STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. W-354, SUB 364

In the Matter of Application of Carolina Water Service, Inc. of North Carolina for Authority to Adjust and Increase Rates for Water and Sewer Utility Service in All of its Service Areas in North Carolina.	)))))	REBUTTAL TESTIMONY OF DANTE DESTEFANO ON BEHALF OF CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA

Pre-Filed Rebuttal Testimony
of
Dante DeStefano

On Behalf of
CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA

November 20, 2019

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS FOR THE RECORD.

A. My name is Dante DeStefano and I am employed as the Director of Financial Planning and Analysis for Carolina Water Service, Inc. of North Carolina ("CWSNC" or "Company"), 4944 Parkway Plaza Boulevard, Suite 375, Charlotte, North Carolina 28217. Effective October 1, 2019 my title changed from Manager of Financial Planning and Analysis to Director of Financial Planning and Analysis for CWSNC.

Q. ARE YOU THE SAME DANTE DESTEFANO WHO SUBMITTED CASE-IN-CHIEF AND SUPPLEMENTAL TESTIMONY ON BEHALF OF CWSNC IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to identify points of agreement between the positions of Public Staff and the Company, as well as explain where and why the Company disagrees with certain recommendations of the Public Staff. Mr. Mendenhall's rebuttal testimony addresses the issue of water loss, and Mr. D'Ascendis' rebuttal testimony addresses the issue of cost of equity. I will also address witness Casselberry's comments regarding the Company's billing data as supplied in this proceeding.

Q. HAVE YOU REVIEWED THE FILED DIRECT TESTIMONY AND THE SUPPLEMENTAL EXHIBITS OF THE PUBLIC STAFF WITNESSES, INCLUDING ALL RELATED EXHIBITS AND REVISED EXHIBITS?

A. Yes.

Q. DOES THE COMPANY AGREE WITH ANY OF PUBLIC STAFF'S ADJUSTMENTS TO THE COMPANY'S REQUESTED REVENUE REQUIREMENT?

A. Yes. The Company believes it is in agreement with the Public Staff on a number of adjustments to the filing, as a result of the ordinary negotiated process of mutual correction of errors, explanations, and provision of additional information, which was largely completed just prior to the Public Staff's filing of Revised Exhibits on Monday, November 18, 2019. It should be noted that the Public Staff and the Company anticipate filing a Joint Partial Stipulation of Settlement prior to the evidentiary hearing in this proceeding. It will both memorialize the agreed-upon items, and will contain pertinent terms for other items still requiring further update (such as anticipated regulatory commission expenses incurred). As such, I will not speak to those items in this rebuttal testimony.

Q. DOES THE COMPANY DISAGREE WITH ANY ADJUSTMENTS OR OTHER POSITIONS PUT FORTH BY THE PUBLIC STAFF IN ITS DIRECT TESTIMONY AND/OR REVISED EXHIBITS?

A. Yes. I will detail the Company's rebuttal regarding the following issues in this proceeding:

- Appropriateness of deferred accounting treatment for the Company's automated meter reading ("AMR") installation projects;
- Plant Acquisition Adjustment ("PAA") amortization expense;

- Rent expense related to the Water Service Corporation ("WSC") Chicago office;
- Insurance expense related to property coverage;
- Application of Hurricane Florence insurance proceeds;
- Storm Recovery expense and the Storm Reserve Fund;
- Tariff Rate Design;
- Proposed Conservation Rate Pilot Program ("Pilot Program"); and
- Proposed Consumption Adjustment Mechanism ("CAM").

Q. WHAT ACCOUNTING AND RATEMAKING DID THE COMPANY PROPOSE WITH RESPECT TO ITS AMR PROJECTS?

A. In a contemporaneously filed petition under Docket No. W-354, Sub 365 ("Sub 365"), the Company sought Commission authority to defer its net post-in-service depreciation and financing costs related to its AMR installation projects in the Fairfield Mountain and Connestee Falls systems, as well as its replacements of the wastewater treatment plants ("WWTPs") at the Nags Head and Connestee Falls systems, from the in-service dates until the date of an Order in this rate case.[1] Our revenue requirement calculations in this case reflect deferral and subsequent recovery through rates of the resulting deferred amounts for each of the four capital projects.

Q. WHAT IS PUBLIC STAFF'S POSITION ON THE COMPANY'S PROPOSAL?

[1] Procedural note: The Company has requested merger of the Sub 365 "deferral" docket with the instant, Sub 364 rate case application docket. The Commission has since ruled to consolidate the Sub 365 docket with this proceeding and the Sub 363 docket.

A. As noted in the Public Staff comments filed under Sub 365 on September 20, 2019, and witness Henry's Direct Testimony in this proceeding, the Public Staff opposes the deferral and subsequent recovery of the carrying costs for the two AMR projects. Witness Henry testifies that the AMR projects are not sufficiently unusual, extraordinary, or material to qualify for deferred accounting treatment.

Q. DO YOU AGREE WITH THE PUBLIC STAFF'S POSITION? IF NOT, PLEASE EXPLAIN WHY.

A. No. Our reply comments filed in the Sub 365 case, incorporated herein by reference and included as Attachment 1 to this testimony for convenience, explain why the Company believes the AMR installation project costs should be eligible for deferred accounting treatment. To briefly summarize those reply comments:

- Contrary to the Public Staff's assertion, major technological upgrades such as the Company's AMR meter projects are the type of projects for which deferred accounting is appropriate. The AMR program involves the mass replacement and technological upgrade of meters in certain targeted geographical areas, as opposed to the typical individual meter replacements that occur due to aging or damaged individual meters. This AMR program differs dramatically from individual meter replacements in scope, scale, purpose, and financial impact.
- The financial impact to the Company of all of its projects for which deferred accounting has been proposed (two WWTP projects and two

AMR projects) is significant and material, and it is appropriate to consider the totality of the adverse regulatory lag impacts. All four projects are part of the Company's pending general rate case and all four of the projects, though beneficial to customers, combine to adversely impact the Company's financial condition due to regulatory lag. Accordingly, all four projects should be evaluated collectively for deferred accounting treatment, rather than separately.

