROM THE EXISTING BILLING RATES TO YOUR RECOMMENDED RATES?

A. Residential customers will experience an average bill increase of $2.11 per month or 4.3%. Other rate classes will see similar or slightly lower rate increases.

Q. WHAT IS YOUR RECOMMENDATION CONCERNING THE

PROPOSED INCREASES IN RECONNECT FEES?

A I recommend that these proposed fees be approved. In response to data requests, PSNC stated that normal increases in operating expenses led it to request this increase in reconnection fees. Allowing these fees to recover the actual costs in disconnecting and then reconnecting customers keeps other customers from subsidizing those who are going through the disconnect/reconnect process. These fees and charges reduce the revenue requirement increase that must be recovered through customers' rates.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes.

APPENDIX A

QUALIFICATIONS AND EXPERIENCE
OF
JAN A. LARSEN
DIVISION DIRECTOR

PUBLIC STAFF - NATURAL GAS DIVISION
NORTH CAROLINA UTILITIES COMMISSION

I graduated from North Carolina State University in 1983 with a Bachelor of Science degree in Civil Engineering. I was employed with Law Engineering Testing Company as a Materials Engineer from 1983 to 1984. From 1984 until 1986, I was employed by the North Carolina Department of Transportation as a Highway Engineer. In 1986, I was employed by the Public Staff's Water Division as a Utilities Engineer I. In 1992, I was promoted to Utilities Engineer II with the Public Staff's Natural Gas Division and promoted to Utilities Engineer III in 2002. In May of 2016, I was promoted to the Director of the Public Staff's Natural Gas Division.

My most current work experience with the Public Staff includes the following topics:

1. Rate Design
2. Cost-of-Service Studies
3. Purchase Gas Cost Adjustment Procedures
4. Tariff Filings
5. Natural Gas Expansion Project Filings
6. Depreciation Rate Studies
7. Annual Review of Gas Costs
8. Weather Normalization Adjustments
9. Customer Utilization Trackers
10. Feasibility Studies / Line Extension Policies
11. Pipeline Integrity Management Riders

(Whereupon, Larsen Exhibits A, B and Revised C were identified as premarked.)

Q Mr. Larsen, do you have a summary of your testimony?

A I do. The purpose of my testimony is to present the Public Staff's recommendation regarding several aspects of the application of Public Service Company of North Carolina, Inc. for a General Increase in Rates and Charges. As a result of these adjustments and a revenue requirement of approximately $18.7 million, I was able to develop a reasonable and appropriate rate design that industrial Intervenors did not oppose and one that results in a rate increase of 4.3 percent for residential customers and similar or slightly lower rate increases for other rate schedules.

This concludes my summary.

MS. HOLT: Thank you. Mr. Larsen is available for questions.

COMMISSIONER BROWN-BLAND: All right. There's no questions from the Company or the Intervenors?

(No response.)

COMMISSIONER BROWN-BLAND: Then the Commission had just a few questions, Mr. Larsen.

EXAMINATION BY COMMISSIONER BROWN-BLAND:

Q In your testimony you recommended approval of increases for the reconnection fees.

A Correct.

Q I think that's around page 11 in your testimony. And you mentioned that the data requests disclosed that normal increase in operating expenses is what led the Company to seek these increases. The weekday, working hour fee was increased from 65 to $80. Do you know how long the reconnection fee with working hours had been at $65?

A It is my understanding that has been in place since 2006.

Q And can you say, based on the data request, that the $80 reconnection fee fully covers the Company's cost?

A Yes. We asked that in the data request response, and they -- PSNC responded that the increase reflected an annual inflation adjustment since 2006 of approximately 2 percent per year, and that's how they justified it. And on top of that, we had done a very in-depth analysis a number of years ago, analyzing all the components of cost of reconnecting gas service. First of all, to reconnect you have to disconnect first, so there's actually two trips out to the customer's property. That's kind of obvious, but needs to be considered. We added up all the time. On a system-wide average it's almost 90 minutes of technician time to go out to disconnect and then to go out again and reconnect and then to check appliances and make sure everything is working properly, there's no leaks.

In addition to that, there's a dispatch cost and a customer service involvement cost, so we added all those up, and in today's dollars that comes to about almost $100 for a reconnect, so we believe the $80 was reasonable and did not exceed the cost that the Company had to incur to provide that service.

Q But am I understanding correct that it leaves a gap? There's a $20 gap?

A Yeah. Our estimate is that it costs on average $100 to reconnect a customer.

Q All right.

A And I understand, you know, that's system-wide, so the $80 is the lower one that's normal working hours for residential.

Q And so -- well, does it recover the facilities charges that a customer avoids paying by disconnecting?

A They don't pay a facilities charge while the meter is off, if that's what you're asking.

Q Uh-huh. Okay. Do you know how PSNC's reconnection fees compares to Piedmont's?

A Piedmont's is $85 for --it's more of a -- I don't have it exactly in front of me, but they do theirs seasonally. In other words, they would rather people reconnect in the summer and all the way up to September, and then once October hits or September/October hits, then it goes up to $85, and the reason for that is there's a huge rush for people to have their gas reconnected who use it for heat only in the fall, and that usually comes the first cold weekend that we get and they're overwhelmed with requests to reconnect service, so they're trying to spread that out by giving an incentive to reconnect before that crunch time hits in the fall. But theirs is 55 and 85 for the residential, and that was done three years ago.

