

**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. W-218, SUB 526

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

IN THE MATTER OF
APPLICATION BY AQUA NORTH CAROLINA, INC.,
202 MACKENAN COURT, CARY, NORTH CAROLINA 27511,
FOR AUTHORITY TO ADJUST AND INCREASE RATES FOR WATER
AND SEWER UTILITY SERVICE IN ALL SERVICE AREAS IN
NORTH CAROLINA

REBUTTAL TESTIMONY OF
PAUL HANLEY
ON BEHALF OF
AQUA NORTH CAROLINA, INC.

June 12, 2020

1 **Q. PLEASE STATE YOUR NAME, YOUR POSITION AS IT RELATES TO**
2 **AQUA NORTH CAROLINA, INC. (“Aqua”, “Aqua North Carolina”, or**
3 **“Company”) AND YOUR BUSINESS ADDRESS.**

4 A. My name is Paul Hanley and my business address is 1000 South Schuyler
5 Avenue, Kankakee, Illinois, 60901. I currently serve as Aqua America’s
6 Regional Controller. My responsibilities include oversight of the financial
7 operations and regulated environment for six states within the Aqua
8 footprint, including Aqua North Carolina. The State Controller for Aqua
9 North Carolina is my direct report, and his department in North Carolina
10 reports up through the finance department for Aqua.

11 **Q. PLEASE DESCRIBE YOUR BACKGROUND AND EXPERIENCE.**

12 A. I have almost nineteen years of progressive experience in the water and
13 wastewater industry and have been employed by Aqua for those nineteen
14 years. I was employed by Aqua Illinois (formerly Consumers Illinois Water
15 Company) in Kankakee, Illinois from September 1996 through May 2000
16 where I served as the Accounting Manager of the state finance department
17 and State Analyst supporting the regulatory process. From June 2000
18 through July 2005, I was employed by RAM Consulting in Oak Brook, Illinois
19 as their Senior Accountant. RAM Consulting was a testing and compliance
20 consultant in Oak Brook, Illinois. The primary client was McDonald’s, and
21 RAM’s important responsibility for McDonalds was testing the products and
22 toys in the Happy Meal product line. I was hired to bring structure and a

1 systematic process to the accounting function. My role with RAM Consulting
2 included implementation of procedural guidelines and oversight of their
3 financial operations (nationally and internationally) and implementation of
4 an Oracle financial system. In August 2005, I was hired back by Aqua
5 Illinois as their State Controller where I served for almost twelve years until
6 March 2017. As the Illinois State Controller, I was responsible for the
7 financial operations of the state, and my roles included the oversight and
8 accountability of the monthly, quarterly, and annual financial closings and
9 reporting, SOX and audit compliance, quarterly regulatory and bondholder
10 filings, budget, forecasting, and 5-year planning, regulatory petitions with
11 the Illinois Commerce Commission, numerous acquisitions, debt and equity
12 financings, and other strategic projects. In April 2017, I was promoted to
13 Regional Controller for Aqua America with financial oversight and support
14 of the six states: Illinois, Indiana, North Carolina, Ohio, Texas, and Virginia.

15 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE A REGULATORY**
16 **COMMISSION?**

17 A. Yes, I have testified before the Illinois Commerce Commission in numerous
18 regulatory filings, that include, but are not limited to, proceedings in base
19 rates petitions, infrastructure surcharges, acquisitions, debt financings, and
20 rulemakings.

21 **Q. WHAT ISSUES DO YOU ADDRESS IN YOUR REBUTTAL TESTIMONY?**

22 A. I rebut the testimony of Public Staff witness Lynn Feasel on the following

1 five (5) Public Staff adjustments as described in my testimony:

2 1. An adjustment to allocate executive compensation to shareholders
3 in the amount of (\$373,874);

4 2. An adjustment to remove 50% of Board of Directors ("BOD")
5 compensation in the amount of (\$62,072);

6 3. An adjustment to remove 50% of BOD various expenses from
7 miscellaneous expense in the amount of (\$16,525);

8 4. An adjustment to reflect the allocation from Corporate Services
9 and Aqua Customer Operations in the amount of (\$242,470); and

10 5. An adjustment to reflect benefits allocated from Corporate
11 Services in the amount of (\$17,037).