- If only the isolated financial impact of the AMR meter projects is considered, that financial impact supports deferred accounting treatment, especially in light of the Company's current earned ROE. Without deferred accounting treatment for the AMR meter projects, the Company will, according to Public Staff, experience approximately a 22-basis point negative impact on its earned ROE. At the same time, the Company is not earning a return anywhere close to its current authorized overall rate of return of 7.75%. Indeed, the Company's actual earned overall rate of return during the test year for this rate case was only 3.69%.

Q. WHAT DID THE COMPANY PROPOSE WITH RESPECT TO CALCULATION OF PAA AMORTIZATION EXPENSE?

A. The Company's revenue requirement utilized the approved PAA amortization rates from the Docket W-354, Sub 360 ("Sub 360") Final Order -- 2.47% and 3.53% for its Water and Sewer Rate Divisions, respectively.

Q. WHAT DOES PUBLIC STAFF PROPOSE WITH RESPECT TO PAA AMORTIZATION EXPENSE?

A. Public Staff Witness Feasel proposes an adjustment to the PAA-related accumulated amortization amounts to include actual general ledger additions made on the Company's books as of September 30, 2019. Ms. Feasel also proposes to adjust PAA amortization to include an annualized level of amortization based on Public Staff's adjusted level of PAA amortization expense. The Public Staff's amortization expense is based on Public Staff's recommended level of PAA times an amortization percentage equal to the composite depreciation rate for the Staff's adjusted level of direct plant in service for each Rate Division.

Q. DO YOU AGREE WITH THE PUBLIC STAFF'S PROPOSAL?

A. CWSNC does not object to the Public Staff position on the levels of PAA and related accumulated amortization; however, the Company disagrees on the PAA amortization rates to be used. The Sub 360 Order authorized specific PAA rates and we are proposing to use those same authorized rates in this proceeding. In contrast, the Public Staff is proposing the same basis for amortization rates as it proposed in Sub 360, which the Commission rejected in that case.

Q. WHAT DID THE COMPANY PROPOSE WITH RESPECT TO RENT EXPENSE RELATED TO THE WSC'S CHICAGO OFFICE?

A. The Company proposed in its initial filing a rent expense level per the lease agreement for the new office located at 550 West Monroe, calculated as a straight-line average of the 15-year term scheduled payments. The Company provided an updated calculation to Public Staff subsequent to its October 4, 2019 update filing in this proceeding, which utilized a similar straight-line average calculation, but included the impact of rent abatements, also calculated as a straight-line average over the 15-year lease term.

Q. WHAT DOES PUBLIC STAFF PROPOSE WITH RESPECT TO RENT EXPENSE?

A. Public Staff witness Feasel, per Revised Exhibit I, Schedule 3-11, proposes to adjust the rent expense for the Chicago office lease based on the upcoming year's scheduled rental expense per the lease, offset by a straight-line credit from the total abatements and tenant improvement credits over the life of the lease.

Q. DO YOU AGREE WITH THE PUBLIC STAFF'S PROPOSAL REGARDING RECOVERY OF RENT EXPENSE FOR THE CHICAGO OFFICE? IF NOT, PLEASE EXPLAIN WHY.

A. The Company recommends the expenses that will be actually booked on a known and measurable basis be utilized for ratemaking in this proceeding. The Chicago office lease payment schedule, notwithstanding the aforementioned rent incentives, requires escalating payments that increase by 3% annually. The Company believes that proper accounting consistent with Generally Accepted Accounting Principles requires the total lease incentives (i.e., abatements and improvement credits) to be combined with the total scheduled lease payments for the lease term and a straight-line average of the net expense be booked to rent expense.[2] In effect, the accounting requirements necessitate a straight-line recognition of scheduled rent payments and rent incentives, which is consistent with the Company's updated position, while Public Staff's position does not utilize a straight-line recognition of the scheduled rent payments. The Company therefore recommends rent expense inclusion in the revenue requirement consistent with the proper accounting that the Company expects to follow.

Q. WHAT DID THE COMPANY PROPOSE WITH RESPECT TO INSURANCE EXPENSE?

A. The Company's application proposed insurance expense of $664,043. The Company's October 4, 2019 update filing adjusted this amount to $847,827, inclusive of estimated policy renewal premiums that were not yet finalized. Corix Infrastructure Inc. ("CII" or "Corix"), the parent company of UI, has recently completed a thorough review of its various insurance policies which has resulted in some consolidation and resetting of coverage levels. The supporting documentation has only become

[2] See FASB Technical Bulletin 85-3, Response 2: https://www.fasb.org/cs/BlobServer?blobkey=id&blobwhere=1175820930623&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs;

FASB Technical Bulletin 88-1, Response 7: https://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175820928519&blobheader=application/pdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=107679&blobheadervalue1=filename=ftb_88-1.pdf&blobcol=urldata&blobtable=MungoBlobs;

available as of November 12, 2019, so Public Staff did not have an opportunity to reflect this new information in its Direct Testimony. The Company has since provided to the Public Staff updated insurance premium calculations, as well as third-party documentation supporting the policy renewal premiums effective November 1, 2019. Of note, the Company's property policy was consolidated with its Corix parent's various subsidiaries and will be allocated based on property replacement cost values covered for each subsidiary.

Q. WHAT DOES PUBLIC STAFF PROPOSE WITH RESPECT TO INSURANCE EXPENSE?

A. Public Staff Witness Feasel has updated her testimony position via Revised Exhibit I, Schedule 3-12. This revised position accounts for the updated policy premium information provided by the Company, and utilizes an allocation methodology for property insurance coverage based on CWSNC's proportion of covered property within the consolidated group.

