

SANFORD LAW OFFICE, PLLC
Jo Anne Sanford, Attorney at Law

September 26, 2017

Ms. M. Lynn Jarvis, Chief Clerk
North Carolina Utilities Commission
4325 Mail Service Center
Raleigh, NC 27699-4325

Via Electronic Delivery

Re: Docket No. W-354, Sub 356
Carolina Water Service, Inc. of North Carolina ("CWSNC")
Application for General Rate Increase
Late-filed Affidavit of Richard A. Linneman

Dear Ms. Jarvis:

Attached for filing electronically please find the late-filed Affidavit referenced above, along with its Exhibits Nos. 1 and 2. Exhibit No. 3 is confidential and will be submitted by separate filing.

As always, thank you and your office for your assistance and please feel free to contact me if there are any questions.

Electronically Submitted
s/Jo Anne Sanford
State Bar # 6831
Attorney for CWSNC

c: Parties of Record

**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. W-354, SUB 356

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

<p>In the Matter of Application by Carolina Water Service,) Inc. of North Carolina, 4944 Parkway) Plaza Boulevard, Suite 375, Charlotte,) North/ Carolina 28217, for Authority to) Adjust and Increase Rates for Water) and Sewer Utility Service in All of Its) Service Areas in North Carolina, Except) Corolla Light and Monteray Shores) Service Area and Elk River) Development)</p>	<p>AFFIDAVIT OF RICHARD A. LINNEMAN IN RESPONSE TO COMMISSION QUESTIONS</p>
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NOW COMES Richard A. Linneman, Financial Planning and Analysis Manager for Carolina Water Service, Inc. of North Carolina (“CWSNC” or “Company”), being first duly sworn, deposes and says the following:

1. I was sworn and qualified as a witness on behalf of CWSNC in Docket No. W-354, Sub 356 in a general rate case hearing held before the North Carolina Utilities Commission (“NCUC” or “Commission”) on September 20, 2017 in the Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina.
2. The Commission has addressed a series of questions to the Public Staff of the North Carolina Utilities Commission (“Public Staff”) and CWSNC, to be answered by late-filed documents. This filing contains responses to those questions which were addressed to me or are within the purview of my

responsibility with the Company, as well as to certain questions posed to the Public Staff. The topics, questions, and answers follow:

A. RATE CASE EXPENSE.

Public Staff accountant Sonja Johnson was asked to provide late-filed exhibits which detail (1) the major components of the \$424,336 rate case expense to which CWSNC and the Public Staff stipulated in this proceeding; and (2) the specific rate case proceedings and unamortized amounts which comprise the unamortized rate case expense in this case of \$285,939.

Company Response: The Company has consulted with the Public Staff and agrees with their calculation and description of rate case expenses. Rate case expense is composed of a variety of factors: (a) capitalized time (the allocated costs of salaries and wages, etc. of internal resources); (b) consultant fees; (c) legal fees; (d) case-related travel; (e) customer notices and miscellaneous charges (postage, printing, and other costs of public notices, application and testimony; and (f) court reporting fees.

In addition, this is the first consolidated rate case for CWSNC, which previously operated (and thus sought rate relief) as six (6) separate entities. For comparison purposes, in the four prior and most recent rate cases decided in 2015 and 2016 for CWSNC and three of the other five subsidiaries of Utilities, Inc. ("UI") which were merged into CWSNC in 2016, those four companies were collectively authorized by the Commission to recover total rate case costs of \$685,735. The breakdown of those

collective rate case costs, taken from Commission Orders in the referenced prior cases, is as follows:

CWSNC (W-354, Sub 344)	\$304,330
Bradfield Farms (W-1044, Sub 21)	\$ 82,254
CWS Systems (W-778, Sub 91)	\$220,350
Elk River (W-1058, Sub 7)	<u>\$ 78,801</u>
TOTAL	\$685,735

The total of \$685,735 set forth above does not include rate case costs for the two other UI subsidiaries which were merged into CWSNC in 2016 (Carolina Trace and Transylvania), because the most recent rate case Orders for those two companies were issued in 2010.

