

**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. W-354, SUB 344

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of	
Application by Carolina Water Service, Inc. of North)
Carolina, 2335 Saunders Road, Northbrook, Illinois)
60062, for Authority to Adjust and Increase Rates for)
Water and Sewer Utility Service in All of its Service)
Areas in North Carolina)
	STIPULATION

Carolina Water Service, Inc. of North Carolina ("CWSNC" or "Company"), Corolla Light Community Association, Inc. ("Community Association" or "CLCA"), and the Public Staff - North Carolina Utilities Commission ("Public Staff"), (collectively, the "Stipulating Parties"), through counsel and pursuant to Section 62-69 of the North Carolina General Statutes and Rule R1-24(c) of the Rules and Regulations of the North Carolina Utilities Commission (Commission), respectfully submit the following Stipulation for consideration by the Commission in this proceeding. The Stipulating Parties hereby stipulate and agree as follows:

1. Background.

A. On February 26, 2015, CWSNC gave notice of its intent to file a general rate case.

B. On March 31, 2015, CWSNC filed an application in this proceeding (1) seeking authority to increase and adjust its rates for water and sewer utility service in all of its service areas in North Carolina; (2) requesting authority for a pass-through of any increases in purchased bulk water rates, subject to sufficient

proof by CWSNC of the increase, as well as a pass-through of any increased costs of wastewater treatment performed by third parties and billed to CWSNC; and (3) to increase certain charges.

C. On April 30, 2015, the Commission issued its *Order Establishing General Rate Case and Suspending Rates*.

D. On May 15, 2015, the Community Association, a customer of CWSNC, filed a petition to intervene, which was granted by the Commission on May 19, 2015.

E. On May 22, 2015, the Commission issued its *Order Scheduling Hearings and Requiring Customer Notice*. On May 26, 2015, the Commission issued a *Reissued Order Scheduling Hearings and Requiring Customer Notice*; and on May 27, 2015, the Commission issued an *Errata Order* correcting an omission to one page in Appendix A-1 of its Order.

F. On June 8, 2015, CWSNC filed its Certificate of Service.

G. On July 1, 2015, CWSNC filed its Three-Year WSIC/SSIC Plan.

H. On July 16, 2015, CWSNC filed a report regarding customer concerns raised at the public hearing held in Jacksonville on June 23, 2015.

I. On August 6, 2015, CWSNC filed a report regarding customer concerns raised at the public hearing held in Raleigh on July 7, 2015.

J. On August 7, 2015, CWSNC filed a report regarding customer concerns raised at the public hearing held in Currituck on June 24, 2015.

K. On August 14, 2015, CWSNC filed a report regarding customer concerns raised at the public hearing held in Charlotte on July 8, 2015.

L. On August 21, 2015, CWSNC filed the direct testimony and exhibits of Company witnesses David Liskoff and Pauline M. Ahern.

M. On August 27, 2015, the Company filed revised testimony of David Liskoff regarding Appendix A-1 of his direct testimony.

N. On September 2, 2015, the Public Staff and CWSNC filed a Stipulation regarding cost of capital and capital structure issues.

O. On September 4, 2015, CWSNC filed a report regarding customer concerns raised at the public hearing held in Boone on July 22, 2015.

P. On September 8, 2015, the Company filed a report regarding customer concerns raised at the public hearing held in Asheville on July 23, 2015.

Q. On September 14, 2015, the Public Staff filed a motion to extend the due date for the filing of Public Staff and Intervenor testimony in this docket to September 25, 2015, and for the filing of rebuttal testimony to September 30, 2015, which was granted by the Commission on September 16, 2015.

R. On September 25, 2015, the Public Staff filed a second motion to extend the due date for the filing of Public Staff and Intervenor testimony and for the filing of a settlement agreement among all parties to this docket to October 1, 2015, which was granted by the Commission on September 25, 2015.

