

**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. W-100, SUB 63

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of)	
Rulemaking Proceeding to Implement)	ORDER ADOPTING COMMISSION
Session Law 2021-149 (Senate Bill 211))	RULE R1-17A

BY THE COMMISSION: On September 14, 2021, the Commission issued an Order Initiating Rulemaking and Requesting Comments in the above-captioned proceeding (Rulemaking Order). In that order, the Commission requested comments and proposed rules to implement the newly enacted N.C. Gen. Stat. § 62-133.1B (WSIP Statute).

On October 19, 2021, the Public Staff filed draft rules and initial comments. On that same date, Aqua North Carolina, Inc. (Aqua), and Carolina Water Services, Inc., of North Carolina (CWSNC, together the Companies) filed joint proposed rules and initial comments.

On November 2, 2021, the Public Staff filed reply comments. On that same date the Companies filed joint reply comments.

After careful consideration of the comments and proposed rules of the parties, the Commission adopts Commission Rule R1-17A, attached to this Order as Appendix A. The balance of this Order discusses the major issues raised by the parties in their comments and provides the Commission's decision relative to those issues.

Issue 1: Structure of Rule

The draft rules provided by the Public Staff in its initial comments place the rules in Chapters 7 and 10 of the Commission Rules for Water Companies and Sewer Companies, respectively.¹ The draft rule provided by the Companies amends Commission Rule 1-17, the Commission Rule applicable to filings of increased rates and applications for authority to adjust rates.

In their reply comments the Companies assert that the rule implementing the Water and Sewer Investment Plan (WSIP or Plan) Statute is more appropriately included in Commission Rule R1-17, as that rule pertains to filings for a general rate case and an approved WSIP will result in multiple changes in base rates through a general rate case proceeding. The Companies further note that the Public Staff's draft rules are similar in

¹ The Public Staff's proposed rules include two set of rules, one for water that utilizes the term Water Investment Plan (WIP) and one for sewer that utilizes the term Sewer Investment Plan (SIP). For brevity, this Order references the proposed rules of the Public Staff a unified proposed rule.

structure to the rule for the Water System Improvement Charge mechanism (WSIC) found in Commission Rule R7-39, and the companion rule for the Sewer System Improvement Charge mechanism (SSIC) found in Commission Rule R10-26. The Companies state that their proposed rule includes changes to the NCUC Form W-1 which are needed to effectuate the practical implications of the WSIP Statute and necessary to support the intended efficiencies within the rate setting process. The Companies contend that duplicating the rules within Chapters 7 and 10 as proposed by the Public Staff would distance the WSIP from its clear link to the setting of base rates.

In its reply comments, the Public Staff notes that it disagrees with the inclusion of the WSIP rule in Chapter 1, Practice and Procedure, of the Commission Rules. The Public Staff asserts that because not all Companies provide both water and sewer service, establishing a combined rule for water and sewer may be problematic. The Public Staff also notes that adding these provisions to Commission Rule R1-17 makes that rule “long and unwieldy.” The Public Staff also asserts that the WSIP rule should be similar to the WSIC/SSIC rules as the mechanisms are comparable.

The Commission agrees with the Public Staff that including the provisions related to implementation of the WSIP Statute in Commission Rule R1-17 would make that rule excessively long and unwieldy. However, the Commission disagrees that the rules implementing the WSIP Statute should be separately stated for water and sewer companies, and that the rule should be included in Chapters 7 and 10. The Commission has created a new Rule, Commission Rule R1-17A, in Chapter 1 of the Commission Rules to more appropriately place the rules related to implementation of the WSIP Statute alongside the rule for the filing of general rate cases and the establishment of base rates. The WSIP Statute requires that an application for a WSIP must be included in a general rate case proceeding.

Issue 2: Burden of Proof

In its initial comments the Public Staff includes a burden of proof clause in its proposed rule that provides the “burden of proof as to whether a WIP mechanism is in the public interest, the correctness and reasonableness of any WIP, including the planned rate adjustments, capital investment projects, and forecasted expenses, and whether the capital investment and expenses were reasonable and prudently incurred shall be on the utility.”

The Companies comment that the Public Staff’s proposed rule on the burden of proof is unnecessary. They state that there is abundant case law supporting the proposition that the burden of proof for requests for rate changes is on the utility.

The Commission agrees with the Companies that the burden of proof clause included in the Public Staff’s proposed rule is unnecessary. The Commission notes that existing statutes place the burden of proof on the public utility, including N.C.G.S. § 62-75, which provides the burden of proof shall be on the utility for the purpose of investigating any rate, service, classification, rule, regulation or practice to show that the same is just and reasonable, and N.C.G.S. § 62-134(c) that provides the burden of proof shall be on

the public utility to show that a changed rate is just and reasonable. Therefore, the Commission finds that the Public Staff's inclusion of a clause in its proposed rule stating that the burden of proof be placed on the public utility as to whether a WSIP mechanism is reasonable, prudent, and in the public interest is unnecessary and redundant and therefore should be excluded from the Rule adopted herein.

The Commission notes that the WSIP Statute provides that the Commission may only approve a WSIP upon a finding that the rates under the Plan are just and reasonable and are in the public interest. The WSIP Statute further provides that in reviewing an application for a WSIP, the Commission shall consider if the Plan "(i) establishes rates that are fair both to the customer and to the water or sewer utility, (ii) reasonably ensures the continuation of safe and reliable utility services, (iii) will not result in sudden substantial rate increases to customers annually or over the term of the plan, (iv) is representative of the utility's operations over the plan term, and (v) is otherwise in the public interest." Although the Commission finds that it is unnecessary for the Rule to reiterate that the burden of proof be placed on the public utility to establish that a WSIP is reasonable, prudent, and in the public interest, the Commission acknowledges that it is imperative that any water or sewer utility filing for a WSIP must set forth sufficient information in its application for the Commission to make a determination as to whether the proposed WSIP meets the criteria set forth in the WSIP Statute. The Commission will carefully consider all elements of a WSIP application for adherence with the WSIP Statute and encourages any utility filing for a Plan under the WSIP Statute and the Commission's approved Rule to set forth sufficient information in its application for the Commission to find that a proposed WSIP meets the criteria set forth in the WSIP Statute. The Commission does not find it necessary to restate the WSIP Statute in the Commission Rule. However, the Commission notes the existing statutory requirements outlined above regarding the burden of proof and the criteria in the WSIP Statute clearly provide any utility filing for approval of a WSIP must provide sufficient evidence and support in its filings and application materials for the Commission to make findings that a WSIP meets the criteria in the WSIP in order for the Commission to approve the Plan.

Issue 3: Performance-based Metrics

The Companies define the term "performance-based metric" in their proposed rule as "a measurement of a utility's operating performance outcomes that is clearly defined, measurable, and easily verified by stakeholders and may be attached to incentives to drive utility performance improvements or support Commission policy goals."

In their initial comments, the Companies reference the North Carolina Energy Process (NCEP) Report. They maintain that while the NCEP Report covers energy policy considerations in North Carolina, it provides guidance on components of Multi-Year Rate Plans (MYRPs) that are consistent with the WSIP Statute.

The Companies state that the WSIP Statute provides that performance-based metrics should advance public policy goals and be clearly defined, measurable, and easily verified. The Companies further state that the performance-based metrics included in an

approved WSIP will allow the Commission, the Public Staff, utility customers, and key stakeholders improved insight into the utility's business plans, cost drivers, and operating performance for several years into the future, while also providing reasonable monitoring of utility performance and customer protections.

The Companies state that the intent of performance-based metrics under the WSIP Statute is to incentivize water and sewer utilities to continuously strive for better performance. The Companies assert that emerging challenges in the water and sewer industry, including new technologies, emerging contaminants, aged infrastructure, safety challenges, and an aging workforce, should shape the considerations on performance-based metrics. As the Commission promulgates new regulations around performance-based metrics, the Companies state that it is important that the metrics be flexible enough to accommodate future changes and challenges facing water and sewer providers.

For establishing and monitoring performance-based metrics, the Companies propose the following four specific categories in their proposed rule to highlight prioritized performance areas that reflect provision of service to customers: (1) operational compliance, (2) customer service, (3) service reliability, and (4) workplace health and safety.

The Companies recommend that all Plans approved by the Commission have at least one performance-based metric in each category listed above. Their proposed rule allows the Commission to modify, reject, or approve any metrics the utility proposes as long as the metrics (1) conform to the categories above, (2) support continue or improved provision of service to customers, and (3) support initiatives or policy goals of the utility or the Commission.

The Companies further propose updates to NCUC Form W-1 with the addition of new Items No. 28 and No. 29. Their revisions would require capital investments to be detailed in Item No. 28 and proposed performance-based metrics to be detailed in Item No. 29. The Companies state that Item No. 29 would require presentation of the calculation formula for each performance metric that was authorized in the most recent WSIP, and it would require three years of historical calculations to allow for trend analysis or establishing of a baseline level.

The Public Staff defines the term "performance-based metric" in its proposed rule to mean:

standards to measure utility operations and management intended to benefit customers and ensure provision of safe, reliable, and cost-effective service by the water/sewer utility. In establishing Performance-based Metrics, the Commission shall consider, at a minimum, effluent quality and regulatory compliance, customer service, reliability, workplace health and safety, number of customer disconnects for nonpayment, timely and cost-effective completion of capital investment projects, and expense efficiency, and may specify penalties and/or incentives based on the results.

The Public Staff comments that a MYRP will benefit and protect ratepayers through improvements in customer service, system operations, reliability, and cost controls that will be implemented through performance-based metrics.

The Public Staff's proposed rule requires that a utility seeking approval of a WSIP shall include in its application proposed performance-based metrics addressing the following seven categories: (1) water quality and regulatory compliance; (2) customer service; (3) reliability; (4) workplace health and safety; (5) number of customer disconnects for nonpayment; (6) timely and cost-effective completion of capital investment projects; and (7) expense efficiency.

In their joint reply comments, the Companies state that the Public Staff's definition of performance-based metrics reiterates the definition from the WSIP Statute, while the Companies' proposed definition builds on the statutory definition by dictating the Commission's parameters for selecting acceptable metrics. The Companies also state that both the Companies and the Public Staff include similar language for consideration of incentives, while the Public Staff allows for penalties based on the results.