12 **I. ADJUSTMENT TO ALLOCATE EXECUTIVE COMPENSATION TO**
13 **SHAREHOLDERS**

14
15 **Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE BASIS FOR**
16 **PUBLIC STAFF WITNESS FEASEL'S ADJUSTMENT OF EXECUTIVE**
17 **COMPENSATION IN THE AMOUNT OF (\$373,874).**

18 A. Witness Feasel made an adjustment, as reflected in Feasel Exhibit 1,
19 Schedule 4, Line 9, to reduce operating costs for Executive Compensation
20 that includes the removal of 50% of the total compensation of the top five
21 executives, which is comprised of total annual salary, Short-Term Incentive
22 Plan ("STIP"), Long-Term Incentive Plan ("LTIP"), and Benefits. The Public
23 Staff has a belief that it is appropriate and reasonable for the shareholders
24 of the very large water and wastewater utilities to bear some of these costs.

1 Furthermore, witness Feasel states that officers have fiduciary duties of
2 care and loyalty to shareholders, but not to customers.

3 **Q. DO YOU AGREE WITH MS. FEASEL'S ADJUSTMENT?**

4 A. No, I do not agree with the recommended reduction of 50%. Moreover, I
5 note that the Public Staff's position, through the testimony of witness
6 Feasel, ignores and fails to follow the prior decision of the Commission,
7 which resolved this issue in the W-218, Sub 497 rate case by imposing a
8 25% adjustment. I believe that the Public Staff's proposed 50% adjustment
9 is and continues to be excessive and unwarranted. While Aqua continues
10 to fundamentally disagree with this type of adjustment, at a minimum, the
11 Company believes the Commission should follow with consistency the
12 decision it employed in the referenced Sub 497 case. Aqua supports and
13 requests that the Commission again reject the Public Staff's proposed 50%
14 adjustment.

15 In its Sub 497 Order, the Commission specifically found that it was not
16 appropriate to adopt the Public Staff's recommended adjustment to allocate
17 to shareholders 50% of the compensation, including pension and incentive
18 plans, of the top five Aqua America executives (Finding of Fact No. 65 at
19 page 19). Instead, the Commission adopted a 25% adjustment to those
20 expenses (Finding of Fact No. 66). On page 101 of its Order, the

1 Commission found the Public Staff's proposed adjustment to be
2 "...unreasonable and not supported by the evidence presented...."¹

3 **Q. PLEASE EXPLAIN WHY YOU DO NOT BELIEVE THAT THE**
4 **REASONS ARTICULATED BY WITNESS FEASEL MERIT A 50%**
5 **REDUCTION IN AQUA AMERICA EXECUTIVE COMPENSATION**
6 **CHARGED TO EXPENSE.**

7 A. Aqua sets compensation levels for its executives to attract and
8 retain qualified personnel and to remain competitive in the market.
9 The efforts of Aqua 's executives ultimately benefit customers
10 through controlling costs and managing a strong overall company,
11 which allows it to attract capital at lower costs. This level of
12 management strength and stability is extremely important in 2020
13 as the country addresses a pandemic, a potential financial crisis,
14 and civil unrest. One cannot overstate the importance of
15 maintaining an unerring focus on key aspects of a major utility's
16 responsibilities---including critical service quality for water and
17 wastewater operations, reliability, environmental compliance, and a
18 high level of safety for Aqua's customers and employees.
19 Aqua leaders have a responsibility not only to all investors in the
20 Company, which include both shareholders and bondholders, but

¹ The Commission premised its decision significantly on the testimony in that proceeding offered by Aqua witness Robert A. Kopas, the retired Regional Controller for Aqua Services, Inc., who testified in support of the Company as a consultant.