S. On October 1, 2015, CWSNC, in compliance with the Commission's Order in the Sub 336 rate case requiring the Company to install meters and fully meter seven specified unmetered mountain systems before the evidentiary hearing in its next general rate case proceeding, filed a notice indicating it had complied with the Commission's Order and installed meters at all seven of the water systems and converted those systems to metered rates. Also on this date, the Stipulating Parties filed a Joint Motion to Reschedule Evidentiary Hearing and Extend Filing Dates (Joint Motion). In the Joint Motion, the Stipulating Parties requested that the Commission reschedule the evidentiary hearing in this docket to allow the Company time to conclude 10 nearly-completed or completed but not documented construction projects (Projects) so that those Projects might be included in the Company's cost of service once their final costs had been determined and requisite invoices and other documentation had been provided to the Public Staff for review and verification. Additionally, the Stipulating Parties requested that the Commission grant the Public Staff and Intervenors additional time to pre-file testimony supporting their stipulation and settlement agreement in this docket.

T. On October 2, 2015, the Chairman of the Commission entered a procedural order in this docket entitled *Order Rescheduling Evidentiary Hearing and Extending filing Dates*. In said Order, the Chairman granted the Stipulating Parties' Joint Motion to file recommended dates for evidentiary hearing and for filing of settlement-related testimony on or before Friday, October 9, 2015, and to convene the hearing scheduled for October 5, 2015, for receipt of customer

testimony only. The Commission tentatively agreed to hold the morning of Tuesday, October 20, 2015, on its calendar for resumption of the evidentiary portion of the case pending receipt of the Parties' final recommendations.

U. On October 9, 2015, the Stipulating Parties filed a Joint Motion Setting Forth Recommended Procedural Dates and to Excuse Witnesses. The Commission issued an Order on October 13, 2015, rescheduling the evidentiary hearing for October 20, 2015, adopting the procedural schedule proposed by the Stipulating Parties and excusing Company witnesses, David Liskoff and Pauline Ahern, from appearing at the October 20th evidentiary hearing.

V. Subsequent to the filing of the Company's Application in this docket, the Public Staff engaged in substantial discovery of CWSNC regarding the matters addressed by the Company's Application and further examined the relevant books and records of CWSNC with respect to the Company's Application. The Public Staff's discovery efforts spanned a period of twenty-two weeks, entailed thirty-nine sets of data requests directed to the Company and numerous informal follow-up questions, and involved three days of on-site audit activities at the Company's corporate headquarters in Northbrook, Illinois. The Public Staff also conducted field inspections of the water systems at Crystal Mountain, Powder Horn, Ski Mountain, Sugar Mountain, Linville Ridge, Mason Landing, and Belvedere, and the sewer systems at Nags Head, Danby, Ashley Hills North and Belvedere; followed up on written customer protests and concerns raised at the public hearings and through e-mails and letters; and reviewed North Carolina Department of Environment and Natural Resources (DENR) records.

W. Following completion of the Public Staff's investigation of the Company's Application and accompanying documents, review of the results of its examination of the Company's books and records, and review of the Company's responses to the Public Staff's data requests, the Stipulating Parties met and participated in meetings and conference calls over the course of several business days to discuss possible settlement.

X. After significant negotiations, in which substantial concessions from their litigation positions were made by all parties, the Stipulating Parties were ultimately able to arrive at a settlement, the terms of which are reflected in the following sections of this Stipulation and the schedules and exhibits attached hereto. The Stipulation involved substantial adjustments to the Company's filed case, as shown on the revenue reconciliation attached hereto as Exhibit B, and resulted in an agreement to increase the Company's combined water and wastewater revenues by approximately 16.11% percent of the Company's total operating revenues or roughly 75.62% percent of the combined rate increase requested in the Application.

Y. On October 15, 2015, the Public Staff pre-filed the testimony and exhibits of Public Staff witnesses Windley Henry, Katherine A. Fernald, Fenge Zhang, Gina Y. Casselberry, and Calvin C. Craig, III. CWSNC has reviewed the Public Staff's pre-filed testimony and exhibits and accepts the Public Staff's recommended revenue requirements, rate design, and other recommendations.

Z. The Stipulating Parties agree that the levels of rate base, revenues and expenses set forth in Henry Exhibit I, which are incorporated by reference herein, are the appropriate levels for use in this proceeding.

2. Test Period. The test period for this rate case is the twelve months ended December 31, 2014, adjusted for certain changes in plant, revenues, and costs that were not known at the time the case was filed but are based upon circumstances occurring or becoming known through July 31, 2015. In addition, several major construction projects completed and placed in service by the date of this Stipulation, have been included in rate base.

