

1 PLACE: Dobbs Building, Raleigh, North Carolina
2 DATE: September 20, 2017
3 DOCKET NO.: W-354, Sub 356
4 TIME IN SESSION: 9:32 A.M. TO 10:03 A.M.
5 BEFORE: Chairman Edward S. Finley, Jr., Presiding
6 Commissioner Bryan E. Beatty
7 Commissioner ToNola D. Brown-Bland
8 Commissioner Jerry C. Dockham
9 Commissioner James G. Patterson
10 Commissioner Lyons Gray
11 Commissioner Daniel G. Clodfelter

12
13 IN THE MATTER OF:
14 Application by Carolina Water Service, Inc. of North
15 Carolina, 5701 Westpark Drive, Suite 101, Charlotte,
16 North Carolina 28217 for Authority to Adjust and
17 Increase Rates for Water and Sewer Utility Service in
18 All of Its Service Areas in North Carolina, Except
19 Corolla Light and Monteray Shores Service Area and
20 Elk River Developments.

21
22 VOLUME 7

23

24

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1 P R O C E E D I N G S

2 CHAIRMAN FINLEY: Good morning. My name is
3 Edward Finley, and with me this morning are Commissioners
4 Bryan E. Beatty, ToNola D. Brown-Bland, Jerry C. Dockham,
5 James G. Patterson, and Lyons -- Lyons Gray, and Daniel
6 G. Clodfelter.

7 The Commission calls for a hearing at this time
8 Docket No. W-354, Sub 356, In the Matter of Application
9 of Carolina Water Service, Inc. of North Carolina for
10 Authority to Increase Rates for Water and Sewer Utility
11 Service for its subdivisions in North Carolina.

12 On March 31, 2017, Carolina Water filed an
13 Application with the Commission seeking authority to
14 increase its rates for providing water and sewer utility
15 service for all of its service areas in North Carolina.

16 On April 26, 2017, the Commission issued its
17 Order Establishing General Rate Case and Suspending
18 Rates. Pursuant to this order, the Commission declared
19 this proceeding to be a general rate case pursuant to
20 G.S. 62-137 that suspended the proposed rates for up to
21 270 days pursuant to G.S. 62-134.

22 On May 23, 2017, Corolla Light Community
23 Association filed a Petition to Intervene, and this
24 petition was granted by order issued June 16, 2017.

1 On June 2, 2017, the Commission issued its
2 Order Scheduling Hearings and Requiring Customer Notice,
3 which, among other things, scheduled this Application for
4 evidentiary hearing for this date, at this time, and in
5 this place. Public hearings in this matter for purposes
6 of taking non-expert public witness testimony were held
7 in Asheville, Boone, Charlotte, New Bern, Wilmington, and
8 Raleigh.

9 On August 7, 2017, Carolina Water prefiled
10 direct testimony of Richard Linneman -- I think that's
11 pronounced right -- in support of the Company's
12 Application.

13 On August 7, 2017, Carolina Water and the
14 Public Staff filed a Stipulation of Settlement regarding
15 cost of capital and capital structure issues.

16 On August 30, 2017, the Public Staff moved for
17 an extension of time to prefile testimony and a
18 corresponding extension of time for Carolina Water
19 Service to file rebuttal testimony, stating that
20 settlement discussions between the Public Staff and
21 Carolina Water were in progress and that the parties
22 needed additional time to complete those discussions.

23 On September 1, 2017, the Commission approved
24 the enlargement of time to September 12, 2017, for the

1 Public Staff to prefile testimony and to September 15,
2 2017, for the Company to file rebuttal testimony.

3 On September 12, 2017, the Public Staff filed a
4 second motion for extension of time for prefiled
5 testimony to September 19, 2017, stating that the Public
6 Staff and Carolina Water had reached a settlement on all
7 issues in dispute, but required additional time for the
8 Company to provide information regarding final capital
9 projects that the Company seeks to include in this case
10 and to allow the Public Staff time to audit those
11 projects.

12 All parties have consented to the request and
13 the Commission approved the extension until September 19,
14 2017, for the Public Staff and the Company to file a
15 Stipulation and Settlement Agreement and supporting
16 prefiled testimony.

17 On September 19, 2017, the Public Staff filed
18 the testimony and exhibits of Public Staff Witnesses Gina
19 L. Casselberry, Lindsay Quant, Sonya R. Johnson, and
20 Calvin C. Craig, III.

21 Also, on September 19th, 2017, a Joint
22 Stipulation was filed by Carolina Water Service and the
23 Public Staff. Carolina Water has reviewed the Public
24 Staff's prefiled testimony and exhibits and accepts the

1 Public Staff's recommended revenue requirements, rate
2 design, and other recommendations.

3 Numerous customer statements of position have
4 been filed in the docket.

5 Pursuant to the State Ethics Act I remind all
6 members of the Commission of their duty to avoid
7 conflicts of interest and inquire whether any member of
8 the Commission has a known conflict of interest with
9 regard to the matters coming before the Commission this
10 morning?

11 (No response.)

12 CHAIRMAN FINLEY: There appear to be no
13 conflicts, so we will proceed, and I will -- I'll call
14 upon the parties to announce their appearances, beginning
15 with the Applicant.

16 MS. SANFORD: Thank you, Chairman Finley and
17 members of the Commission. I'm Jo Anne Sanford with
18 Sanford Law Office representing Carolina Water Service of
19 North Carolina. With me at counsel table are Bob Bennink
20 also representing the Company; Matt Klein, State
21 President; Richard Linneman, Bryce Mendenhall, and with
22 us in the audience are Anthony Gray and Deb Clark. I
23 think that's all the Company people who are here.

24 I would like to quickly say that we know we

1 have made a -- a big negative intrusion on your schedule
2 and on your ability to hear this case, and I apologize.

3 MR. ALLEN: Good morning, Chairman Finley and
4 Commissioners. My name is Brady Allen. I'm an attorney
5 with the Allen Law Offices, PLLC, in Raleigh, North
6 Carolina. I'm here today to represent the Corolla Light
7 Community Association. It is a group of about 450
8 homeowners in Corolla Light, which is on the Outer Banks
9 of North Carolina. All of these customers are -- all of
10 these members are wastewater customers of Carolina Water
11 Service. Thank you.

12 MS. HOLT: Good morning. I'm Gina Holt with
13 the Public Staff here -- here on behalf of the Using and
14 Consuming Public. And with me at counsel table is Public
15 Staff Engineer Gina Casselberry and co-counsel is William
16 Grantmyre.

17 CHAIRMAN FINLEY: All right. Other than the
18 procedural matters that we've discussed before we opened
19 the hearing, are there other preliminary matters that we
20 need to discuss before hearing from the public witnesses?

21 MS. SANFORD: No, sir.

22 MS. HOLT: No.

23 CHAIRMAN FINLEY: All right. Ms. Holt?

24 MS. HOLT: Public Staff calls Mr. Bryan McCabe.

1 BRYAN McCABE; Having been duly sworn,

2 Testified as follows:

3 DIRECT EXAMINATION BY MS. HOLT:

4 Q Could you please state your name and address
5 for the record.

6 A I am Bryan McCabe. I live at 612 Brewster Lane
7 in Wilmington, North Carolina.

8 Q Now, Mr. McCabe, are you here as a customer or
9 in a representative capacity?

10 A I'm here representing the Pender County Board
11 of Commissioners who have asked me to read this letter of
12 position that they have.

13 Q Okay. Please proceed.

14 A This letter was already provided and is in the
15 docket, I know, written on July 24th, 2017, to the North
16 Carolina Utilities Commission. "Dear Members of the
17 Commission: We understand that Utilities, Inc. has a
18 request for a rate increase for the Belvedere Plantation
19 system, which was heard at the August 23rd, 2017 meeting.
20 For the first time in our combined service of over 30
21 years as County Commissioners, we are submitting a letter
22 in opposition to a requested rate increase. We recognize
23 that authority to approve or deny rate increases is
24 vested solely in your Commission, but hope that you will

1 consider this letter in your deliberations. The
2 customers of Utilities, Inc. have experienced multiple
3 service issues, including pressure problems and
4 discolored water, which made cleaning themselves, their
5 dishes, and their homes futile, and often ruined any
6 light colored clothes which they washed. Utilities, Inc.
7 claims to be working on correcting the problems which it
8 admits occurred. The customers who have had to deal with
9 murky and muddy water want more than promises. They want
10 and deserve actual performance. On behalf of our
11 citizens who have been so negatively affected by the
12 repeated failures of Utilities, Inc. to provide a basic
13 level of service, we implore you not to add insult to
14 injury by raising their rates. At a minimum, we ask that
15 you defer any action on the requested rate increase until
16 after the repairs to the system have been made. Perhaps
17 if you delay any final decision, that will motivate
18 Utilities, Inc. to expedite the much needed corrective
19 action. Respectfully submitted, George Brown, Chairman
20 of the Pender County Board of Commissioners, and Jay
21 David Williams from District 1."

22 CHAIRMAN FINLEY: All right. Thank you, Mr.
23 McCabe. Are there questions of Mr. McCabe?

24 MS. HOLT: I have no questions.

1 CHAIRMAN FINLEY: All right. Thank you for
2 coming up this morning.

3 THE WITNESS: Thank you.

4 CHAIRMAN FINLEY: Yes, sir.

5 MS. HOLT: Mr. Vince Roy..

6 MR. ROY: Good morning.

7 CHAIRMAN FINLEY: Are you -- I think you've
8 already been sworn in this case, haven't you, Mr. Roy?
9 Have you testified already in this case?

10 MS. HOLT: Yes, he has.

11 CHAIRMAN FINLEY: Then you've already been
12 sworn, so let's -- let's hear from you.

13 VINCENT P. ROY; Having been previously been sworn,
14 Testified as follows:

15 THE WITNESS: You have all my testimony, my --
16 my documentation, my August 28th presentation, and I
17 won't repeat that. And I'm scrapping my presentation for
18 today and move getting the -- a copy of the Joint
19 Stipulation through my subscription with the UC. And I
20 must say that I want to compliment both the Public Staff
21 and Utilities, Inc. for -- for working out many of the
22 issues that we were concerned about, and -- and I -- I
23 understand that you're going to -- haven't reviewed it
24 yet; you will be.

1 And so I'll keep my comments short and -- and
2 limited to the couple of concerns that we had at the
3 beginning that we still have, and that is, number one,
4 the fact that instead of relying on -- on usage of the
5 water and sewer, they're asking for an extremely -- in
6 our opinion, an extremely high base rate with a minimum
7 usage rate. And our argument in that regard is that it
8 certainly discourages conservation and it -- it provides
9 to them a -- a guaranteed income, which I talked about
10 before showing my charts of our certified public
11 accountant. And, for example, I'm opening up my office
12 in Dubai on -- in October, and over the months we've
13 worked very hard in -- in reducing our costs and making
14 sure that we're going to be a viable operation in Dubai
15 and -- and mitigating our risks, and it just appears to
16 us that I haven't seen that effort on the part, at least
17 not in writing, on the part of Utilities, Inc. in terms
18 of making sure that -- that all of their costs, their
19 fixed and variables have been reduced to the minimum
20 necessary. And I know that when they get into the
21 uniform rate program, they won't have to be going through
22 individual rates, and so that should further allow them
23 to reduce their -- their cost of doing business.

24 And in -- in that same vein, as we look at our

1 operation coming up in Dubai, looking at where our sales
2 are going to cross the expense line or our break-even
3 point is, there's no break-even point necessary for
4 Utilities, Inc. because on day one with the base rates
5 that they're proposing and apparently going to get for --
6 for each customer, they're going to make profit on day
7 one, which is not the typical classic kind of business
8 pro forma that you'd be developing.

9 At any rate, that, along with the fact that in
10 addition we still think that the 9.6 percent profit rate
11 that is in the Joint Stipulation is, in our opinion,
12 high. And, of course, we leave it to you all. You're
13 going to review it. You'll make your decision.

14 But, again, I thank both -- both operations,
15 Public Staff and Utilities, Inc., for -- for working
16 together and producing a Joint Stipulation, and we'll go
17 back home and read it more thoroughly, too.

18 CHAIRMAN FINLEY: All right.

19 THE WITNESS: That's all I have, sir.

20 CHAIRMAN FINLEY: Thank you for coming back,
21 Mr. Roy. All right. Ms. Sanford?

22 MS. SANFORD: Let's see. Thank you, Mr.
23 Chairman. We will call Richard Linneman.

24 RICHARD LINNEMAN; Having been duly sworn,

1 Testified as follows:

2 DIRECT EXAMINATION BY MS. SANFORD:

3 Q We're passing out copies of Mr. Linneman's
4 summary, and while we're doing that, let me ask you a few
5 qualifying questions, Mr. Linneman. Would you state your
6 name and business address for the record, please.

7 A My name is Richard Linneman. My business
8 address is 4944 Parkway Plaza Boulevard, Suite 375,
9 Charlotte, North Carolina.

10 Q Thank you. And your position with the Company?

11 A I am Financial Planning and Analysis Manager.

12 Q Okay. Did you cause to be prepared testimony
13 consisting of 19 pages and one exhibit filed on August
14 the 7th?

15 A Yes.

16 Q Do you have any changes to make to that
17 testimony?

18 A I do have one change to make --

19 Q Okay.

20 A -- from the original testimony.

21 Q All right.

22 A On page 5 -- or page 1, line 5, where it states
23 that I have -- was employed with the Company since
24 November 2016, I've actually been employed with the

1 Company since November 2015, and that has been adjusted
2 in the testimony that was just passed out.

3 Q Okay. All right. Thank you. Any other
4 changes?

5 A That's it.

6 Q Have you prepared a summary?

7 A I have.

8 MS. SANFORD: We'd ask --

9 CHAIRMAN FINLEY: Let's -- let's -- let's get
10 his testimony copied into the record.

11 MS. SANFORD: I would ask that it be copied
12 into the record, his testimony, and his exhibit.

13 CHAIRMAN FINLEY: Mr. Linneman's direct
14 prefiled testimony submitted on August 7, 2017,
15 consisting of 19 pages, is copied into the record as
16 though given orally from the stand, and his one exhibit
17 is marked for identification as premarked in the filing.

18 MS. SANFORD: Thank you.

19 (Whereupon, the prefiled direct
20 testimony of Richard Linneman, as
21 corrected, was copied into the record
22 as if given orally from the stand.)

23

24

1 **Q. Please state your name, occupation and business address for**
2 **the record.**

3 A. My name is Richard Linneman. I am employed as the Financial
4 Planning and Analysis Manager for Carolina Water Service, Inc. of North
5 Carolina ("CWSNC" or "Company"), 4944 Parkway Plaza Boulevard,
6 Suite 375, Charlotte, North Carolina 28217.

7 **Q. Please summarize your professional background.**

8 A. I have been employed by CWSNC since November 2016. I
9 graduated from Coastal Carolina University in Conway, South Carolina with
10 a Bachelor of Science degree in Finance. Prior to joining CWSNC, I was
11 the Director of Financial Planning and Analysis for Leslie's Poolmart, Inc.,
12 the world's largest retailer of swimming pool supplies and chemicals.
13 During my five years in that position, I was responsible for forecasting,
14 budgeting, financial analysis, strategic planning, acquisitions, and market
15 valuations.

16 **Q. Please explain your job responsibilities at CWSNC.**

17 A. My primary responsibilities include forecasting, budgeting, and
18 financial analysis. I am also responsible for the oversight of gathering data
19 and preparation of rate cases, filing applications for rate cases, and
20 providing data request responses for support of rate case filings.

21 **Q. Please describe Carolina Water Service, Inc. of North Carolina.**

1 A. CWSNC is a wholly-owned subsidiary of Utilities, Inc. ("UI").
2 CWSNC is an investor-owned public utility pursuant to North Carolina
3 General Statute ("G.S.") 62-3, does business as a regulated water and
4 sewer utility in North Carolina, and is subject to the regulatory oversight of
5 the North Carolina Utilities Commission ("Commission" or "NCUC").¹
6 CWSNC has provided water and sewer service in North Carolina for
7 52 years. CWSNC has applied for an adjustment in water and sewer rates
8 and charges for all of its service areas in North Carolina, excluding the
9 Corolla Light and Monteray Shores service area and the Elk River
10 Development. This is the first general rate case filed by CWSNC since its
11 2016 merger and consolidation of the North Carolina systems.

12 The Company is the State's second-largest Commission-regulated
13 water and sewer public utility. CWSNC presently serves approximately
14 34,402 water customers and 21,373 sewer customers in North Carolina and
15 operates approximately 92 water systems and 38 sewer systems in the
16 State. The Company's service territory spans 38 counties in North Carolina,
17 from Bear Paw in Cherokee County to Corolla in Currituck County.

¹ On April 22, 2016, CWSNC, Bradfield Farms Water Company (Bradfield Farms), Carolina Trace Utilities, Inc. (Carolina Trace), CWS Systems, Inc. (CWSS), Elk River Utilities, Inc. (Elk River), and Transylvania Utilities, Inc. (Transylvania) filed a Joint Application for Approval of Merger with the Commission in Docket No. W-354, Sub 350 requesting approval of the merger of Bradfield Farms, Carolina Trace, CWSS, Elk River, and Transylvania (all of which, like CWSNC, were wholly-owned subsidiaries of UI) into CWSNC. On August 17, 2016, the Commission entered an Order Approving Merger. The Articles of Merger were filed with the North Carolina Secretary of State on August 30, 2016. Since that date, CWSNC has owned and operated all of the merged water and sewer systems previously owned and operated by the five former UI subsidiaries.