The Companies disagree with the Public Staff's final two metric categories, stating that these topics should be addressed with reporting requirements in the Annual Review process as they are directly related to cost-of-service components rather than operational service performance. The Companies state that operational service performance is the focus of the metrics contemplated in the WSIP Statute. The Companies note that in their proposed amendments to the NCUC Form W-1, forecasted capital investments for the Plan are captured in new Item No. 28 and the proposed performance-based metrics are included in new Item No. 29.

In its reply comments, the Public Staff notes that Item No. 29 of the Companies' proposed changes to NCUC Form W-1 requires the utility to provide three years of historical calculations to allow for trend analysis or establishing of a baseline level for proposed performance-based metrics. The Public Staff states that it recognizes the value of historical data, but the absence of available data should not preclude the establishment of performance metrics, especially in the first WSIP.

The Public Staff further notes that the Companies' proposed rule allows the Commission to modify, reject, or approve additional performance-based metrics that (1) conform to the categories, (2) support continued or improved provision of service to customers, and (3) support initiatives or policy goals of the utility or the Commission. The Public Staff states that requiring any additional metrics to meet all three of these conditions in the Companies' proposed rule unduly limits the Commission's authority to establish performance-based metrics.

Further, the Public Staff updates its definition of performance-based metrics to add a provision that provides: "Some metrics can be tracking metrics with or without targets or benchmarks to measure water utility achievement."

The Commission finds that the Public Staff's proposed definition of "performance-based metrics" is reasonable, and the term should be defined as "standards to measure utility operations and management." The Commission further agrees that the metrics are intended to benefit customers by ensuring the provision of safe, reliable, and cost-effective service by the utility as stated in the WSIP Statute. However, the Commission amends the Public Staff's proposed definition to clarify that operations and management of a utility includes the management of capital investment projects. Further, the Commission agrees with the Companies that the intent of the metrics should also be to drive improved utility performance or support Commission policy goals, provided that they also benefit customers by ensuring safe, reliable, and cost-effective service.

The Commission agrees with the Companies regarding the categories for performance-based metrics that should be proposed by a utility in its application. The Commission finds that the categories proposed by the Companies satisfy the WSIP Statute requirement that the metrics ensure the provision of safe, reliable, and cost-effective service and therefore are appropriate to include in the definition of "performance-based metrics."

The Commission does not include the final two categories of performance-based metrics proposed by the Public Staff in Rule R1-17A approved herein. As noted above, the definition of performance-based metrics has been clarified to include the management of capital investment projects as part of utility operations and management. The Commission finds that the Public Staff's inclusion of the number of customer disconnections is not appropriate as a performance-based metric. The Commission notes that information on customer disconnections for nonpayment is more appropriately captured in reporting requirements rather than a performance-based metric.

Furthermore, the Commission agrees with the Companies that performance-based metrics must be clearly defined, measurable, and easily verified by stakeholders as recommended in the NCEP Report. The Commission recognizes that clearly defined, measurable, and easily verified performance-based metrics will help align the Commission, the Public Staff, utility customers, and other stakeholders on shared objectives which will promote improved utility performance for the benefit of the customers. Therefore, the Commission finds it appropriate to incorporate "clearly defined, measurable, and easily verified by stakeholders" in the definition of performance-based metrics.

The Commission also agrees with the Public Staff that the Commission may impose penalties as well as provide incentives based on results of any approved performance-based metrics. The Commission notes that the Companies did not object to the inclusion of penalties when a utility fails to meet an approved performance-based metric. Further, the Commission concludes that an incentive mechanism such as performance-based metrics should be accompanied with appropriate rewards and penalties to motivate a utility to act efficiently to achieve its approved performance-based metrics.

The Commission agrees with the Public Staff's statement provided in its reply comments that some performance-based metrics may act as tracking metrics with no

specific target or benchmark. The Commission acknowledges that not all metrics require specific targets in order to measure utility achievement. The Commission notes that these “tracking metrics” may be appropriate in gauging a utility’s performance relative to its past operations in order to determine if a utility is improving or worsening over time. The Commission finds that this statement provides further flexibility and clarity in setting appropriate metrics for the water or sewer utility and finds it appropriate to include the statement in the definition for performance-based metrics.

The Commission agrees with the concerns of the Public Staff regarding the Companies’ proposal to require performance-based metrics to meet conditions to (1) conform to the categories, (2) support continued or improved provision of service to customers, and (3) support initiatives or policy goals. Requiring the Commission to set performance-based metrics that meet all three conditions unduly limits the Commission in setting performance-based metrics that are sufficiently flexible to accommodate the changes and challenges facing water and sewer utilities. However, the Commission also agrees with the Companies’ proposal to include in the definition for performance-based metrics that the Commission “shall consider, at a minimum” the categories outlined therein. The Commission finds that this definition will allow flexibility for the Commission to set performance-based metrics that go beyond the specific categories and does not unduly limit the Commission to the categories and other conditions prescribed by the Companies in their proposed rule.

The Commission declines to include the proposed language of the Companies that all WSIPs approved by the Commission must include at least one performance-based metric in each of the listed categories. As previously noted, all components of the WSIP must meet the criteria set forth in the WSIP Statute for approval by the Commission. While the WSIP Statute requires a utility filing a proposed WSIP to include performance-based metrics in its proposed Plan, the WSIP Statute does not require the Commission to adopt a minimum number of performance-based metrics. Further, the WSIP Statute authorizes the Commission to approve, deny, modify, or terminate any Plan. Requiring the Commission to adopt metrics in each of the categories is unduly restrictive and beyond the scope of the WSIP Statute.

Issue 4: Definition of Rate Year, Definition of Water and Sewer Investment Plan, Identification of Rate Year, and Establishment of Annual Revenue Requirement.

The Companies proposed rule provides that “Test Year” or “Base Year” of a Plan shall mean “the fully historic 12-month period” consistent with Commission Rule R1-17, and that “Rate Year” shall mean “each of the three fully projected 12-month periods covered by a Water and Sewer Investment Plan.” In addition, the Companies’ proposed rule requires a filing utility to identify the rate year period covered by each rate year.

In support of these provisions, the Companies state that a WSIP is, by definition, a forward-looking plan and will account for future investments to be placed in service through the plan period. The Companies further state that a WSIP will allow the timing of authorized rates and revenue levels to properly match the timing of costs of service provided and

incurred. The Companies maintain that this is consistent with the matching principle, a Generally Accepted Accounting Principle that is based on the cause-and-effect relationship between spending and earning. This accounting principle requires that any expenses incurred must be recorded in the same period as related revenues. The Companies state that while this is a recognized policy shift that many regulated jurisdictions have more recently implemented and addressed with fully projected future test years or multi-year rate plans, the matching of revenues and related costs is commonly used for businesses, nonprofits, and municipal entities.

The Companies further state that the use of fully historic test years to set rates while experiencing consistently increasing operating and maintenance (O&M) costs and heightened levels of infrastructure investment has prevented water and sewer utilities from having an opportunity to achieve allowed returns on equity. This, in turn, has resulted in a higher frequency of base rate cases, straining all stakeholders' resources and adding costs to customers. The Companies assert that one of the goals of the WSIP Statute is to strive to better align capital investments with recovery of those investments. They state that utilizing a WSIP to set rates based on forecasted cost levels better implements the matching principle and leverages forward-looking expectations of the utility while providing customer protections through monitoring and the review processes.

According to the Companies, many state jurisdictions have, for some time, set rates utilizing a fully projected future test year, which forecasts expenses and capital investments made beyond what would be considered a historical test year and beyond the point in time when new rates go into effect. The Companies maintain that the WSIP Statute similarly allows for the setting of rates based on forecasted cost of service and for multiple future years in a MYRP.

The Companies note that in a MYRP, rates are generally set using existing ratemaking considerations with cost forecasts, trends, and indexes used to project cost of service levels throughout the MYRP period. The NCEP Report notes: "In contrast to the current system, where the underlying costs recovered in rates reflect prior costs incurred in some previous twelve-month period (referred to as the historic test year), costs and revenues for a multi-year rate plan are forward-looking". The Companies explain that in utilizing three pre-determined 12-month periods, the Commission would authorize revenue levels and rates in its final order consistent with the cost of service forecasted to be incurred by the utility in each of the three future 12-month periods. In diverging from certain recommendations in the NCEP Report, the WSIP Statute does not contemplate an annual "true-up" process to adjust rates during the MYRP, confirming that the base rates for the three rate years of the Plan will be authorized prior to the start of Rate Year One.

The Public Staff's proposed rule defines Water Investment Plan (WIP), WIP Period, and WIP Year 1 as follows:

- (3) "Water Investment Plan or WIP" means a plan under which the Commission sets water base rates, revenue requirements through banding

of authorized returns and authorizes annual rate changes for a three year-period based on reasonably known and measurable, reasonable and prudent capital investments and anticipated reasonable and prudent expenses approved under the plan without the need for a base rate proceeding during the plan period.

(4) “WIP Period” means the three-year period starting the first full calendar month beginning on or after the effective date of the Commission’s final order setting base rates.

(5) “WIP Year 1” means the first 12 months of the WIP Period. Base rates approved by the Commission pursuant to G.S. 62-133 and Commission Rule R1-17 in the general rate case shall be effective during WIP Year 1.

In its initial comments the Public Staff states that “[t]he Statute does not establish how rates to be charged in the first year of a plan are calculated or cap the rate adjustment in the first year of the plan.” The Public Staff also states that its proposed rule provides procedures and a schedule for the implementation of a WSIP during a three-year period, including annual reporting of performance-based metrics, banding of authorized returns, refunding customers, and annual review of costs. The Public Staff maintains that its proposed rules were drafted with consideration to the foundational principles: (1) that, in fixing rates, the Commission allows utilities to recover the cost of property that is used and useful, or to be used and useful within a reasonable time after the test period, in providing service, and (2) that costs are known and measurable.