3. Rate Base. The original cost rate base used and useful in providing service to the Company's customers is \$30,984,960 for CWSNC water operations, \$18,868,610 for CWSNC sewer operations, \$6,668,286 for Corolla Light/Monterey Shores (CLMS) sewer operations, and \$2,092,182 for Nags Head sewer operations, for a total rate base for combined operations of \$58,614,038, as shown on Exhibit A attached hereto and incorporated herein by reference.

4. Revenue Requirement.

A. The appropriate present level of operating revenues under present rates for use in this proceeding is \$9,455,466 for CWSNC water operations, \$5,726,688 for CWSNC sewer operations, \$1,116,656 for CLMS sewer operations, and \$692,904 for Nags Head sewer operations, for a total level of operating revenues for combined operations of \$16,991,714 as shown on Exhibit A.

B. The overall level of operating expenses under the present rates appropriate for use in this proceeding is \$7,770,065 for CWSNC water operations, \$4,823,608 for CWSNC sewer operations, \$788,610 for CLMS sewer operations, and \$531,327 for Nags Head sewer operations, for a total level of operating revenues under present rates for combined operations of \$13,913,611 as shown on Exhibit A.

C. As agreed to in the Stipulation between CWSNC and the Public Staff regarding cost of capital and capital structure issues, dated September 2, 2015, the capital structure appropriate for use in this proceeding is a capital structure consisting of 51% common equity and 49% long-term debt at a cost of 6.6% as shown on Exhibit C.

D. As agreed to in the Stipulation dated September 2, 2015, between CWSNC and the Public Staff, the rate of return on common equity (ROE) that the Company should be allowed an opportunity to earn is 9.75%, as shown on Exhibit C. This agreed level of ROE represents a significant compromise by each of the Stipulating Parties from their respective litigation positions. For purposes of this proceeding, this agreed ROE is deemed by each Stipulating Party to be a reasonable rate of return on common equity that will provide the Company with a reasonable opportunity, by sound management, to produce a fair return for its shareholders, considering changing economic conditions and other factors, to maintain its facilities and services in accordance with the reasonable requirements of its customers in the territory covered by its franchises, and to compete in the market for capital funds on terms that are fair to its customers and to its existing

investors. Each of the Stipulating Parties further agrees that such agreed rate of return on common equity, together with the agreed capital structure and adjustments to the Company's rate base and operating expenses, results in a revenue requirement that is just and reasonable to the Company's customers in light of changing economic conditions.

E. The overall rate of return that the Company should be allowed an opportunity to earn on its rate base is 8.20%, as shown on Exhibit C.

F. The Stipulating Parties acknowledge that CLMS and the other Outer Banks (OBX) systems were designated for separate rate treatment in Docket No. W-354, Sub 314, based, in part, on anticipated changes in the water systems serving those areas, the cost of the substantial upgrade of the wastewater treatment plant that was to serve the CLMS service area, and the expectation that all of the OBX systems, which included CLMS and Nags Head, would be sold. Only one of these changes – the upgrade of the CLMS wastewater treatment plant – actually occurred. The water systems were sold to Currituck County, and the sale of the sewer systems did not take place. As a result of the establishment of separate rates, the customers of the OBX systems experienced significantly higher percentage sewer rate increases in Docket No. W-354, Sub 327, than customers in other areas served by the Company under uniform rates. In recognition of these circumstances and events, in Docket No. W-354, Sub 336, the Public Staff, CWSNC and CLCA entered into a stipulation agreement, which was approved by the Commission, to keep the sewer rates for CLMS unchanged, thus beginning the process of moving CLMS toward uniform rates.

In the present docket, the Public Staff again evaluated the rate disparity between the customers in CLMS and Nags Head when compared to CWSNC's uniform sewer customers, the unique character of the OBX service area, which distinguishes it from other uniform sewer service areas, and the significant impact on the Company's uniform sewer rates if CLMS and Nags Head were immediately rolled back in. While it is the Stipulating Parties' opinion that system-specific sewer rates for the OBX should eventually be eliminated, in order to prevent "rate shock" for CWSNC's uniform sewer customers, the Stipulating Parties agree that the process should be implemented gradually and reevaluated in future rate case proceedings to determine the appropriate consideration that should be given to uniform rate customers and OBX customers in light of the facts and circumstances that exist at that time. Therefore, as a further step in the process, the Stipulating Parties recommend that in this proceeding the current system-specific sewer rates for CLMS and Nags Head remain unchanged from those previously established.