Q. DO YOU AGREE WITH THE PUBLIC STAFF'S PROPOSAL IN REVISED EXHIBIT I, SCHEDULE 12? IF NOT, PLEASE EXPLAIN WHY.

A. The Company recognizes that the update of insurance policy renewal information to the Public Staff did not initially include an updated Schedule of Values ("SOV") which supports CWSNC's proportion of the overall consolidated group of property covered. The Company has since provided support for the property coverage levels for the Corix subsidiaries to the

Public Staff and recommends that the premium of $1,877,143 (less commission fees billed separately) for Corix's US subsidiaries be allocated based on CWSNC's 17.54% proportion of property covered in the updated SOV, resulting in a CWSNC allocated expense of $279,912.

Q. WHAT DID THE COMPANY PROPOSE WITH RESPECT TO RECOGNITION OF HURRICANE FLORENCE INSURANCE PROCEEDS?

A. Subsequent to the filing of the current rate case, the Company received proceeds from its insurer for a portion of the costs incurred that were related to damage sustained from Hurricane Florence on its water and sewer systems. In its October 4, 2019 update filing, the Company recognized as a regulatory liability the receipt of insurance proceeds that recovered costs incurred to replace damaged assets due to Hurricane Florence, which struck North Carolina in September 2018. The Company also recognized a portion of the proceeds received as an offset to operating expenses requested to be deferred in Docket No. W-354, Sub 363 ("Sub 363"), since consolidated with the current proceeding. It should be noted that the Company received an overpayment of its requested claims, as the insurance company provided reimbursement of contractor costs that had not been paid by the Company but were directly reimbursed to the contractors themselves, and only included in its update filing the actual proceeds amount received net of overpayment. The Company has a significant dollar amount for a second claim submission still under review by its insurer, and there is therefore a potential for further proceeds to be received in the next few months.

Q. WHAT DOES PUBLIC STAFF PROPOSE WITH RESPECT TO RECOGNITION OF HURRICANE FLORENCE INSURANCE PROCEEDS RECEIVED TO-DATE?

A. Public Staff Witness Feasel proposes to apply the insurance proceeds proportionally across the capital investments made for replacement of damaged assets, as well as across the requested deferred operating expense activity. However, the Public Staff calculation also includes the portion of funds received that is an overpayment of claims resolved to-date. The Public Staff has noted to the Company that it is applying the overpayment funds against the Company's replacement assets and operating expenses deferred to reflect the full amount of proceeds received.

Q. DO YOU AGREE WITH THE PUBLIC STAFF'S PROPOSED RECOGNITION OF HURRICANE FLORENCE INSURANCE PROCEEDS RECEIVED? IF NOT, PLEASE EXPLAIN WHY.

A. The Company recommends that the actual proceeds received, excluding overpayments, be utilized for offsetting the Company's incurred capital and operating costs related to Hurricane Florence. The Company has also stressed to the Public Staff, and in this testimony, that should no further claims be deemed recoverable from insurance, it would return the overpayment to the insurer. While it is possible that the Company could recover additional funds from its insurer due to still-pending claims being resolved favorably, it would be improper and an unfair penalty to CWSNC to recognize amounts beyond those known and measurable for claims resolved to-date in this proceeding. For these reasons, CWSNC requests that the Commission reject the Public Staff's adjustment.

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED STORM RESERVE FUND AND RELATED STORM RECOVERY EXPENSE.

A. The Company proposed the establishment of a Storm Reserve Fund, which would initiate a surcharge to customers in order to fund a $250,000 reserve to be utilized when expenses are incurred due to storm events that exceed the level of storm recovery costs included in base rates. The Company recommended using a three-year average of storm expenses, excluding Hurricane Florence expenses from 2018, to be used for setting base rates.

Q. WHAT DOES PUBLIC STAFF PROPOSE WITH RESPECT TO STORM RECOVERY EXPENSE AND THE PROPOSED STORM RESERVE FUND?

A. The Public Staff opposes the creation of the Storm Reserve Fund, on the basis that the Company's proposal would ensure an over-recovery and therefore is unfair to customers. Further, Public Staff proposes to use a ten-year average of storm costs to set the amount of storm recovery expense to include in base rates.

Q. DO YOU AGREE WITH THE PUBLIC STAFF'S PROPOSAL?

A. Yes, in part. We do not agree with Public Staff's position rejecting the creation of a Storm Reserve Fund. First, as history demonstrates, storm recovery costs can be volatile, unpredictable, and largely beyond the Company's control. Additionally, as seen with Hurricane Florence and demonstrated in Sub 363, a single storm event can cause material impacts to the Company's financial status. The use of a reserve fund will allow the Company to recover the true costs of storm damage recovery without the need to use other funds already allocated to other necessary activities. As noted by witness Henry in his direct testimony, building an estimated amount into base rates by definition will either over-compensate or under-compensate the utility for its storm damage remediation costs. However, absent filing for deferred accounting treatment, as was done in Sub 363, the Company has no available recourse to recover costs related to major storm events. Our proposal for a Storm Reserve Fund recognizes that the cost to restore service following a storm is a reasonable and necessary cost of providing service and, because this can be volatile, the proposed reserve fund provides a means to reflect in the price for water and wastewater service the cost of storm damage recovery. Further, storm damage recovery is a vital utility activity, involving around-the-clock restoration efforts. Our proposed reserve fund mitigates the potential for a catastrophic storm to erode the Company's earnings and impair the Company's financial ability; impacts that adversely affect customers because they lead to increasing capital costs and diminish resources for other needs.

While we differ with the Public Staff's position on the propriety of a Storm Reserve Fund, we recognize the Public Staff's point that our proposed reserve fund is asymmetrical with regard to the level of costs recovered in base rates. Accordingly, we revise our Storm Reserve Fund proposal as follows: CWSNC will track the balance of the storm recovery costs, calculating any over-recovery or under-recovery by comparing the level of storm damage expenses in comparison to recovery in base rates. If the incurred expense is less than the amount reflected in the revenue requirement, the Company will defer the over-recovery to the Storm Reserve Fund regulatory liability; if the incurred expense exceeds the amount included in the revenue requirement, the Company will draw from the Storm Reserve Fund regulatory liability to offset the excess expenses. The cumulative net regulatory liability balance would be maintained at the $250,000 threshold as originally requested, and the inclusion of over-recoveries that occur would mitigate the need for customer charges to replenish the fund. To accomplish this regulatory liability accounting, the Commission's Order should provide for prospective rate adjustments related to the reserve fund, either upward or downward, to recover from customers or return to customers the variance from the $250,000 threshold in the regulatory liability balance.