In their reply comments, the Companies contend that the Public Staff reiterates and embellishes the definition of a Plan contained in the WSIP Statute. In particular, the Companies state that the Public Staff adds to the original statutory language and concept by inserting the phrase “reasonable and prudent” regarding capital investments. According to the Companies, the legislature wrote in the WSIP Statute “reasonably known and measurable” as the consideration for forecasting capital investments. The Companies assert that the added verbiage may cause confusion due to overlapping terms and may also imply an additional subjective limitation beyond the terms or intent of the WSIP Statute. The Companies further assert that an evaluation of prudence for the proposed capital investments in the Plan application will be performed by Public Staff and other intervenors during the rate case proceeding, and any approved WSIP would necessarily only include projected prudent investments. Therefore, the Companies recommend omitting this definition from the approved rule.

The Companies further assert that MYRPs set rates on a forward-looking basis based on forecasted costs to provide service. The Companies also contend that the WSIP provides for the matching of revenues with costs expected to be incurred during the periods for which the rates are effective. The Companies maintain that the Public Staff’s proposed rule signifies that for at least Rate Year One (and presumably the following Rate Years Two and Three), the cost bases for setting rates will not match the rate effective

period. The Companies state that this reflects a significant disagreement between the proposals of the Public Staff and the Companies, results in no change from the traditional ratemaking approach, and conflicts with N.C.G.S. § 62-133.1B(b) (which requires the Commission to consider whether the Plan “is representative of the utility’s operations over the plan term”). They note that this imbalance of revenues and costs also makes an earnings test problematic, as such a test relies on cost and revenue levels being aligned to fairly gauge the utility’s results. Additionally, the Companies contend that the Public Staff’s proposal to use the traditional ratemaking method to develop Rate Year One’s revenue requirements conflicts with the requirement of the WSIP Statute to incorporate projected capital investments for Rate Year One. They state that the WSIP Statute’s requirement to use forecasted capital investments will have a distinct revenue requirement impact for each rate year based on total capital investment cost, in-service date, and depreciation rate, among other factors, and the inclusion of forecasts inherently expands the scope of the traditional ratemaking method of setting revenue requirements. The Companies recommend that the Commission’s rule require alignment of the cost bases and revenues for each rate year in the Plan. They state that absent such alignment, it is reasonable to expect a utility’s earnings to be skewed for each rate year.

The Companies also state that the Public Staff’s proposal that the WSIP start date be based on an unknown Commission order date is highly problematic. They state that the Public Staff’s proposal effectively makes the WSIP start date a “moving target.” The Companies explain that an unknown WSIP period makes projected expense levels, billing determinants, and rate base applicable to the rate years’ specific 12-month windows impossible to estimate. The Companies assert that the Public Staff’s proposal is in conflict with the WSIP Statute that provides an approved WSIP must be effective no later than the end of the suspension period.

The Public Staff’s proposed rule establishes rates in WSIP Rate Year One to be the Commission-approved rates set by traditional ratemaking. The Public Staff notes that the Companies are seeking cost recovery in rates for costs expected to be incurred by asserting that each rate year be fully projected. The Public Staff states that under the Companies’ proposed rule, costs would begin to be recovered for capital investments before the plant is used and useful to customers and for projected expenses that may not ultimately be fully incurred by the utility.

In its reply comments, the Public Staff states that the Companies’ use of the term “fully historic test years” is inaccurate. The Public Staff explains that the test year used in North Carolina ratemaking is not “fully” historic; in a ratemaking proceeding, test year expenses can be and are in fact often adjusted for known and measurable changes to reflect the annualization of operating revenues and expenses to produce the amounts associated with or needed for serving the number of customers present as of the end of the test year (or a later update period). Therefore, the Public Staff maintains that the test year used in North Carolina is better referred to as an “adjusted historic test year.” The Public Staff states that an adjusted historic test year is also, by definition, less subject to regulatory lag concerns than a “fully historic test year” would be.

As noted above, the WSIP Statute provides that the Commission may only approve a WSIP upon a finding that the rates under the Plan are just and reasonable. The WSIP Statute further provides that in reviewing an application for a WSIP, the Commission shall consider if the Plan “(i) establishes rates that are fair both to the customer and to the water or sewer utility, (ii) reasonably ensures the continuation of safe and reliable utility services, (iii) will not result in sudden substantial rate increases to customers annually or over the term of the plan, (iv) is representative of the utility's operations over the plan term, and (v) is otherwise in the public interest.”

The Commission agrees with the Companies' proposal that the revenue requirement for each rate year of an approved WSIP may include projected costs, including reasonably known and measurable capital investments and anticipated reasonable and prudent expenses, provided the Plan is approved by the Commission and meets the criteria for approval set forth in the WSIP Statute.

The Commission acknowledges that the WSIP Statute authorizes annual rate changes for a three-year period based on reasonably known and measurable capital investments and anticipated reasonable and prudent expenses approved under a WSIP. Further, the WSIP Statute requires that the Plan become effective no later than the end of the maximum suspension period pursuant to N.C.G.S. § 62-134(b) with Rate Year One as the first year of the three-year plan. Commission Rule R1-17A as adopted herein reflects that the Commission may approve a revenue requirement for the first year of the Plan that includes reasonably known and measurable capital investments and anticipated reasonable and prudent expenses provided that the Plan meets the requirements of the WSIP Statute. However, the Commission is not persuaded that the WSIP Statute *requires* the Commission to establish a revenue requirement for the first year of an approved WSIP that includes reasonably known and measurable capital investments and anticipated reasonable and prudent expenses. Rather, the Commission concludes that the first year of a WSIP *may* include projected costs if the utility applying for approval of a WSIP adequately introduces evidence to support its case and the proposed WSIP meets the statutory requirements set forth in N.C.G.S. § 62-133.1B(b).

The Commission further notes that the WSIP Statute provides that an application for a WSIP must be included in a general rate case proceeding. As acknowledged by the Companies in their reply comments, should the Commission reject an application for a WSIP, the underlying rate case proceeding would proceed with the rates for the utility being established using the Commission's traditional ratemaking practices under N.C.G.S. § 62-133 using the historic test year adjusted for known and measurable changes. The Commission acknowledges that at the time the WSIP is proposed by the utility in its general rate case application there will not be actual cost data available pertaining to the “reasonably known and measurable capital investments” for the Public Staff to review and analyze. However, the Rule approved herein requires that the utility provide to the Public Staff and the Commission, among other things, “a detailed description, including the reason for and scope of each proposed capital investment project”.

The Commission recognizes that the WSIP, by definition, is a forward-looking three-year rate plan that may include future investment in infrastructure projected to be placed in service during the entire WSIP period. An evaluation of prudence for the proposed capital investments in the WSIP will be performed by the Public Staff and other intervenors during the rate case proceeding, and any approved WSIP should therefore only include projected prudent capital investments. The actual infrastructure improvements installed by the utility related to the utility's approved WSIP will be reviewed by the Public Staff and the Commission through the quarterly reporting process established in the Rule adopted herein and will be subject to a certain level of review again for prudence and reasonableness in the utility's next general rate case proceeding. The Commission finds that while an approved WSIP will allow cost recovery resulting in limited or capped rate increases for years two and three of the WSIP, the utility's investment decisions remain subject to the reasonable and prudent standard set forth in N.C.G.S. § 62-133. That is, the Commission continues to have authority in the utility's next general rate case proceeding to disallow, prospectively, costs related to capital investments included in the WSIP that are subsequently determined to be unreasonable or imprudent.

Further, the customer protections established in the Rule approved herein, in particular, the reporting requirements in subsection (j) of the Rule outline that the utility shall provide a quarterly construction status report by rate division for each capital investment project. These reports will be used by the Public Staff and the Commission to, among other things, review actual capital investments compared to the WSIP. The Public Staff's scrutiny and review of these quarterly reports will enable the Public Staff to identify any prudence concerns regarding actual capital investments that it should investigate and bring to the attention of the Commission in the next general rate case proceeding.

The Commission acknowledges that in typical WSIC/SSIC proceedings, the Public Staff has, at the direction of the Commission, thoroughly reviewed any request for cost recovery through these rate mechanisms before customers are actually charged through rates. However, in the case of the WSIP such thorough review of actual capital investment costs is not feasible prior to customers being charged under a WSIP, nor is it intended under the WSIP Statute. The Commission agrees with the Companies that the WSIP process is not designed or intended to replace the existing base rate case process with a continuous annual audit of activity across the WSIP period. Rather, the WSIP is intended to streamline the processes which currently drive rate case frequency and filing requirements.

For these reasons, the Commission agrees with the Companies that the Commission Rule does not need to insert the phrase "reasonable and prudent" in the definition of WSIP as proposed by the Public Staff.

The Commission also agrees with the Companies' proposal to include the identification of each of the three rate year periods in the filing of the WSIP. By utilizing three predetermined 12-month periods, the Commission may authorize revenue levels and rates in its final order in the general rate case proceeding consistent with the cost of

service forecasted to be incurred by the utility in each of the three future 12-month periods.

Issue 5: Filing Requirements

In initial comments, the Public Staff's proposed rule included specific filing requirements for a WSIP application, including for each year of a proposed Plan detailed information on capital investment projects, proposed expenses, and the proposed revenue requirement. The Public Staff's proposed rule also required proposed rate adjustments for Rate Years Two and Three of the Plan and proposed performance-based metrics. In addition to this detailed information, the Public Staff rule included a provision outlining the testimony, affidavits, and exhibits to be filed with an application for a WSIP, and a provision requiring applicants to acknowledge upward adjustments during a WSIP are subject to refund if the rate adjustment is found to be unreasonable. The Public Staff also included a form notice to customers of the WSIP application.

The Companies' proposed rule in their initial comments provides that an applicant for a WSIP must identify the test year and the three rate years of a Plan, a calculation of rate base, as included for rate year revenue requirements, based on a 13-month average balance for each rate year, a proposed banding range for the utility's requested rate of return on equity, and the identification of any gross domestic product (GDP) index used to forecast costs included in any rate year revenue requirements. The Companies also propose changes to the NCUC Form W-1 as part of their filing requirements for a WSIP application. In reply comments the Public Staff revised its proposed rule regarding a WSIP application to include identification of any index and inflation rate used to forecast expenses, and information concerning projected number of customers and consumption. Further, the Public Staff states that utilization of 13-month averaging may or may not be appropriate for calculating the rate base in setting the rate years' revenue requirements because it would depend on other conditions, such as how revenues and expenses are or are not annualized. The Public Staff recommends that use of 13-month averaging should be considered on a case-by-case basis as part of the application process.