G. The Company should be authorized to increase its annual level of operating revenues through the rates and charges approved in this case by \$2,737,728, consisting of an increase for CWSNC water operations of \$1,355,194, an increase for CWSNC sewer operations of \$1,382,534, and no change in revenues for CLMS and Nags Head. After giving effect to these increases, the annual operating revenues for the Company would be \$19,729,442, consisting of \$10,810,660 for CWSNC water operations, \$7,109,222 for CWSNC sewer operations, \$1,116,656 for CLMS for sewer operations, and \$692,904 for Nags Head sewer operations, as shown on Exhibit A.

H. The Company should be allowed to increase its new sewer customer charge from \$20.70 to \$22.00, increase the return check fee from \$14.11 to \$25.00 for Nags Head; increase the meter testing fee from \$19.20 to \$20.00, new water customer charge from \$25.92 to \$27.00, reconnection charge for commercial customers from \$25.92 to \$27.00, and return check charge from \$24.00 to \$25.00 for the Linville Ridge Subdivision.

5. Rate Design. The Stipulating Parties agree to the changes in rates set forth in Exhibit D. Exhibit E shows the calculation of the average monthly residential bills.

6. Belvedere Pump and Haul Costs. The Stipulating Parties agree that CWSNC's pump and haul expenses and the new spray charges are not a part of Belvedere's system modification project, but are a result of an extraordinary expense and should continue to be amortized for a 10-year amortization period with no unamortized balance included in rate base. For the Belvedere pump and haul costs, only invoiced costs should be included, and not capitalized time or interest during construction.

7. Regulatory Fee Adjustment. The Stipulating Parties agree that the revenue requirement set forth herein reflects the statutory regulatory fee rate of 0.148%, applied to total operating revenues at present rates, Company proposed rates and Public Staff recommended rates.

8. State Income Tax. On July 23, 2013, North Carolina Session Law 2013-316 (House Bill 998) was signed into law. Among other things, House Bill 998

added a new section, G.S. 105-130.3C, to the general statutes concerning possible future rate reductions in the corporate state income tax rate. On August 6, 2015, the North Carolina Department of Revenue announced that, pursuant to this new section, the target for the fiscal year ended 2014-2015 had been met, and the state corporate income tax rate will decrease from the current rate of 5% to 4%, effective for taxable years beginning on or after January 1, 2016. The Stipulating Parties agree that it is reasonable and appropriate to calculate state income taxes based on the statutory corporate rate effective January 1, 2016, of 4%.

9. Excess Deferred Income Tax. Due to the reduction in the state income tax rate from 6.9% to 5%, the Company has excess deferred income taxes. In its May 13, 2014, Order issued in the Docket No. M-100, Sub 138, the Commission ordered that excess deferred taxes for all utilities be held in a deferred tax regulatory liability account until they can be amortized as credits to income tax expense in each utility's next general rate case proceeding. The Stipulating Parties agree that the regulatory liability related to excess deferred income taxes should be amortized over three years, consistent with the amortization period for rate case expense. Since the North Carolina Department of Revenue has announced that the target has been met and the state corporate income tax rate will decrease to 4% effective January 1, 2016, the Stipulating Parties also agree that the excess deferred taxes related to the decrease from 5% to 4% in the regulatory liability also should be amortized over three years.

10. Gain on Sale Unamortized Balance. The Stipulating Parties agree that the unamortized balance of the gain on sale of systems sold to CMUD as of December 31, 2015, should be amortized over an additional three-year period.

11. Rate Case Expense. The Stipulating Parties agree that, for purposes of this rate case, it is appropriate to use rate case costs of \$448,525, consisting of \$304,330 related to the current proceeding and \$144,195 of unamortized rate case expense from prior proceedings, to be amortized and collected over a three-year period, for an annual level of rate case expense of \$149,508.