Finally, we disagree with the Public Staff's proposal to calculate the amount of storm damage recovery expenses in base rates using a 10-year historical average of such costs. Again, recent history suggests that storm activity is increasing in frequency and severity. Additionally, setting the expense recovery level at a 3-year average allows for a higher baseline recovery level, allowing for greater possibility of additional funds being generated to replenish the Storm Reserve Fund as modified above and mitigate the need for surcharges. For these reasons, we believe the proposed 3-year average of storm damage recovery costs should be used to set the amount to be reflected in base rates.

Q. WHAT DID THE COMPANY PROPOSE WITH RESPECT TO A CONSERVATION RATE PILOT PROGRAM IN THIS PROCEEDING?

A. In our application, we proposed a Conservation Rate Pilot Program be initiated for The Point Subdivision, along with a Revenue Adjustment Mechanism, in response to the NCUC's Docket No. W-100, Sub 59 ("Sub 59").

Q. WHAT DOES THE PUBLIC STAFF PROPOSE WITH RESPECT TO THE COMPANY'S PROPOSED PILOT PROGRAM?

A. The Public Staff opposes the proposed Pilot Program and recommends that the Commission reject it. The Staff's primary rationale is that a Pilot Program should be applicable to all customers, not a small subset, and that The Point Subdivision customers are not average or typical customers within the Company's service area.

Q. WHAT IS THE COMPANY'S REBUTTAL POSITION WITH RESPECT TO THIS PROPOSED PILOT PROGRAM?

A. The Company has filed a notice to the NCUC withdrawing our proposed Pilot Program from consideration in this case. The Company notes that Sub 59 is still a pending docket with the NCUC, and coupled with the recently initiated Docket No. W-100, Sub 61 ("Sub 61"), expects the considerations that prompted the Company's proposed Pilot Program to be resolved in the Sub 59 and Sub 61 proceedings.

Q. WHAT DID THE COMPANY PROPOSE WITH RESPECT TO A CONSUMPTION ADJUSTMENT MECHANISM?

A. I submitted supplemental testimony on August 2, 2019 which proposed a Consumption Adjustment Mechanism be approved in this Docket, after the passage of authorizing legislation by the North Carolina General Assembly, signed by the Governor on July 8, 2019.

Q. WHAT IS THE PUBLIC STAFF'S POSITION WITH RESPECT TO THIS PROPOSED CONSUMPTION ADJUSTMENT MECHANISM?

A. The Public Staff opposes the Company's proposed consumption adjustment mechanism, and proposes an alternative mechanism that, among other things, includes a significant change in the Company's current rate design allocation of fixed and volumetric revenues for water and sewer.

Q. WHAT IS THE COMPANY'S REBUTTAL POSITION WITH RESPECT TO THE PROPOSED CONSUMPTION ADJUSTMENT MECHANISM?

A. Although the authorizing legislation for a consumption adjustment mechanism has been signed into law, the Company recently filed a notice with the NCUC that it is withdrawing its proposal for implementation of such a mechanism in this rate case. We recognize that the Commission has recently opened a rulemaking on this subject under Sub 61 which will provide guidance on the design and implementation of consumption adjustment mechanisms. Sub 61 will allow all interested regulated water companies in North Carolina to participate in a more comprehensive and thorough process than can be included in the scope of the current rate case. Additionally, the Company recognizes that the recent initiation of the rulemaking process results in a timeline that likely extends beyond the resolution of the current proceeding, especially considering the significant implications of such a mechanism to the setting of base rates and future regulatory proceedings and requirements.

Q. WHAT DID THE COMPANY PROPOSE WITH RESPECT TO RATE DESIGN?

A. The Company proposes to maintain the fixed and volumetric rate recovery proportions approved in Sub 360 by the Commission – a 52%/48% fixed/volume ratio for the uniform water rate division, and 80%/20% fixed/volume ratio for the uniform sewer rate division, as well as maintain the existing ratios for its Bradfield Farms/Fairfield Harbour/Treasure Cove rate divisions.

Q. WHAT DOES PUBLIC STAFF PROPOSE WITH RESPECT TO RATE DESIGN?

A. The Public Staff has proposed two recommended rate designs: one with a consumption adjustment mechanism and one without a consumption adjustment mechanism. The rate design without the consumption adjustment mechanism utilizes a 45%/55% ratio of fixed charge to volumetric charge for water, and a 65%/35% ratio of fixed charge to volumetric charge for sewer. These ratios are comparable to those proposed by the Public Staff in CWSNC's last rate case.

Q. DO YOU AGREE WITH THE PUBLIC STAFF'S PROPOSAL? IF NOT, PLEASE EXPLAIN WHY.

A. We do not agree with Public Staff's position concerning the fixed charge to volumetric charge ratios for water and sewer rate designs for the current proceeding, for several reasons. First, the Public Staff's proposed rate designs represent fairly significant changes, especially with regard to customer bill impacts. Given the potential for significant customer billing volatility and complaints (as occurred following the Company's W-354, Sub 336 rate case, which resulted in significant rate design changes for sewer customers), we believe a more cautious and incremental approach is prudent at this time. Additionally, as noted earlier in this testimony, the Commission is in the midst of a generic proceeding addressing rate design, as well as a rulemaking proceeding on a revenue-related alternative rate mechanism, and we believe it would be appropriate to wait for guidance from the Commission upon the conclusion of those generic proceedings before making any rate design changes in this proceeding – let alone the significant changes proposed by the Public Staff.[3] It is important to note that not only would customers' bills become more volatile under the Public Staff's proposal, but the Company's revenue levels would become more unstable as well. The Company agrees with the Commission's rationale in the Sub 360 Order, page 107, regarding the existing water ratio: "The Commission concludes that such rate design is fair and reasonable to both CWSNC and its customers as it appropriately balances the competing interests involved…" This rationale remains true in this proceeding, at least until we receive Commission guidance from the pending generic proceedings. Without a consumption adjustment mechanism authorized in this rate case, it is prudent and reasonable to maintain the current balance between fixed and volumetric charges in our rate structure until a large-scale policy and process is codified and implemented on a consistent basis for North Carolina water and sewer utilities, which would allow for more comprehensive and unified customer education measures and messaging as to the priorities and rationales behind the resulting rate design.