The Public Staff asserts that the Companies' proposal to "roll-up" small and/or recurring capital investments would eliminate important detail about the individual investments and transform them into budget amounts or "buckets," giving the utility further discretion and flexibility in spending but also inviting distortive utility behavior. The Public Staff suggests that an option to address this potential "roll-up" issue in the MYRP is to exclude these "[s]maller and/or recurring capital investments" from the plan. The Public Staff states that because these assets are, "primarily in replacement of assets already in the asset base and therefore being recovered in current rates" and smaller in magnitude, the financial impact is significantly less than other capital investment projects. The Public Staff further states that exclusion of these "[s]maller and/or recurring capital investments" from the MYRP would significantly reduce the administrative burden involved in the utility compiling records for its application, annual reports, and other incremental reporting requirements, and in the Public Staff's and Commission's review of these records. In their reply comments, the Companies state that their proposed rule, and their proposed

revisions to the NCUC Form W-1 require more detail and support than the Public Staff's proposed rule, while attempting to present the volume of information in an efficient yet practical manner.

The Companies assert that several items in the Public Staff's proposed rule regarding the filing requirements are unnecessary or duplicative. The Companies state that the portion of the of the Public Staff's proposed rule regarding specific testimony, affidavits, exhibits, and other evidence appears to reiterate language in the WSIP Statute regarding the demonstrations needed by the utility for the Commission to approve a Plan generally, as well as performance-based metrics specifically. The Companies argue that this portion of the Public Staff rule is redundant and unnecessary.

The Companies also object to the Public Staff's requirement for labeling WSIC/SSIC eligible investments. The Companies believe this is unnecessary as the WSIP Statute provides that a WSIP may not coincide with a WSIC/SSIC request and, therefore, is not relevant reporting during a WSIP.

The Commission agrees with the Public Staff that use of 13-month averaging for calculating the rate base in setting the rate years' revenue requirements should be considered on a case-by-case basis as part of the application process. The utility should provide its proposed method for calculating rate base in its application, subject to review and audit by the Public Staff. If the parties to the rate case proceeding disagree on the method, the parties will present their testimony and evidence to the Commission for decision.

The Commission finds that the information to be included in the three-year plan required in the Public Staff's proposed rule is necessary and relevant. Although the Commission has declined to adopt at this time the changes to the NCUC Form W-1 proposed by the Companies, the Commission finds that the Public Staff and the Companies should work together and propose any additional information that should be included on the NCUC Form W-1 as a result of the Rule adopted herein. The Commission agrees with the Companies that the Public Staff's proposed rule provision outlining the testimony, affidavits, and exhibits to be filed with an application for a WSIP reiterates language in the WSIP Statute regarding the demonstrations needed by the utility for the Commission to approve a WSIP.

The Commission further agrees that it is unnecessary to include language requiring a utility to demonstrate that the proposed WSIP would improve the regulatory process for the recovery of costs included in the WSIP as compared to available alternative ratemaking mechanisms. This is an additional burden of proof on the utility that is highly subjective, vague, and not contemplated in the WSIP Statute. The criteria in the WSIP Statute, as mentioned above, requires that the Commission must find that a proposed WSIP results in rates that are just and reasonable and are in the public interest. The Commission also shall consider whether the utility's application, as proposed, (i) establishes rates that are fair both to the customer and to the utility, (ii) reasonably ensures the continuation of safe and reliable utility services, (iii) will not result in sudden substantial rate increases to customers

annually or over the term of the plan, (iv) is representative of the utility's operations over the plan term, and (v) is otherwise in the public interest. Nowhere in the WSIP Statute is there a requirement for the Commission to determine that a proposed WSIP would improve the regulatory process for the recovery of costs included in the WSIP as compared to available alternative ratemaking mechanisms.

The Commission also finds that it unnecessary to include language requiring the utility to state whether the proposed water or sewer capital investment project would be eligible for the WSIC/SSIC mechanism. It is the utility's choice whether to continue with traditional rate-of-return regulation, with or without the use of a WSIC/SSIC, or seek Commission approval of a WSIP. There is no language in the WSIP Statute regarding whether a particular project could potentially be recovered through use of the WSIC/SSIC mechanism.

The Commission finds that it is necessary to include the additional filing requirements in the Rule including (1) proposed revenue requirements, pro forma revenues, and proposed base rates for each rate year by rate division, including supporting calculations and exhibits; (2) proposed schedule of rates by rate division for each rate year; and calculation of the proposed percent increase for each rate year, if applicable.

Issue 6: Banding of Authorized Rates of Return

The Companies' proposed rule regarding the banding of authorized rates of return provides that the "Commission will authorize a return on equity for rate year revenue requirement calculation consistent with the evidence in the record, and will set high and low bands for earned return on equity or otherwise consistent with G.S. 62-133.1B(g) and supported by the evidence in the record."

The Public Staff proposed rule provides the following definition for "Banding of Authorized Returns":

"Banding of Authorized Returns" means a rate mechanism under which the Commission sets an authorized return on equity for a water utility that acts as a midpoint and then applies a low- and high-end range of returns to that midpoint under which a water utility or a rate division thereof will not overearn if within the high-end range and will not underearn if within the low end range. Any banding of the water utility's authorized return shall not exceed 100 basis points above or below the midpoint.

The Public Staff also includes two provisions in its draft rule regarding what happens if a utility files a rate case after falling below the low-end of the band of authorized returns. The Public Staff's proposed rule provides that if a utility files a rate case for falling below the low-end of the band, the test year for that rate case would be the then-current year of the Plan, and that if a utility provides notice of its intent to file a rate case after

falling below the low-end of the band, the rates for the utility will revert back to the “the base rates set by the Commission in the utility’s most recent general rate case.”

In their reply comments, the Companies state that the Public Staff’s proposed definition of “banding of authorized returns” reiterates the statutory definition and adds a consideration of the earnings test by rate division. The Companies assert that it is not necessary to restate the definition from the WSIP Statute in the Commission Rule.

In their reply comments, the Companies amend their rule to include a provision that the Commission may consider the decreased or increased risk to a utility that may result from having an approved Plan in setting the authorized return for a utility.

In their reply comments, the Companies object to the Public Staff’s proposal to dictate the test year for a rate case filed after falling below the low-end of the band of authorized returns. The Companies state that as the then-current year of the Plan would be ongoing at the time the Company would request to file a rate case, this provision would delay the ability of the utility to file, and potentially extend the time of the utility underearning. The Companies also assert that dictating the test year for any general rate case is overly prescriptive, unnecessary, goes beyond the considerations of the WSIP Statute, and may result in adverse impacts to the utility and its customers.

The Companies object to the Public Staff’s proposal that the event of underearning would revert a company to lower rates than those currently producing insufficient revenues and would be a “clear instance of retroactive ratemaking.” The Companies note there will have been no showing of imprudent expenditures and this proposal could revert rates to those established “far in the past.” In addition, such a course of action risks unwinding rate consolidation, “yo-yoing” of rates and deprivation of the utility’s ability to recover its costs. The Companies argue if their underearning is confirmed after Public Staff and Commission review, they will likely continue to underearn for the duration of a Plan, even after accounting for incremental Plan rate increases. They argue that the Public Staff’s proposed rule is inconsistent with statutory intent, is likely to cause arbitrary results, may adversely impact customers, and threatens the financial or operational performance of the utility.

The Commission agrees that the Public Staff’s definition of “banding of authorized returns” is duplicative of the WSIP Statute and, therefore, unnecessary. The Commission also agrees that the Public Staff’s proposals to dictate the test year for a rate case filed as the result of falling below the low-end of the band of authorized returns, and the provision to require that a utility revert to “the base rates set by the Commission in the utility’s most recent general rate case” are unnecessary and beyond the scope of the WSIP Statute. Conceivably, a utility would file a general rate case for falling below the low-end of the band only if it believed it would continue to underearn on its rate base for a substantial portion of the remainder of its approved Plan. Implicit in this underearning is the fact that the utility’s current rates are insufficient. As such, the Commission finds that it would be unreasonable to revert to prior rates which would reflect outdated rate base, sales volumes, and cost structure for the utility.

Issue 7: Changes to Rates During a WSIP

In its draft rule, the Public Staff proposes that a utility provide reports on capital projects that were canceled or postponed during a WSIP and provide a proposal to adjust rates to reflect the cancellation or postponement.

The Public Staff also proposes in its draft rule that a utility must acknowledge that “upward rate adjustments during the course of the WIP are subject to refund if the rate adjustment is determined to have been unreasonable and/or inappropriate, and a waiver of any claim that such refunds represent retroactive ratemaking.”

The Companies state that the WSIP Statute does not contemplate refunds or resetting of rates beyond the annual excess earnings test. While the Companies state they understand the Public Staff’s concerns in reconciling projected and actual capital investment, they maintain that requiring a project-by-project audit necessary to assess a refund for projects that are postponed or canceled is a reach far beyond the WSIP Statute and is impractical when considering the context of a utility’s process of capital planning and execution.

The Companies explain that a utility’s capital plan – and a water or sewer utility’s plan in particular – is constantly in flux and evolving, with new information regularly being gathered and real-time, unplanned changes in market factors heavily influencing the results. They further explain that material and labor costs, engineering studies and investigations, and many other factors influence the scope, timing, and final costs of any given project. Events outside the utility’s control, such as changes in permitting requirements, new legislation or compliance standards, timing and scope of government (namely, Department of Transportation) projects, major storms, and contractor or materials availability have significant implications for the utility’s ability to execute planned projects. The Companies state that unplanned operational events such as pipe breaks, treatment equipment issues, or emergent water quality concerns change the utility’s priorities for capital investment. The Companies state that certain projects may be postponed or canceled, and other projects replace those expected investments as the overall infrastructure needs are reassessed and reprioritized.