1 also to employees and most of all---to customers. Aqua is in a
2 highly-regulated business both on the environmental and financial
3 side. Aqua leaders are also charged with the responsibility of
4 meeting these standards of providing safe and reliable water and
5 wastewater service to customers served by Aqua in North Carolina.
6 Only then is Aqua granted an opportunity to earn a return on the
7 dollars invested by shareholders. In my opinion, the ability of Aqua
8 as a public utility to meet the needs of its customers is the highest
9 priority of all Company employees, as only then will the financial
10 returns be achieved to attract both debt and equity capital needed
11 in the business. A full compensation package, even for executive
12 compensation, is a necessary part of the Company's overall cost of
13 service to meet the needs of its customers, and a ratemaking
14 adjustment of 50% to Aqua America executive compensation is not
15 warranted.

16 **II. ADJUSTMENT TO REMOVE 50% OF BOARD OF DIRECTORS' ("BOD")**
17 **COMPENSATION**

18 **Q. WHAT DID PUBLIC STAFF WITNESS FEASEL ADJUST FOR BOD**
19 **COMPENSATION IN THE AMOUNT OF (\$62,072)?**

20 **A.** Ms. Feasel made an adjustment, as reflected in Feasel Exhibit 1, Schedule
21 7, Line 3 to remove 50% of the compensation expenses associated with the
22 Aqua America BOD.

1 **Q. DO YOU AGREE WITH MS. FEASEL'S ADJUSTMENT?**

2 A. No, I do not agree with the Public Staff's reduction of 50%. Here again, the
3 Public Staff, through the testimony of witness Feasel, has decided to
4 relitigate the prior decision of the Commission as explained and adopted in
5 the Sub 497 case. Although parties and the Commission are generally free
6 to change positions from case to case, the rationale imposed in the last rate
7 case served as a guide to the industry and the Public Staff, as well as other
8 intervenors. Aqua continues to fundamentally disagree with any ratemaking
9 adjustment here.

10 The Commission, in the Sub 497 rate case Order (at page 104) reached the
11 following conclusions, in pertinent part, in support of its decision on BOD
12 compensation and expenses:

13 ...The Commission generally agrees with Aqua NC's
14 assertions that adequate compensation is required to attract
15 extremely competent, qualified members of a Board of
16 Directors to lead a company such as Aqua America, Inc. and
17 that North Carolina ratepayers and Aqua America, Inc.
18 shareholders share a mutual interest in a highly skilled and
19 qualified Board. The Commission also generally agrees that
20 ratepayers' best interests depend on a regulated utility's
21 ability to attract capital; in this instance, to support the level of
22 investment required by Aqua NC as a regulated water and
23 wastewater service provider in this state. As stated by
24 Aqua NC, these financial and investment decisions are made
25 at the parent company level and are integrally related to and
26 supportive of the local company's ability to provide safe and
27 reliable service.

28
29 Again, while Aqua disagrees with any adjustment, if the Commission so
30 chooses, the Company asserts that an adjustment of 25% for

1 ratemaking purposes is the maximum adjustment which the
2 Commission should adopt in this case for BOD compensation.

3 **III. ADJUSTMENT TO REMOVE 50% OF BOD VARIOUS EXPENSES AND**
4 **FEES FROM MISCELLANEOUS EXPENSE**

5 **Q. WHAT DID PUBLIC STAFF WITNESS FEASEL ADJUST FOR BOD**
6 **VARIOUS EXPENSES AND FEES IN THE AMOUNT OF (\$16,525)?**

7 A. Witness Feasel made an adjustment, as reflected in Feasel Exhibit 1
8 Schedule 7, Lines 4-6 to remove 50% of the miscellaneous expenses
9 (insurance and other fees) associated with the Aqua America BOD.

10 **Q. DO YOU AGREE WITH WITNESS FEASEL'S ADJUSTMENT?**

11 A. No, Aqua does not agree with the Public Staff's proposed 50% reduction.
12 For the reasons enunciated previously in my rebuttal testimony regarding
13 both Executive and BOD Compensation, the Company requests that the
14 Commission also reject the Public Staff's position on this issue. As
15 with the Executive and BOD Compensation issues, if the
16 Commission feels that an adjustment is necessary, Aqua urges the
17 Commission to adhere to the Sub 497 case precedent. The 50%
18 ratemaking adjust proposed by the Public Staff is unreasonable and
19 unjustified by the facts presented.