Q. DOES THE COMPANY HAVE A RESPONSE TO THE CONCERNS IN THE DIRECT TESTIMONY OF PUBLIC STAFF WITNESS CASSELBERRY RELATED TO BILLING DATA?

[3] In Public Staff witness Junis' testimony, page 18, it is acknowledged that the timing of the rulemaking Docket W-100, Sub 61 causes practicability concerns with implementing a consumption adjustment mechanism in the current proceeding.

A. Yes. The Company recognizes that witness Casselberry's identified several issues with the billing data provided by the Company in its initial filing. The Company worked with witness Casselberry during the case to reconcile the data in order to provide accurate information upon which rates can be set in this proceeding, and the Company does not object to witness Casselberry's pro-forma present rate revenues as a result.

It should be noted that the data provided in this proceeding was billing data, not active customer count data, which would more closely align with witness Casselberry's expectations as described on page 15, lines 18-30 of her Direct Testimony. Billing data should not be expected to be as stable as active customer count data, as it is subject to much more volatile activity on a going basis. For example, customers may receive a standard monthly bill in a particular month, but also a final bill at move-out in the same month, which would increase billed days and number of bills issued for that month. In addition, the Company's billing cycles may vary by a few days in order to align with scheduling of meter readers and weekends or holidays. This can cause some variability in billed days from month to month, as well as an occasional month where two reads are obtained and bills are released. These nuances are reasonable to reflect in a standard bill analysis that supports the activity in a given Test Year, though the Company recognizes that certain adjustments to this activity may be needed when considering pro-forma revenue projections.

The Company and its parent companies are in the process of implementing significant upgrades to their software packages and systems, and anticipate an improved capacity for robust reporting and data collection in the near future. Corix has also added a billing analyst to its staff that assists in creating custom reports to support regulatory and compliance requirements. The Company is anticipating no issues in complying with reporting or filing requirements or requests in future rate cases or that may emanate from authorized alternative rate mechanisms.

Q. IS THIS TESTIMONY TRUE AND ACCURATE TO THE BEST OF YOUR KNOWLEDGE, INFORMATION, AND BELIEF?

A. Yes, it is.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. W-354, SUB 365

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of Petition by Carolina Water Service, Inc. of North Carolina, 4944 Parkway Plaza Boulevard, Suite 375, Charlotte, North Carolina 28217, for Accounting Order to Defer Post-In-Service Depreciation and Financing Costs Relating to Major New Projects That Are or Will Be In-Service Prior to the Date of An Order in Petitioner's Pending Base Rate Case	)))))))))	REPLY COMMENTS REGARDING PETITION FOR AN ACCOUNTING ORDER TO DEFER POST-IN-SERVICE DEPRECIATION AND FINANCING COSTS RELATING TO MAJOR NEW PROJECTS

NOW COMES Carolina Water Service, Inc. of North Carolina ("CWSNC" or "Company") to file Reply Comments in support of CWSNC's Petition requesting the North Carolina Utilities Commission ("NCUC" or "Commission") to issue an accounting order for regulatory and financial accounting purposes authorizing the Company to establish a regulatory asset and defer incremental post-in-service depreciation expenses and financing costs associated with four major new projects that will be in-service prior to the effective date of an Order ("2020 Rate Order") in CWSNC's pending general rate case, Docket No. W-354, Sub 364.

In support of these Reply Comments and the Company's Petition, CWSNC states the following:

1. CWSNC filed its Petition for a deferral accounting order on June 28, 2019. The four major, new, and essential projects for which CWSNC seeks post-in-service deferred accounting treatment are:

- Connestee Falls Wastewater Treatment Plant ("WWTP")
- Nags Head WWTP
- Fairfield Mountain Automated Meter Reading ("AMR") Meters
- Connestee Falls AMR Meters

2. On July 18, 2019, the Commission entered an *Order Requesting Comments* in this docket. That Order allowed interested parties to file petitions to intervene by August 30, 2019, and set that same date for the Public Staff and any Intervenors to file initial comments. The Order further provided that all parties could file reply comments by September 30, 2019. The deadlines for filing initial and reply comments were subsequently extended by two Commission Orders to September 20, 2019, and October 21, 2019, respectively.

3. On September 20, 2019, the Public Staff filed Initial Comments in this docket. No other parties intervened or filed initial comments on that date. In Paragraph 10 of its initial comments, the Public Staff addressed the Company's request regarding its Nags Head and Connestee Falls WWTPs as follows:

> The Public Staff has evaluated the deferrals requested in CWSNC's petition against the criteria set forth above. Based on these criteria and other Commission precedent, the Public Staff does not oppose deferral accounting treatment for costs related to the WWTPs at Nags Head and Connestee Falls. These costs are related to major construction projects involving WWTPs that are not yet in service but are expected to be completed and in operation prior to the date of the evidentiary hearing in CWSNC's pending general rate case. The deferral accounting request was made contemporaneously with the filing of the rate case application, and the deferral period is not so long as to cause undue concern that the ratepayers who pay rates that include costs incurred to provide service during the deferral period may not be the same ratepayers who received the service. The impact of the costs, if not deferred, on the Company's ROE [return on equity] of 9.75% approved in the Sub 360 Rate Case will be significant. Without deferral, the

> Company's earnings can be expected to decline due to the WWTPs becoming plant in service. Thus, in the Public Staff's view, the WWTPs at Nags Head and Connestee Falls present the kind of circumstances in terms of nature, impact, and timing for which deferral accounting treatment may be appropriate.

