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Oct 10 2016

October 10, 2016

**VIA ELECTRONIC FILING**

Chief Clerk  
North Carolina Utilities Commission  
Dobbs Building  
430 North Salisbury Street  
Raleigh, North Carolina 27603

Re: Docket No. G-5, Sub 565

Dear Chief Clerk:

Enclosed on behalf of Public Service Company of North Carolina, Inc. and the North Carolina Utilities Commission – Public Staff is their Joint Proposed Order of the Stipulating Parties for filing in the above-referenced proceeding.

If you have any questions regarding this filing, please do not hesitate to call me. Thank you for your assistance with this matter.

Very truly yours,

/s/Mary Lynne Grigg

MLG:kjg

Enclosure

**STATE OF NORTH CAROLINA  
UTILITIES COMMISSION  
RALEIGH**

DOCKET NO. G-5, SUB 565

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of	
Application of Public Service	)
Company of North Carolina, Inc. for a	)
General Increase in its Rates and	)
Charges	)
	JOINT PROPOSED ORDER OF
	THE STIPULATING PARTIES

HEARD IN: Gaston County Courthouse, Gastonia, North Carolina, on August 23, 2016; Buncombe County Courthouse, Asheville, North Carolina, on August 24, 2016; Government Center, Statesville, North Carolina, on August 25, 2016; and, the Commission Hearing Room, Dobbs Building, Raleigh, North Carolina, on August 29 and 30, 2016

BEFORE: Commissioner ToNola D. Brown-Bland, presiding, Chairman Edward S. Finley, Jr., Commissioners Bryan E. Beatty, Don M. Bailey, Jerry C. Dockham, James G. Patterson, and Lyons Gray

APPEARANCES:

For Public Service Company of North Carolina, Inc.:

Mary Lynne Grigg, McGuireWoods, LLP, 434 Fayetteville Street,  
Suite 2600, Raleigh, North Carolina 27601

William R. Pittman, PO Box 706, Raleigh, North Carolina 27602

B. Craig Collins, Associate General Counsel, SCANA Corporation,  
MC C222, 220 Operation Way, Cayce, South Carolina 29033-3701

For the Using and Consuming Public:

Gina C. Holt, William Grantmyre, and Heather Fennell, Staff  
Attorneys, Public Staff – North Carolina Utilities Commission, 4326  
Mail Service Center, Raleigh, North Carolina 27699-4326

Margaret A. Force, Assistant Attorney General, North Carolina  
Department of Justice, Post Office Box 629, Raleigh, North  
Carolina 27602

For Carolina Utility Customers Association, Inc.:

Robert F. Page, Crisp, Page & Currin, LLP, 4010 Barrett Drive,  
Suite 205, Raleigh, North Carolina 27607

For Evergreen Packaging:

Adam Olls and Jeffrey D. McKinney, Bailey & Dixon, LLP, 434  
Fayetteville Street, Suite 2500, Raleigh, NC 27601

BY THE COMMISSION: On February 17, 2016, Public Service Company of North Carolina, Inc. (PSNC or the Company), filed its Letter of Intent to File for authority to adjust and increase its retail natural gas rates and charges pursuant to Commission Rule R1-17(a).

On March 3, 2016, the Carolina Utility Customers Association, Inc. (CUCA), filed a Petition to Intervene, which was granted by the Commission on March 7, 2016.

On March 31, 2016, PSNC filed an Application for a General Rate Increase (Application) seeking a general increase in and revisions to its rates and charges, implementation of a new Integrity Management Tracker mechanism, implementation of new depreciation rates, updates and revisions to the Company's service regulations and tariffs, and proposed funding for gas distribution research activities conducted by the Gas Technology Institute (GTI). Included with its Application were information and data required by the NCUC Form G-1, pursuant to Commission Rule R1-17(b)(12), and the direct testimony and exhibits of Company witnesses: D. Russell Harris, President and Chief Operating Officer of PSNC and President of Gas Operations for South Carolina Electric & Gas Company (SCE&G); Jimmy E. Addison, Executive Vice President

and Chief Financial Officer of PSNC, SCANA Corporation, and the other subsidiaries of SCANA; George B. Ratchford, Vice President – Gas Operations for PSNC; Sharon D. Boone, Business Unit Controller of PSNC; James A. Spaulding, Financial Accounting Manager for PSNC; Candace A. Paton, Rates & Regulatory Manager for PSNC; Rose M. Jackson, General Manager – Supply & Asset Management for SCANA Services, Inc.; Robert B. Hevert, Partner of ScottMadden, Inc.; and John J. Spanos, Senior Vice President of Gannett Fleming Valuation and Rate Consultants, LLC.