In summary, rate case costs in this, the first consolidated CWSNC rate case, are approximately 62% of the collective total of the four recent individual rate cases decided in 2015 and 2016. The percentage would be even lower than 62% had the Carolina Trace and Transylvania rate cases occurred in the 2015 – 2016 time-period. This illustrates only one early example of an efficiency resulting from the 2016 corporate merger. Over time, and with additional uniformity of rates, the impact of this regulatory efficiency should be a persistent benefit to customers and Company alike, as well as to regulatory resources.

B. FINANCIAL QUESTIONS AND ISSUES.

Commissioner Clodfelter asked a series of questions of both CWSNC and the Public Staff regarding financial matters.

(a) First, Commissioner Clodfelter asked about the current debt rating for UI's debt.

Company Response: There is no debt rating for Utilities, Inc's current outstanding debt. This debt is in the form of a commercial loan. Therefore, no debt rating is assigned to it, as would be the case if the outstanding debt were in the form of a bond issuance.

(b) Second, Commissioner Clodfelter inquired as to the status of UI's current interest coverage ratio.

Company Response: UI's interest coverage ratio as of June 30, 2017, is 4.52x. Please see the attached exhibit (*Linneman Late-Filed Exhibit 1, "Interest Coverage Ratio"*), which shows the quarterly interest coverage ratios for UI for the last six (6) calendar quarters.

(c) Third, Commissioner Clodfelter requested a description of the barriers to CWSNC's ability to earn the Return on Equity ("ROE") of 9.75% which was authorized in the Company's last rate case.

Company Response: Regulatory lag is the primary factor impairing CWSNC's ability to earn the ROE which was approved, or "authorized," in the Company's last general rate case. Except for certain "system improvement charges," the ratemaking process set forth in the Public Utilities Act allows a utility such as CWSNC to recover the costs of capital projects in rates only when authorized by the Commission to do so in a rate case order. This means that capital costs incurred by CWSNC between general rate cases are generally not recoverable in rates during

the regulatory lag period; i.e., the period of time between rate case orders. CWSNC must also forego the ability to earn a return on capital investments and applicable O&M costs between general rate cases. The capital-intensive nature of the water and wastewater industry is characterized by a constant need to invest to ensure that all infrastructure is in a condition that is compliant with environmental and other regulatory standards.

For example, since December 7, 2015, the final order date of the last general rate increase approved for CWSNC in Docket No. W-354, Sub 344, the Company has invested approximately \$24 million in additional capital in its North Carolina water and sewer utility systems. This illustrates the significance of the regulatory lag as it obviously impacts the ability of CWSNC to earn its currently-authorized return on equity of 9.75%. Although the system improvement charge mechanisms¹ are in place, are helpful, and have been utilized by CWSNC, the current scope of those mechanisms restricts the types of investments which qualify for recovery. Specifically, the WSIC / SSIC mechanisms address: (1) historical capital investments, not future capital investments; (2) only capital investments, not operational expenses; and (3) only a limited scope of water and wastewater system assets (e.g., it does not address wastewater treatment plants).

Thus, the Company's experience of regulatory lag as a drag on its ability to actually earn its authorized return is not fully addressed by the WSIC and SSIC mechanisms, given the magnitude and timing of the

¹ "Water System Improvement Charge," or "WSIC," and "Sewer System Improvement Charge," or "SSIC." Authorized by G.S. Chapter 62-133.12, adopted in 2013.

investment necessary to comply with regulatory requirements and provide the highest level of service to customers. It is a significant issue. CWSNC currently assesses a need for rehabilitation of more than two dozen wastewater treatment plants over approximately the next fifteen (15) years. The capital investment for each plant will likely extend over 2-3 years prior to the in-service date. This is simply a current, long-range assessment, but it is illustrative of the magnitude of on-going capital expenditures.