The Companies further state that significant amounts of water and sewer utilities’ capital plans consist of a high-volume of small to medium scope and dollar projects that are regularly reprioritized as necessary to best and efficiently serve customers’ needs. The Companies maintain that water and sewer utilities need reasonable flexibility for their actual capital investment activity, as compared to the forecasted investments in the Plan and with a concomitant responsibility to provide sufficient explanation for major changes. The Companies do not believe adjustments to rates mid-Plan are allowed per the WSIP Statute nor are they authorized as a component of the Commission’s Rule. Instead, in their reply comments the Companies modify their proposed rule to provide for additional reporting that accommodates the Public Staff’s concerns for identifying potential variances to authorized capital investments. The Companies note that, per N.C.G.S. § 62-133.1B(b), the Commission has the ability to impose conditions on the

Plan that ensure the utility complies with the Plan, allowing for utility-specific requirements to be implemented on a Plan-to-Plan basis.

The Commission recognizes that certain projects planned by a utility may be postponed or canceled, and that other projects may replace those expected investments as the overall infrastructure needs of the utility are reassessed and reprioritized. The Commission also acknowledges that water and sewer utilities' capital plans typically consist of a high volume of small to medium scope and dollar projects that are regularly reprioritized as necessary to best and efficiently serve customers' needs. The Commission notes that the service areas of many of the regulated water and sewer utilities are largely geographically dispersed with many small, independently operated systems. The Commission agrees with the Companies that water and sewer utilities must have reasonable flexibility for their actual capital investment activity, as compared to the forecasted investments in the Plan, but the Commission determines that this flexibility must be paired with a concomitant responsibility to provide sufficient explanation for major changes.

The Commission finds that capital investment changes to the WSIP should be provided in the quarterly reporting process as set forth in the Rule approved herein. The Public Staff, in its role as the consumer advocate, should carefully review and analyze the proposed changes to the capital investments submitted by the company in its quarterly reports. Rates will not be changed to reflect changes in actual capital spending compared to the Plan unless such modification is determined to be necessary by the Commission pursuant to N.C.G.S. § 62-133.1B(f). In general, if the revised capital investments exceed the amount approved in the Plan, rates will not be increased beyond the rates approved at the beginning of the WSIP period. The Commission does not intend for Rule R1-17A approved herein to result in a "mini rate case" review for each year of the Plan. Rather, the Commission determines that the oversight by the Public Staff with regard to actual capital investment spending compared to the approved Plan as provided for by the company's quarterly reporting process as well as the Commission's annual review of a utility's earnings to ensure the utility is not earning in excess of its allowable rate of return on equity to be reasonable safeguards to allow for changes in planned capital investments during the WSIP period.

The Companies assert that the proposal of the Public Staff regarding upward rate adjustments is also beyond the bounds of the Plan as contemplated in the WSIP Statute, and the Companies recommend its omission from the final rules. The Companies assert that it is clear from the WSIP Statute that the Commission maintains the ability to modify or terminate a Plan, after opportunity for hearing and for good cause, if determined to be in the public interest. The Companies maintain that the proposal of the Public Staff regarding upward adjustments would effectively allow a relitigation of the rate-setting process, and refunds (but not surcharges) that would potentially impact the results of Plan years that are fully completed and reviewed.

The Companies further argue that the annual review and excess earnings test provide overarching controls on the review of the utility's performance and a mechanism

for providing refunds should the Plan result in higher earnings levels than allowed. The Companies state that reporting requirements for these controls can be tailored to provide clarity on the utility's performance and assurance that the utility is abiding by the terms of the Plan. The Companies assert that the WSIP Statute and the Companies' proposed WSIP structure do not contemplate or allow for retroactive resetting of base rates based on information obtained well beyond the process of determining rates in the Plan.

The Commission agrees with the Companies that there is no language in the WSIP Statute that authorizes customer refunds (or additional payments to the company for any under-charges) during a WSIP, other than in the case of excess earnings. The Commission notes that the WSIP Statute allows the Commission to modify or terminate an approved WSIP, on a prospective basis, after good cause is shown and there is an opportunity for hearing. Further, the Commission finds that the annual review and excess earnings test provide overarching controls on the review of the utility's performance and a mechanism for providing refunds should the Plan result in higher earnings levels than allowed. Therefore, the Commission declines to adopt the Public Staff's proposed provision to adjust rates to stop collecting from customers any costs related to canceled or postponed projects or the provision allowing for possible refunds and a waiver of any claim that such a refund would represent retroactive ratemaking.

Issue 8: Unplanned Costs and Modification of a Plan

Subsection (4)(a) of the Companies' proposed rule states that the establishment of a Plan "does not preclude a request by the utility, and authorization by the Commission, for an Accounting Order that addresses extraordinary, unplanned costs not included in the setting of the Plan." In their reply comments, the Companies explain that this provision allows the Commission to maintain its practices regarding the issuance of Accounting Orders. Further, the Companies' proposed rule (4)(b) provides that the "Commission may, for good cause shown and after an opportunity for hearing, modify an existing Water and Sewer Investment Plan for circumstances unforeseen at the time the Plan was established." In their reply comments, the Companies explain that this provision allows the Commission to modify an existing Plan should circumstances outside the control of the utility affect the Plan's assumptions.

In its reply comments, the Public Staff points out that the WISP Statute does not address special accounting orders, and, as such, it is not appropriate to address them in the rule. The Public Staff further asserts that the evaluation of requests for special accounting treatment such as deferral accounting should continue to be no less rigorous than the Commission's established criteria, e.g., "a clear and convincing showing that the costs in question were of an unusual and/or extraordinary nature and that, absent deferral, would have a material impact on the Company's financial condition." (See Order Approving Deferral Accounting with Conditions, Docket No. E-7, Sub 874, at 25 (March 31, 2009)).

In addition, the Public Staff takes issue with the Companies' proposal regarding modifications to a Plan because it does not include the requirement that the Commission determine a modification to be in the public interest. The Public Staff points out that

N.C.G.S. § 62-133.1B.(f) provides, “At any time, for good cause shown and after an opportunity for hearing, the Commission may modify or terminate an approved Water and Sewer Investment Plan if modification or termination is determined to be in the public interest.” The Public Staff expresses the concern that the Companies’ omission could function as a loophole for modification of the plan at the request of and benefit to the utility.

With respect to requests for special accounting orders, the Public Staff and the Companies agree that the Commission should maintain its practices regarding the issuance of special accounting orders. However, as pointed out by the Public Staff, the WISP Statute does not address special accounting orders, and the Commission concludes it is unnecessary to address them in the rule. The evaluation of requests for special accounting treatment made while a Plan is in effect will proceed in accordance with the Commission’s established practices related to special accounting orders.

With respect to modification of a Plan for circumstances unforeseen at the time of the establishment of the Plan, the Commission finds that the Companies’ proposed rule provision is consistent with the WSIP Statute and appropriate for inclusion in the Commission Rule. However, as recommended by the Public Staff, the Commission will modify the Companies’ proposal to include the requirement that the Commission find the modification to be in the public interest in order to be approved.

Finally, on the issue of unplanned costs, the Commission notes that subsection (c) of the WSIP Statute authorizes the Commission to “consider the addition of unplanned emergency capital investments that must be undertaken during a plan term to address risk of noncompliance with primary drinking water or effluent standards, or to mitigate cyber or physical security risks, even if such expenditures would cause the above-referenced cap to be exceeded.” Neither the Public Staff nor the Companies addressed this statutory provision directly in their comments. The Commission, however, would benefit from recommendations on how this statutory provision should be implemented. Thus, the Commission directs the Public Staff and the Companies to provide comments on whether Rule R1-17A should be amended to include the process for how the Commission will consider the type of costs contemplated by this statutory provision.

Issue 9: Annual Review

In their initial comments, the Companies note that the Commission Rulemaking Order noted that the new WSIP Statute requires the Commission to adopt rules establishing (1) a procedure for a water or sewer utility to annually refund or credit the customers excess earnings above the high end of the authorized band of returns; and (2) a methodology to annually review the costs subject to the adjustment mechanism, including the opportunity for public hearings.

The Companies prescribe the timeline and filing requirements for the annual review filing in their proposed rule. The Companies also provide a timeline exhibit for the Plan, including the proposed timing of the annual review filings.

In their proposed rule, the Companies recommend a 90-day window after the end of each rate year for the filing on the annual review report. As proposed by the Companies, the annual review report shall include the following for the completed rate year:

- (1) a consolidated balance sheet and income statement;
- (2) a statement of per books operating income based on Commission ratemaking;
- (3) a statement of rate base based on a 13-month average balance;
- (4) a calculation of earned return on equity based on a 13-month average of the actual capital structure applicable to the utility;
- (5) a summary schedule of capital additions estimated to be placed in service during the remaining rate years of the Plan, including the total in-service costs, in-service date, applicable rate division, NARUC asset account, and annual depreciation rate; and
- (6) summary schedule of results for any performance-based metrics authorized in the Plan.

The Companies suggest that the Public Staff review and report its findings and recommendations on the utility's annual review report filing to the Commission within 60 days after the utility submits its annual review report.

The Public Staff's proposed rule provides that within 60 days after the end of each rate year, the utility shall file an annual review report, including the following for the completed rate year:

- (1) a comparison of its actual and pro forma capital investment costs, expenses, revenues, capital structure, and rate of return on equity to those contained in the WSIP as approved by the Commission and reconciling the EMF computation;
- (2) a list of capital investment projects included in the WIP that were canceled or postponed;
- (3) a proposal to adjust rates to stop collecting any costs related to canceled or postponed projects and refund to customers any costs already collected;
- (4) the results of the performance-based metrics established by the Commission; and
- (5) a statement on the utility's earnings. If the utility contends that its earnings fell below the low-end of the band of authorized returns established by the Commission, the utility shall also state whether it intends to file a general rate case as allowed by N.C.G.S. § 62-133.1B(g)(2).

The Public Staff's rule provides that the Public Staff shall audit the utility's annual review report and shall file a report detailing its findings and recommendations no later than six months after the end of each rate year. The proposed rule further provides that

the Commission shall issue an order addressing its findings and making effective any reconciliation or adjustment to the Plan it deems appropriate no later than ten months after the end of each rate year. The Public Staff's rule also prescribes that any reconciliation or adjustment to the Plan as ordered by the Commission, including any refund or credit to customers of excess earnings above the high end of the banding of authorized returns, shall be effective 12 months after the completed rate year. As part of their draft rule on the annual review, the Public Staff also proposes that the Commission may consider pro forma adjustments to the utility's per books capital expenditures, expenses, and revenues, when determining the utility's earned rate of return on equity.