12. WSIC and SSIC Mechanism. The Stipulating Parties acknowledge that the Commission rulemaking in Docket No. W-100, Sub 54 establishing the procedures for implementing and applying the Water System Improvement Charge (WSIC) and Sewer System Improvement Charge (SSIC) approved in the CWSNC Sub 336 rate case now apply to Linville Ridge and Nags Head, which were not included in the prior rate case application. Thus, CWSNC's Commission-authorized WSIC/SSIC rate adjustment mechanism will, on a going-forward basis, now apply to all of the Company's customers and all current service areas. The Stipulating Parties further agree that the On-Going Three-Year WSIC/SSIC Plan filed by CWSNC in this docket on July 1, 2015, is reasonable and meets the requirements of Commission Rules R7-39(m) and R10-26(m).

13. Agreement to Support Settlement; Non-Waiver. The Stipulating Parties will support this Stipulation in any proposed order or brief and in any hearing before the Commission in this docket; provided, however, that the settlement of any issue

pursuant to this Stipulation shall not be cited as precedent by any of the Stipulating Parties in any other proceeding or docket before this Commission. The provisions of this Stipulation do not necessarily reflect any position asserted by any of the Stipulating Parties. Rather, the provisions of this Stipulation reflect a settlement among the Stipulating Parties as to all issues, and no Stipulating Party waives the right to assert any position in any future docket before the Commission.

14. Final Order and Waiver of Right to File Exceptions and Appeal. The Stipulating Parties agree that any Order approving rates and charges agreed to in this Stipulation may become the Final Order of the Commission upon issuance and waive the right to file exceptions and appeal the Final Order of the Commission incorporating the matters stipulated herein.

15. Introduction/Withdrawal of Testimony and Waiver of Cross-Examination. The Stipulating Parties agree that all Company pre-filed testimony and exhibits, as well as the testimony and exhibits filed by the Public Staff in support of the Stipulation, may be introduced into evidence without objection, and the Stipulating Parties waive their respective right to cross-examine all witnesses with respect to all such pre-filed testimony and exhibits. If questions should be asked by any person, including a Commissioner, who is not a Stipulating Party, the Stipulating Parties may present testimony and/or exhibits to respond to such questions and may cross-examine any witnesses with respect to such testimony and/or exhibits; provided, however, that such testimony, exhibits, and/or cross-examination shall not be inconsistent with this Stipulation. The Stipulating Parties

further agree that the Public Staff will file testimony in support of the Stipulation provided that such testimony shall not be inconsistent with this Stipulation.

17. Binding Only if Entire Stipulation Accepted. This Stipulation is the product of give-and-take negotiations, and no portion of this Stipulation shall be binding on the Stipulating Parties unless the entire Stipulation is accepted by the Commission. The terms and conditions set forth above represent, in full, the agreement of the Stipulating Parties.

The foregoing is agreed and stipulated to this the 15th day of October, 2015.

Carolina Water Service, Inc. of North Carolina

By: Electronically submitted
/s/ Jo Anne Sanford
Sanford Law Office, PLLC
Post Office Box 28085
Raleigh, North Carolina 27611-8085
(919) 829-0018
sanford@sanfordlawoffice.com

Corolla Light Community Association, Inc.

By: Electronically submitted
/s/ Dwight W. Allen
The Allen Law Offices, PLLC
1514 Glenwood Ave., Suite 200
Raleigh, North Carolina 27608
dallen@theallenlawoffices.com

Public Staff - North Carolina Utilities
Commission

By: Electronically submitted
/s/ Gina C. Holt
Staff Attorney
4326 Mail Service Center
Raleigh, North Carolina 27699-4326
(919) 733-6110
gina.holt@psncuc.nc.gov

Electronically submitted
/s/ William E. Grantmyre
Staff Attorney
4326 Mail Service Center
Raleigh, North Carolina 27699-4326
(919) 733-6110
william.grantmyre@psncuc.nc.gov

SCHEDULE OF EXHIBITS

Exhibit A	-	Net Operating Income, Rate Base and Overall Return
Exhibit B	-	Revenue Impact of Stipulated Adjustments
Exhibit C	-	Calculation of Gross Revenue Effect Factors
Exhibit D	-	Rate Comparisons
Exhibit E	-	Calculation of Average Monthly Residential Bills