1 Consequently, CWSNC, as a regulated public utility, has a continuing
2 responsibility to upgrade the Company's widely-dispersed utility
3 infrastructure and make necessary improvements to ensure its ability to
4 continue to consistently provide adequate, efficient, and reasonable service
5 to its customers as required by G.S. 62-131(b).

6 The Company also has an obligation to comply with changing
7 environmental, health, and safety regulations and to fulfill its overall
8 obligation to provide quality, dependable service pursuant to its certificate
9 of public convenience and necessity. To that end, CWSNC has invested
10 more than \$23 million in capital improvements during the period of time
11 extending from 2016 to 2017. In addition, the Company continues to fund
12 required operations and expense ("O&M") increases to ensure quality and
13 compliant service.

14 **Q. Please describe UI.**

15 A. UI is relatively unique within the water and sewer industry in some
16 respects. From its inception 52 years ago, UI has concentrated on the
17 purchase, formation and expansion of smaller water and/or sewer utility
18 systems. Most often, these are the types of systems that cause state
19 regulators and health authorities an inordinate amount of time and concern,
20 due to problems related to product quality, customer service, financial
21 stability and rates.

1 At the present time, UI has 16 subsidiary operating companies---like
2 CWSNC---which provide water and sewer utility service to approximately
3 197,732 customers in 16 states.

4 **Q. How do CWSNC's customers benefit from the Company's**
5 **affiliation with UI?**

6 A. The affiliation with UI has many benefits for CWSNC customers.
7 One of the primary benefits is that CWSNC has access to a large pool of
8 human resource capabilities upon which to draw. There are experts in
9 various critical areas, such as construction, engineering operations,
10 accounting, data processing, billing, regulation, and customer service.
11 UI has the highest level of combined expertise and level of experience,
12 allowing it to provide service in a more cost-effective manner.

13 While operating only water and sewer systems, UI personnel have
14 the ability to meet the challenges of the rapidly changing utility industry.
15 Because the UI companies are focused on the water and sewer industry,
16 our companies enjoy some unique advantages, one of which is that capital
17 is available for improvements and expansion at a reasonable cost. With
18 increasingly more stringent health, safety, and environmental standards,
19 ready access to capital will prove vital to continued quality service in the
20 water and sewer utility business.

21 In addition, the UI group of companies has national purchasing

1 power, resulting in lower costs to ratepayers. Expenditures for insurance,
2 vehicles, chemicals, and meters are a few examples of purchases where
3 national contracts provide tangible benefits to ratepayers.

4 **Q. What is the purpose of your direct testimony?**

5 A. The purpose of my direct testimony is to explain why CWSNC has
6 requested Commission approval to increase its water and sewer rates. The
7 Company filed its Application for a general rate increase ("Rate Case
8 Application") on March 31, 2017. I discuss some of the factors that have
9 contributed to the need for these increases and their impact on CWSNC's
10 customers. I also discuss the terms regarding the cost of debt and equity,
11 the overall cost of capital, and rate of return on rate base. In addition, I will
12 sponsor the Company's financial exhibits, including pro forma income
13 statements and balance sheets.

14 **Q. When did CWSNC and the other former UI subsidiaries receive**
15 **their last general rate increases?**

16 A. CWSNC's last general rate case (pre-merger) was decided by
17 NCUC Order ("2015 Rate Case Order") entered on December 7, 2015, in
18 Docket No. W-354, Sub 344. Transylvania's last general rate case
19 (pre-merger) was decided by NCUC Order entered on January 15, 2010, in
20 Docket No. W-1012, Sub 12. Carolina Trace's last general rate case
21 (pre-merger) was decided by NCUC Order entered on November 24, 2010,

1 in Docket No. W-1013, Sub 9. Bradfield Farms' last general rate case
2 (pre-merger) was decided by NCUC Order entered on March 27, 2015, in
3 Docket No. W-1044, Sub 41. CWSS's last general rate case (pre-merger)
4 was decided by NCUC Order entered on February 24, 2016, in Docket No.
5 W-778, Sub 91. Elk River's last general rate case (post-merger) was
6 decided by NCUC Order entered on September 20, 2016, in Docket No.
7 W-1058, Sub 7.²

8 CWSNC is both obligated and committed to facilitate and maintain
9 the continued achievement of its goals and high standards regarding safety,
10 operational performance and customer service. Therefore, the Company's
11 capital investments in utility plant in service and O&M expense---which
12 provide necessary benefits to customers and which are dedicated to public
13 use---must be recovered in rates.

14 This is the first general rate case filed by CWSNC since the merger
15 was approved by the Commission on August 17, 2016. By its Rate Case
16 Application, which was filed in this docket on March 31, 2017, CWSNC
17 proposes to establish four Rate Divisions for ratemaking purposes in this
18 proceeding as follows:

19 CWSNC Uniform Water
20 CWSNC Uniform Sewer

² The NCUC Order in the Elk River rate case was issued after consummation of the merger.

1 Bradfield Farms/Fairfield Harbour Water³

2 Bradfield Farms/Fairfield Harbour Sewer

3 **Q. Please describe the four Rate Divisions and how they will**
4 **operate.**

5 A. The CWSNC Uniform Water and Sewer Rate Divisions will consist
6 of all water and sewer systems currently owned and operated by the
7 Company, except for the Bradfield Farms and Fairfield Harbour service
8 areas. The Bradfield Farms and Fairfield Harbour water and sewer service
9 areas have been combined into separate Water and Sewer Rate Divisions
10 for purposes of this case, with uniform water and sewer rates within each
11 Rate Division. CWSNC's ultimate goal, in future general rate cases, is to
12 move Bradfield Farms and Fairfield Harbour into the CWSNC Uniform
13 Water and Sewer Rate Divisions.

14 **Q. Please describe the Company's proposed rate design in this**
15 **case.**

16 A. CWSNC proposes no rate changes for customers in the Company's
17 Elk River Development and Corolla Light/Monteray Shores service area.
18 Customers in the Elk River Development service area were impacted by a
19 recent rate increase effective September 20, 2016, and, for that reason, the
20 Company is reluctant, at this time, to further increase rates for those

³ Bradfield Farms is located in Mecklenburg County and Fairfield Harbour is in Craven County.

1 particular customers by applying CWSNC's uniform water and sewer rates
2 to them. This course of action will be reevaluated in the Company's next
3 rate case.

4 As for the Corolla Light/Monteray Shores service area, CWSNC's
5 proposal to not increase (but hold constant) the water and sewer rates for
6 those affected customers is consistent with the ratemaking and rate design
7 approved by the Commission in the Company's last two general rate cases
8 (Docket Nos. W-354, Subs 336 and 344) and will continue the orderly
9 process of moving the Corolla Light/Monteray Shores service area toward
10 full inclusion in the Company's uniform water and sewer rates in future
11 general rate cases.

12 **Q. What is the test year for this rate case?**

13 A. The test year for this general rate case is the year ended
14 December 31, 2016. This is the most recent twelve months of data
15 available.

16 **Q. Did CWSNC cause a notice of rate increase of its petition to be**
17 **mailed to its customers?**

18 A. Yes. CWSNC caused the prescribed Notices to Customers, as
19 approved by the North Carolina Utilities Commission, to be mailed to all of
20 its affected customers in a timely manner.

21 **Q. Please describe the rates which CWSNC's customers are**

1 currently being charged for water and sewer utility service.

2 A. By Order dated December 20, 2016, the current water and sewer
3 rates and charges for CWSNC's customers were approved by the
4 Commission in Docket Nos. W-354, Sub 342 and M-100, Subs 138 and
5 142, effective January 1, 2017. The current Schedules of Rates, which
6 were attached to the Commission's December 20, 2016 Order as
7 Appendices A-1 through A-14, are incorporated herein by reference.

8 **Q. What rates does CWSNC propose in this case?**

9 A. The proposed water and sewer rates charges for CWSNC's
10 customers are attached to my testimony as Exhibit 1.

11 **Q. Were the financial schedules attached to CWSNC's Rate Case**
12 **Application prepared by you and/or under your direction?**

13 A. Yes, the schedules attached to the Rate Case Application were
14 prepared by me.

15 **Q. Are those financial schedules incorporated as part of your**
16 **testimony?**

17 A. Yes. They are incorporated herein by reference.

18 **Q. Please describe those schedules.**

19 A. The Rate Case Application includes the financial statements for
20 CWSNC. The referenced Schedules are as follows:

- 1 Schedule A – Balance Sheet
- 2 Schedule B – Income Statement
- 3 Schedule C – Rate Base and Rate of Return
- 4 Schedule D – Test Year / Present Revenues
- 5 Schedule E – Proposed Revenues

6 **Q. Please explain how test year expenses were adjusted.**

7 A. As previously stated, the Company's test year is the twelve-month
8 period ended December 31, 2016. Pro forma adjustments were made to
9 the test year expenses based on known and measurable changes to actual
10 expenses.

11 **Q. Were known and measurable pro forma adjustments also made**
12 **to the Company's income statement (Schedule B) and its rate base**
13 **statement (Schedule C)?**

14 A. Yes, as detailed therein.

15 **Q. Why is CWSNC requesting rate relief at this time?**

16 A. CWSNC's current balance sheet and income statement are
17 contained in the Company's Rate Case Application. CWSNC's balance
18 sheet is attached to the Application as Schedule A and the Company's
19 income statement is attached to the Application as Schedule B. The

1 Company's current rate base and rate of return is shown on Schedule C of
2 the Application.

3 Without satisfactory rate relief, CWSNC's ability to continue to
4 provide safe, reliable and efficient water and sewer utility services to its
5 customers and to meet its financial obligations will be impaired and made
6 more difficult. In addition, capital will likely become more costly.

7 More specifically, under present rates, CWSNC is not able to meet
8 its operating costs and earn a reasonable return on its investment in the
9 Company's system. During the test year, CWSNC experienced the
10 following overall rate of return for its combined water and sewer operations:
11 7.23%. The Company's test year overall returns were 6.59% for water
12 operations and 7.93% for sewer operations. These rates of return are well
13 below CWSNC's currently-authorized overall rate of return on rate base of
14 8.20%, which is based on an authorized rate of return on common equity of
15 9.75%, established by the Commission in its 2015 Rate Case Order in
16 Docket No. W-354, Sub 344.

17 Furthermore, over the two-year period of time from 2015 through
18 2016, CWSNC's achieved returns on common equity have averaged
19 5.18%. The disparity between the levels of the Company's actually-
20 achieved returns on common equity and its Commission-authorized rates
21 of return in prior rate cases are not in the best long-term interests of
22 CWSNC's customers, the Commission's effective regulatory oversight, or

1 the Company's shareholders. CWSNC must have a reasonable *opportunity*
2 to earn its Commission-authorized rate of return in order to facilitate its
3 ability to continue to raise the capital necessary to provide adequate,
4 efficient, and reasonable service to customers.⁴

5 **Q. WHAT RATES OF RETURN AND CAPITAL STRUCTURE DID THE**
6 **COMPANY INITIALLY REQUEST IN THIS CASE?**

7 A. After pro forma adjustments as set forth in its Rate Case Application,
8 CWSNC requested an overall rate of return of 8.55% for its combined water
9 and sewer operations. This overall rate of return of 8.55% was based upon
10 a capital structure consisting of 47.11% long-term debt and
11 52.89% common equity and cost rates of 6.58% for long-term debt and
12 10.30% for common equity.

13 **Q. HAVE THE COMPANY AND THE PUBLIC STAFF NEGOTIATED**
14 **A STIPULATED SETTLEMENT REGARDING THE RATE OF RETURN**
15 **AND CAPITAL STRUCTURE ISSUES?**

16 A. Yes. On August 7, 2017, CWSNC and the Public Staff filed a
17 Stipulation in this docket whereby we reached a settlement on all rate of

⁴ To facilitate this opportunity, CWSNC supports, among other possible changes, adoption by the North Carolina General Assembly of ratemaking legislation authorizing utilization of a fully-projected future test period (as an alternative to use of the traditional G.S. 62-133(c) test period) by water and sewer public utilities in North Carolina.

1 return and capital structure issues in this case. The terms of such
2 settlement are as follows:

- 3 a. Long-Term Debt Ratio: 48.0%
- 4 b. Common Equity Ratio: 52.0%
- 5 c. Embedded Cost of Debt: 5.93%
- 6 d. Return on Common Equity: 9.60%
- 7 e. Overall Weighted Rate of Return: 7.84%

8 CWSNC supports the August 7, 2017 Stipulation and urges the
9 Commission to adopt, as just and reasonable, the terms thereof for
10 purposes of deciding this case.

11 **Q. Please describe the primary reasons which underlie the**
12 **Company's need for rate relief.**

13 A. The primary reasons for CWSNC's requested rate increase involve
14 increases in expenses and plant additions. Significant capital investment
15 has occurred since the last rate cases for CWSNC and the former
16 UI subsidiaries which were merged into CWSNC. The Rate Case
17 Application also includes approximately \$8,966,000 of anticipated post-test
18 year additions for projects which are currently in progress and are intended
19 to be completed by the close of the hearing in this case.

20 The new rates applied for by CWSNC are necessary because the
21 Company has been unable to achieve the levels of earnings specified by
22 the Commission in the last general rate cases for CWSNC and the other

1 merged UI subsidiaries. The failure to achieve these levels of earnings was
2 caused by increased operating costs to upgrade the level of service,
3 increased operating costs and capital investments required to comply with
4 service obligations (including the regulatory lag encountered in the
5 Company's inability to timely recover such costs through rates), and
6 changes in consumption, all occurring since the last rate increases.⁵

7 **Q. Please describe the revenue increases requested in this case,**
8 **including details regarding the Company's underlying investment in**
9 **utility plant, capital structure, and debt and equity costs.**

10 A. The Rate Case Application was prepared and submitted pursuant to
11 the provisions of G.S. 62-133 based upon a requested return on the
12 Company's rate base.⁶ The proposed tariffs are designed to produce
13 additional gross revenues on a companywide basis of \$5,557,499, a
14 19.14% increase over the total revenue level generated by the rates
15 currently in effect for CWSNC. For the CWSNC Uniform Water Rate
16 Division, the proposed tariffs are designed to produce additional gross
17 revenues of \$3,290,544, a 21.70% increase over the total revenue level

⁵ Regarding customer consumption patterns, CWSNC, like the water utility industry in general, has experienced a decline in consumption. This decline in consumption, combined with regulatory lag resulting from use of traditional historical test year ratemaking principles, impairs CWSNC's opportunity to achieve its Commission-authorized rate of return on equity.

⁶ By its Application, the Company has requested that the Commission allow it to recover total water service revenues of \$19,480,792 and total sewer service revenues of \$15,120,335 on a companywide basis.

1 generated by the rates currently in effect for that Rate Division. For the
2 CWSNC Uniform Sewer Rate Division, the proposed tariffs are designed to
3 produce additional gross revenues of \$1,538,630, a 13.05% increase over
4 the total revenue level generated by the rates currently in effect for that
5 Rate Division. For the Bradfield Farms/Fairfield Harbour Water Rate
6 Division, the proposed tariffs are designed to produce additional gross
7 revenues of \$310,166, a 43.12% increase over the total revenue level
8 generated by the rates currently in effect for that Rate Division. For the
9 Bradfield Farms/Fairfield Harbour Sewer Rate Division, the proposed tariffs
10 are designed to produce additional gross revenues of \$418,159, a 30.51%
11 increase over the total revenue level generated by the rates currently in
12 effect for that Rate Division. CWSNC requires increased revenues at this
13 level in order to earn a fair return on its companywide investment of
14 \$99,190,317.

15 The proposed tariffs also include a provision allowing for a
16 pass-through of the cost of water and sewer service, including applicable
17 taxes and fees, required to serve the needs of customers being served by
18 CWSNC in a particular service area, when that water or sewer service is
19 purchased from another supplier. This pass-through provision is authorized
20 by G.S. 62-133.11.

21 **Q. Has the Company included costs for anticipated post-test year**
22 **plant additions as part of its rate case application?**

1 A. Yes. As previously stated, the rate case application includes
2 approximately \$8,966,000 of anticipated post-test year additions.

3 **Q. Has CWSNC been authorized to implement Water and Sewer**
4 **System Improvement Charge Mechanisms pursuant to G.S. 62-133.12**
5 **and Commission Rules R7-39 and R10-26?**

6 A. Yes. Pursuant to G.S. 62-133.12 and NCUC Rules R7-39 and
7 R10-26, the Commission found it to be in the public interest to authorize
8 CWSNC, as part of the Company's 2014 and 2015 general rate cases in
9 Docket Nos. W-354, Subs 336 and 344, to implement Water and Sewer
10 System Improvement Charge ("WSIC/SSIC") Mechanisms applicable to all
11 of the Company's pre-merger customers.⁷ By these statutorily and
12 Commission-authorized Mechanisms, the Company is allowed to recover
13 the annual incremental depreciation expense and capital costs of eligible
14 water and sewer system improvements completed and placed in service
15 between rate cases.