*By Order Scheduling Investigation and Hearing, Suspending Proposed Rates, Establishing Intervention and Testimony Dates and Discovery Guidelines, and Requiring Public Notice* issued April 26, 2016, and corrected in the Errata Order issued on April 27, 2016, the Commission declared the Company's Application to be a general rate case pursuant to G.S. 62-137 and suspended the proposed rates for a period of up to 270 days from and after May 1, 2016. In that Order, the Commission also set the matter for hearing, required the Company to give notice of hearing, established discovery guidelines, and established dates for interventions and for the prefiling of direct testimony by the Public Staff and intervenors and for the prefiling of rebuttal testimony by the Company.

On May 31, 2016, Blue Ridge Paper Products Inc. d/b/a Evergreen Packaging (Evergreen) filed an Application to Intervene, and its Petition was granted by Commission Order dated June 2, 2016.

On June 13, 2016, the Attorney General filed its Notice of Intervention pursuant to G.S 62-20. Also on this date, PSNC, on behalf of attorney B. Craig

Collins, filed a Motion for Admission to Practice pursuant to G.S 84-4.1 seeking an order from the Commission allowing Mr. Collins to appear before the Commission on behalf of PSNC in this proceeding. By Order dated June 14, 2016, the Commission granted the request of Mr. Collins for admission pro hac vice in the present docket.

On June 16, 2016, PSNC filed affidavits of publication of public notice.

Between June 22, 2016 and September 21, 2016, the Commission received four consumer statements of position regarding PSNC's rate increase proposal.

On June 23, 2016, PSNC filed its Certification that it had provided Notice of Hearing to each of its customers.

On August 8, 2016, the Public Staff filed a Motion for Extension of Time in which it sought an extension of the dates for filing Public Staff, Intervenor, and Company rebuttal testimony. The Commission approved a shortened extension of time by Commission Order dated August 9, 2016.

On August 12, 2016, PSNC and the Public Staff filed a Joint Motion for Extension of Time in which the parties requested the Commission to reconsider its prior order and grant the extension period originally requested. The Commission approved the extension by Order dated August 17, 2016. On August 17, 2016, the Public Staff by verbal motion requested that the Commission grant the Public Staff and Intervenors an extension until noon of the following day within which to file their testimony. This motion was granted by Order dated August 17, 2016.

On August 18, 2016, PSNC, CUCA, Evergreen, and the Public Staff (Stipulating Parties) filed a Partial Stipulation resolving all but one of the issues between these parties. On the same date, the Public Staff filed the Direct Testimony and Exhibits of James G. Hoard, Director, Accounting Division, Michelle M. Boswell, Staff Accountant, Natural Gas Section, Accounting Division, Julie G. Perry, Supervisor of the Natural Gas Section of the Accounting Division, and Jan A. Larsen, Director of the Natural Gas Division.

On August 22, 2016, PSNC filed a Motion for Extension of Time in which it sought a two-day extension of time for PSNC to file its Hearing Witness List and Cross-Examination Estimate. On the same date, the Stipulating Parties filed a corrected page 7 of the Partial Stipulation.

On August 23, 2016, the Commission issued an Order granting PSNC's request for an extension of time to file the witness list and cross-examination estimate.