20 **IV. ADJUSTMENTS TO REFLECT THE ALLOCATION FROM CORPORATE**
21 **SERVICES AND AQUA CUSTOMER OPERATIONS**

22 **Q. WHAT DID PUBLIC STAFF WITNESS FEASEL ADJUST FOR THE**
23 **ALLOCATION FROM CORPORATE SERVICES AND AQUA**
24 **CUSTOMER OPERATIONS IN THE AMOUNT OF (\$242,470)?**

1 A. Witness Feasel made an adjustment, as reflected in Feasel Exhibit 1,
2 Schedule 4, Lines 10-11 to reduce operating costs for (1) the salaries of
3 nineteen open positions that were allocated to Aqua North Carolina from
4 Corporate Services and the Aqua Customer Operations ("ACO") team;
5 (2) 35% for the short-term incentive bonus plan allocated to Aqua North
6 Carolina from Corporate Services and ACO; and (3) 50% for the stock
7 options and awards allocated to Aqua North Carolina from Corporate
8 Services and the ACO. The Public Staff's adjustments would allocate the
9 adjusted amounts to the Company's shareholders.

10 **Q. DO YOU AGREE WITH WITNESS FEASEL'S ADJUSTMENT IN THE**
11 **AMOUNT OF (\$242,470)?**

12 A. No, I do not agree with the reduction of (\$242,470) as I will further explain
13 below. The Company asserts that the following proposed adjustments
14 should not reduce our operating costs:

- 15 1. \$91,121 for nineteen open positions for Corporate Services
16 and Aqua Customer Operations;
- 17 2. \$58,577 for 35% of bonuses for Corporate Services
18 employees;
- 19 3. \$76,222 for 50% of Restricted Share Units/Performance
20 Share Units/Stock Options for Corporate Services employees;
- 21 4. \$12,350 for 35% of bonuses for Aqua Customer Operations
22 employees; and
- 23 5. \$4,200 for 50% of Restricted Share Units/Performance Share
24 Units/Stock Options for Aqua Customer Operations
25 employees.
26
27
28
29
30

1 Regarding the nineteen vacant positions from Aqua Customer Operations
2 and Corporate Services whose allocated salaries were removed from the
3 Company's cost of service by the Public Staff, Aqua contends that the
4 Staff's proposed ratemaking adjustment should be denied by the
5 Commission. These positions, which were filled during most if not all of the
6 test year, were vacant as of March 31, 2020 (the close of the update period).
7 These are all critical positions in Corporate Services and ACO which must
8 be filled to support all Aqua's operations (including customers) and for which
9 no ratemaking adjustment is appropriate in this case. Efforts to fill these
10 positions have been slowed during the recent work from home assignments.
11 None of the positions have been eliminated; one has been filled by a
12 temporary employee. In fact, since actual costs are allocated to the Aqua
13 states during the historical test year, any vacancies during the test year
14 would result in no costs allocated for any positions which are open.
15 **Therefore, the allocated costs, or lack thereof, from Corporate**
16 **Services and Aqua Customer Operations already contain a level of**
17 **vacancies before they reach Aqua North Carolina.** Aqua urges the
18 Commission to deny the Public Staff's proposed adjustment for this
19 legitimate allocated salary expense which has been charged to Aqua.
20 The reasons which support Aqua's opposition to the remainder of these
21 adjustments in the total amount of (\$151,349) for incentive compensation
22 will be set forth in the next section of my rebuttal testimony which discusses

1 Public Staff adjustments to reflect benefits allocated from Corporate
2 Services.

3 **V. ADJUSTMENTS TO REFLECT BENEFITS ALLOCATED FROM**
4 **CORPORATE SERVICES**
5

6 **Q. WHAT DID PUBLIC STAFF WITNESS FEASEL ADJUST FOR BENEFITS**
7 **ALLOCATED FROM CORPORATE SERVICES IN THE AMOUNT OF**
8 **(\$17,037)?**

9 A. Ms. Feasel made an adjustment, as reflected in Feasel Exhibit 1, Schedule
10 5, Line 4 to reduce operating costs for benefits that were allocated from
11 Corporate Services and Aqua Customer Operations and allocated them to
12 the Company's shareholders.