⁷ CWS Systems, Inc. and Elk River Utilities, Inc. were also authorized by the Commission to implement WSIC/SSIC Mechanisms in their last general rate cases in Docket Nos. W-778, Sub 91 and W-1058, Sub 7, respectively. Bradfield Farms Water Company, Carolina Trace Utilities, Inc., and Transylvania Utilities, Inc. did not have pre-merger general rate cases by which those companies were authorized to implement WSIC/SSIC Mechanisms; thus, to date, the WSIC/SSIC Mechanisms are not authorized and in effect for the Bradfield Farms, Carolina Trace, and Transylvania post-merger CWSNC service territories. In Paragraph 16 of the Company's Rate Case Application, CWSNC requested that the Commission specifically find and conclude that the Company's Commission-authorized WSIC/SSIC Mechanisms will, going-forward, apply to all customers now served by CWSNC on a post-merger basis.

1 Q. Has CWSNC in fact implemented the Commission-authorized
2 WSIC/SSIC Mechanisms?

3 A. Yes. The WSIC/SSIC Mechanisms were implemented pursuant to
4 Commission authorization consistent with applicable State law and NCUC
5 Rules.

6 Q. Please explain what changes will occur regarding the
7 Company's authorized WSIC/SSIC Mechanisms subsequent to a
8 decision by the Commission in this case.

9 A. Consistent with NCUC Rules R7-39(k) and R10-26(k), CWSNC's
10 Commission-authorized WSIC and SSIC surcharges will be reset to zero as
11 of the effective date of new base rates established in this general rate case.
12 Thereafter, only the incremental depreciation expense and capital costs of
13 new eligible water and sewer system improvements that have not previously
14 been reflected in the Company's rates will be recoverable through the
15 WSIC/SSIC Mechanisms on a going-forward basis.

16 By law, the cumulative maximum charges between rate cases that
17 the Company may recover through the use of its Commission-authorized
18 WSIC/SSIC Mechanisms cannot exceed five percent of the total service
19 revenues that the Commission ultimately approves in this general rate case.

1 **Q. Will CWSNC's Commission-authorized WSIC/SSIC Mechanisms**
2 **now apply to all water and sewer utility customers served by the**
3 **Company in North Carolina?**

4 A. Yes. All of CWSNC's post-merger customers are subject to the
5 application in this general rate case.⁸ Therefore, the Company's
6 Commission-authorized WSIC/SSIC Mechanisms will, on a going-forward
7 basis, apply to all customers served by CWSNC, including those customers
8 incorporated into the Company as a result of the Commission-authorized
9 2016 corporate merger. To that end, CWSNC has requested the
10 Commission to specifically find and conclude that it is in the public interest
11 for the Company's Commission-authorized WSIC/SSIC Mechanisms to
12 henceforth apply to all customers now served by CWSNC on a post-merger
13 basis.

⁸ Decretal Paragraph 9 of the August 17, 2016 Order Approving Merger in Docket Nos. W-354, Sub 350 et al. provided as follows:

That the WSIC and SSIC Mechanisms currently in effect for CWSNC and CWSS (and Elk River, if approved by the Commission in its pending rate case in Docket No. W-1058, Sub 7) shall continue in effect post-merger, but shall not apply to customers in the Bradfield Farms, Carolina Trace, or Transylvania service areas until such time as CWSNC has either (1) a consolidated general rate case affecting the rates applicable to customers in the areas currently served by Bradfield Farms, Carolina Trace, and/or Transylvania; or (2) a stand-alone general rate case or cases where the Company proposes implementation of a separate WSIC/SSIC Mechanism specific to one or more of the areas currently served by Bradfield Farms, Carolina Trace, or Transylvania.

1 **Q. Has CWSNC developed and filed an Ongoing Three-Year**
2 **WSIC/SSIC Plan as part of the Company's pending Rate Case**
3 **Application?**

4 A. Yes. Consistent with NCUC Rules R7-39(c)(1) and R10-26(c)(1), the
5 Company's Three-Year WSIC/SSIC Plan was attached to the Rate Case
6 Application as Appendix C. A copy of that Plan is incorporated herein by
7 reference. The Company proposes and describes in detail thirty-nine (39)
8 proposed WSIC and SSIC projects, including estimates of the cost of the
9 specific improvements and dates when the improvements will be placed into
10 service, that it will implement at an investment cost of almost \$2.49 million
11 during the period of the Three-Year Plan; i.e., the 2017-2020 timeframe.
12 CWSNC will invest a total of almost \$1.27 million of capital in WSIC projects
13 and \$1.22 million of capital in SSIC projects during the entire Three-Year
14 WSIC/SSIC period ending in 2020.

15 **Q. Is this testimony true and accurate to the best of your**
16 **knowledge, information, and belief?**

17 A. Yes, it is.

18 **Q. Does this conclude your testimony?**

19 A. Yes.

1 (Whereupon, Linneman Exhibit 1 was
2 identified as premarked.)

3 BY MS. SANFORD:

4 Q All right. Mr. Linneman, if you would proceed
5 with your summary, please.

6 A Yes. After months of discovery, the Company
7 and Public Staff filed two Stipulations whereby we
8 settled all of the ratemaking issues in this case and
9 agreed upon matters such as the appropriate capital
10 structure, cost of capital, revenue requirement, and the
11 design of new rates, which we have submitted for review
12 and approval by the Commission.

13 The Company fully supports the Stipulations and
14 the Public Staff's testimony filed in support thereof,
15 and recommends and requests that the Commission approve
16 the Stipulations as filed.

17 The primary reason for CWSNC's stipulated rate
18 adjustments involve increases in operating costs and
19 capital investments required to comply with the service
20 obligations. Significant capital investment has occurred
21 since the last rate case for CWSNC and the former UI
22 subsidiaries which were merged into CWSNC. The rate case
23 application also included almost \$9 million of
24 anticipated post-year additions for 69 capital projects

1 which were intended to be completed by the close of the
2 hearing in this case. Of those 69 projects, all but two
3 were completed and in service by the agreed upon
4 September 13th cutoff date for project eligibility.

5 This concludes my summary.

6 CHAIRMAN FINLEY: All right, Mr. Linneman.
7 We're going to let you step aside for the moment, but
8 don't -- don't leave.

9 THE WITNESS: Okay.

10 CHAIRMAN FINLEY: All right. Public Staff?

11 MS. HOLT: Public Staff calls Ms. Gina
12 Casselberry.

13 GINA CASSELBERRY; Having been duly sworn,
14 Testified as follows:

15 DIRECT EXAMINATION BY MS. HOLT:

16 Q Would you -- could you please state your name
17 and business address for the record.

18 A My name is Gina Casselberry. My business
19 address is 430 North Salisbury Street, Raleigh, North
20 Carolina.

21 Q And what is your title?

22 A I'm a Utilities Engineer with the Public Staff
23 Water and Sewer and Communications Division.

24 Q Ms. Casselberry, on September 19th, 2017, did

1 you prefile in this docket 28 pages of testimony and 27
2 exhibits?

3 A I did.

4 Q Do you have any additions or corrections?

5 A No, I do not.

6 Q If I asked the same questions, would your
7 answers be the same?

8 A Yes.

9 MS. HOLT: The Public Staff moves that Ms.
10 Casselberry's testimony be copied into the record as if
11 given orally from the stand, and that her exhibits be
12 admitted as premarked -- identified as premarked.

13 CHAIRMAN FINLEY: Ms. Casselberry's direct
14 prefiled testimony submitted September 19th, 2017,
15 consisting of 28 pages, is copied into the record as
16 though given orally from the stand, and her 27 exhibits
17 are marked for identification as premarked in the filing.

18 (Whereupon, the prefiled testimony of
19 Gina Y. Casselberry was copied into
20 the record as if given orally from
21 the stand.)

22

23

24

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA
DOCKET NO. W-354, SUB 356

TESTIMONY OF GINA Y. CASSELBERRY
ON BEHALF OF THE PUBLIC STAFF

SEPTEMBER 19, 2017

1 Q. PLEASE STATE FOR THE RECORD YOUR NAME, BUSINESS
2 ADDRESS, AND PRESENT POSITION.

3 A. My name is Gina Y. Casselberry. My business address is 430 North
4 Salisbury Street, Dobbs Building, Raleigh, North Carolina. I am an
5 Advanced Utilities Engineer with the Public Staff's Water, Sewer and
6 Communications Division.

7
8 Q. BRIEFLY STATE YOUR QUALIFICATIONS AND EXPERIENCE
9 RELATING TO YOUR PRESENT POSITION WITH THE PUBLIC
10 STAFF.

11 A. I graduated from Michigan Technology University receiving a Bachelor
12 of Science Degree in Civil Engineering. Prior to joining the Public Staff,
13 I worked for McKim and Creed Engineers, PA, as a Project Engineer
14 designing water and sewer systems. I have been with the Public Staff's
15 Water Division since February, 1992. I have presented
16 recommendations in rate increase proceedings, new franchise and

1 transfer proceedings, and other matters before the Commission for the
2 past twenty-five years.

3 **Q. WHAT ARE YOUR DUTIES IN YOUR PRESENT POSITION?**

4 A. My duties with the Public Staff are to monitor the operations of
5 regulated water and sewer utilities with regard to service and rates.
6 Included in these duties are field investigations to review, evaluate, and
7 recommend changes, when needed, in the design, construction, and
8 operations of regulated water and sewer utilities; presentation of expert
9 testimony in formal hearings; and presentation of information, data,
10 and recommendations to the Commission.

11

12 **Q. PLEASE DESCRIBE THE SCOPE OF YOUR INVESTIGATION IN**
13 **THIS CASE.**

14 A. On March 31, 2017, Carolina Water Service, Inc. of North Carolina
15 (CWSNC or Company) filed an application with the Commission to
16 increase its rates for providing water and sewer utility service in all of
17 its service areas in North Carolina, except Corolla Light and Monteray
18 Shores Service Area (CL/MS) and Elk River Development (Elk River).
19 My investigation included review of customer complaints, contact with
20 the Division of Water Resources (DWR), Water Quality and Public
21 Water Supply, review of company records and analysis of revenues at
22 existing and proposed rates. I have also assisted Public Staff
23 Accountant Sonja Johnson in reviewing expenses and plant in service.

1

2 Q. BRIEFLY DESCRIBE THE COMPANY'S APPLICATION IN THIS
3 CASE.

4 A. On August 17, 2016, the Commission approved the merger of
5 Bradfield Farms Water Company (Bradfield Farms), Carolina Trace
6 Utilities, Inc. (Carolina Trace), CWS Systems, Inc. (CWSS), Elk
7 River, and Transylvania Utilities, Inc. (Transylvania), into CWSNC,
8 which were all subsidiaries of Utilities, Inc.. This is the first general
9 rate case filed by CWSNC since the Commission approved the
10 merger. CWSNC is proposing four rate divisions: CWSNC Uniform
11 Water, CWSNC Uniform Sewer, Bradfield Farms/Fairfield Harbour
12 Water and Bradfield Farms/Fairfield Harbor Sewer. CL/MS and Elk
13 River have separate rates and CWSNC is not proposing a rate
14 change for either.

15

16 CWSNC is proposing uniform water rates for the former Clearwater
17 systems, Treasure Cove, Register Place Estates/North Hills, Glen
18 Arbor/North Bend and Forest Hills Subdivisions; and uniform water
19 and sewer rates for the Fairfield Mountain Valley (a.k.a. Rumbling
20 Bald) service area, Highland Shores Subdivision, Laurel Mountain
21 Estates, the Fairfield Sapphire Valley service area, Carolina Trace,
22 Connestee Falls Subdivision, and the Nags Head service area
23 (sewer only). CWSNC is proposing a base facility charge, based on

1 meter size, for metered residential water and sewer customers in all
2 of its service areas except CL/MS and Elk River. These base facility
3 charges would also apply to CWSNC's purchased water and sewer
4 systems. CWSNC is also requesting to increase the meter testing
5 fee from \$19.95 to \$20.00, the new water customer charge from
6 \$26.93 to \$27.00, the reconnection charge from \$26.93 to \$27.00,
7 the new sewer customer fee from \$21.95 to \$27.00 and the charge
8 for processing NSF checks from \$24.94 to \$25.00 for all its
9 applicable service areas except CL/MS and Elk River.

10 **Q. PLEASE DESCRIBE CWSNC's SERVICE AREAS.**

11 A. CWSNC operates 92 water utility systems and 39 sewer utility
12 systems, some of which serve multiple subdivisions. These water
13 and sewer utility systems are spread throughout North Carolina.
14 CWSNC serves primarily residential customers, but it does serve a
15 limited number of retail and commercial customers. Casselberry
16 Exhibit Nos. 1 and 2 list the water and sewer systems operated by
17 CWSNC. As of the twelve month period ending December 31, 2016,
18 CWSNC served 29,883 water customers and 20,020 wastewater
19 customers, including Elk River and CL/MS. There are also 3,636
20 water availability customers in the Carolina Forest, Woodrun, Linville
21 Ridge, Sapphire Valley, Connetsee Falls, and Fairfield Harbour

1 service area, and 1,224 sewer availability customers in Sapphire
2 Valley, Connestee Falls, and Fairfield Harbour.

3 **Q. WHAT ARE CWSNC'S PRESENT AND PROPOSED RATES?**

4 A. CWSNC's present and proposed rates for water and sewer utility
5 service are shown in Casselberry Exhibit No. 3.

7 **Q. WHAT EFFECTS WOULD THE PROPOSED RATES HAVE ON
8 RESIDENTIAL CUSTOMERS?**

9 A. Based on the average monthly usage in gallons shown, the average
10 residential bills for a 5/8 inch meter would increase (decrease) as
11 follows if the rates requested by CWSNC are approved:

WATER OPERATIONS

<u>Service Area</u>	<u>Average Usage</u>	<u>Existing</u>	<u>Proposed</u>	<u>Percentage</u>
Uniform Flat Rate		\$41.60	\$50.17	20.60%
Uniform Metered Rate	3,980	\$47.87	\$57.60	20.33%
Clearwater systems	3,980	\$34.18	\$57.60	68.52%
Treasure Cove	3,980	\$22.06	\$57.60	161.11%
Forest Hill	3,980	\$43.25	\$57.60	33.18%
Fairfield Mountain	3,980	\$47.49	\$57.60	21.29%
Sapphire Valley	3,980	\$56.39	\$57.60	2.15%
Connestee Falls	3,980	\$53.88	\$57.60	6.90%
Carolina Trace	3,980	\$34.19	\$35.75	4.56%
Carolina Forest	3,980	\$35.10	\$39.65	12.96%
High Vista Estates	3,980	\$35.34	\$39.89	12.87%
Riverpointe	3,980	\$47.47	\$52.02	9.59%
Whispering Pines	3,980	\$31.28	\$35.83	14.55%
White Oak/Lee Forest	3,980	\$35.34	\$39.89	12.87%
Winston Plantation	3,980	\$35.34	\$39.89	12.87%
Winston Pointe	3,980	\$35.34	\$39.89	12.87%
Woodrun	3,980	\$35.10	\$39.65	12.96%
Yorktown	3,980	\$42.34	\$46.89	10.75%
Zemosa Acres	3,980	\$43.37	\$47.92	10.49%
Fairfield Harbour	3,980	\$20.44	\$26.97	31.95%
Bradfield Farms	3,980	\$16.05	\$26.97	68.04%

SEWER OPERATIONS

<u>Service Area</u>	<u>Average Usage</u>	<u>Existing</u>	<u>Proposed</u>	<u>Percentage</u>
Uniform Flat Rate		\$52.55	\$ 60.22	14.60%
Sapphire Valley		\$35.52	\$ 60.22	69.54%
Nags Head		\$62.65	\$ 60.22	(3.88%)

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Connetsee Falls		\$49.92	\$ 59.93	20.05%
Uniform Metered Sewer	3,417	\$52.31	\$ 59.93	14.57%
White Oak Plantation/Lee				
Forest/Winston Point	3,417	\$49.47	\$ 54.42	10.01%
Kings Grant	3,417	\$46.90	\$ 51.85	10.55%
College Park	3,417	\$53.40	\$ 58.35	9.27%
Mt. Carmel	3,417	\$54.19	\$ 65.73	21.30%
Fairfield Mountain	3,417	\$86.67	\$108.37	25.04%
Carolina Trace	3,417	\$64.04	\$ 59.93	(6.42%)
Fairfield Harbour		\$37.89	\$ 42.83	13.04%
Bradfield Farms		\$26.56	\$ 42.83	61.26%
Bulk Sewer		\$25.20	\$ 41.83	65.99%

Q. HAVE YOU REVIEWED THE OPERATIONAL STATUS OF THE WATER AND SEWER SYSTEMS WITH THE WATER QUALITY AND PUBLIC WATER SUPPLY SECTIONS OF THE DIVISION OF WATER RESOURCES (NORTH CAROLINA DEPARTMENT OF ENVIRONMENTAL QUALITY)?

A. Yes. I contacted all of the regional offices. None of the regional office personnel expressed any major concerns with the systems serving CWSNC customers or identified any major issues concerning water quality.