On August 24, 2016, PSNC filed the Supplemental Testimony of Robert B. Hevert. On the same date, PSNC filed its Witness List and Motion to Excuse Witnesses, wherein the Company, after consulting with all of the parties of record, provided the proposed order of appearance of witnesses and estimates of cross-examination times. PSNC also requested in the filing that Company witnesses Harris, Boone, Spaulding, Jackson and Spanos and Public Staff witness Larsen be excused from appearing at the evidentiary hearing, since none of the parties had questions for these witnesses. PSNC also filed a Motion for Extension of Time requesting an extension until noon on August 25, 2016, for

PSNC to file its rebuttal and supplemental testimony. By Order dated August 25, 2016, the Commission granted the Company's extension. On August 29, 2016, the Commission issued an *Order Denying in Part Motion to Excuse Witnesses*, and excused only Company witnesses D. Russell Harris, James A. Spaulding, and John J. Spanos from attending the expert witness hearing and accepted their testimony and exhibits into evidence.

On August 23, 2016, the matter came on for hearing in Gastonia as scheduled. No person appeared to testify as a public witness.

On August 24, 2016, the hearing was continued in Asheville as scheduled. No person appeared to testify as a public witness.

On August 25, 2016, PSNC filed the Supplemental Testimony of Candace A. Paton, the Rebuttal Testimony of Jimmy E. Addison, and the Rebuttal Testimony of Candace A. Paton. On the same date, the Stipulating Parties filed an Amended Partial Stipulation. The Public Staff also filed an Amended Exhibit C, which amended page 2 of Mr. Larsen's original filed Exhibit C in support of the Amended Partial Stipulation.

On August 25, 2016, the hearing was continued in Statesville as scheduled. No person appeared to testify as a public witness.

On August 29, 2016, the Stipulating Parties filed a Stipulation and Exhibits by and between the Stipulating Parties resolving all issues between them. On the same date, PSNC filed the supporting Supplemental Testimony and Exhibits of Candace A. Paton, and the Public Staff filed Boswell's Revised Exhibit 1 in support of the Stipulation.

On August 29, 2016, the hearing was continued in Raleigh as scheduled. No person appeared to testify as a public witness.

On August 30, 2016, the Commission convened the evidentiary hearing as scheduled in Raleigh. No person appeared to testify as a public witness. On the same date, the Stipulating Parties filed an Amended Stipulation, which made corrections to the Stipulation filed on the previous day.

At the hearing, the Company reported, and the Stipulating Parties confirmed, that following substantial negotiations a comprehensive agreement had been reached between the Company, the Public Staff, CUCA, and Evergreen, and that this agreement resolved all issues in the case as between those parties, and that this agreement was reflected in the Amended Stipulation.

At the hearing, the various prefiled Direct and Supplemental Testimony and Exhibits of the following Company witnesses were offered and accepted into evidence by the Commission: D. Russell Harris, Jimmy E. Addison, Robert B. Hevert, John J. Spanos, George B. Ratchford, Sharon D. Boone, James A. Spaulding, Candace A. Paton, and Rose M. Jackson. Company witnesses Addison, Hevert, Ratchford, Boone, Paton, and Jackson testified at the hearing. The various prefiled Direct Testimony and Exhibits of the following Public Staff witnesses were offered and accepted into evidence by the Commission: Michelle Boswell, Julie Perry, and Jan Larsen. Public Staff witnesses Boswell and Larsen testified at the hearing.

On September 1, 2016, the Public Staff filed two late-filed exhibits pertaining to the supporting workpapers and the calculation of the lead-lag



working capital reflected in the Amended Stipulation pursuant to Commission request.

On September 6, 2016, PSNC filed late-filed Exhibits B and D and Revised Exhibit C to the Amended Stipulation.

On September 14, 2016, PSNC filed a letter with the Commission stating that it had reviewed the two late-filed exhibits filed by the Public Staff on September 1, 2016, which included work papers with updated adjustments to working capital, and agreed that the exhibits accurately reflect the information that Presiding Commissioner Brown-Bland requested PSNC to provide.

Based upon the verified Application, the testimony and exhibits received into evidence at the hearings, the Amended Stipulation, the late-filed exhibits, and the record as a whole, the Commission makes the following:

## FINDINGS OF FACT

### Jurisdiction

1. PSNC is a corporation organized and existing under the laws of the state of South Carolina, duly authorized to do business in and engaged in the business of transporting, distributing, and selling natural gas within North Carolina.