13 **Q. DO YOU AGREE WITH ANY OF WITNESS FEASEL'S ADJUSTMENTS**
14 **AS DISCUSSED IN SECTIONS IV AND V OF THIS REBUTTAL**
15 **TESTIMONY?**

16 A. No, I do not agree with any of the separate parts of the proposed reductions
17 totaling (\$242,470) and (\$17,037), as I will explain below.

18 **Q. PLEASE EXPLAIN WHY YOU DO NOT BELIEVE THAT THE**
19 **REASONS ARTICULATED BY WITNESS FEASEL MERIT A**
20 **RATEMAKING ADJUSTMENT TO COSTS FOR CORPORATE**
21 **SERVICES AND AQUA CUSTOMER OPERATIONS.**

22 A. As described above, Aqua America sets compensation levels to
23 attract and retain qualified personnel. The total compensation

1 packages may assist with the retention of our employees in the
2 corporate services and customer operations divisions; areas that
3 directly impact the satisfaction of our customers. Some of the
4 employees have direct contact with our customers, and I completely
5 disagree with cost cutting for these important positions in our
6 Company. Therefore, Aqua disagrees with the reduction to Aqua's
7 Customer Operations and Aqua Corporate Services costs in the
8 amounts of (\$242,470) and (\$17,037).

9 In the Aqua Sub 497 Rate Case, the Public Staff proposed an
10 accounting adjustment to allocate 30% of North Carolina
11 Supervisory employee bonuses to shareholders. The Commission
12 found that the Public Staff's proposed adjustment was inappropriate
13 (See Finding of Fact No. 64 on page 19 of the Sub 497 Rate Case
14 Order). In so ruling, the Commission once again premised its decision
15 significantly on the testimony in that proceeding offered by Aqua witness
16 Kopas, which I hereby adopt by reference in support of my testimony in this
17 proceeding.

18 The Commission, in the Sub 497 rate case Order (at pages 94 - 96) reached
19 the following conclusions, in pertinent part, in support of its decision on the
20 Staff's proposed adjustment to allocate 30% of North Carolina
21 Supervisory employee bonuses to shareholders:
22

1 Aqua NC witness Kopas testified on rebuttal that he
2 disagreed with Public Staff witness Henry's adjustment to
3 allocate 30% of bonuses paid to North Carolina supervisory
4 employees to shareholders. Witness Kopas stated that, for
5 the reasons set forth in his testimony regarding the
6 Company's opposition to the Public Staff's accounting
7 adjustment to executive compensation, the STI is part of the
8 total compensation paid to attract and retain qualified
9 supervisory employees at Aqua NC. He testified that this
10 financial metric reinforces to employees that it is their
11 responsibility to serve Aqua NC's customers in a prudent and
12 efficient manner. He further testified that the Company's
13 ability to provide reliable service to its customers is directly
14 related to its financial viability and linking a portion of those
15 employees' compensation to a financial target encourages
16 employees to achieve customer-based objectives in a cost-
17 efficient manner. Witness Kopas testified that the STI (or
18 supervisory bonus) program for Aqua NC has been in place
19 without any ratemaking adjustment having been proposed or
20 made in the Company's last two rate case proceedings.

21
22 After reviewing all of the evidence presented, the
23 Commission concludes that the Public Staff's proposed
24 adjustment to exclude 30% of the bonuses paid to North
25 Carolina supervisory employees in the amount of \$29,648
26 from the cost of service in this case is unreasonable and
27 inappropriate for the reasons testified to by Aqua NC witness
28 Kopas.

29
30 First, the Commission gives substantial weight to Aqua
31 NC witness Kopas' rebuttal testimony that Aqua NC's STI is
32 part of the total compensation paid to attract and retain
33 qualified supervisory employees who actually work for Aqua
34 NC in North Carolina and directly provide service to customers
35 in this State in a manner designed to ensure that those
36 customers are served in a prudent and efficient manner.