Q. HAS THE PUBLIC STAFF RECEIVED ANY CUSTOMER COMPLAINTS AS A RESULT OF THE CUSTOMER NOTICES IN THIS PROCEEDING?

A. Yes. The Public Staff received approximately 120 email messages or letters from CWSNC customers. The service areas represented are Abington (1), Belvedere (6), Bradfield Farms (3), Carolina Trace (63), Connetsee Falls (19), Fairfield Mountain (1), Mt. Carmel (2), Mt. Mitchell (2), Sapphire Valley (7), Sugar Mountain (1),

Treasure Cove (5), Watauga Vista (1), Woodhaven (1), and from unspecified service areas (8). All of the customers objected to the magnitude of the increase. Many complaints received were concerning the corporate structure, rate of return, the notice to customers, and rate design. The Public Staff also received numerous complaints that pertained to rate comparisons between CWSNC's current and proposed rates and the rates of municipalities in North Carolina and other states. Hearings were held across the state for customer testimony, which voiced similar complaints.

Magnitude of the Rates and Other Concerns

Corporate Structure, Management and Rate of Return:

Utilities, Inc. is the parent company and sole owner of CWSNC, which consists of approximately 216 wells, 98 booster stations, 41 wastewater treatment plants, 366 lift stations, 745 miles of water main, 305 miles of sewer main and other equipment such as meters, pumps, valves, blowers, diffusers, vehicles, office equipment, that are necessary to provide water and sewer service. CWSNC manages all operations and has two regional managers, seven area managers, 58 full-time operators, one part-time operator, and five field technicians. The Company manages and operates 92 water systems and 38 sewer systems in 38 counties across North Carolina

1 from Bear Paw Subdivision in Cherokee County to Corolla
2 Light/Monteray Shores in Currituck County. CWSNC's total
3 operating expenses are approximately \$13,350,784 for water and
4 \$10,471,771 for sewer.

5
6 Under North Carolina law, private utility companies are entitled to
7 recover their reasonable and verified operational expenses and earn
8 a rate of return on their investment. During the five month
9 investigation in this rate case, Public Staff accountants and
10 engineers completed an extensive audit, including a billing analysis
11 and review of CWSNC's books, records and general ledgers, which
12 provide the basis for our findings and recommendations to the
13 Commission. The revenue requirement is the amount necessary to
14 enable the Company to recover its reasonable operational expenses
15 and earn a reasonable return on its plant investment. The rate of
16 return is addressed in Public Staff Economist, Calvin Craig's
17 testimony.

18
19 Notice to Customers and Rate Design:

20 The Notice to Customers (Notice) that customers received might
21 have been confusing, since this is the first CWSNC rate case that
22 includes all of its newly consolidated companies. The Notice shows
23 the existing and proposed rates of CWSNC's uniform customers for

1 "Water Utility Service" and also the rates for each consolidated
2 service area thereafter, starting with the "Former Clearwater
3 Systems", which, if approved by the Commission, will be moved from
4 system specific rates to CWSNC's uniform rates. The rates for
5 "Sewer Utility Service", which are listed starting on page 9 of the
6 Notice, are set forth in the same manner. Bradfield Farms and
7 Fairfield Harbour have a separate Notice and proposed rates.

8
9 Water and sewer bills consist of two components, the base facility
10 charge and the usage charge. In theory, the base facility charge
11 recovers the fixed costs incurred by the Company divided by all of
12 the customers, and the usage charge recovers the variable costs.
13 However, most of the cost to produce water or treat sewage is fixed.
14 Approximately 75% of the cost to provide water service is fixed, and
15 approximately 90% of the cost to provide sewer service is fixed. In
16 order to promote conservation and allow a reasonable level of
17 monthly revenue, or "cash on hand", to pay fixed costs, the split
18 between the base facility charge and the usage charge for water
19 operations is approximately 45%:55% and 80%:20% for sewer
20 operations, respectively. In setting rates, the Commission has to
21 take into account all of the customers. Seasonal customers or those
22 who are retired prefer a high usage charge because they use little
23 water, whereas, a larger household might prefer to have a higher

1 base charge because they use a lot of water. It is the Public Staff's
2 position that the split is appropriate for all users. Purchase water and
3 sewer customers pay the same base facility charge as uniform
4 customers. The usage charge for purchased water and sewer
5 customers is the same consumption charge as the supplier.
6

7 Comparison between Private Utilities and Municipalities:

8 It is inappropriate to compare the rates of private Commission-
9 regulated utilities like CWSNC to municipalities or county systems for
10 the following reasons:

- 11 1. Economies of Scale: The operational costs per customer are
12 lower for customers of municipalities because of economies of
13 scale, as there are tens of thousands of customers versus
14 thousands of customers among whom the costs are divided.
15 CWSNC serves approximately 30,000 water customers and
16 20,000 sewer customers; and operates 92 water systems and 38
17 sewer systems across 38 counties spanning from the mountains
18 to the coast. Charlotte Water, for example, is a regional supplier
19 of drinking water and has over 834,000 customers in one county,
20 a much larger customer base from which to recover its fixed
21 costs.
- 22 2. Water Source: The majority of CWSNC's water production is
23 through a series of wells, utilizing ground water. The majority of

- 1 municipalities, at least in North Carolina, utilize surface water.
2 For example, the City of Sanford has an abundant water supply
3 from a single surface water source, the Cape Fear River. The
4 Water Treatment Plant is located in close proximity to the
5 headwaters of the Cape Fear River. Depending on the size of
6 the service area, CWSNC may have dozens of wells throughout
7 the service area. A single well might pump 20 gallons per minute
8 (28,800 gallons per day), whereas the treatment facility in
9 Sanford produces on average seven million gallons per day. The
10 water source is different. The economy of scale is overwhelming.
11 The type of treatment, equipment, personnel and operating
12 expenses are different.
- 13 3. Regulation: Private utilities are regulated by the State of
14 North Carolina. The general statutes allow a utility the right to
15 recover its operational expenses and a reasonable rate of return.
16 Municipal or county systems are not regulated by the Utilities
17 Commission and may subsidize the operating expenses of their
18 utility systems thorough taxation.
- 19 4. Capital projects: Private utilities fund capital projects through
20 private investors or loans. Municipalities and county systems
21 may qualify for low interest tax free bonds and other loans to fund
22 capital projects.

5. **Rate of Return:** Under the general statutes, private utilities have the right to earn a rate of return on their investment and to recover their operating expenses.

Service and Water Quality Complaints

Asheville Hearing

Twenty-one customers testified at the hearing in Asheville: Michael Sanders, Carl Burkhardt, Susan Kish, Phil Reitano, James Hemphill, Jack Zinselmeier, John Jennings, Alan Higgins, Jack Barton, Margaretta Lang, Warren Grafer, Donn Levine, Richard Adams, Vernon McMinn, James Cain, Dennis Shellenberger, Gerard Worster, Tom Haynes, Sean O'Meara, Chuck Van Rens and Betty Jackson. The subdivisions represented included Connestee Falls (4), Fairfield Mountain/Apple Valley (a.k.a. Rumbling Bald) (6), Mt. Carmel (2), Woodhaven Subdivision (4) and Mt. Mitchell Lands (5). All of the customers at the hearing complained about the magnitude of the increase. Many filed information regarding rate comparisons to municipalities, opposed the large base facility charge, noted the lack of improvements to their specific system, opposed the proposed rate of return, questioned the stock transfer to Corix, and believed that CWSNC provided no justification for the increase, which I addressed in the previous section.

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2

Mr. Sanders, Mr. Burkhart, Ms. Kish and Mr. McMinn all testified to the number of water outages in Connestee Falls and their concern with a sewage spill that ran into Lake Atagahi.

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Mr. Zinselmeier, a customer in Fairfield Mountain, testified that CWSNC was slow in repairing roads after the Company repaired a leak.

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Ms. Lang, who resides in Mt. Mitchel Land, complained about the number of water outages; and further stated that the boil water advisories they received were not made in a timely manner and, many times, customers were not notified when the advisories were rescinded. Mr. Levine stated that the water pressure was inadequate at his home and that Company personnel suggested that he install a jet pump to boost the water pressure from the meter to his home.

On August 29, 2017, CWSNC filed its Report on Customer Comments from Public Hearings in Asheville and Boone, North Carolina. I have read the report and commend CWSNC for its thorough response concerning customer complaints. The Public Staff is satisfied with the Company's response and has no recommendations.

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Boone Hearing

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Charlotte Hearing

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One customer testified at the hearing in Boone, Howell Sharee, who lives in Sugar Mountain. Mr. Sharee is a seasonal customer who spends the summer months in Sugar Mountain and a month or so in the winter. He testified concerning the magnitude of the rate increase, particularly the high base facility charge. He stated that the service was good and he did not have any water quality issues. I have previously addressed the Public Staff's position concerning rate design and the split between the base facility charge and usage charge.

Four customers testified at the hearing in Charlotte. The customers testifying were William R. Colyer, Damian Michael Werner, Isaac Cochran and Chanyne Cupil. All four customers represented Bradfield Farms and opposed the magnitude of the increase. Mr. Colyer stated that the service he received from CWSNC was excellent. Mr. Werner stated that some of his neighbors complained of sewage backups, and Ms. Cupil stated her sewage had backed up but the situation was resolved.

1 On September 11, 2017, CWSNC filed its Report on Customer
2 Comments from Public Hearings in New Bern and Charlotte, North
3 Carolina. I have read the report and I am satisfied with the
4 Company's response and have no recommendations.

5
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7

New Bern Hearing

8 Two customers testified at the hearing in New Bern. The customers
9 testifying were Simon Lock and Tom Musser, representing Fairfield
10 Harbour. Both testified as to the magnitude of the increase. Mr. Lock
11 opposed the rate design and suggested a much lower base facility
12 charge and higher usage charge. He also opposed the flat sewer
13 rate and stated that the Notice to customers lacked details and did
14 not show the proposed rates. Neither had any service complaints.

15

16 As I discussed previously, the split between the base facility charge
17 and the usage charge for water operations is approximately
18 45%:55% and 80%:20% for sewer operations, respectively. In
19 setting rates, the Commission has to take into account the rate
20 impact on all of the customers. Seasonal customers or those who
21 are retired prefer a high usage charge because they use little water,
22 whereas, a larger household might prefer to have a higher base

1 charge because they use a lot of water. It is the Public Staff's
2 position that the split is appropriate for all users.

3
4 In order to prevent "rate shock", CWSNC combined Fairfield Harbour
5 and Bradfield Farms into one rate division for water and sewer
6 service. This was intended as an "interim rate" between CWSNC's
7 uniform rates and Fairfield Harbour's and Bradfield Farm's specific
8 rates.

9
10 Under the existing rates, Fairfield Harbour and Bradfield Farms have
11 system specific rates. However, CWSNC is proposing to include
12 them under one new rate division, and therefore, there are no
13 proposed rates for either under their prior system specific rates. The
14 proposed new rates for monthly metered water service for residential
15 and commercial customers are shown in Appendix A-2, page 2 of 7;
16 and on page 4 of 7 for monthly sewer, in the Notice to Customers for
17 the Fairfield Harbour and Bradfield Farm Service Areas.

18

19 Wilmington Hearing

20 Eight customers testified at the hearing in Wilmington. The
21 customers testifying were Frances Carroll, Diana Woolley, Edward
22 Morrell, Danny Conner, Ferrell Drewry, Earnest Chance, Thomas
23 Mathis and Mandy Ware. The subdivisions represented included

1 Belvedere Plantation (3), and Treasure Cove/North Hills (5). In
2 addition, Mr. Carroll filed a petition with 165 signatures from
3 Belvedere Plantation opposing the magnitude of the rates. Mr.
4 Randall Woodruff, Pender County Manager, testified on behalf of the
5 Pender County Commissioners and in support of all CWSNC
6 customers in Pender County. All of the customers who testified in
7 Wilmington opposed the magnitude of the rate increase.

8
9 Mr. Carroll testified about a meeting between customers and
10 personnel from CWSNC on August 16, 2017. Representing CWSNC
11 was President Matthew Klein and Vice President of Operations,
12 Bryce Mendenhall. Also in attendance were County Commissioner
13 Williams and approximately 122 customers. Mr. Carroll testified that
14 he was not satisfied with CWSNC's answers at the meeting and
15 raised the following issues: 1) the hardness of the water; 2) brown
16 and black stains in the toilets; 3) water stains on shower doors and
17 cars; 4) the need for a water softener and filtration similar to the one
18 in Olde Point Subdivision; 5) high chlorine and HHA5's levels; 6) Gen
19 X and CWSNC's decision not to open the valve to the Pender County
20 water system; 7) the recent pump failure and brown water; 8) timely
21 repairs; 9) multiple outages in the last few months; and 10)
22 expansion of the system. By a show of hands, 28 customers agreed
23 with Mr. Carroll's concerns. Mr. Drewry testified regarding a concern

1 with the high mineral content and the magnitude of the rates
2 compared to other non-profit and private utility companies. Ms. Ware
3 testified that she is concerned with water quality, especially brown
4 water, and the number of boil advisory notices issued by CWSNC.

5
6 Mr. Conner is a customer of Treasure Cove and had the following
7 concerns: 1) the broken fire hydrants; 2) heavy metal content in the
8 water; 3) no extra treatment for the water; 4) extra cost for cleaning
9 products; 5) call center; and 6) lack of flushing for the water system
10 Mr. Chance also is a customer of Treasure Cove and his complaints
11 included the following: 1) the notice to customers was confusing; 2)
12 the proposed usage charge is too high; 3) CWSNC does not maintain
13 the ditch causing floods; 4) a decorative fence on the lot needs
14 repairing; and 5) all of the meter boxes leak.

15
16 Complaints concerning rate design, the magnitude of the rates,
17 comparisons between CWSNC and non-profit utilities and Notice to
18 customers have been previously addressed.

19
20 In regard to the situation at Belvedere, CWSNC informed the Public
21 Staff about the problems they were having with well No. 2 and their
22 decision not to activate the emergency connection with Pender
23 County. The Public Staff agreed with their decision. Prior to the

1 hearing held on August 23, 2007, I inspected the water and sewer
2 systems serving Belvedere. At the time of my inspection, Well No. 2
3 was running clear.

4
5 On August 24, 2017, I inspected the water system serving Treasure
6 Cove. The ditch causing floods is not a ditch but a small creek which
7 runs parallels to the well lot. The well lot was mowed with the
8 exception of approximately two feet along the bank of the creek. It
9 is the Public Staff's opinion that the well lot is being properly
10 maintained.

11
12 On September 18, 2017, CWSNC filed its Report on Customer
13 Comments from Public Hearings in Wilmington and Raleigh, North
14 Carolina, August 23 and 28, 2017, respectively. I have read the
15 report and I am satisfied with the Company's response. I have no
16 further recommendations.

17
18 Raleigh Hearing

19 Four customers testified at the hearing in Wilmington. The customers
20 testifying were Vincent P. Roy, William Glance, Judith Bassett and
21 Ben Farmer. The subdivisions represented included Carolina Trace,
22 Amber Acres and Jordan Woods. All of the customers who testified
23 in Raleigh opposed the magnitude of the rate increase.

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1
2 Mr. Roy, a utilities representative for the Carolina Trace community,
3 testified on behalf of the 18 Property Owners Associations (POA).
4 Mr. Roy stated that the call center was not familiar with the 18
5 different POA's and that many times when a boil notice is required,
6 the call center contacts the wrong POA representative. He did say
7 that they have a good working relationship with Company personnel
8 and that the quarterly meetings are successful in resolving issues
9 within the community. Mr. Roy stated that he understands that the
10 Company is moving towards uniform rates. However, Mr. Roy
11 suggested that implementing regional rates or such as the mountains
12 communities verses the coastal communities or groups of rates
13 depending on their costs, would be more equitable than having one
14 uniform rate. Mr. Roy also suggested that the base facility charge
15 should be suspended during natural disasters such as Hurricane
16 Matthew. Mr. Roy testified in regard to the rate of return and
17 provided a Classic Cost-Volume Profit model for the Public Staff's
18 review.

19
20 Mr. Glance is also a customer of Carolina Trace and objected to the
21 proposed rate structure because he believed that it benefits the
22 Company's shareholders at the expense of the ratepayers.
23

1 Ms. Bassett is a customer of Amber Acres and opposed the
2 magnitude of the increase. She did not have any service related
3 problems.

4

5 Mr. Famer is a customer of Jordan Woods who also opposed the
6 magnitude of the increase. He did not have any service concerns
7 either.

8

9 The rate of return and rate design issues were addressed earlier in
10 my testimony. However, I would like to point out that Carolina Trace
11 is a purchased water system and the usage charge is the same as
12 the supplier's. The base facility charge covers the fixed costs, and
13 Carolina Trace's rate is the same as uniform customers.

14

15 On September 18, 2017, CWSNC filed its Report on Customer
16 Comments from Public Hearings in Wilmington and Raleigh North
17 Carolina, August 23 and 28, 2017, respectively. I have read the
18 report and I am satisfied with the Company's response. I have no
19 further recommendations.