2. PSNC is a public utility within the meaning of G.S. 62-3(23).

3. The Commission has jurisdiction over, among other things, the rates and charges, rate schedules, classifications, and practices of PSNC in its capacity as a public utility.

4. In the Application in this docket, the Applicants are seeking approval of: (a) a general increase in and revisions to the rates and charges for customers served by the Company; (b) certain changes to the cost allocation, rate designs, and practices underlying existing rates for the Company; (c) changes to the Company's existing service regulations and tariffs; (d) implementation of a new Integrity Management Tracker (IMT) mechanism; (e) implementation of new depreciation rates; (f) proposed funding of gas distribution research and development activities conducted by GTI; (g) authority to include \$2,000,000 related to distribution integrity management program operations in the Company's cost of service; and (h) implementation of a rate decrement to refund to its customers over a one-year period the Company's excess deferred income tax balance as of December 31, 2015.

5. The Applicant is properly before the Commission with respect to the relief sought in the Application in this proceeding pursuant to the provisions of Chapter 62 of the General Statutes.

#### Test Period

6. The parties submitting evidence in this case with respect to revenue, expenses, and rate base levels used a test period of the twelve months ended December 31, 2015, adjusted for certain known and measurable changes through June 30, 2016, or thereafter, and the Amended Stipulation was based upon the same test period.

7. The appropriate test period for use in this proceeding is the twelve months ended December 31, 2015, updated for certain known and measurable changes through June 30, 2016, or thereafter.

#### Stipulation

8. The Amended Stipulation executed by PSNC, the Public Staff, CUCA, and Evergreen is actively supported or not opposed by all parties to this docket with the exception of the Attorney General.

9. The Amended Stipulation settles all matters in this docket as to all parties except for matters raised by the Attorney General through cross-examination of witnesses.

#### Revenue Increase

10. The Application seeks an increase in annual revenues for the Company of \$41,583,020. The Amended Stipulation provides for a total increase in annual revenues for the Company of \$19,054,160, of which \$276,576 is

recovered through the proposed increase in other operating revenues, and is just, reasonable and appropriate for use in this proceeding.

#### Rate Base

11. The Stipulating Parties agreed that the original cost of the Company's used and useful property, or to be used and useful within a reasonable time after the test period, in providing natural gas utility service to the public within North Carolina, is \$946,722,235, consisting of gas plant in service of \$1,839,643,565 and working capital – lead lag of \$13,714,498, reduced by accumulated depreciation of \$657,141,088, working capital – other of \$7,817,284, and accumulated deferred income taxes of \$241,677,456, as set forth in Paragraph 4 and Exhibit A of the Amended Stipulation, the Public Staff Late-Filed Exhibit I, and reflected on Schedule 1 hereto. These provisions of the Amended Stipulation are reasonable and appropriate for use in this docket.

#### Revenues and Operating Expenses

12. The Stipulating Parties agreed that the Company's *pro forma* annual operating revenues under the agreed-upon rates for use in this proceeding are \$453,499,827, which is comprised of \$448,904,033 of sales and transportation revenues, \$792,254 of special contract revenues, and \$3,803,540 of other operating revenues, as set forth in Paragraph 5 and Exhibit A of the Amended Stipulation and reflected on Schedule 1 hereto. These provisions of the Amended Stipulation are reasonable and appropriate for use in this docket.

13. The Stipulating Parties agreed that the Company's operating expenses of \$201,794,677, including actual investment currently consumed

through reasonable actual depreciation, as set forth on Exhibit A of the Amended Stipulation, Public Staff Late-Filed Exhibit I, and reflected on Schedule 1 hereto, are reasonable and appropriate for use in this docket.

#### Capital Structure

14. The capital structure set forth in Paragraph 5(B) and Exhibit A of the Amended Stipulation and supported by expert witness evidence, consisting of 52% common equity, 44.62% long-term debt at a cost of 5.52%, and 3.38% short-term debt at a cost of 0.77%, is reasonable and appropriate for use in this docket.