In their reply comments, the Companies state that after review and further discussion, given the Companies' proposed scope of review anticipated to assess earnings and report on performance-based metrics, the Companies revise their proposed rule to allow 45 days to file the annual review report and 60 days for the Public Staff to review the report. In addition, the Companies' revised rule amends or adds the following for the annual review report filing:

- (1) amending the provision for a calculation of earned return on equity based on a 13-month average of the actual cost of debt applicable to the utility and the authorized ratios of capital components instead of "based on a 13-month average of capital structure" as originally proposed;
- (2) adding a provision for a schedule of credit/refund billed to customers by month and reconciliation of EMF activity by month; and
- (3) adding a provision for an opportunity for the utility to respond to Public Staff's findings on the annual review report.

The Companies comment that there are three factors that show it is not the intent of the WSIP Statute to have three annual rate cases during the Plan. First, the capital-intensive nature of the water and sewer industry cannot be disputed, and the need for extensive capital investment drives the increase in rates. The legacy method of conducting base rate cases on a nearly annual basis has proven to be inefficient and expensive for all stakeholders. The second factor is that water and sewer regulated utilities have relatively small customer bases to absorb rate case costs. The third factor is that any viable regulatory mechanism must maintain, enable, and facilitate the Commission's duty to ensure just and reasonable rates. The Companies further assert that they are not aware of any jurisdiction with a MYRP, a fully projected test year, or a historical test year that adopts or endorses a process of analyzing the rate year activity to the level of an "audit" of every capital investment, let alone all components of the cost of service on an annual basis. The Companies opine that such a detailed level of analysis, especially coupled with the Public Staff's proposed timeline, would amount to a rate case-level of activity for all parties each year of a Plan, which overrides a primary benefit of the WSIP as compared to traditional ratemaking.

Regarding the proposal of the Public Staff to consider pro forma adjustments when determining the utility's earned rate of return on equity, the Companies consider these adjustments to be unnecessary. In support of their position, the Companies state two

specific reasons: (1) the actual results will reflect all reasonable and prudent costs related to the specific rate year; and (2) the rates for each rate year are designed to match the expected costs for the rate year.

In its reply comments, the Public Staff states that the scope of the annual review contemplated by the Companies' comments and proposed rule, and the time allotted for the annual review, are inadequate and would inhibit the Public Staff from carrying out its statutory duty to review, investigate, and make appropriate recommendations to the Commission regarding rates charged and service provided by public utilities. The Public Staff comments that the Companies' proposed rule is very broad, would create loopholes for special considerations, and would give the utility unchecked discretion in spending and recovery of projected costs that may not be appropriate, prudent, or reasonable.

The Public Staff notes that the Companies' proposed annual review report is unnecessarily rigid in some respects because the rule restricts the reporting on rate base and the calculation of earned return to a 13-month average. The Public Staff states that the utilization of a 13-month average is one way of presenting this information, but not the only way. The Public Staff criticizes the Companies' proposed annual review report stating it materially lacks pertinent, valuable information such as a comparison of the capital investment projects and associated in-service dates and costs that the utility planned for, and the Commission approved in the WSIP, with those actually completed during the rate year.

The Public Staff maintains its proposed timeline of 60 days for the company to file the annual review report, and four months for the Public Staff to file a report outlining its review the annual review filing. The Public Staff revises its rule to give the Commission flexibility in making its decision on the annual review. Lastly, the Public Staff states that it finds the 15-day period for a utility to respond to the Public Staff's report on annual review filing as shown on the timeline exhibit presented with the Companies' initial and reply comments to be appropriate.

The Public Staff notes the following revision to its proposed rules in its reply comments:

- (1) adding "unless extended for good cause" to its initial proposed ten months for the Commission to issue an order addressing the annual review report; and
- (2) adding a provision for "any refund or credit shall be included on customer bills as a separate line item and will not be included in the calculation of earnings performed for annual audit and reconciliation filings".

The Commission finds that the 45-day time period proposed by the Companies in their reply comments for the utility to file an annual review report is appropriate. The Commission agrees with the Companies that the WSIP Statute does not intend for the required annual review to amount to three rate cases during the Plan. Rather, the WSIP Statute requires the Commission to "establish a methodology to annually review the costs

subject to the adjustment mechanism.” In consideration of the WSIP Statute and the time restriction concerns expressed by the Public Staff in its comments, the Commission finds that four months after the conclusion of a rate year should be sufficient time for the Public Staff to report to the Commission its findings and recommendations on the company’s annual review report. Further, the Commission finds that the Companies’ proposal to allow a utility 15 days to respond to the Public Staff’s report on the utility’s annual review filing to be appropriate.

The Commission observes that the Public Staff considers the Companies’ proposed annual review report to be unnecessarily rigid in some respects because the Companies’ proposed rule restricts the reporting on rate base and the calculation of earned return to a 13-month average. The Public Staff states that the utilization of a 13-month average is one way of presenting this information, but not the only way.

The Commission acknowledges that in the quarterly earnings surveillance reports, the ES-1 and GS-1 reports, filed with the Commission by the major electric and natural gas companies, respectively, those companies utilize a 13-month average for calculating rate base and the earned rate of return on equity for the reporting period. The calculations provided by the major electric and natural gas companies have effectively provided useful information for review by the Commission for decades. Further, use of a 13-month average rather than a 12-month average takes into consideration the base month in the calculation. The Commission acknowledges that use of a 13-month average of actual rate base activity in the annual review process reasonably balances the actual revenue recovery level to the impact of the actual rate base activity within the review period. Thus, for purposes of establishing the annual review process approved herein, the Commission agrees with the Companies that it is appropriate to use the 13-month average for the utility to report on rate base and calculate its earned rate of return on equity.

Further, in their reply comments, the Companies propose to use the 13-month average of the actual cost of debt applicable to the utility in the annual review process rather than the Public Staff’s proposed cost of debt approved in the utility’s last general rate case. The Commission agrees with the Companies that the 13-month average of the actual cost of debt should be utilized because the cost of debt is a real cost to the utility and can change significantly over the three-year period of the plan just like any other cost considered in the rate year. Since actual debt costs change, the annual review process approved herein should recognize that reality.

As mentioned above in the summary of the parties’ comments, the proposed components of the annual review report differ significantly between the Public Staff and the Companies, except for the results of the performance-based metrics established by the Commission. The Commission has outlined above that it disagrees with the Public Staff on the requirement for a proposal to adjust rates to stop collecting any costs related to canceled or postponed projects and to refund to customers any costs already collected. The Commission finds this matter can be addressed by the annual review and the test for excess earnings. In addition, the Commission finds that the WSIP Statute does not restrict the timing of the completion of projects included in the Plan or require a refund if projects

are postponed. In addition, the Commission disagrees with the Public Staff that the annual review report should specifically include a list of capital investment projects included in the Plan that were canceled or postponed.

The Commission also disagrees with the Public Staff that it is necessary to include a statement of intent to file a general rate case if the utility's earnings fell below the low-end of the band of authorized returns in the annual reporting requirements. The WSIP Statute states that the utility may file a general rate case if the earnings fall below the low-end of the band. However, the decision of whether to file a rate case is at the discretion of the utility. If a utility does decide to file a rate case, the requirements of Commission Rule 1-17 apply, including the requirement for a statement of intent to file a general rate case.

The Commission notes that the Public Staff's proposal to consider pro forma adjustments in determining the utility's earned rate of return on equity is permissive. The Commission finds that it is reasonable to include this language in the Rule, and the Commission may consider pro forma adjustments to the utility's per books capital expenditures, expenses, and revenues in determining the utility's earned rate of return on equity if adequately supported by evidence.

Issue 10: EMF

In their initial comments, the Companies do not propose an experience modification factor (EMF). In their draft rule, the Companies included a "make-whole" provision in case the effective date of Rate Year One occurs before rates can be put in place. The provision allows either (i) Rate Year One rates to be collected on a compressed time frame, or (ii) a deferred accounting mechanism to recover the revenue shortfall. The Company states that if this provision is adopted, the Companies will not need to request temporary rates set under bond if the order approving the rate case is issued after the start of Rate Year One.

The Public Staff proposes an EMF that provides "the rates shall be modified through the use of an experience modification factor (EMF) that reflects the difference between the revenue requirement of any adjustment or refund ordered by the Commission pursuant to subsection (h)(5) of this section and the revenues that were actually realized during the applicable year of the WIP. The EMF shall remain in effect for the 12-month period following the applicable year of the WIP."

In reply comments the Companies strongly object to the Public Staff's inclusion of any adjustment and the use of "applicable year" in its EMF proposed rule. The Companies state that the EMF should only reconcile any variance between the authorized credit amount and the actual credit amount but not reconcile the actual full base rate revenues. The Companies explain that the refund or credit activity will not be booked as revenue but rather in a regulatory liability account capturing the credits applied to the customer bills against the liability account balance, resulting in balance sheet only transactions. The Companies also comment that any true-up for over- or under-recovery for a given 12-month

refund or credit period will be combined with any active, approved refund or credit related to the Plan.

Further, the Companies believe the Public Staff's proposed "applicable year" is in reference to the recently completed rate year. If so, it makes the EMF effective period impossible to accommodate using the Public Staff's proposed timeline for the annual review. Therefore, the Companies modify their rule to include the EMF filing within the annual review process.

In reply comments the Public Staff states that it believes the proposal of the Companies to include a "make-whole provision" is more properly addressed by the EMF. The Public Staff further states that the Companies' proposal to compress the rate in a shorter period would ignore seasonality or differences in consumption based on time of year. The Public Staff also notes any revenue shortfall resulting from the difference in the effective date of the rates and the issuance of the order would likely not meet the traditional requirements for deferral accounting.