Regulatory lag is not only associated with capital spend, but also with operations and maintenance (“O&M”) spend. Many of the expenses involved with running a compliant water and wastewater system are unavoidable and not completely within the control of the Company. For instance, a utility like CWSNC cannot control whether a municipality or regulated public utility providing electricity, natural gas, and/or water and sewer services raises rates. Nor can it control or even anticipate the magnitude of the rate increase. Because, generally, these rate increases are unknown at the time CWSNC makes a rate case filing, and in the absence of a “known and measurable” type adjustment mechanism, the Company must necessarily absorb the increased expense levels incurred between rate cases. CWSNC works diligently to identify these expenses and develop solutions to mitigate the impact from any O&M increase. However, in many instances there is no solution, or the solution results in the need for additional O&M spend which then in turn increases regulatory

lag. For reference purposes, the O&M expenses for CWSNC have increased approximately \$3 million since the Company's last rate case.

(d) Fourth, Commissioner Clodfelter asked about the current yield for US Treasury Bonds.

Company Response: The current yield for U.S. Treasury Bonds varies depending on the term of the bond. According to the U.S. Department of the Treasury, the current yields for Common Treasury Bonds are as follows: 3-month Treasury Bond 0.99%; 1-year Treasury Bond 1.31%; 10-year Treasury Bond 2.27%; and 30-year Treasury Bond 2.80%. Please see the attached "*Linneman Late-Filed Exhibit 2, U.S. Treasury Bond Yields*", for the current yields for all available terms.

(e) Fifth, Commissioner Clodfelter asked a question regarding comparison of the average cost of debt for UI to the average cost of debt for the proxy group of water companies used by Public Staff witness Craig in his testimony.

Company Response: The stipulated² average cost of debt for CWSNC in this case is 5.93%. In comparison, the average cost of debt for the proxy group of water companies was 4.89% as of 2015. This is a decline from the high of 5.36% which occurred in 2012. The cost of debt for CWSNC in the Stipulation is a weighted average cost based upon the long-term debt which was issued in 2006 at a cost of 6.58% and the cost of the revolving balance

² Between CWSNC and the Public Staff, for purposes of settlement. This agreement is contained in the Stipulation filed on August 7, 2017, and is supported by the testimony of Public Staff witness Calvin Craig.

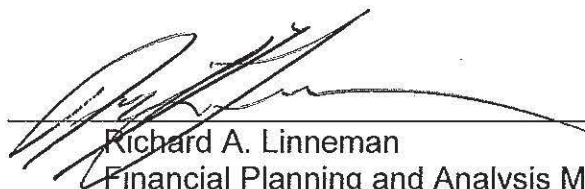
loan which was issued in 2015 and carries a variable interest rate that has fluctuated from a low of 1.70% in 2015 to a high of 2.45% in May of 2017. The long-term debt also includes a “make whole” penalty payment requirement in excess of \$50 million, should the debt be refinanced or paid in full prior to the maturity date of July 21, 2036.

C. COMPENSATION

Pursuant to my agreement to provide the “market based salary study,” conducted by CWSNC’s consultant, I am attaching it as “*Linneman CONFIDENTIAL Late-Filed Exhibit 3, Market Based Wage Study*”. This study was provided to the Public Staff during discovery.

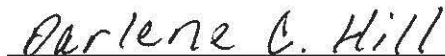
D. CONCLUSION

We are reviewing the Transcript and working with the Public Staff to ensure that all the Commission's questions are addressed promptly and thoroughly. If additional responses are required, then I will be pleased to provide them.


Richard A. Linneman
Financial Planning and Analysis Manager
Carolina Water Service, Inc. of North Carolina

Sworn to and subscribed before me this
the 26th day of September, 2017.