4. In Paragraph 11 of its Initial Comments, the Public Staff addressed the Company's request regarding its AMR meter projects at Fairfield Mountain and Connestee Falls, in pertinent part, as follows:

> In regard to the installation costs of AMR meters in Fairfield Mountain and Connestee Falls, the Public Staff believes that CWSNC has failed to make a clear, complete, and convincing showing that the costs in question are of an unusual or extraordinary nature and, absent deferral, will have a material impact on the Company's financial condition….

5. In Paragraph 12, the Public Staff concluded its Initial Comments with the following recommendation:

> In conclusion, the Public Staff submits that the requested deferral accounting treatment with respect to the cost of the WWTPs at Nags Head and Connestee Falls be granted and that the requested deferral accounting treatment with respect to the AMR meters installed in Fairfield Mountain and Connestee Falls be denied in its entirety.

CWSNC's Reply Comments

CWSNC appreciates the position taken by the Public Staff in support of the Company's request for approval of deferral accounting with respect to the cost of the WWTPs at Nags Head and Connestee Falls. However, the Company opposes the Public Staff's position in opposition to CWSNC's request for approval of deferred accounting with respect to the installation of AMR meters at the Fairfield Mountain and Connestee Falls systems. CWSNC offers the following Reply

Comments in support of its position regarding AMR meters and in response to the Public Staff.

The Commission should authorize deferred accounting for the Company's Fairfield Mountain and Connestee Falls AMR meter projects for the following reasons: (1) contrary to the Public Staff's assertion, major technological upgrades such as the Company's AMR meter projects are the type of projects for which deferred accounting is appropriate; (2) the financial impact to the Company of all of its projects for which deferred accounting has been proposed is significant and material, and it is appropriate to consider the totality of the adverse regulatory lag impacts; but (3) even if only the isolated financial impacts of the AMR meter projects are considered, those financial impacts support deferred accounting treatment, especially in light of the Company's current earned ROE.

The Company has attached to these Reply Comments updated Schedules 1 and 2, which reflect the actual costs for the four projects, updated deferral calculation, and updated ROE impact. The figures noted throughout the comments below utilize the information in the updated Schedules 1 and 2.

Deferred Accounting Treatment is Appropriate for Major Investments in New Metering Technology. The Fairfield Mountain AMR meter project involves the installation of approximately 1,110 new automated meter reading meters at a cost of $449,560. The Connestee Falls AMR meter project involves the installation of approximately 1,419 new automated meter reading meters at a cost of $430,649. Together, these two AMR meter projects will result in a total investment by CWSNC of nearly $900,000 in used and useful utility plant to serve customers. These meter projects will benefit customers by minimizing estimated reads, re-reads, high/low reads, and water loss. These meter projects also provide safety and operational efficiency benefits to CWSNC and its employees.

At pages 7 - 8 of its Initial Comments, the Public Staff asserts that "…the Company's decision to upgrade does not change the nature of the typical and expected project of meter replacements." To the contrary, CWSNC asserts that replacing aged, manually-read, analog meters en masse with more modern remote-read meters, which require RF devices, touchpads and new software support to be properly utilized, is a significant — not typical — change in the operating processes and nature of service for both the Company and its affected customers. Unlike typical meter replacements, which are made when an individual meter fails, is damaged, or is found to be inaccurate, the Company has embarked on a mass replacement of its aging analog meters with digital AMR meters in two mountainous service areas of its service territory. These AMR meter replacement projects have been undertaken to improve service, efficiency, and safety, through the use of advanced technology. These technology investments are quite different from the typical, individual meter replacements the Public Staff cites. The Company agrees that deferred accounting would not be appropriate for the typical, individual analog meter replacements that take place regularly across a utility system: such replacements could potentially meet the "in-kind" criterion for WSIC eligibility, which would present an alternative recovery option. However, the Fairfield Mountain and Connestee Falls AMR projects differ markedly in scope, scale, purpose, and financial impact from such routine meter change-outs.

Further, on page 8, the Public Staff states that: "Additionally, traditional meter and AMR meter replacement projects have not been proposed for deferral accounting in the past." Even if that is the case, this rationale is unpersuasive. These are among the first major implementations of AMR meters in the Company's system, and much more meter replacement work must be done in the coming years. The proposed rejection of deferred accounting here, as well as the inability of CWSNC to recover the costs of depreciation and a return on the full investment of AMR meters in a WSIC filing, has the effect of significantly penalizing the Company through denial of timely cost recovery for investments in modernizing its water system operations. If CWSNC's cost recovery for AMR meters is limited solely to a final decision in a general rate case (with no interim deferred accounting), the Company's earnings will be materially affected to its detriment.[1]

Moreover, state regulatory commissions have authorized deferred accounting in connection with meter replacement projects. *See, for example, In re Verified Petition of Southern Indiana Gas and Electric Company*, Cause No. 44910

[1] At page 8 of its Initial Comments, the Public Staff argues, without evidence, that: "The increased cost of AMR meters and number of meters replaced is the result of management decisions by CWSNC and a failure to implement a systematic and measured meter replacement program." This allegation is inconsistent with the Public Staff's comment on Page 7 - in that same paragraph - that: "It is not unusual for a water and sewer utility to undertake a meter replacement project that includes an entire subdivision or service area, because it promotes efficiency of time and cost when replacing a number of meters having similar ages due to being installed within a similar time period." In this instance, CWSNC undertook necessary, prudent, and comprehensive meter replacement projects affecting all of its customers served within its Fairfield Mountain and Connestee Falls mountain water systems. CWSNC's actions with regard to these two mountain system projects were reasonable and prudent and continue the Company's planned implementation of an expanded AMR footprint throughout the mountain systems as demonstrated by the Prefiled Direct Testimony of J. Bryce Mendenhall at pages 8 (beginning at line 17) and 9 (ending at line 9) in CWSNC's pending rate case, Docket No. W-354, Sub 364.