20

21 Q. BRIEFLY EXPLAIN YOUR BILLING ANALYSIS FOR PRESENT
22 AND PROPOSED RATES.

1 A. In determining end of period (EOP) customers for present rates, I
2 compared the EOP customers from Item 26 in the Company's Form
3 W-1 filing with the billing data for each service area, for each meter
4 type, for the twelve months ended December 31, 2016. I also
5 compared total consumption from Item-26 with total consumption
6 billed for each service area, for each meter type for the twelve
7 months ended December 31, 2016. In determining EOP customers
8 for proposed rates, I consolidated EOP customers at present rates
9 from the former subsidiary companies, Bradfield Farms, Carolina
10 Trace, CWSS, and Transylvania, into the four rate divisions: uniform
11 water, uniform sewer, Bradfield Farms/Fairfield Harbour water and
12 Bradfield Farms/Fairfield Harbour sewer. I also consolidated
13 consumption for the four rate divisions. My billing analysis for EOP
14 water and sewer customers at present rates, consolidated EOP
15 water and sewer customers at proposed rates, and consolidated
16 consumption at proposed rates is shown in Casselberry Exhibit Nos.
17 4, 5, 6, 7, 8 and 9.

18
19 **Q. DID YOU MAKE AN ADJUSTMENT FOR CUSTOMER GROWTH?**

20 A. No. The composite customer growth factor (CGF) for customers with
21 meters less than 1 inch was less than 1 percent.

22

61

1 Q. WHAT ARE THE ANNUAL SERVICE REVENUES UNDER
2 PRESENT AND PROPOSED RATES?

3 A. CWSNC's and Bradfield Farms/ Fairfield Harbour's (BF and FH)
4 present and consolidated proposed service revenues for the twelve
5 months ended December 31, 2016, are shown below:

6 SERVICE REVENUES

7 Water Utility Service:

8		<u>Present</u>	<u>Proposed</u>
9	CWSNC	\$15,122,929	\$18,414,144
10			
11	BF and FH	\$ 717,509	\$ 1,029,392
12			
13			

14 Sewer Utility Service:

15		<u>Present</u>	<u>Proposed</u>
16	CWSNC	\$11,755,741	\$13,294,803
17			
18	BF and FH	\$ 1,370,666	\$ 1,792,244
19			
20			

21
22 For the calculations, see Casselberry Exhibit Nos. 10, 11, 12, 13, 14,
23 15, 16 and 17.

24
25 Q. HAVE YOU RECOMMENDED ANY ADJUSTMENTS TO
26 EXPENSES RELATED TO WATER AND SEWER OPERATIONS?

27 A. Yes, I have provided Public Staff Accountant Johnson with
28 recommendations for purchased water and maintenance and repair
29 expenses for water operations under uniform rates, and sludge hauling
30 for uniform rates and BF/FH.

1

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PURCHASED WATER

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MAINTENANCE AND REPAIR EXPENSES

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SLUDGE HAULING

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Based on my review of invoices and the general ledgers, I determined purchased water in the amount of \$1,286,586. I removed \$20,844 for purchased water outside the test year. I increased purchased water by \$4,510 to account for the City of Hendersonville's new rate in High Vista Estates and Johnston County's new rates for White Oak Plantation, Lee Forest, Winston Planation and Winston Point. I also reduced purchased water by \$40,851 for water losses greater than 20 percent. I recommend \$1,286,686 for purchased water. My adjustments are shown in Casselberry Exhibit Nos 18 and 19.

I reclassified \$21,221 from maintenance and repair expenses to purchased water.

Sludge hauling can vary from year to year depending on whether or not a digester, clarifier or equalization tank is pumped out in addition to routine sludge hauling. In order to determine a representative level, I reviewed the Company's books and records for 2014, 2015 and 2016. In addition, I calculated the three-year average. For

1 systems where a change in the process had occurred, I adjusted the
2 three-year average accordingly. I recommend \$424,765 as a
3 representative level for sludge hauling for uniform rates and \$54,249
4 for BF/FH. My calculations are shown in Casselberry Exhibit 20.

5

6

7 **Q. WHAT IS YOUR RECOMMENDATION CONCERNING CWSNC'S**
8 **PROPOSAL TO CHANGE THE BASE FACILITY CHARGE FOR**
9 **RESIDENTIAL SEWER?**

10 **A.** The Company is proposing to change the base facility charge for
11 residential sewer customers to the same base facility charges as
12 commercial sewer customers. The Public Staff acknowledges that
13 in the Company's general rate case in Docket No. W-354, Sub 336,
14 the Public Staff recommended that CWSNC maintain accurate
15 records for all sewer customers and that, in the Company's next
16 general rate case proceeding, residential customers with meter sizes
17 greater than 5/8 inch be charged the same rate as commercial
18 customers with the same meter size. In the next general rate case,
19 Docket No. W-354, Sub 344, the Company did not have the data for
20 residential customers with varying meter sizes, and, as a result, the
21 Public Staff recommended one base facility charge regardless of
22 meter size. In recognition of the significant impact the Company's
23 proposed base facility charge would have on a relatively small

1 number of residential customers in the herein docket, the Public Staff
2 recommends that all residential sewer customers pay the same base
3 facility charge regardless of their meter size. Most of the residential
4 customers with larger meters are located in the mountain systems. For
5 example, Sapphire Valley has 128 residential customers with a 1.5
6 inch meter and 68 residential customers with a 2 inch meter, and
7 Fairfield Mountain has 12 residential customers with a 1 inch meter.
8 Most likely, the larger meter was installed to increase the pressure for
9 these mountain homes which are at significantly higher elevations than
10 the water main, or to be used for irrigation purposes, in which case the
11 water does not flow back to the sewer plant. It is the Public Staff's
12 position that, in these situations, it is unreasonable to charge a
13 residential customer a base facility charge of \$242.95 for a 1.5 inch
14 meter or a base facility charge of \$388.72 for a 2 inch meter for
15 "residential" sewer service, especially under uniform rates. As part of
16 the settlement agreement in this case, the Company supports this
17 recommendation.

18
19
20 **Q. WHAT IS YOUR RECOMMENDATION CONCERNING THE**
21 **PROPOSED RATES FOR TREASURE COVE?**

22 **A.** In order to reduce "rate shock" for customers in Treasure Cove, the
23 Public Staff is recommending the same rates as customers in Fairfield

65

1 Harbour and Bradfield Farms.. The Company agrees with and
2 supports the Public Staff's recommendation.
3

4 **Q. WHAT IS YOUR RECOMMENDATION CONCERNING CWSNC'S**
5 **PROPOSED RATES?**

6 A. The Public Staff's recommended service revenues are listed below:

7
8 Service Revenues

9	Water Utility Service	
10	CWSNC Uniform	\$17,415,028
11		
12	BF/FH	\$ 950,755
13		
14	Sewer Utility Service	
15	CWSNC Uniform	\$12,627,226
16		
17	BF/HF	\$ 1,733,316
18		

19 My revenue calculations are shown on Casselberry Exhibit Nos. 21,
20 22, 23, and 24. CWSNC's present, proposed and the Public Staff's
21 recommended rates are shown on Casselberry Exhibit No. 25 and
22 26. The effect of the rates are shown in exhibit 27.
23

24 **Q. WHAT IS YOUR RECOMMENDATION CONCERNING OTHER**
25 **CHARGES?**

26 A. The Public Staff's does not oppose increasing CWSNC's meter testing
27 fee from \$19.95 to \$20.00, the new water customer charge from \$26.93
28 to \$27.00, the reconnection charge from \$26.93 to \$27.00, the new

1 sewer customer fee from \$21.95 to \$27.00, and the charge for
2 processing NSF checks from \$24.94 to \$25.00 for all applicable
3 service areas except the Corolla Light/Monteray Shores service area
4 and the Elk River Development.

5

6 **Q. DO YOU HAVE ANY OTHER RECOMMENDATIONS?**

7 A. Yes. The Public Staff recommends that CWSNC consider
8 implementing metered sewer rates for customers in its Fairfield
9 Harbour, Bradfield Farms, and Sapphire Valley service areas in the
10 Company's next general rate case and reserves the right to
11 independently propose metered sewer rates for these systems. As
12 part of the settlement agreement in this case, CWSNC supports this
13 recommendation and agrees to undertake such consideration in
14 conjunction with its next rate case filing.

15

16 The Public Staff opposes including "per residential or single family
17 equivalent" in regard to the flat rate for water service. The Company
18 has agreed to remove this language from its tariff.

19

20 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

21 A. Yes.

1 (Whereupon, Casselberry Exhibits
2 1 through 27 were identified as
3 premarked.)

4 CHAIRMAN FINLEY: If you'll step aside, Ms.
5 Casselberry, and don't leave the building, please, except
6 for lunch perhaps.

7 MS. HOLT: Public Staff calls Ms. Lindsay
8 Quant.

9 LINDSAY QUANT; Having been duly sworn,
10 Testified as follows:

11 DIRECT EXAMINATION BY MS. HOLT:

12 Q Could you please state your name and business
13 address for the record.

14 A Lindsay Quant. Address is 430 North Salisbury
15 Street, Raleigh, North Carolina.

16 Q Thank you. And what is your position with the
17 Public Staff, Ms. Quant?

18 A I'm a Utilities Engineer for the Water, Sewer,
19 and Communications Division.

20 Q And on September 19th, 2017, did you prefile in
21 this docket five pages of testimony and one exhibit?

22 A Yes.

23 Q Do you have any additions or corrections to
24 that testimony?

1 A No.

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

4 A Yes.

5 MS. HOLT: At this time the Public Staff moves
6 that Ms. Quant's testimony be copied into the record as
7 if given orally from the stand, and that her exhibit be
8 identified as premarked.

9 CHAIRMAN FINLEY: Ms. Quant's direct prefiled
10 testimony submitted September 19, 2017, consisting of
11 five pages, is copied in the record as though given
12 orally from the stand, and her exhibits -- three exhibits
13 are marked for identification as premarked in the filing.

14 MS. HOLT: Thank you.

15 (Whereupon, the prefiled testimony
16 of Lindsay Quant was copied into the
17 record as if given orally from
18 the stand.)

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20

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24

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA
DOCKET NO. W-354, SUB 356

TESTIMONY OF LINDSAY QUANT
ON BEHALF OF THE PUBLIC STAFF

SEPTEMBER 19, 2017

1 Q. PLEASE STATE FOR THE RECORD YOUR NAME, BUSINESS
2 ADDRESS, AND PRESENT POSITION.

3 A. My name is Lindsay Quant. My business address is 430 North
4 Salisbury Street, Dobbs Building, Raleigh, North Carolina. I am a
5 Utilities Engineer with the Public Staff's Water, Sewer &
6 Communications Division.

7

8 Q. BRIEFLY STATE YOUR QUALIFICATIONS AND EXPERIENCE
9 RELATING TO YOUR PRESENT POSITION WITH THE PUBLIC
10 STAFF.

11 A. I graduated from North Carolina State University, earning a Bachelor
12 of Science Degree in Civil Engineering. I am a licensed Professional
13 Engineer (State of North Carolina #042110). I am also certified as a
14 B-Well Operator (#130281) by the North Carolina Operators
15 Certification Board. I worked for the North Carolina Department of
16 Environmental Quality (NCDEQ), Public Water Supply Section for four

1 years and then joined the Public Staff in December 2016. I have
2 presented recommendations in water and sewer rate case
3 proceedings, new franchise applications, and other matters relating to
4 water and sewer utility regulation before the Commission.

5

6 **Q. WHAT ARE YOUR DUTIES IN YOUR PRESENT POSITION?**

7 A. My duties with the Public Staff are to monitor the operations of
8 regulated water and sewer utilities with regard to rates and service.
9 Included in these duties are field investigations to review, evaluate,
10 and recommend changes, when needed, in the design, construction,
11 and operations of regulated water and sewer utilities; presentation of
12 expert testimony in formal hearings; and presentation of information,
13 data, and recommendations to the Commission.

14

15 **Q. PLEASE DESCRIBE THE SCOPE OF YOUR INVESTIGATION IN**
16 **THIS CASE.**

17 A. On March 31, 2017, Carolina Water Service, Inc. of North Carolina
18 (CWSNC or Company) filed an application with the Commission to
19 increase its rates for providing water and sewer utility service in all of
20 its service areas in North Carolina except the Corolla Light and
21 Monteray Shores Service Area and the Elk River Development. I have
22 assisted Public Staff Engineer Gina Casselberry in review of customer
23 complaints, contact with the Department of Environmental Quality

1 (DEQ), Public Water Supply Section (PWSS), and review of Company
2 records. I have also assisted Public Staff Accountant Sonja Johnson
3 with review of expenses.

4
5 Q. HAVE YOU RECOMMENDED ANY ADJUSTMENTS TO
6 EXPENSES RELATED TO WATER AND SEWER OPERATIONS?

7 A. Yes, I have provided Public Staff Accountant Johnson with
8 recommendations for adjustments to testing expenses, chemical
9 expenses, purchased sewer and permit fees.

10

11

TESTING EXPENSES

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My recommendation for testing expenses reflects new testing requirements, changes to the number or frequency of each test, and current testing costs, represented over the required frequency (monthly, annually, and every three, six, or nine years) for each test under the Safe Drinking Water Act and CWSNC's wastewater permits. For CWSNC's uniform rate systems, I recommend testing expenses of \$168,248 for water operations and \$266,405 for sewer operations. For Bradfield Farms and Fairfield Harbor, I recommend testing expenses of \$5,557 for water operations and \$21,922 for sewer operations. My calculations are shown in Quant Exhibit No. 1.

CHEMICAL EXPENSES

Based on Company records and invoices, I recommend chemical expenses of \$243,711 for water operations and \$309,149 for sewer operations for CWSNC's uniform rate systems. I recommend chemical expenses of \$35,438 for water operations and \$29,611 for sewer operations for Fairfield Harbor and Bradfield Farms. CWSNC allocated their costs for water and sewer chemicals by equivalent residential connection (ERC). The ERC is based on meter size. The recommended total amount of chemical expense did not change from the total amount provided by the Company but the expenses have been redistributed. My calculations and recommendations reallocated those amounts to directly correspond to the specific water or sewer operation.

PURCHASED SEWER TREATMENT

Based on invoices provided by the Company, I have updated purchased sewer treatment to reflect gallons treated for the twelve months ended December 31, 2016. As of June 2016, Ridges at Mountain Harbour purchases 100 percent of its sewer treatment. I estimated an amount for 12 months based on the invoices provided over the past six months of operation. I also updated purchased sewer treatment for White Oak Plantation to reflect the Johnston County Public Utilities Department current rates. Johnston County

1 Public Utilities notified the Company of the rate increase in a letter
2 dated April 6, 2017. I recommend \$589,536 for purchased sewer
3 treatment. My calculations are shown in Quant Exhibit No. 2.

4

5 PERMIT FEES

6 Based on Company records and invoices, I recommend permit fees
7 of \$62,430 for water operations and \$53,362 for sewer operations for
8 CWSNC's uniform rate systems. I recommend permit fees of \$2,330
9 for water operations and \$3,498 for sewer operations for Fairfield
10 Harbor and Bradfield Farms. CWSNC allocated their costs for water
11 and sewer permit fees by ERC. My calculations and
12 recommendations reallocated those amounts to directly correspond
13 to the system specific water or sewer operation. My calculations are
14 shown in Quant Exhibit No. 3.

15

16 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

17 A. Yes, it does.

1 (Whereupon, Quant Exhibits
2 1-3 were identified as
3 premarked.)

4 CHAIRMAN FINLEY: You're temporarily excused,
5 Ms. Quant.

6 MS. HOLT: Ms. Sonja Johnson.

7 SONJA R. JOHNSON; Having been duly sworn,

8 Testified as follows:

9 DIRECT EXAMINATION BY MS. HOLT:

10 Q Could you please state your name and business
11 address for the record.

12 A My name is Sonja R. Johnson. My business
13 address is 430 North Salisbury Street in Raleigh, North
14 Carolina.

15 Q And what -- and what position are you with the
16 Public Staff?

17 A I'm a Public Utilities Accountant with the
18 Public -- with the Accounting Division of the Public
19 Staff.

20 Q Thank you. Ms. Johnson, on September 19, 2017,
21 did you prefile in this docket 20 pages of testimony, one
22 exhibit, and several schedules?

23 A Yes, I did.

24 Q Do you have any additions or corrections to

1 make?

2 A No, I do not.

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

5 A Yes, they would be.

6 MS. HOLT: The Public Staff moves the admission
7 -- moves that Ms. Johnson's testimony be copied into the
8 record as if given orally from the stand, and that her
9 exhibit and schedules be identified as premarked.

10 CHAIRMAN FINLEY: Ms. Johnson's direct prefiled
11 testimony submitted September 19th, consisting of 20
12 pages, is copied into the record as though given orally
13 from the stand, and her one exhibit with the number of
14 schedules is marked for identification as premarked in
15 the filing.

16 (Whereupon, the prefiled testimony
17 of Sonya R. Johnson was copied into
18 the record as if given orally from
19 the stand.)

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CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA
DOCKET NO. W-354, SUB 356

TESTIMONY OF SONJA R. JOHNSON
ON BEHALF OF THE PUBLIC STAFF
NORTH CAROLINA UTILITIES COMMISSION

September 19, 2017

1 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND
2 PRESENT POSITION.

3 A. My name is Sonja R. Johnson and my business address is 430 N.
4 Salisbury Street, Raleigh, North Carolina. I am a Staff Accountant
5 with the Accounting Division of the Public Staff – North Carolina
6 Utilities Commission, and represent the using and consuming public.