Notary Public



My Commission Expires: 1.23.21

CERTIFICATE OF SERVICE

I hereby certify that on this the 26th day of September, 2017, a copy of the foregoing **AFFIDAVIT OF RICHARD A. LINNEMAN IN RESPONSE TO COMMISSION QUESTIONS** has been duly served upon all parties of record by electronic service, as follows:

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**ATTORNEY FOR CAROLINA WATER
SERVICE, INC. OF NORTH CAROLINA**

	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017
	12,366	13,619	15,110	16,796	16,699	16,229
	(A)					
Net Income	12,640	12,729	12,782	12,708	12,604	12,811
Add:	10,261	10,924	11,715	9,796	9,426	9,039
(i) Interest Expense	18,567	18,118	17,276	19,181	19,335	20,030
(ii) Income taxes paid or accrued	0	0	0	0	0	0
(iii) Depreciation and amortization	0	0	0	0	0	0
(iv) Extraordinary expenses or losses	0	0	0	0	0	0
(v) Non-cash expenses or losses	0	0	0	0	0	0
Less:						
(vi) Interest Income	0	0	0	0	0	0
(vii) Income tax credits or refunds	0	0	0	0	0	0
(viii) Cash payments made in reference to items (iv) or (v)	0	0	0	0	0	0
(ix) Extraordinary income or (gains) losses	577	573	508	(220)	(192)	(220)
(x) Cash payments related to non-cash charges added back to EBITDA	0	0	0	0	0	0
EBITDA	54,411	55,963	57,391	58,261	57,872	57,889
	(B)					

Interest Coverage Ratio (B/A)

4.30 4.40 4.49 4.58 4.59 4.52

Linneman Late Filed Exhibit 2
US Treasury Bond Yields
W-354, Sub 356

Date	1 mo	3 mo	6 mo	1 yr	2 yr	3 yr	5 yr	7 yr	10 yr	20 yr	30 yr
9/1/2017	0.96	1.02	1.10	1.24	1.35	1.46	1.73	1.99	2.16	2.51	2.77
9/5/2017	1.30	1.03	1.13	1.23	1.30	1.40	1.65	1.90	2.07	2.43	2.69
9/6/2017	1.04	1.07	1.17	1.24	1.30	1.42	1.69	1.93	2.10	2.46	2.72
9/7/2017	0.98	1.05	1.15	1.21	1.27	1.38	1.63	1.88	2.05	2.40	2.66
9/8/2017	0.96	1.04	1.14	1.22	1.27	1.39	1.64	1.89	2.06	2.41	2.67
9/11/2017	0.97	1.05	1.16	1.24	1.32	1.44	1.71	1.96	2.14	2.49	2.75
9/12/2017	0.99	1.03	1.16	1.27	1.33	1.46	1.75	1.99	2.17	2.52	2.78
9/13/2017	0.99	1.04	1.16	1.27	1.35	1.48	1.78	2.01	2.20	2.53	2.79
9/14/2017	0.99	1.05	1.17	1.28	1.37	1.50	1.79	2.01	2.20	2.52	2.77
9/15/2017	0.98	1.05	1.17	1.30	1.39	1.53	1.81	2.04	2.20	2.52	2.77
9/18/2017	0.96	1.05	1.18	1.30	1.40	1.54	1.83	2.06	2.23	2.56	2.80
9/19/2017	0.97	1.04	1.19	1.31	1.40	1.55	1.84	2.07	2.24	2.57	2.81
9/20/2017	0.98	1.04	1.20	1.32	1.45	1.60	1.89	2.12	2.28	2.59	2.82
9/21/2017	0.99	1.04	1.19	1.31	1.45	1.59	1.89	2.11	2.27	2.57	2.80
9/22/2017	0.97	1.03	1.19	1.30	1.46	1.58	1.88	2.10	2.26	2.57	2.80
9/25/2017	0.97	1.05	1.19	1.30	1.44	1.56	1.85	2.07	2.22	2.53	2.76

Source: US Department of the Treasury