The Commission recognizes that there may be a discrepancy between the authorized credit due to excess earnings and the actual credit that the utility applies to the customer bills in a credit period. The Commission agrees with the Companies that the EMF should only reconcile the variance between the authorized credit amount and the actual credit amount applied to customer bills but not reconcile the actual full base rate revenues. In addition, the Commission agrees with the Companies that any true-up for over- or under-recovery for a given 12-month credit period should be combined with any active, approved credit related to the Plan. If there is any other adjustment considered by the Commission, it should be addressed in the annual review, not in the EMF.

Further, the Commission agrees with the Public Staff that the Companies' concerns regarding any revenue shortfall resulting from a delay between the issuance of a Commission order approving a WSIP and the effective date of the rates is more appropriately addressed in the EMF.

Issue 11: Calculation of Excess Earnings Refund

In initial comments the Public Staff provides that if a utility exceeds the high-end range of the band of authorized returns, the utility must credit to customers the excess earnings, with interest. However, the Public Staff's proposed rule did not provide explicit instructions on how to calculate the refunds for customers.

The Companies' proposed rule provides their calculation of the refund to customers. Further, the Companies' proposed rule provides that refunds shall be separately stated on the bill and "expressed as a percentage carried to two decimal places and shall be applied to the total utility bill of each customer under the utility's applicable service rates and charges." The rule further states that the "surcredit percentage shall be computed by dividing the authorized Total Service Revenues for the following 12 months which the surcredit will be in effect by the amount to be surcredited to customers, inclusive of interest."

In reply comments the Public Staff addresses one portion of the Companies' proposal for the refund of excess earnings. The Public Staff revised its rule to also provide that the credit would be separately stated on the customers' bills, and that any credit would not be included in the calculation of earning performed in the annual review filings.

The Commission finds that the Companies' proposal for the calculation of refunds is reasonable and should be included in Commission Rule R1-17A. Further, the Commission agrees with the Public Staff that any refund or credit would not be included in the calculation of earning performed in the annual review filings.

Issue 12: Reporting Requirements

The Companies did not provide specific proposed language regarding periodic reporting requirements in their initial comments other than the annual filings proposed following the end of each rate year related to the annual review process.

The Public Staff proposes the following section in its rule regarding reporting requirements:

(j) Reporting Requirements. – The utility shall make filings addressing each three-month period within the WIP Period. The first filing shall be made no later than 45 days after the first three-month period, and subsequent reports shall be made every three months thereafter. Each filing shall contain the following:

- (1) An earnings report consisting of the following:
 - a. A balance sheet and income statement for the three months and twelve months to date for the utility;
 - b. A statement of the per books net operating income for the three months and twelve months to date for each rate division of the utility based on North Carolina ratemaking;
 - c. A statement of rate base at the end of the three months for each rate division of the utility based on North Carolina ratemaking; and
 - d. The number of customers, gallons sold, and service revenue for the three months for each rate division by rate type (meter size, flat rate, etc.).
- (2) A report of refunds or credits disbursed to customers during the three months by rate division and rate type.
- (3) A construction status report which includes by rate division the following information for each capital investment project:
 - a. The costs incurred during the three months;
 - b. The cumulative amount incurred;
 - c. The estimated total cost for each project;
 - d. The completion date estimated in the WIP; and
 - e. The actual completion date or, if not complete, the current estimated completion date.

As stated in its proposed rules, the Public Staff requires the utility to make quarterly filings during the Plan period, with the first report filed within 45 days after the first three months and subsequent reports to be filed in three-month intervals thereafter. The Public Staff also requires that each quarterly report shall include an earnings report, a refund disbursement to customer report by rate division and rate type, and a construction status report.

In reply comments the Companies state that the Public Staff's proposed reporting requirements mirror those of the WSIC/SSIC Commission Rules R7-29 and R10-26. The Companies maintain that the difference between the Plan and the WSIC/SSIC mechanism is that the WSIC/SSIC is limited to certain eligible capital projects while the Plan would include the entire cost of service of the utility. They further state that the details proposed to be provided by the Public Staff would be a massive undertaking for the utility's staff and for the Public Staff to review and effectively amount to the preparation of a mini-rate case on an ongoing basis. However, the Companies acknowledge that the Public Staff and the Commission may wish to track the utility's progress during the Plan period; consequently, the Companies modified their proposed rule to include a filing for actual capital investments in service as of six months into a rate year and as part of the annual review, consistent with the level of detail proposed by the Companies' in NCUC Form W-1 Item No. 28.

The Public Staff emphasizes that its proposed rule would require a utility to include information that would permit the Public Staff and the Commission to evaluate whether the Company has adhered to the approved Plan and that it has acted reasonably and prudently in completing projects. In addition, the Public Staff quotes the reporting requirements from the Minnesota Public Utilities Commission Order Establishing Terms, Conditions, and Procedures for Multiyear Rate Plans as follows:

The Commission generally monitors the operations of regulated utilities. The need for Commission scrutiny only increases when a utility asks ratepayers to bear the cost of a plant that is not even built at the time the utility proposes its rates. The Commission must have access to information that will permit the Commission to monitor the plant's progress and to evaluate whether the project remains prudent.

The Commission agrees with the Companies that there is a balance to strike between the oversight obligation of the Commission and the burden on the utility to provide the information needed for the Commission to exercise its oversight duty. The Commission also agrees with the Public Staff that certain information is needed in addition to each annual review to track the progress and financial status of the utility during the period of an approved WSIP.

The Commission acknowledges that the WSIP Statute specifically states that a utility cannot implement both a Plan and the WSIC/SSIC mechanism for the same period. However, the utility can switch between a Plan and the WSIC/SSIC mechanism. The

Commission's WSIC/SSIC mechanism rules require the utility to file quarterly financial information and a construction status report. To reduce confusion and provide consistency in the information presented if there is a change from a Plan to a WSIC/SSIC mechanism, the Commission finds that the utility should be required to file the financial and project status information for the WSIP in a similar manner as the WSIC/SSIC reports. Therefore, the Commission adopts the Public Staff's proposed reporting requirement, as amended, to accomplish this goal.

The Commission also notes that it is required by the WSIP Statute to report data on the number of customer disconnections for non-payment to the Joint Legislative Commission on Energy Policy for each Plan and finds that the best format to collect this data is through the quarterly reports.

Issue 13: End of WSIP

The Companies did not provide initial comments on whether Rate Year Three rates should remain in effect following the expiration of the WSIP period. In their proposed rules filed with their initial comments the Companies include a provision that if the utility does not have a new general rate case approved at the end of a Plan, the "utility shall continue to file an Annual Review Report for each 12 month period beyond the end of the authorized Plan."

The Public Staff includes a provision in its proposed rule that states that rates for Rate Year Three shall remain in effect after expiration of the WSIP until further order of the Commission.

The Companies state that the Public Staff's proposed rule regarding the rates in effect at the end of a Plan period is unnecessary because abundant case law exists supporting that the most recently approved rates remain in effect until adjusted by Commission order.

The Public Staff did not provide any reply comments concerning the rates that will be in effect after the expiration of a WSIP. However, the Public Staff did include updates to its proposed rules that requires a utility to file reports under the Public Staff's annual review process and quarterly reporting requirements after the end of the final rate year of a WSIP.

The Commission disagrees with the Companies that the Public Staff's proposed rule provision specifying the rates in effect after the expiration of the WSIP is unnecessary. The Commission notes that with traditional ratemaking an order granting a rate increase typically approves an annual revenue requirement and a schedule of rates attached as appendices. The schedule of rates become effective for utility service rendered on and after the issuance date, or a date otherwise provided in the order. The Commission anticipates that a similar process will be used to approve a utility's WSIP. An order approving a WSIP will approve an annual revenue requirement and a schedule of rates for each year of the Plan. As stated in the Rule approved herein, the rates for Rate Year Three will remain effective until otherwise ordered by the Commission. While the

Commission agrees with the Companies and the Public Staff that the most recently approved rates remain in effect until adjusted by order of the Commission, the Commission agrees with the Public Staff that the reporting requirements required under the rule will remain in effect until otherwise ordered by the Commission. Further, the Commission finds the Public Staff's proposed frequency of quarterly reporting to be more appropriate than the Companies' proposed annual reporting frequency.

Conclusion

Based upon the foregoing and the entire record in this proceeding, the Commission adopts Rule R1-17A, as set forth in Appendix A to this Order, effective as of the date of this Order. The Commission notes that while the Rule is effective there are outstanding issues that will be addressed as the new WSIP process moves forward.

The Public Staff proposed a template notice to customers of the WSIP application as part of its proposed rule. As part of their proposed rule, the Companies proposed additional information that would be included in the NCUC Form W-1 for a utility applying for a WSIP. The Commission directs the Public Staff and the Companies to propose a template notice to customers and any additional information to be included on the NCUC Form W-1 in conformity with Commission Rule R1-17A as adopted in this Order. The parties are requested to work together to reach consensus on these remaining issues.

IT IS, THEREFORE, ORDERED as follows:

1. That Commission Rule R1-17A, as shown in Appendix A, is approved and effective as of the date of this Order;
2. That the Companies and the Public Staff shall file a template notice to customers of the WSIP application and any proposed additional information that should be included in the NCUC Form W-1 for a utility applying for a WSIP, on or before February 15, 2022; and
3. That the Companies and the Public Staff shall file comments on subsection (c) of the WSIP Statute related to unplanned emergency capital additions on or before March 1, 2022, and reply comments, if any, on or before March 11, 2022.

ISSUED BY ORDER OF THE COMMISSION.

This the 7th day of January, 2022.

NORTH CAROLINA UTILITIES COMMISSION

A handwritten signature in black ink, appearing to read "Erica N. Green". The signature is fluid and cursive, with the first name "Erica" and last name "Green" clearly distinguishable.

Erica N. Green, Deputy Clerk

**Rule R1-17A PROCEDURE FOR WATER AND SEWER INVESTMENT PLAN
RATE ADJUSTMENTS UNDER G.S. 62-133.1B.**

(a) Purpose. – This rule provides the procedures for the approval and administration of the Water and Sewer Investment Plan mechanism authorized under G.S. 62-133.1B.