37
38 Second, the Commission gives great weight to witness
39 Kopas' testimony that linking a portion of the compensation of
40 North Carolina supervisory personnel to a financial target, as
41 is the case with the STI, clearly encourages those employees
42 to achieve customer-based objectives in a cost-effective
43 manner.
44

1 Third, the Commission gives little weight to Public Staff
2 witness Henry's testimony, which emphasizes his earnings
3 per share analysis as essentially benefiting only the Aqua
4 America shareholders' value with no stated benefit to
5 ratepayers. The Commission agrees with Aqua NC that
6 employee compensation packages that include financial
7 metrics appropriately incentivize individuals to achieve goals
8 that support strong operations of a company that ultimately
9 does benefit ratepayers.

10
11 Further, the Commission concludes that if it approved
12 the Public Staff's position on this issue, it would send the
13 wrong message to Aqua NC and its North Carolina-based
14 supervisory personnel. The Public Staff does not propose to
15 exclude any of the salaries or other benefits earned by Aqua
16 NC's North Carolina supervisory personnel in this case, and
17 the Commission finds no reasonable basis to exclude any
18 portion of the STI program from the Company's cost of service
19 in this proceeding. Also, the Commission notes that witness
20 Kopas specified that there have been no similar ratemaking
21 adjustments either proposed or made in Aqua NC's last two
22 rate case proceedings

23
24 **Q. WHY DO YOU CITE THE ABOVE-QUOTED LANGUAGE FROM THE**
25 **COMMISSION'S SUB 497 RATE CASE ORDER AT THIS POINT IN**
26 **YOUR TESTIMONY?**

27 A. Aqua believes and asserts that the rationale used by the
28 Commission in the Sub 497 Order, as quoted above, is also
29 applicable to the ratemaking adjustments proposed by the Public
30 Staff as discussed in Sections IV and V of this rebuttal testimony.
31 The services provided to Aqua North Carolina by employees in
32 Corporate Services and Aqua Customer Operations provide
33 services directly to the Company as it provides water and sewer
34 service to its customers. These services are centralized to provide

1 economies of scale to each state's operation they support and
2 reduce the cost that may otherwise be necessary for each state to
3 maintain these same redundant services independently. Aqua
4 admits that these employees are not directly employed by the
5 Company, but they provide services which are critical to Aqua's
6 ability to provide "adequate, efficient and reasonable service" to its
7 customers as required by G.S. 62-131(b). In fact, nearly forty
8 Customer Service Representatives ("CSRs"), who work from a
9 customer call center which is located in Cary, North Carolina, have
10 direct interactions with Aqua's customer base on a daily basis. The
11 Public Staff's attempt to adjust responsibility for the specified valid
12 expenses under discussion is misguided, incorrect, and not justified
13 by the facts. Approval of any or all these proposed ratemaking
14 adjustments would send the wrong message in that it will only
15 embolden the Public Staff to continue to propose meritless
16 positions in the future.

17 **Q. WHAT DOES AQUA RECOMMEND IN THIS CURRENT PROCEEDING?**

18 A. Compensation and benefits, whether for the Aqua America Executives,
19 Board of Directors, Corporate Services, or Aqua Customer Operations
20 employees, unquestionably benefit both ratepayers and shareholders.
21 These individuals---through their governance and vital contributions to the
22 operation of Aqua's business---have a fiduciary responsibility to maintain a

1 high level of quality. This requires great proficiency as they guide, direct,
2 and contribute to Aqua's impact---as an essential water and sewer utility
3 service provider---on the environment, on customers' welfare and safety,
4 and on economic development. The relationships among ratepayers,
5 shareholders, and employees are greatly enhanced when the leaders of
6 Aqua align the interests of all parties and society as a whole. Considering
7 these facts, Aqua requests the Commission to adopt the Company's
8 position on the significant issues addressed by this rebuttal testimony.

9 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

10 **A.** Yes, it does.