7

8 Q. HOW LONG HAVE YOU BEEN EMPLOYED BY THE PUBLIC
9 STAFF?

10 A. I have been employed by the Public Staff since January 1, 2006.

11

12 Q. WILL YOU STATE BRIEFLY YOUR EDUCATION AND
13 EXPERIENCE?

14 A. I am a graduate of North Carolina State University with a Bachelor of
15 Science and Master of Science degree in Accounting. I was initially
16 an employee of the Public Staff from December 2002 until May 2004,
17 and rejoined the Public Staff in January 2006. Since initially joining
18 the Public Staff in December 2002, I have filed testimony or affidavits
19 in several water and sewer general rate cases. I have also filed

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1 testimony in applications for certificates of public convenience and
2 necessity of existing systems. My experience also includes filing
3 affidavits in several fuel rate cases of Duke Energy Carolinas, LLC.

4
5 Q. WHAT ARE YOUR DUTIES?

6 A. I am responsible for analyzing testimony, exhibits, and other data
7 presented by parties before this Commission. I have the further
8 responsibility of performing and supervising the examinations of
9 books and records of utilities involved in proceedings before the
10 Commission, and summarizing the results into testimony and
11 exhibits for presentation to the Commission.

12
13 Q. MS. JOHNSON, WHAT IS THE NATURE OF THE APPLICATION IN
14 THIS PROCEEDING?

15 A. On March 31, 2017, Carolina Water Service, Inc. of North Carolina
16 (CWSNC or Company) filed an application with the Commission
17 seeking authority to adjust and increase rates for all of its water and
18 sewer service areas in North Carolina, except Corolla Light and
19 Monteray Shores Service Area and Elk River Development. My
20 investigation included a review of the application filed by CWSNC,
21 an examination of the Company's books and records for the test
22 year, and a review of additional documentation provided by the
23 Company in response to written and verbal data requests.

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

3 A. The purpose of my testimony in this proceeding is to present the
4 results of my investigation of the levels of revenue, expenses, and
5 investment filed by CWSNC in support of its requested increase in
6 operating revenues for its uniform water operations (CWSNC water),
7 uniform sewer operations (CWSNC sewer), Bradfield Farms and
8 Fairfield Harbour water operations (BF/FH water), and Bradfield
9 Farms and Fairfield Harbour sewer operations (BF/FH sewer).
10

11 Q. WOULD YOU BRIEFLY DESCRIBE THE PRESENTATION OF
12 YOUR TESTIMONY AND EXHIBITS?

13 A. Yes. My testimony contains a discussion of each issue resulting from
14 my investigation, and my exhibit consists of schedules showing the
15 calculation of my adjustments to revenues, expenses, and rate base.
16 My schedules also reflect adjustments recommended by other Public
17 Staff witnesses. Schedules 1(a) through 1(d) of my Exhibit I present
18 the return on original cost rate base for water and sewer operations
19 under present rates, Company proposed rates, and Public Staff
20 recommended rates. Schedules 2(a) through 2(d) of Exhibit I, along
21 with their supporting schedules, present the original cost rate base
22 for each of the water and sewer operations. Schedule 3(a) through
23 3(d) of Exhibit I, along with their supporting schedules, present the

1 calculation of net operating income for a return under present rates,
2 Company proposed rates, and Public Staff recommended rates.

3

4 Q. WHAT MODIFICATIONS TO THE TEST PERIOD HAVE YOU
5 MADE IN THIS PROCEEDING?

6 A. In its application, CWSNC made pro forma adjustments to rate base
7 to include construction work in progress (CWIP) projects, net of
8 retirements, which will be placed in service between January 1, 2017,
9 and the hearing date in this proceeding. The Public Staff agrees with
10 the Company that the test year should be updated for certain events
11 that occurred after the test year. Those events should be known and
12 measurable as of a certain date before they should be considered in
13 evaluating the need for rate relief. Therefore, the Public Staff
14 witnesses have made adjustments in this proceeding to update the
15 Company's test year to recognize certain events affecting rate base,
16 revenues, and expenses as a result of certain known and
17 measurable events that occurred through June 30, 2017.

18

19 As part of this overall update adjustment, I have made the
20 adjustments to recognize changes to plant in service, accumulated
21 depreciation, contributions in aid of construction (CIAC), purchase
22 acquisition adjustment (PAA), and other rate base changes that

1 occurred through June 30, 2017. Deferred charges have been
2 amortized through December 31, 2017.

3

4 In addition, several major CWIP projects expected to be completed
5 and placed in service prior to the hearing in this proceeding, have
6 been included in rate base.

7

8 Q. WHAT ARE THE COMPANY'S PROPOSED INCREASES IN
9 SERVICE REVENUES IN THIS CASE?

10 A. The service revenues under present rates, the Company's proposed
11 increases, and the Company's proposed rates are as follows:

	Present Rates	Proposed Increase	Proposed Rates
CWSNC Water	\$ 15,122,929	\$ 3,291,215	\$ 18,414,144
CWSNC Sewer	11,755,741	1,539,062	\$ 13,294,803
BF/FH Water	717,509	311,883	\$ 1,029,392
BF/FH Sewer	1,370,666	421,578	\$ 1,792,244
Total	<u>\$ 28,966,845</u>	<u>\$ 5,563,738</u>	<u>\$ 34,530,583</u>

12

13 Q. WHAT CONCLUSIONS HAVE YOU REACHED AS TO THE
14 COMPANY'S RATE INCREASE REQUEST?

15 A. Based on my investigation, the original cost rate base as of
16 December 31, 2016, updated to June 30, 2017, is as follows:

CWSNC Water	\$ 51,860,184
CWSNC Sewer	39,028,369
BF/FH Water	1,830,765
BF/FH Sewer	5,559,273
Total	<u>\$ 98,278,591</u>

1

2

3

4

Based on the overall rate of return of 7.84% stipulated to by CWSNC and the Public Staff, I recommend that rates be set to produce the following revenues:

	Service Revenues	Other Revenues & Uncollectibles	Total Operating Revenues
CWSNC Water	\$ 17,415,028	\$ 71,864	\$ 17,486,892
CWSNC Sewer	12,627,226	51,578	12,678,804
BF/FH Water	950,755	29,021	979,776
BF/FH Sewer	1,733,316	(2,431)	1,730,885
Total	<u>\$ 32,726,325</u>	<u>\$ 150,032</u>	<u>\$ 32,876,357</u>

5

6

7

Based on these levels of revenues, I recommend the following increases in service revenues:

CWSNC Water	\$ 2,292,099
CWSNC Sewer	871,485
BF/FH Water	233,246
BF/FH Sewer	362,650
Total	<u>\$ 3,759,480</u>

8

9 Q. DOES JOHNSON EXHIBIT I REFLECT ADJUSTMENTS
10 SUPPORTED BY OTHER PUBLIC STAFF WITNESSES?

11 A. My exhibit reflects the following adjustments supported by other
12 Public Staff witnesses:

- 1 (1) The recommendations of Public Staff witnesses Casselberry
2 and Quant regarding the following items:
- 3 (a) Service revenues at present rates
4 (b) Service revenues at Company proposed rates
5 (c) Purchased water
6 (d) Purchased sewer
7 (e) Maintenance and repair
8 (f) Maintenance testing
9 (g) Chemicals

10

11 Q. WHAT ADJUSTMENTS WILL YOU DISCUSS?

12 A. The accounting and ratemaking adjustments that I will discuss relate
13 to the following items:

- 14 (a) Plant in service
15 (b) Accumulated depreciation
16 (c) Cash working capital
17 (d) Contributions in aid of construction (CIAC)
18 (e) Accumulated deferred income taxes
19 (f) Customer deposits
20 (g) Gain on sale and flow back taxes
21 (h) Plant acquisition adjustment (PAA)
22 (i) Excess book value
23 (j) Cost-free capital
24 (k) Average tax accruals
25 (l) Deferred charges
26 (m) Pro forma plant
27 (n) Miscellaneous revenues
28 (o) Uncollectibles
29 (p) Salaries and wages
30 (q) Maintenance and repair
31 (r) Regulatory commission expense
32 (s) Miscellaneous expense
33 (t) Depreciation expense
34 (u) Amortization of CIAC
35 (v) Amortization of PAA
36 (w) Payroll taxes
37 (x) Regulatory fee
38 (y) Gross receipts tax
39 (z) State income tax
40 (aa) Federal income tax

1 PLANT IN SERVICE

2 Q. IN WHAT AREAS HAVE YOU MADE ADJUSTMENTS TO PLANT
3 IN SERVICE?

4 A. First, I made an adjustment to remove from direct plant in service,
5 plant held for future use. Plant held for future use is not currently
6 used nor useful in provided service to CWSNC's water and sewer
7 customers. This adjustment is consistent with similar treatment
8 made by the Public Staff and ordered by the Commission in prior
9 CWSNC rate cases.

10

11 Next, I adjusted direct and allocated plant in service to include actual
12 general ledger additions made on the Company's books from
13 January 1, 2017 through June 30, 2017, the update period for rate
14 base items.

15

16 Direct plant in service was also adjusted to include actual costs for
17 CWIP projects that have been completed and are in service as of
18 September 13, 2017.

19

20 ACCUMULATED DEPRECIATION

21 Q. HOW HAVE YOU ADJUSTED ACCUMULATED DEPRECIATION?

22 A. I adjusted accumulated depreciation to include actual and known
23 additions made on the Company's books as of June 30, 2017.

1 Accumulated depreciation also reflects a matching adjustment based
2 on the Public Staff's recommended level of depreciation expense.

3

4

CASH WORKING CAPITAL

5 Q. PLEASE DESCRIBE YOUR CALCULATION OF CASH WORKING
6 CAPITAL.

7 A. Cash working capital provides the Company with the funds
8 necessary to carry on the day to day operations of the Company. In
9 my calculation, I have included 1/8 of total O&M and G&A expenses,
10 less purchased water and sewer expense, as a measure of cash
11 working capital.

12

13 **CONTRIBUTIONS IN AID OF CONSTRUCTION (CIAC)**

14 Q. PLEASE EXPLAIN YOUR ADJUSTMENTS TO CIAC.

15 A. CIAC has been adjusted to included actual and known additions
16 made on the Company's books as of June 30, 2017, for both CIAC
17 and accumulated amortization. Accumulated amortization also
18 reflects a matching adjustment based on the Public Staff's
19 recommended level of amortization expense.

20

21

1 ACCUMULATED DEFERRED INCOME TAXES (ADIT)

2 Q. PLEASE DESCRIBE YOUR ADJUSTMENT TO ADIT.

3 A. I have adjusted ADIT to include the Public Staff's recommended
4 levels of unamortized regulatory commission expense and deferred
5 maintenance and repair.

6

7 CUSTOMER DEPOSITS

8 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO CUSTOMER
9 DEPOSITS.

10 A. Customer deposits were adjusted to reflect the balance as of June
11 30, 2017, resulting in an increase in customer deposits for CWSNC
12 water, CWSNC sewer, BF/FH water and BF/FH sewer.

13

14 GAIN ON SALE AND FLOW BACK TAXES

15 Q. WHAT ADJUSTMENT DID YOU MAKE TO GAIN ON SALE AND
16 FLOW BACK TAXES?

17 A. I have adjusted gain on sale and flow back taxes to amortize the gain
18 on sale of systems sold to CMUD through December 31, 2017, so
19 that the unamortized balance can be re-amortized over a three-year
20 period.

21

1 PLANT ACQUISITION ADJUSTMENT (PAA)

2 Q. PLEASE DESCRIBE YOUR ADJUSTMENTS TO PAA.

3 A. PAA has been adjusted to include actual general ledger additions
4 made on the Company's books as of June 30, 2017, in my
5 recommended calculation of PAA. PAA amortization has also been
6 adjusted to include an annualized level of amortization based on the
7 Public Staff's adjusted level of PAA amortization expense.

8

9 EXCESS BOOK VALUE

10 Q. WHY DID YOU ADJUST EXCESS BOOK VALUE?

11 A. Excess book value represents the difference between the price paid
12 by CWSNC to purchase stock of water and sewer systems and the
13 net book value of the stock. I have adjusted the excess book value
14 to reflect the accumulated amortization and unamortized balances
15 as of December 31, 2017.

16

17 COST-FREE CAPITAL

18 Q. WHAT ADJUSTMENT DID YOU MAKE TO COST-FREE CAPITAL?

19 A. CWSNC did not include an amount for cost-free capital on its
20 application. I adjusted cost-free capital for the amounts filed in the
21 Company's Docket No. W-354, Sub 266 rate case proceeding and
22 approved by the Commission.

23

1 AVERAGE TAX ACCRUALS

2 Q. HOW DID YOU CALCULATE AVERAGE TAX ACCRUALS?

3 A. Average tax accruals, calculated as 1/2 of property taxes plus 1/5 of
4 regulatory fee, are taxes which the Company collects in rates but
5 does not pay to the governmental agency every month. Since the
6 Company has the use of the money until it is paid to the
7 governmental agency, these tax accruals should be deducted from
8 rate base. Payroll taxes are not included in my calculation of average
9 tax accruals since they are paid to the taxing agencies on a more
10 frequent basis.

11

12 DEFERRED CHARGES

13 Q. PLEASE DESCRIBE YOUR ADJUSTMENTS TO DEFERRED
14 CHARGES.

15 A. I have adjusted deferred charges to reflect the unamortized balance
16 of deferred maintenance costs for tank painting, tank inspection, and
17 wastewater treatment plant painting as of December 31, 2017. I did
18 not include the unamortized balance of the Belvedere pump and haul
19 costs in deferred charges. It is the Public Staff's recommendation
20 that the Company should not be able to earn a return on these
21 unusual and nonrecurring expenses that are abnormally high due to
22 a disagreement with the golf course. My exclusion of the
23 unamortized balance of the pump and haul expenses is consistent

1 with the treatment stipulated to by CWSNC and the Public Staff in
2 the Sub 344 rate case proceeding.

3

4 Next, I have adjusted unamortized rate case expense to reflect the
5 Public Staff's recommended level of rate case costs, less one year
6 of amortization, as discussed later in my testimony under regulatory
7 commission expense.

8

9

PRO FORMA PLANT

10 Q. WHY DID YOU ADJUST PRO FORMA PLANT?

11 A. In this proceeding, CWSNC included in rate base, estimated
12 amounts for construction work in progress (CWIP projects) expected
13 to be completed and in service by the hearing date. I have removed
14 the estimated cost for these projects from rate base and adjusted
15 plant in service to include the actual cost of CWIP projects completed
16 and in service as of September 13, 2017.

17

18

MISCELLANEOUS REVENUES

19 Q. WHY DID YOU ADJUST MISCELLANEOUS REVENUES?

20 A. I adjusted miscellaneous revenues to correct the Company's error in
21 omitting proceeds from the sale of utility property from its original
22 application. The Company also misclassified lease revenue received
23 from cellular phone companies for antenna space on its elevated

1 storage tanks. The Company recorded these revenues as purchase
2 water for BF/FH. My adjustments corrects these errors.

3
4 I calculated a forfeited discount rate for CWSNC and BF/FH water
5 and sewer operations by dividing the respective test year forfeited
6 discounts by test year service revenues. The resulting rates were
7 then applied to the Public Staff's present, proposed and
8 recommended levels of service revenues to determine an
9 appropriate level of forfeited discounts to include in miscellaneous
10 revenues.

11

12 UNCOLLECTIBLES

13 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO UNCOLLECTIBLES.

14 A. I have calculated uncollectibles percentages for CWSNC water
15 operations, CWSNC sewer operations, BF/FH water operations and
16 BF/FH sewer operations based on the per books levels of
17 uncollectibles and service revenues for the test year. I then applied
18 these percentages to my adjusted levels of service revenues under
19 present, Company proposed, and recommended rates to derive my
20 adjusted levels of uncollectibles.

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1 SALARIES AND WAGES

2 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO SALARIES AND
3 WAGES.

4 A. I have adjusted salaries and wages to reflect the updated payroll
5 information provided by CWSNC. The Company's updated payroll
6 includes salary and wage increases granted since the end of the test
7 year, the removal of terminated employees, and the addition of new
8 employees hired since the end of the test year. In addition to the
9 updated adjustment to salaries and wages, I removed test year
10 bonuses.

11

12 MAINTENANCE AND REPAIR

13 Q. HOW HAVE YOU ADJUSTED MAINTENANCE AND REPAIR
14 EXPENSE?

15 A. Maintenance and repair expense was adjusted to reflect one year of
16 annual amortization expense on the Public Staff's recommended
17 level of deferred charges discussed above under deferred charges.

18

1 REGULATORY COMMISSION EXPENSE

2 Q. PLEASE EXPLAIN HOW YOU CALCULATED REGULATORY
3 COMMISSION EXPENSE.

4 A. Based on information provided by the Company regarding costs
5 incurred to date and expected costs that will occur to complete this
6 rate case proceeding, I have included a total of \$424,336 of rate case
7 expenses for this proceeding, which is comprised of legal fees;
8 postage and stock for customer notices; FedEx, copying, printing,
9 and administrative; travel, hotel, meals, and rental car; capitalized
10 salaries and wages; and consulting fees. I have allocated this total
11 rate case expense to CWSNC water, CWSNC sewer, BF/FH water
12 and BF/FH sewer based on the customer allocation percentages
13 calculated from the Company's equivalent residential connections
14 (ERCs). I also included in my calculation of rate case expense the
15 unamortized balance rate case expense from prior rate case
16 proceedings. I am recommending that the allocated level of rate
17 case costs be amortized to operating expenses over three years.