Q So PSNC, through the reports that the Commission receives, it seems from 2009 to 2015, PSNC disconnected about 23,000 residential customers for nonpayment. Do you have a feel for the impact of reconnection fees on the number of residential customers who disconnect?

A I do not, no.

Q Okay. Now, is the Amended Exhibit Larsen C in support of the Amended Partial Settlement, is that still -- has that changed or is that -- is that still --

A That will be changing somewhat. We need to develop winter/summer differential rates that are consistent with fixed gas cost recovery rates and those kind of things, but it will pretty much stay pretty close to where it's at, but just to get all the intricate details between margin fixed gas cost in each rate schedule and each rate block needs to be developed so it's completely accurate.

Q Well, could you generally discuss the changes to the rates that are involved there with that exhibit?

A Sure. You're talking about how much rate increase is --

Q Yeah, and in particular with the block rate structure and the schedule.

A For the industrial customers?

Q Yes.

A Through negotiation we reached a settlement with the Intervenors in this case to not increase -- to increase Sales Rates 145 and 150 by no more than 3.25 percent per rate block and then rate -- Transportation Rates 175 and 180 by no more than 2.25 percent. So that's the agreement we reached with those parties, and then the balance of the rates were spread across the firm market, and the result was rate increases in the low 4 percent ranges, so we thought that was a very reasonable overall settlement that represented all customers in a fair manner.

Q Could you speak to -- the new rate design, as I understand it, has four step blocks of 15,000 therms each and adds a step block of 1,000,000 therms, with a final block that goes over 1,060,000 therms.

A That's correct. Rate 175 was originally put together a number of years ago to attract smaller industrial customers. It used to be you had to use 180,000 therms a year to qualify for any industrial rate with PSNC. And a number of years ago they dropped that threshold down to 120,000 therms, and then they dropped it down to 60,000 therms, so we had a lot of smaller customers who were able to transport or be on those industrial rates. And then over the years, we think, especially in the last two years there were migration of interruptible customers from Rate 180 to 175 due to curtailment issues or whatever other issues they wished a firm rate schedule, so we began to see a much larger -- several very large customers in the Rate 175 class. And there's about four customers that are very, very large users in that class, and the rate blocks are set up now for really a relatively small customer grouping, so there was an agreement to go ahead and put a sixth block on there that would take care of an extremely large user would not be paying the, you know, relatively high last block compared to how much volume gas they would be putting through the system.

Q So -- and that rate now is lower than it was under the 60,000 therm -- the over 60,000 block?

A It's slightly lower, yes.

Q Okay. And so it's fair to say that that rate schedule has now been designed to benefit the large volume users?

A Yes. There's four large volume users that will likely fall into that category, at least from some months to the other.

Q Do you know or have an estimate of how many customers will be in that Rate Schedule 175 that will use that final block?

A I believe four customers will.

Q All right.

COMMISSIONER BROWN-BLAND: Any other questions from the Commissioners?

(No response.)

COMMISSIONER BROWN-BLAND: Any follow-up questions?

MS. GRIGG: No, ma'am.

COMMISSIONER BROWN-BLAND: All right. Mr. Larsen, I don't think we have any more questions for you. You may be excused. We appreciate --

THE WITNESS: Thank you.

(Witness excused.)

COMMISSIONER BROWN-BLAND: We have -- and we need to take care of his exhibits?

MS. HOLT: Yes. I move that Mr. Larsen's exhibits be admitted into evidence.

COMMISSIONER BROWN-BLAND: All right. There being no objections, the exhibits filed with Mr. Larsen's direct testimony will be received into evidence.

(Whereupon, Larsen Exhibits A, B and Revised C were admitted into evidence.)

MS. HOLT: We have no further witnesses.

COMMISSIONER BROWN-BLAND: All right. Is there anything else to come before the Commission from either of the parties, the Intervenors?

MS. GRIGG: No, ma'am.

COMMISSIONER BROWN-BLAND: We'll just note for the record that Mr. McKinney joined us a short time ago, substituting for Mr. Olls.

All right. What -- would the parties be able to make proposed hearing filings within 30 days from receipt of the mailing of the transcript? Is that acceptable to everybody?

MS. GRIGG: Yes, ma'am.

MS. FORCE: Yes.

COMMISSIONER BROWN-BLAND: Do you know any reason today why you could not do that?

MS. GRIGG: No, ma'am.

COMMISSIONER BROWN-BLAND: All right. Then that will be so ordered that the post-hearing filings be made within 30 days from the mailing of the transcript.

Well, it looks like we've come to an end on this, and I thank everybody for their patience and participation, and we will stand adjourned.

(The hearing was adjourned.)

STATE OF NORTH CAROLINA

COUNTY OF WAKE

C E R T I F I C A T E

I, Linda S. Garrett, Notary Public/Court Reporter, do hereby certify that the foregoing hearing before the North Carolina Utilities Commission in Docket No. G-5, Sub 565, was taken and transcribed under my supervision; and that the foregoing pages constitute a true and accurate transcript of said Hearing.

I do further certify that I am not of counsel for, or in the employment of either of the parties to this action, nor am I interested in the results of this action.

IN WITNESS WHEREOF, I have hereunto subscribed my name this 2nd day of September, 2016.

Linda S. Garrett

Linda S. Garrett
Notary Public No. 19971700150