(b) Definitions. – As used in this rule, the following definitions shall apply:

- (1) “Performance-based metrics” shall mean standards to measure utility operations and management, including the management of capital investment projects, intended to benefit customers by ensuring the provision of safe, reliable, and cost-effective service by the utility. Metrics may also be standards that are intended to drive utility performance or support Commission policy goals provided that they benefit customers by ensuring the provision of safe, reliable, and cost-effective service. In establishing performance-based metrics, the Commission may consider, at a minimum, operational compliance, customer service, service reliability, and workplace health and safety. Performance-based metrics shall be clearly defined, measurable, and easily verified by stakeholders. The Commission may approve penalties or incentives based on the results of approved metrics. Some metrics may be tracking metrics with or without targets or benchmarks to measure utility achievement.
- (2) “Test Year” or “Base Year” shall mean the 12-month period consistent with the term “Operating Experience” as defined in sub-section (b)(8) of Rule R1-17.
- (3) “Rate Year” shall mean each of the three 12-month periods as approved in a Water and Sewer Investment Plan.
- (4) “Utility” shall mean a water, sewer, or water and sewer public utility.
- (5) “Water and Sewer Investment Plan” or “Plan” shall mean a plan under which the Commission sets base rates and revenue requirements through the banding of authorized returns, and authorizes annual rate changes for a three-year period based on reasonably known and measurable capital investments and anticipated reasonable and prudent expenses approved under the plan without the need for a base rate proceeding during the plan period.

(c) Filing Requirements. – A request for a Water and Sewer Investment Plan must be consistent with Rule R1-17 unless otherwise noted in this Section. A utility’s application for a Water and Sewer Investment Plan must include the following:

- (1) Identification of the Test Year and three Rate Year periods. The first Rate Year shall begin no later than the first day of the month which includes the end of the statutory suspension period under G.S. 62-134.
- (2) A three-year capital investment plan by rate division that includes the following:
 - a. All proposed capital investment projects expected to be placed in service in the period starting on the date immediately following the end date specified by the Commission for the update of utility plant in service and continuing through the conclusion of the Plan for which the utility seeks cost recovery through the Plan mechanism.

- b. A detailed description, including the reason for and scope of, each proposed capital investment project.
 - c. The estimated in-service date of each proposed capital investment project.
 - d. The asset account per the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts and the annual depreciation rate for each proposed capital investment project.
- (3) Calculations of rate base, as included for Rate Year revenue requirements, by rate division, with exhibits setting forth the specific method utilized for the calculations.
- (4) All proposed expenses expected to be incurred during each Rate Year by rate division including the following:
- a. Any forecasts, including all calculations and assumptions, of changes in each expense account.
 - b. Justification for any variation from expense levels proposed in the utility's rate case application.
- (5) To the extent an inflation factor is used to forecast costs included in Rate Year revenue requirements, identification of the GDP index and the inflation rate used in such forecasts.
- (6) Proposed revenue requirements, pro forma revenues, and base rates for each Rate Year by rate division, including supporting calculations and exhibits.
- (7) Proposed Schedule of Rates by rate division for each Rate Year.
- (8) A calculation of the proposed percent increase for each Rate Year, if applicable.
- (9) A proposed banding range for the utility's requested rate of return on equity.
- (10) At least one proposed performance-based metric in each of the following categories:
- a. Operational compliance.
 - b. Customer service.
 - c. Service reliability.
 - d. Workplace health and safety.

(d) Establishment of Annual Revenue Requirement. – The Commission shall establish the annual revenue requirement for each Rate Year of a Water and Sewer Investment Plan. The annual revenue requirement for each Rate Year may include reasonably known and measurable capital investments and anticipated reasonable and prudent expenses, provided the Commission finds the Plan results in rates that are just and reasonable and are in the public interest, and meets the other criteria of G.S. 62-133.1B.

(e) Banding of Authorized Rate of Return on Equity. – The Commission will authorize a rate of return on equity for each Rate Year revenue requirement calculation consistent with the evidence in the record and will set high and low bands for earned rates of return on equity consistent with G.S. 62-133.1B(g). In setting an authorized rate of return on equity for banding of authorized returns pursuant to this Section, the Commission may consider any decreased or increased risk to a utility that may result from having an

approved Plan. A utility with an approved Plan may not apply for a general rate increase pursuant to G.S. 62-133 or G.S. 62-133.1 to be effective before the end of the Plan unless the utility's earned rate of return on equity falls below the low-end range of the band established by the Commission.

(f) Modification. – The Commission may, for good cause shown and after an opportunity for hearing, modify or terminate an existing Water and Sewer Investment Plan for circumstances unforeseen at the time the Plan was established if the Commission determines it is in the public interest. Should a Plan modification be authorized that adjusts previously approved tariff rates, the Commission shall prescribe the form of Notice to Customers.

(g) Annual Review. – The Plan shall be subject to the following:

- (1) Within 45 days after the end of each Rate Year, each utility shall file a report, containing the following information for the preceding Rate Year:
 - a. A report of refunds or credits disbursed to customers by month and reconciliation of EMF activity by month during the Rate Year by rate division and rate type, if applicable.
 - b. An analysis, including results, of the performance-based metrics established by the Commission, and the calculation of any applicable incentives or penalties.
 - c. A statement that the utility's earnings during the subject Rate Year of the Plan fell within, exceeded the high-end, or fell below the low-end of the band of authorized rate of returns established by the Commission.
 - d. A statement of rate base based on North Carolina ratemaking depicting a 13-month average balance for the completed Rate Year.
 - e. A calculation of earned rate of return on equity based on a 13-month average of the actual cost of debt applicable to the utility for the completed Rate Year, and the authorized ratios of capital components approved in the utility's last general rate case proceeding.
 - f. A schedule of the estimated capital investment projects to be placed in-service during the remaining Rate Years of the Plan, including: total in-service costs, in-service date, applicable rate division, NARUC asset account, and annual depreciation rate.
- (2) The Public Staff shall review the utility's report and shall file a report detailing its findings and recommendations no later than four months after the end of each Rate Year of the Plan. The utility may respond to the Public Staff's report within 15 days after such filing.
- (3) When determining the utility's earned rate of return on equity, the Commission may consider pro forma adjustments to the utility's per books capital expenditures, expenses, and revenues. For the purpose of

determining whether the rate of return on equity for any Rate Year falls outside of the high and low bands, the earned return on equity shall be calculated based on the capital structure established in the utility's last general rate case, and on a 13-month average of the actual cost of debt.

- a. If the utility's earned rate of return on equity exceeds the high-end range of the band established by the Commission, the excess earnings shall be refunded to customers as provided in subsection (i) of this rule.
 - b. If the utility's earned rate of return on equity falls below the low-end range of the band established by the Commission, the utility may apply for a general rate increase pursuant to G.S. 62-133 or G.S. 62-133.1.
- (4) The Commission shall issue an order addressing its findings and making effective any reconciliation or adjustment to the Plan it deems appropriate. Any reconciliation or adjustment ordered by the Commission, including any credit to customers of excess earnings above the high end of the banding of authorized rates of returns on equity established by the Commission, shall remain effective for a 12-month period. Any refund or credit shall be included on customer bills as a separate line item and will not be included in the calculation of earnings performed for annual audit and reconciliation filings.
- (h) Experience Modification Factor. – The experience modification factor (EMF) shall be established when applicable to reconcile the difference between the credit ordered by the Commission pursuant to subsection (i) of this section and the actual credit amount applied to customer bills. If the effective date of Rate Year One is before the date of the Commission's Order approving the Plan, the Commission may establish an EMF to account for a delay between the implementation of Rate Year One tariff rates and the effective date of Rate Year One. The EMF shall remain in effect for the 12-month period unless the true up is included in the excess earnings credit calculation.
- (i) Credit for Excess Earnings. – If the Annual Review determines that the utility earned higher than the authorized high band rate of return on equity for a Rate Year, the Commission will authorize a credit to applicable utility customers.
 - (1) The credit shall be included on customer bills as a separate line item and will not be included in the calculation of earnings performed for Annual Review filings.
 - (2) The credit shall be expressed as a percentage carried to two decimal places and shall be applied to the total utility bill of each customer under the utility's applicable service rates and charges.
 - (3) Pursuant to G.S. 62-130(e), any amount to be credited to a utility's customers shall include an amount of interest at such rate as the Commission determines to be just and reasonable, not to exceed the maximum statutory rate.

- (4) The credit percentage shall be computed by dividing the Total Service Revenues for the following 12 months for which the credit will be in effect by the amount to be credited to customers, inclusive of interest. The credit will be effective no later than the first day of the second month following the Commission order authorizing the credit.
 - (5) In its order authorizing a credit for excess earnings, the Commission shall include a form of Notice to Customers to be issued with customer bills in the first billing cycle the credit is effective.
- (j) Reporting Requirements. – The utility shall make filings addressing each three-month period within the Plan period. The first filing shall be made no later than 45 days after the first three-month period, and subsequent reports shall be made every three months thereafter. Each filing shall contain the following:
- (1) An earnings report consisting of the following:
 - a. A balance sheet and income statement for the three months and twelve months to date for the utility.
 - b. A statement of the per books net operating income for the three months and twelve months to date for each rate division of the utility based on North Carolina ratemaking.
 - c. A statement of rate base at the end of the three months for each rate division of the utility based on North Carolina ratemaking.
 - d. The number of customers, gallons sold, and service revenue for the three months for each rate division by rate type (meter size, flat rate, etc.).
 - (2) A status report which includes by rate division the following information for each capital investment project:
 - a. The costs incurred during the three months.
 - b. The cumulative amount incurred.
 - c. The original and revised estimated total cost for each project.
 - d. The in-service date estimated in the Plan.
 - e. The actual date placed in service or, if not yet placed in service the current estimated placed in-service date.
 - f. A schedule of all changes to the capital investment projects approved in the Plan for the remainder of the Plan period, including the information outlined in subsections (c)(2)(b)-(d) of this Rule for any capital investment project not approved in the original Plan.
 - (3) The number of utility customers disconnected for nonpayment for the three-month period and cumulative rate-year to date.
- (k) Continuation of Rates. – If the utility does not have a new general rate case effective at the end of Rate Year Three, the rates in effect at the end of Rate Year Three shall remain in effect, and the utility shall continue to file the reports required under subsection (j) of this rule, until further order of the Commission.