(IURC; Sept. 20, 2017); *In the Matter of Northwest Natural Gas*, Order No. 10-076; UM 1413(1) (Ore. PUC; Mar. 2, 2010); *In the Matter of the Application of Avista Corp*., Case No. AVU-E-04-1, AVU-G-04-1; Order No. 29602 (Idaho PUC; Oct. 8, 2004).

Notably, this Commission has considered the collective financial impact of various different types of projects when determining whether to grant deferred accounting authorization. For example, in a 2009 Duke Energy Carolinas case, the Commission authorized the utility to use deferred accounting for both environmental compliance costs and the purchase of a portion of the Catawba Nuclear Station, finding that "if the requested deferral is not allowed, it would appear to be very likely that the Company's 2008 ROE, of 9.79%, would be further eroded in 2009, due to the fact that the ROE impact of the costs for which deferral is requested is estimated to be 114 basis points (67 basis points for the Allen scrubbers and 47 basis points for the Catawba Nuclear Station acquisition)." *See In the Matter of Petition of Duke Energy Carolinas*, Docket No. E-7, Sub 874 (NCUC; Mar. 31, 2009).

The Financial Impact of All Four Projects for Which Deferred Accounting Treatment is Sought is Significant and Should Be Considered in Total. The Public Staff gives separate consideration to the issue of materiality by segregating the costs of the two WWTP projects from the costs of the two AMR meter projects and then evaluating them separately. The most reasonable and fair course of action in this case is to collectively consider and evaluate the materiality of the total cost all four capital projects proposed for accounting cost deferral by the Company. All four projects are part of the Company's pending general rate case and all four of the projects, though beneficial to customers, combine to adversely impact the Company's financial condition due to regulatory lag. Accordingly, all four projects should be evaluated collectively for deferred accounting treatment, rather than separately.

Importantly, all four projects for which CWSNC seeks deferred accounting treatment will result in improved service and benefits to customers as well as operational and efficiency improvements during the pendency of CWSNC's general rate case in Docket No. W-354, Sub 364, and well in advance of the effective date of the 2020 Rate Order in that case.

Moreover, as indicated in updated Schedule 2 attached to these Reply Comments, CWSNC calculates that the post-in-service depreciation expense and financing costs that will be incurred with respect to these four projects, between their respective in-service dates and the estimated date of the 2020 Rate Order, will be approximately $167,679 and $507,894, respectively. CWSNC has calculated these impacts based on the Utility Plant In-Service additions net of any retirements

Without approval of this deferred accounting request in full, CWSNC's earnings during 2019 and 2020 will be adversely impacted by approximately $675,573, as shown in updated Schedule 2 attached hereto. Absent a deferral of costs or rate case recovery, the Company would experience an adverse impact on return on equity of approximately 187 basis points (167 basis points for the two WWTP projects and 20 basis points for the two AMR meter projects), as shown in updated Schedule 1 attached hereto. At the same time, the ultimate impact of this deferred accounting on a typical residential customer, assuming a five-year amortization period, would be $0.03 per month for water customers and $0.53 per month for sewer customers, as shown in updated Schedule 2.

The financial impacts to CWSNC from placing these four major new projects in service, without corresponding deferred accounting relief, would be material and adverse, and would degrade the Company's earnings. Approval of this deferral request in total will benefit CWSNC and its customers by helping to assure access to capital on reasonable terms. These deferral costs should then be eligible for cost-recovery in CWSNC's pending Sub 364 general rate case.

Even if Analyzed on a Separate Basis, Deferred Accounting Treatment is Warranted for the AMR Meter Projects. Even if the Commission ultimately determines to conduct separate evaluations for purposes of materiality, CWSNC asserts that deferred accounting treatment is appropriate for the AMR meter projects, based on the projects' impact on the Company's ROE — particularly given the Company's current material underearning position.

Without deferred accounting treatment for the AMR meter projects, the Company will, according to Public Staff, experience an approximately 22-basis point negative impact on its earned ROE based upon the initial cost estimates contained in the Company's Petition.[2] At the same time, the Company is not

[2] Curiously, at page 8 of its Initial Comments, the Public Staff states that: "The financial impact of including AMR meters in CWSNC's Uniform Water operations is not material…" However, the Public Staff subsequently calls the validity of that statement into question by asserting that it "…believes the materiality of the impact of the AMR meters on CWSNC's Uniform Water operations, absent deferral, is **questionable.**" (Emphasis added)

earning a return anywhere close to its current authorized overall rate of return of 7.75%. Indeed, the Company's actual earned overall rate of return during the test year for its pending Sub 364 rate case was only 3.69%.[3] In another deferred accounting case, this Commission granted deferred accounting treatment for plant additions that were projected to produce similar ROE reductions in the absence of deferred accounting treatment. *See In the Matter of Duke Energy Carolinas*, Docket No. E-7, Sub 999 (NCUC; June 20, 2012) (deferred accounting approved for Buck and Bridgewater generation additions, estimated to reduce ROE by 24 basis points and 5 basis points, respectively, in the absence of such approval). At the same time, CWSNC's situation is distinguishable from the 2013 Duke Energy deferred accounting request rejected by this Commission. In that case, the Commission concluded that an 11-basis point ROE impact, when the utility was earning a robust ROE in excess of other recently stipulated electric utility ROEs, was insufficient to justify deferral accounting approval. *See In the Matter of the Petition of Duke Energy Carolinas*, Docket No. E-7, Sub 1029 (NCUC; April 03, 2013). Based upon the Company's updated Schedules, CWSNC will experience a minimum 20-basis point negative ROE impact if deferral accounting is not granted for the AMR meter projects, while already materially underearning its authorized return.