18
19 MISCELLANEOUS EXPENSE

20 Q. WHAT ADJUSTMENT WAS MADE TO MISCELLANEOUS
21 EXPENSE?

22 A. I have adjusted miscellaneous expense to include the amortization
23 of excess deferred income taxes that were reclassified from

1 depreciation expense. This treatment of excess deferred income
2 taxes is consistent with the treatment in the Company's rate case
3 proceeding in Docket No. W-354, Sub 344 (Sub 344).
4

5 **DEPRECIATION EXPENSE**

6 Q. HOW DID YOU ADJUST DEPRECIATION EXPENSE?

7 A. I have adjusted depreciation expense to reflect an ongoing annual
8 level of depreciation expense for direct plant in service, based on the
9 Public Staff's adjusted level of plant in service and the depreciation
10 lives for each plant account.
11

12 Direct depreciation also includes one-third of the unamortized
13 balance of gain on sale of systems sold to CMUD. The unamortized
14 balance of the gain on sale is being re-amortized over a three-year
15 period, resulting in a reduction in the amount of gain on sale
16 deducted from depreciation expense.

17 My calculation of depreciation also includes the annual amortization
18 of excess book value for both CWSNC uniform water and sewer
19 operations.
20

21 Finally, I have included the annual level of depreciation expense for
22 the allocated plant.
23

AMORTIZATION OF CIAC

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Q. WHAT ADJUSTMENT DID YOU MAKE TO AMORTIZATION OF
CIAC?

A. CIAC amortization expense was adjusted to reflect the Public Staff's recommended level of CIAC times an amortization percentage based on the overall depreciation rate for the Public Staff's adjusted level of direct plant in service.

AMORTIZATION OF PAA

Q. WHY DID YOU ADJUST AMORTIZATION OF PAA?

A. PAA amortization expense was adjusted to reflect the Public Staff's recommended level of PAA times an amortization percentage based on the composite overall depreciation rate for the Public Staff's adjusted level of direct plant in service.

PAYROLL TAXES

Q. WHY DID YOU ADJUST PAYROLL TAXES?

A. In its Application, the Company included a pro forma level of payroll taxes for operations and maintenance, NC leadership and shared services. I have made an adjustment to reflect payroll taxes for operations and maintenance, NC leadership and shared services based on the adjusted level of salaries at the current payroll tax rates.

1 REGULATORY FEE

2 Q. WHAT ADJUSTMENT HAVE YOU MADE TO REGULATORY FEE?

3 A. I have calculated regulatory fee using the statutory rate of 0.14%
4 applied to total operating revenues under present, Company
5 proposed, and Public Staff recommended rates.
6

7 GROSS RECEIPTS TAX

8 Q. HOW DID YOU ADJUST GROSS RECEIPTS TAX?

9 A. With the repeal of G.S. 105-116, water and sewer companies are no
10 longer subject to gross receipts tax, effective July 1, 2014, and,
11 instead, corporations will be only subject to the standard franchise
12 tax under G.S. 105-122. I have removed the gross receipts tax that
13 the Company included in its application from operating expenses
14 because CWSNC will no longer pay this tax to the NCDOR.
15

16 STATE INCOME TAX

17 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO STATE INCOME
18 TAX.

19 A. State income tax was calculated based on the adjusted levels of
20 revenues and expenses, and the State income tax rate of 3%,
21 effective January 1, 2017.
22

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1 FEDERAL INCOME TAX

2 Q. WHAT ADJUSTMENT HAVE YOU MADE TO FEDERAL INCOME
3 TAX?

4 A. Federal income tax is based on the statutory corporate rates for the
5 level of income presented after all Public Staff adjustments.
6

7 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

8 A. Yes, it does.

1 (Whereupon, Johnson Exhibit 1
2 was identified as premarked.)

3 CHAIRMAN FINLEY: So you're temporarily
4 excused, Ms. Johnson.

5 MS. HOLT: Mr. Chairman, we have one more
6 witness, Calvin Craig, who has been detained. He was on
7 the -- under the impression that we would just have
8 customer testimony this morning. We are trying to locate
9 him and --

10 CHAIRMAN FINLEY: Please -- please do. Run him
11 down, if you can.

12 MS. HOLT: We're -- we're working on it.

13 MR. GRANTMYRE: I am available to sponsor his
14 testimony -- I was the attorney that prepared it -- if we
15 can get it into the record.

16 CHAIRMAN FINLEY: All right, Mr. Grantmyre.
17 Step up there.

18 MS. SANFORD: I've waited for this day.

19 CHAIRMAN FINLEY: You might have made a
20 grievous mistake.

21 (Laughter.)

22 MR. GRANTMYRE: I'll give it my best shot.
23 How's that?

24 (Laughter.)

1 WILLIAM E. GRANTMYRE; Having been duly sworn,

2 Testified as follows:

3 DIRECT EXAMINATION BY MS. HOLT:

4 Q Could you please state your name and business
5 address for the record.

6 A My name is William Grantmyre. My business
7 address is 430 North Salisbury Street. I am a Staff --
8 Staff Attorney with the Public Staff.

9 Q And Mr. Grantmyre, are you familiar with -- was
10 the testimony of Public Staff Economist Calvin C. Craig
11 prepared under your direction?

12 CHAIRMAN FINLEY: He said he wrote it, so he
13 ought to be familiar with it. Go ahead.

14 A No. Calvin actually wrote it. I read it about
15 10 times. Yes. I've read it, and I'm very familiar with
16 it, and I had a number of corrections and modifications,
17 and I'm very familiar with it.

18 Q And are you available to -- I mean, are you
19 able to adopt that testimony?

20 A Yes. I would adopt the testimony, the 20 pages
21 that were filed on September 19th, 2017, and Exhibits 1
22 through 5.

23 Q All right. And you have no additional edits or
24 corrections to it?

1 A That is correct. We have no additions,
2 corrections, or modifications.

3 MS. HOLT: Okay. At this time the Public Staff
4 moves that Mr. Craig's testimony be copied into the
5 record as if given orally from the stand, and that his
6 five exhibits be identified as premarked.

7 CHAIRMAN FINLEY: All right. Mr. -- Mr.
8 Craig's direct prefiled testimony submitted on September
9 19th, 2017, consisting of 20 pages, as adopted by Mr.
10 Grantmyre, is copied into the record as though given
11 orally from the stand, and his five exhibits are marked
12 for identification as premarked in the filing.

13 MS. HOLT: Thank you.

14 (Whereupon, the prefiled testimony
15 of Calvin C. Craig, III, adopted by
16 William E. Grantmyre, is copied into
17 the record as if given orally from
18 the stand.)

19

20

21

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23

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DOCKET NO. W-354, SUB 356

TESTIMONY OF CALVIN C. CRAIG, III
ON BEHALF OF THE PUBLIC STAFF
NORTH CAROLINA UTILITIES COMMISSION

September 19, 2017

1 Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS
2 ADDRESS FOR THE RECORD.

3 A. My name is Calvin C Craig, III. I am a Financial Analyst in the
4 Economic Research Division of the Public Staff of the North
5 Carolina Utilities Commission (Public Staff), representing the using
6 and consuming public. My business address is 430 North Salisbury
7 Street, Raleigh, North Carolina 27603.

8
9 Q. PLEASE OUTLINE YOUR EDUCATIONAL BACKGROUND AND
10 RELEVANT EMPLOYMENT EXPERIENCE.

11 A. I received a Bachelor of Science degree in Industrial Relations from
12 the University of North Carolina at Chapel Hill in 1985, an MBA
13 degree from East Carolina University in 1993, and a Juris Doctor
14 degree from North Carolina Central University in 2006. Since
15 joining the Public Staff in November 1995, I have been involved
16 with natural gas expansion projects, have conducted rate of return
17 studies, testified in rate of return proceedings, and have filed
18 affidavits assessing financial viability and a fair rate of return in
19 numerous water and wastewater utility rate cases.

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

3 A. The purpose of my testimony in this proceeding is to address the
4 fair rate of return of 7.84%, specifically the return on equity
5 component of 9.60%, agreed to in the Stipulation between Carolina
6 Water Service, Inc. of North Carolina (CWSNC or Company), a
7 wholly owned subsidiary of Utilities, Inc., and the Public Staff, and
8 to provide support for the Public Staff's position that the return on
9 equity component is just and reasonable for use as a basis for
10 adjusting the water and sewer rates of the Company's systems
11 involved in this docket.

12

13 Q. HOW IS YOUR TESTIMONY STRUCTURED?

14 A. My testimony is presented in the following five sections:

- 15 I. Legal and Economic Guidelines for Fair Rate of Return
16 II. Present Financial Market Conditions
17 III. Appropriate Capital Structure and Cost of Long Term Debt
18 IV. The Cost of Common Equity
19 V. Overall Recommended Cost of Capital

20

1 I. LEGAL AND ECONOMIC GUIDELINES FOR FAIR RATE OF RETURN

2 Q. ARE THERE ANY LEGAL AND ECONOMIC GUIDELINES TO
3 FOLLOW WHEN DETERMINING THE COST OF CAPITAL TO A
4 PUBLIC UTILITY?

5 A. Yes. In Federal Power Comm'n v. Hope Natural Gas Co.,
6 320 U.S. 591 (1944), the U.S. Supreme Court stated:

7 [T]he return to the equity owner should be
8 commensurate with returns on investments in other
9 enterprises having corresponding risks. That return,
10 moreover, should be sufficient to assure confidence in
11 the financial integrity of the enterprise, so as to
12 maintain its credit and to attract capital. Id. at 603.

13 In Bluefield Water Works & Improvement Co. v. Public Serv.
14 Comm'n of West Virginia, 262 U.S. 679 (1923), the U S. Supreme
15 Court stated:

16 A public utility is entitled to such rates as will permit it
17 to earn a return on the value of the property which it
18 employs for the convenience of the public equal to
19 that generally being made at the same time and in the
20 same general part of the country on investments in
21 other business undertakings which are attended by
22 corresponding risks and uncertainties; but it has no
23 constitutional right to profits such as are realized or

1 anticipated in highly profitable enterprises or
2 speculative ventures. The return should be
3 reasonably sufficient to assure confidence in the
4 financial soundness of the utility and should be
5 adequate, under efficient and economical
6 management, to maintain and support its credit and
7 enable it to raise the money necessary for the proper
8 discharge of its public duties. A rate of return may be
9 reasonable at one time and become too high or too
10 low by changes affecting opportunities for investment,
11 the money market and business conditions generally.

12 Id. at 692-93.

13 These two decisions recognize that utilities are competing for the
14 capital of investors and provide legal guidelines as to how the
15 allowed rate of return should be set. The decisions specifically
16 speak to the standards or criteria of capital attraction, financial
17 integrity, and comparable earnings. The Hope decision, in
18 particular, recognizes that the cost of common equity is
19 commensurate with risk relative to investments in other enterprises.
20 In competitive capital markets, the required return on common
21 equity will be the expected return foregone by not investing in
22 alternative investments of comparable risk. For the utility to attract
23 capital, possess financial integrity, and exhibit comparable

1 earnings, the return allowed on a utility's common equity should be
2 that return required by investors for stocks with comparable risk.
3 It is widely recognized that a public utility should be allowed a rate
4 of return on capital which, under prudent management, will allow
5 the utility to meet the criteria or standards referenced by the Hope
6 and Bluefield decisions. If the allowed rate of return is set too high,
7 consumers are burdened with excessive costs, current investors
8 receive a windfall, and the utility has an incentive to overinvest. If
9 the return is set too low, and the utility is not able to attract capital
10 on reasonable terms to invest in capital improvements for its
11 service area, its future service obligations may be impaired.
12 Because a public utility is capital intensive, the cost of capital is a
13 very large part of its overall revenue requirement and is a crucial
14 issue for a company and its ratepayers.

15
16 **Q. WHAT IS A FAIR RATE OF RETURN?**

17 **A.** The fair rate of return is simply a percentage, which, when
18 multiplied by a utility's rate base investment, will yield the dollars of
19 net operating income a utility should have the opportunity to earn.
20 This dollar amount of net operating income is available to pay the
21 interest cost on a utility's debt and a return to the common equity
22 investor. The fair rate of return multiplied by the utility's rate base

1 yields the dollars a utility needs to recover in order to earn for
2 investors the cost of capital.

3

4 Q. HOW DID YOU DETERMINE THE FAIR RATE OF RETURN THAT
5 YOU RECOMMEND IN THIS PROCEEDING?

6 A. To determine the fair rate of return that I recommend, I performed a
7 cost of capital study consisting of three steps. First, I determined
8 the appropriate capital structure for ratemaking purposes, i.e., the
9 proper proportions of each form of financial capital. Utilities
10 normally finance assets with debt and common equity. Because
11 each of these forms of capital have different costs, especially after
12 income tax considerations, the relative amounts of each form
13 employed to finance the assets can have a significant influence on
14 the overall cost of capital, revenue requirements, and rates. Thus,
15 the determination of the appropriate capital structure for ratemaking
16 purposes is important to the utility and to ratepayers.

17 Second, I determined the cost rate of each form of financial capital.
18 The individual debt issues have contractual agreements explicitly
19 stating the cost of each issue. The embedded annual cost of debt
20 may be calculated by simply considering these agreements and the
21 utility's books and records. The cost of common equity is more
22 difficult to determine, however, because it reflects common equity
23 investors' expectations. Various economic and financial models or

1 methods are available to measure the cost of common equity.
2 Third, by combining the appropriate capital structure ratios for
3 ratemaking purposes with the associated cost rates, I calculated an
4 overall weighted cost of capital or fair rate of return to the utility.

5

6 **II. PRESENT FINANCIAL MARKET CONDITIONS**

7 **Q. CAN YOU BRIEFLY DESCRIBE CURRENT FINANCIAL MARKET**
8 **CONDITIONS?**

9 A. Yes. After dropping several hundred basis points since 2009, the cost
10 of financing has remained relatively stable over the past seven
11 years. According to the issue of Credit Trends by Moody's Investors
12 Service, Inc., yields on long-term "A" rated public utility bonds are
13 3.86% for the month-ending August, 2017; as compared to 4.40%
14 average yield for 2015, 4.23% for 2014, and 4.68% for 2013 as
15 shown in Exhibit CCC-1.

16

17 **Q. HOW DO THESE LOWER INTEREST RATES AFFECT THE**
18 **FINANCING COSTS OF A COMPANY?**

19 A. In simple terms, the current lower interest rates and stable
20 inflationary environment of today, relative to the early 1990's,
21 indicate that borrowers are paying less for the time value of money.
22 This finding is significant since utility stocks and utility costs of capital

1 are highly interest rate-sensitive relative to most industries within the
2 securities markets.

3

4 III. APPROPRIATE CAPITAL STRUCTURE AND COST OF LONG

5

TERM DEBT

6 Q. WHY IS THE ISSUE OF THE APPROPRIATE CAPITAL
7 STRUCTURE IMPORTANT FOR RATEMAKING PURPOSES?

8 A. For companies that do not have monopoly power, the price that an
9 individual company charges for its products or services is set in a
10 competitive market and that price is generally not influenced by the
11 company's capital structure. However, the capital structure that is
12 determined appropriate for a regulated public utility has a direct
13 bearing on the fair rate of return, revenue requirements, and,
14 therefore, the prices charged to captive ratepayers.

15

16 Q. PLEASE EXPLAIN THE TERM CAPITAL STRUCTURE AND
17 HOW THE CAPITAL STRUCTURE APPROVED FOR
18 RATEMAKING PURPOSES AFFECTS RATES.

19 A. The capital structure is simply a representation of how a utility's
20 assets are financed. It is the relative proportions or ratios of debt
21 and common equity to the total of these forms of capital. It is
22 important to note at this point that debt and common equity have
23 different costs. Common equity is far more expensive than debt for

1 ratemaking purposes for two reasons. First, and most important,
2 are income tax considerations. Interest on debt is deductible for
3 purposes of calculating income taxes. The cost of common equity
4 must be "grossed up" to allow the utility sufficient revenue to pay
5 income taxes and to earn its cost of common equity on a net or
6 after-tax basis. Therefore, the amount of revenue the utility must
7 collect from ratepayers to meet income tax obligations is directly
8 related to both the common equity ratio in the capital structure and
9 cost of common equity. A second reason for this cost difference is
10 that the cost of common equity must be set at a marginal or current
11 cost rate. Conversely, the cost of debt is set at an embedded rate,
12 because the utility is incurring only the costs previously established
13 in contracts with senior security holders.

14 Because the Commission has the duty to promote economical
15 utility service, it must decide whether or not a utility's requested
16 capital structure is appropriate for ratemaking purposes. Each
17 dollar of its common equity and long term debt which supports the
18 retail rate base has the following approximate annual costs
19 (including income tax and regulatory fee expense) to CWSNC's
20 ratepayers:

- 21 (1) Each \$1 of common equity costs ratepayers 15 cents per
22 year.
23 (2) Each \$1 of long term debt costs ratepayers 6 cents per year.

1 Q. WHAT IS YOUR RECOMMENDED CAPITAL STRUCTURE AND
2 RECOMMENDED EMBEDDED COST OF LONG TERM DEBT?

3 A. The Company's application listed its capital structure as consisting
4 of 47.11% long term debt and 52.89% common equity. In this
5 proceeding, through discovery, it was determined that the Company
6 was in position to update its capital structure to 47.32% long term
7 debt and 52.68% common equity. As part of the overall Stipulation,
8 the Company agreed to a lower cost capital structure consisting of
9 48% long term debt and 52% common equity. I recommend use of
10 a hypothetical capital structure to set rates for CWSNC in this
11 proceeding. The recommended capital structure for CWSNC as of
12 December 31, 2016, and embedded cost of long term debt are as
13 follows:

14

15	<u>Component</u>	<u>Ratio</u>	<u>Cost Rate</u>
16	Long Term Debt	48.00%	5.93%
17	<u>Common Equity</u>	<u>52.00%</u>	
18	Total	100.00%	

19

20 IV. THE COST OF COMMON EQUITY

21 Q. HOW DID YOU DETERMINE THE COST OF COMMON EQUITY
22 CAPITAL FOR THE COMPANY?

23 A. I have employed the discounted cash flow (DCF) model for water

1 utility companies and the risk premium method using a regression
2 analysis of allowed returns for water utilities.

3 **Q. WOULD YOU PLEASE DESCRIBE THE DCF MODEL?**

4 A. The discounted cash flow model is a method of evaluating the
5 expected cash flows from an investment by giving appropriate
6 consideration to the time value of money. The theory dictates that
7 the price of the investment will equal the discounted cash flows of
8 returns. The return to an equity investor comes in the form of
9 expected future dividends and price appreciation. However, as the
10 new price will again be the sum of the discounted cash flows, price
11 appreciation can be ignored and attention focused on the expected
12 stream of dividends. Mathematically, this relationship may be
13 expressed as follows:

- 14 Let D_1 = expected dividends per share over the next twelve months;
15 g = expected growth rate of dividends;
16 k = cost of equity capital; and
17 P = price of stock or present value of the future income stream.

18 Then,

$$19 \quad P = \frac{D_1}{1+k} + \frac{D_1(1+g)}{(1+k)^2} + \frac{D_1(1+g)^2}{(1+k)^3} + \dots + \frac{D_1(1+g)^{t-1}}{(1+k)^t}$$

22 This equation represents the amount an investor would be willing to
23 pay for a share of common equity with a dividend stream over the
24 future periods. Using the formula for a sum of an infinite geometric
25 series, this equation may be reduced to:

$$P = \frac{D_1}{k-g}$$

Solving for k yields the DCF equation:

$$k = \frac{D_1 + g}{P}$$

Therefore, the rate of return on equity capital required by investors is the sum of the dividend yield (D_1/P) plus the expected long term growth rate in dividends (g).

Q. DID YOU APPLY THE DCF METHOD DIRECTLY TO CWSNC?

A. No, because the common equity of CWSNC is not publically traded. As such, I applied the DCF method to a comparable group of water utilities followed by Value Line Investment Survey (Value Line) and that exhibit comparable measures of investor-related risk measures as shown in Exhibit CCC-2.

Q. WHY DID YOU CONSIDER THE COST OF EQUITY FOR A GROUP OF COMPANIES COMPARABLE IN RISK TO CWSNC?

A. The cost of equity capital is a cost borne by firms whose equity shares are considered to be risk-comparable investments. In order to estimate the investor required rate of return for CWSNC, I performed a DCF analysis on comparable risk companies. Use of a comparable risk group reduces the possibility of error in

///

1 judgment, can be used as a check, and also insures that the
2 standards and criteria of the Hope and Bluefield cases are met.

3

4 Q. HOW DID YOU DETERMINE THE DIVIDEND YIELD
5 COMPONENT OF THE DCF?

6 A. I calculated the dividend yield by using the Value Line estimate of
7 dividends to be declared over the next 12 months divided by the
8 price of the stock as reported in the Value Line Summary and Index
9 sections for each week of the 13-week period from June 16, 2017
10 through September 8, 2017. A 13-week averaging period tends to
11 smooth out short-term variations in the stock prices. This process
12 resulted in a 2.0% average dividend yield for the comparable group
13 of water utilities as shown in Exhibit CCC-3.

14

15 Q. HOW DID YOU DETERMINE THE EXPECTED GROWTH RATE
16 COMPONENT OF THE DCF?

17 A. I employed the growth rates of the comparable group in earnings
18 per share (EPS), dividend per share (DPS), and book value per
19 share (BPS) as reported in Value Line over the past five and ten
20 years. They apply a smoothing process in an attempt to avoid the
21 distortion that may be associated with choosing an
22 unrepresentative high or low beginning or ending point.

23 Secondly, I employed the forecasts of the growth rates of the

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1 comparable group in EPS, DPS, and BPS as also reported in Value
2 Line. These forecasts are prepared by analysts of an independent
3 advisory service. This service is widely available to investors and
4 should also provide an estimate of investor expectations.

5 Thirdly, I incorporated the consensus of various analysts' forecasts
6 of five-year EPS growth rates projections as reported in Yahoo
7 Finance. On Exhibit CCC-3, I have presented the dividend yields
8 and growth rates as described above for each of the companies
9 individually as well as average for the group.

10

11 **Q. WHAT IS YOUR CONCLUSION REGARDING THE COST OF**
12 **COMMON EQUITY TO THE COMPANY BASED ON THE DCF**
13 **METHOD?**

14 **A.** Based upon the DCF results for the comparable group of water
15 utilities, I determined that the cost of common equity is within the
16 range of 8.3% to 9.7%. This range is consistent with a dividend
17 yield of 2.0% and an expected growth rate of 6.3% to 7.7%.

18

19 **Q. PLEASE DESCRIBE THE RISK PREMIUM METHOD BASED ON**
20 **COMMISSION APPROVED ALLOWED RETURNS OF EQUITY.**

21 **A.** I used a regression analysis to analyze the historical relationship
22 between approved returns on common equity for water utilities and
23 yields on utility bonds. The regression analysis incorporates annual

1 average allowed returns as reported by Regulatory Research and
2 Associates (RRA) and the annual average single 'A' rated public
3 utility bond yields as reported by Moody's Investor Service
4 (Moody's). Using the last three months of 'A' rated bond yields, the
5 regression analysis generates a prediction of the current allowed
6 return of equity and the associated risk premium.

7 The method was relied upon by this Commission in Docket No.
8 E-22, Sub 333, a 1993 general rate case of North Carolina Power,
9 and Docket No. G-5, Sub 327, a 1994 general rate case of Public
10 Service Company of North Carolina. This method has been used in
11 filings by the Public Staff in previous general rate cases that were
12 ultimately settled. The method has been used in annual formula
13 rate plans for LDCs¹ regulated by the Mississippi Public Service
14 Commission for over ten years and the method has used in filings
15 by the Staff of the Federal Energy Regulatory Commission in
16 litigated rate cases.

17

18 Q. WHAT DID YOU CONCLUDE FROM THE ANALYSIS OF
19 ALLOWED RETURNS AND UTILITY BOND YIELDS?

20 A. Based on current Moody's single "A" rated utility bond yields and the
21 regression equation, the predicted return on common equity is

¹ Mississippi Valley Gas, Docket No. 92-UN-230; Willmut Gas & Oil Co., Docket 01UN0524.

1 9.65%, as shown in Exhibit CCC-4, page 2 of 2. This result is
2 derived by adding the value for the intercept coefficient
3 (0.086778646) to the value of the x-variable coefficient
4 (0.247358711), and multiplying the result by the average bond yield
5 for "A" rated bonds during the past 90 days (3.93%).
6

7 Q. BASED UPON YOUR DCF AND RISK PREMIUM METHODS,
8 WHAT IS YOUR RECOMMENDED COST OF EQUITY FOR
9 CWSNC?

10 A. Based on the results of the two methods, I conclude that a
11 reasonable range of estimates for the cost of equity is between
12 8.30% and 9.70%.
13

14 Q. TO WHAT EXTENT DOES YOUR RECOMMENDED RATE OF
15 RETURN ON COMMON EQUITY TAKE INTO CONSIDERATION
16 THE IMPACT OF A WSIC/SSIC MECHANISM PURSUANT TO
17 G.S. 62-133.12 ON THE COMPANY'S FINANCIAL RISK?

18 A. I believe the ability for enhanced recovery of the eligible
19 WSIC/SSIC capital improvements reduces regulatory lag and is
20 seen by investors as supportive regulation that mitigates risk.
21 However, a clear method does not exist to quantify the reduction in
22 risk and the return on equity from the investor perspective.

1 As such, I believe that this mechanism supports the
2 reasonableness of my recommendation.

3

4 Q DID YOU SUPPORT SETTLING WITH THE COMPANY AT 9.60%
5 RATE OF RETURN ON COMMON EQUITY?

6 A. Yes. While the results of my study support a cost of equity between
7 8.30% and 9.70% with a mid-point estimate of 9.00%, which would
8 be my recommendation if cost of capital were fully litigated, I
9 believe that the 9.60% return on common equity in the Stipulation
10 represents a reasonable compromise. The 9.60% should enable
11 CWSNC by sound management to produce a fair return for its
12 shareholders, considering economic conditions and other factors,
13 as they now exist, to maintain its facilities and services in
14 accordance with the reasonable requirements of its customers in
15 the territories covered by its franchises, and to compete in the
16 market for capital funds which are reasonable and which are fair to
17 the customers and to its existing investors.

18

19 V. OVERALL RECOMMENDED COST OF CAPITAL

20 Q. WHAT IS YOUR RECOMMENDED OVERALL RATE OF
21 RETURN?

22 A. The recommended cost of capital is 7.84%, as shown in Exhibit
23 CCC-5.

1 Q. DID YOU PERFORM ANY TESTS OF REASONABLENESS WITH
2 YOUR RECOMMENDED RETURN OF EQUITY AND OVERALL
3 COST OF CAPITAL?

4 A. In regard to reasonableness assessment with financial risk, I
5 considered the pre-tax interest coverage ratio as a result of my cost
6 of capital recommendation. Based on the recommended capital
7 structure, cost of debt, and equity return of 9.60%, the pre-tax
8 interest coverage ratio is approximately 3.7 times. This level of pre-
9 tax interest coverage should allow the Company to qualify for a
10 "BBB" bond rating.
11

12 Q. TO WHAT EXTENT DOES THE RETURN ON EQUITY AGREED
13 TO IN THE STIPULATION TAKE INTO CONSIDERATION THE
14 IMPACT OF CHANGING ECONOMIC CONDITIONS ON THE
15 CWSNC CUSTOMERS?

16 A. I am aware of no clear numerical basis for quantifying the impact of
17 changing economic conditions on customers in determining an
18 appropriate return on equity in setting rates for a public utility.
19 Rather, the impact of changing economic conditions nationwide is
20 inherent in the methods and data used in my study to determine the
21 cost of equity for utilities that are comparable in risk to CWSNC. In
22 addition, customer testimony at the public hearings in this
23 proceeding focused on the amount of proposed rate increases in

1 the various service areas. There was no customer testimony on the
2 impact of changing economic conditions on the Company's cost of
3 equity capital.

4 In order to obtain information on the economic conditions in the
5 area served by CWSNC, I conducted a review of the data on total
6 personal income for the years 2013 through 2015 as compiled by
7 the Bureau of Economic Analysis (BEA) and data on the
8 unemployment rate published by the North Carolina Department of
9 Commerce for the counties within the Company's service area
10 which have the greatest number of CWSNC customers. The
11 Company's service area, which stretches from the mountains to the
12 coast, consists of thirty-eight counties and includes nine of the ten
13 most populous counties in North Carolina.

14 The three largest counties within the Company's service area,
15 Forsyth, Mecklenburg, and Wake, experienced average growth in
16 personal income of more than 3.7% annually during the years 2013
17 through 2015, while the statewide average was 3.5%. Most of the
18 counties within its service area experienced growth in personal
19 income from 2013 through 2015, and the overall annual average for
20 these counties was 3.5%.

21 The average unemployment rate of the 38 counties in the CWSNC
22 service territory was 5.0% at the end of 2016, which was virtually
23 identical to North Carolina's statewide unemployment rate of 4.9%

1 at the end of 2016. From 2014 through 2016, the unemployment
2 rate in the Company's service territory fell from 5.6% in 2014 to
3 5.0%, while the state unemployment rate fell from 5.4% in 2014 to
4 4.9%. The falling unemployment rate in the Company's service
5 territory demonstrates the continued improvement in North
6 Carolina's economy and the economy of the service territory of
7 CWSNC.

8 The determination of the rate of return for regulatory proposes must
9 be based on the requirements of capital markets. However, as
10 noted by the North Carolina Supreme Court in recent decisions, it is
11 necessary to consider the impact of changing economic conditions
12 on consumers in general rate cases. As noted in the discussion on
13 present economic conditions, there are reasons to believe that the
14 economic conditions in the nation and in North Carolina will
15 continue to improve which should provide a benefit for many
16 CWSNC customers.

17 In any event, the Commission's duty to set rates as low as
18 reasonably possible consistent with constitutional constraints is the
19 same regardless of the customer's ability to pay, and this was the
20 principle underlying the Stipulation.

21
22 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

23 **A. Yes.**

1 (Whereupon, Exhibits CCC-1
2 through Exhibits CCC-5 were
3 identified as premarked.)

4 CHAIRMAN FINLEY: Thank you, Mr. Grantmyre.
5 What about -- has the Stipulation been submitted as a
6 part of some of this testimony?

7 MS. HOLT: We move the admission of the
8 Stipulation that was also filed on September 19th, 2017.

9 CHAIRMAN FINLEY: All right. We will -- we
10 will --

11 MS. HOLT: And also the Cost of Capital
12 Stipulation, which was filed August --

13 MR. GRANTMYRE: Previously.

14 MS. HOLT: -- previously.

15 CHAIRMAN FINLEY: All right. We will admit the
16 Capital Structure and Cost of Capital Stipulation that
17 has been filed earlier in this case and the Stipulation
18 on the revenue requirement that was filed yesterday into
19 evidence at this point.

20 (Whereupon, the Stipulation Between
21 Carolina Water Service, Inc. of North
22 Carolina and the Public Staff
23 Regarding Cost of Capital and Capital
24 Structure Issues and the Joint

1 Stipulation were admitted into
2 evidence.)

3 CHAIRMAN FINLEY: What about your Application?

4 MS. SANFORD: The Application, yes, sir. We --
5 I have a list, but we -- we move the Application -- would
6 you like for me to go through the whole list?

7 CHAIRMAN FINLEY: What is on your list?

8 MS. SANFORD: Well, the Application, The Form
9 1, plus Supplemental Item 26, Certificate of Service for
10 Customer Notices, the Notices to Customers and the
11 Certificate of Service saying that we served them, the
12 Notice to the Commission regarding the filing of the
13 semi-annual WSIC and SSIC adjustments. That was --

14 CHAIRMAN FINLEY: We don't -- we don't need the
15 notices. Let's --

16 MS. SANFORD: Okay.

17 CHAIRMAN FINLEY: -- let's admit the
18 Application and Form W-1.

19 (Whereupon, Application for a
20 General Rate Increase and
21 Form W-1 were admitted into
22 evidence.)

23 MS. SANFORD: And the Customer Reports?

24 CHAIRMAN FINLEY: We will admit the Customer

1 Reports.

2 (Whereupon, the Customer Reports
3 were admitted into evidence.)

4 MS. SANFORD: Okay. And that -- that is it for
5 my case. Well, and Linneman's -- Mr. Linneman's
6 testimony, if now is the right time for that.

7 CHAIRMAN FINLEY: It's already been admitted.

8 MS. SANFORD: Okay.

9 CHAIRMAN FINLEY: All right. We're going to
10 take a recess, and we'll let you know. The Commission
11 will read and meet and let you know where we stand when
12 -- when we come back, okay?

13 So for the moment, the hearing is temporarily
14 adjourned.

15 (Hearing adjourned from 9:56 a.m. to 10:02 a.m.)

16 CHAIRMAN FINLEY: We're going to adjourn for
17 the moment, and be on call to see if we come back at 3:00
18 or not.

19 MS. SANFORD: I think we have a question as to
20 how close you want us to be.

21 CHAIRMAN FINLEY: Well, we'll call you as soon
22 as we know. It may be 2:30 before we know.

23 MS. SANFORD: Okay. I mean, I didn't know if
24 you wanted us to stay in the room or --

1 CHAIRMAN FINLEY: No, no, no, no.

2 MS. SANFORD: Okay. All right. Well, thank

3 you.

4 (The hearing was adjourned, to be
5 reconvened upon Commission notification.)

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STATE OF NORTH CAROLINA

COUNTY OF WAKE

C E R T I F I C A T E

I, Linda S. Garrett, Notary Public/Court Reporter,
do hereby certify that the foregoing hearing before the
North Carolina Utilities Commission in Docket No.
W-354, Sub 356 was taken and transcribed under my
supervision; and that the foregoing pages constitute a
true and accurate transcript of said Hearing.

I do further certify that I am not of counsel for
or in the employment of either of the parties to this
action, nor am I interested in the results of this
action.

IN WITNESS WHEREOF, I have hereunto subscribed my
name this 24th day of September, 2017.



Linda S. Garrett, CCR
Notary Public No. 19971700150