Given CWSNC's size and current under earnings position, a 20-basis point AMR meter impact is, unquestionably, material to the Company, even standing alone, and is even more so when combined with the negative earnings impact

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[3] Prefiled Direct Testimony of Catherine E. Heigel, Docket W-354, Sub 364, Appendix 8, Schedule G-1, at Page 5, lines 13-15.

which accompanies the Company's Nags Head and Connestee Falls WWTP projects. Under either analysis, deferred accounting treatment is appropriate and should be granted.

CONCLUSION

An accounting order granting the relief that CWSNC seeks will benefit both the Company and its customers, is equitable, and ultimately will not materially increase rates. Therefore, as described above, the Company respectfully petitions the Commission to allow CWSNC to establish a regulatory asset and defer for inclusion in CWSNC's pending Sub 364 general rate case the incremental post-in-service depreciation expense and financing (or return) costs associated with the four major new projects described in the Petition.

The Company's request reflects the financial imperative, fully experienced by water and wastewater companies in the face of sharply increased investment requirements, to address and combat the corrosive impact of regulatory lag on earnings. This impact manifests more strongly at higher and persistent levels of investment, which are and will continue to be experienced by CWSNC.

Accordingly, CWSNC requests that the Commission (1) grant the Public Staff's recommendation in support of the Company's requested deferred accounting treatment with respect to the cost of the WWTPs at Nags Head and Connestee Falls and (2) deny the Public Staff's recommendation in opposition to the Company's requested deferred accounting treatment with respect to the AMR meters installed in Fairfield Mountain and Connestee Falls (thereby affirmatively granting the Company's entire request for deferred accounting).

Respectfully submitted, this the 21st day of October 2019.

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Electronically Submitted

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ATTORNEYS FOR CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA

Carolina Water Service, Inc. of North Carolina
W - 354, Sub 365
Petition for Deferred Accounting of Major Capital Projects
Rate of Return Drag

Schedule 1
Updated for Reply Comments

Authorized Combined Capital Structure, W-354 Sub 360

	Rate Base	Ratio	Cost	RoR	Operating Income
Equity	58,617,524	50.91%	9.75%	4.96%	5,715,209
Debt	56,521,985	49.09%	5.68%	2.79%	3,210,449
Total	115,139,509	100.00%		7.75%	8,925,657

Adjustments:	12,975,188	Net Plant Additions	330,967	Depreciation
	(43,212)	ADIT	(21,194)	Net O&M Adjustments
	(330,967)	A/D	(71,186)	Adj Income Tax
	127,740,518	Adj Rate Base	8,687,070	Adj Operating Income

Adjusted Combined Capital Structure, W-354 Sub 360

6.80% Adj RoR

	Rate Base	Ratio	Cost	RoR	Operating Income
Equity	65,032,698	50.91%	7.88%	4.01%	5,125,266
Debt	62,707,820	49.09%	5.68%	2.79%	3,561,804
Total	127,740,518	100.00%		6.80%	8,687,070

Rate Base Change	12,601,009	-1.87%	ROE Lag	(238,587)	Operating Loss

Carolina Water Service, Inc. of North Carolina
W - 354, Sub 365
Petition for Deferred Accounting of Major Capital Projects
Calculation of Deferral to be Included in W-354, Sub 364 and Customer Impact

Schedule 2
Updated for Reply Comments

Line No.	Item	Costs	Notes - References to W-354, Sub 364 Schedules
	CWSNC Uniform Sewer:		
1	**Connestee Falls WWTP: In-Service 10/3/2019**		
2	Net Plant Additions	6,130,174.56	Per Schedule 15, line 3, Column C
3	Rate of Return on Net Plant Additions (10/2019-3/2020)	237,544.26	L2 * 6 months * RoR
4	Depreciation Expense (10/2019-3/2020)	76,627.18	Per Schedule 15, line 3, Column E * 6 months
5			
6	Total Deferred Carrying Costs (L3 + L4)	$ 314,171.45	
7	**Nags Head WWTP: In-Service 8/31/2019**		
8	Net Plant Additions	6,054,544.52	Per Schedule 15, line 7, Column C
9	Rate of Return on Net Plant Additions (10/2019-3/2020)	234,613.60	L8 * 6 months * RoR
10	Depreciation Expense (10/2019-3/2020)	75,681.81	Per Schedule 15, line 7, Column E * 6 months
11			
12	Total Deferred Carrying Costs (L9 + L10)	$ 310,295.41	
13	Total Uniform Sewer Deferred Costs (L6 + L12)	$ 624,466.85	
14	Annual Amortization, 5-year term	$ 124,893.37	
	CWSNC Uniform Water:		
14	**Fairfield Mountain AMR: In-Service 8/31/2019**		
15	Net Plant Additions	409,485.04	Per Schedule 15, line 24, Column C
16	Rate of Return on Net Plant Additions (9/2019-3/2020)	18,512.14	L15 * 7 months * RoR
17	Depreciation Expense (9/2019-3/2020)	7,962.21	Per Schedule 15, line 24, Column E * 7 months
18			
19	Total Deferred Carrying Costs (L3 + L4)	26,474.35	
20	**Connestee Falls AMR: In-Service 8/31/2019**		
21	Net Plant Additions	380,983.87	Per Schedule 15, line 23, Column C
22	Rate of Return on Net Plant Additions (9/2019-3/2020)	17,223.65	L21 * 7 months * RoR
23	Depreciation Expense (9/2019-3/2020)	7,408.02	Per Schedule 15, line 23, Column E * 7 months
24			
25	Total Deferred Carrying Costs (L3 + L4)	24,631.67	
26	Total Uniform Water Deferred Costs (L19 + L25)	$ 51,106.01	
27	Annual Amortization, 5-year term	$ 10,221.20	
28	Total Annual Water Customer Bills per Schedule E, W-354, Sub 364	365,400	
29	Monthly Water Charge per Customer (L27/L28)	$ 0.03	
30	Total Annual Sewer Customer Bills per Schedule E, W-354, Sub 364	236,012	
31	Monthly Sewer Charge per Customer (L14/L30)	$ 0.53	