#### Return

15. Based on the expert witness evidence and the Amended Stipulation, the overall rate of return that the Company should be allowed the opportunity to earn on the cost of the Company's used and useful property is 7.53%, as set forth in Paragraph 5(D) and Exhibit A of the Amended Stipulation and reflected on Schedule 1 hereto, and is reasonable and appropriate for use in this docket.

16. Based on the expert witness evidence and the Amended Stipulation, the rate of return on common equity that the Company should be allowed the opportunity to earn in this docket is 9.70%, as set forth in Paragraph 5(C) and Exhibit A of the Amended Stipulation, and is reasonable and appropriate for use in this docket.

17. The authorized levels of overall return and return on common equity set forth above are supported by competent, material, and substantial

record evidence, are consistent with the requirements of G.S. 62-133, and are fair to PSNC's customers in light of changing economic conditions or otherwise.

18. With respect to the foregoing ultimate findings on the appropriate overall rate of return on rate base and allowed rate of return on common equity for use in this proceeding, the Commission relies on the following more specific findings of fact:

a. The overall rate of return on rate base and allowed rate of return on common equity underlying PSNC's current base rates are 8.54% and 10.60% respectively.<sup>1</sup>

b. PSNC's current base rates became effective on November 1, 2008 and have been in effect since that date except for adjustments due to state tax changes.

c. In its Application, PSNC sought approval for rates which were based on an overall rate of return on rate base of 8.14% and an allowed rate of return on common equity of 10.60%.

d. In the Amended Stipulation, the Stipulating Parties seek approval of an overall rate of return on rate base of 7.53% and an allowed rate of return on common equity of 9.70%.

e. The currently authorized allowed rate of return on common equity underlying Piedmont Natural Gas Company, Inc.'s base rates is 10.0%.<sup>2</sup>

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<sup>1</sup> See *In the Matter of Application of Public Service Company of North Carolina, Inc., for a General Increase in its Rates and Charges*, Order Approving Partial Rate Increase and Requiring Conservation Program Filing and Reporting, Docket No. G-5, Sub 495 (Oct. 24, 2008) ("2008 Rate Order").

f. The currently authorized allowed rate of return on common equity for Duke Energy, Progress Energy, and Dominion Power is 10.2%.<sup>3</sup>

g. Since January 1, 2014, a total of 24 of the 54 authorized returns for natural gas utilities were 9.70% or above, with the average authorized ROE over all such cases being 9.65%.

h. In determining the rate of return on equity for PSNC, it is inappropriate to rely on past rate of return on equity determinations authorized for other utilities without evidence tying those determinations to the facts of this case. It is, however, appropriate to rely on such determinations as a check or as corroboration and as justification to reject rates of return on equity that are above or below the cost of equity.

i. The stipulated overall rate of return on rate base of 7.53% and allowed rate of return on common equity of 9.70% are supported by competent, material, and substantial evidence.

j. Continuous safe, adequate, and reliable natural gas service by PSNC is essential to the well-being of the people, businesses, institutions and economy of PSNC's North Carolina service areas.

k. The rate of return on PSNC's equity approved by the Commission appropriately balances the benefits received by PSNC's customers from PSNC's provision of safe, adequate, and reliable natural gas in support of

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<sup>2</sup> *Order Approving Partial Rate Increase and Allowing Integrity Management Rider*, Docket No. G-9, Sub 631 (December 17, 2013).

<sup>3</sup> *Order Granting General Rate Increase*, Docket No. E-7, Sub 1026 (September 24, 2013); *Order Granting General Rate Increase*, Docket No. E-2, Sub 1023 (May 30, 2013); and *Order Granting General Rate Increase*, Docket No. E-22, Sub 479 (December 12, 2012).

the well-being of the people, businesses, institutions, and economy of North Carolina, with the difficulties that some of PSNC's customers will experience in paying PSNC's increased rates.

I. Unchallenged expert evidence presented in this matter indicates that the overall economic climate in North Carolina and PSNC's service territory (as well as nationally) continues to improve. This evidence includes data and projections from reliable sources that in the few months before the hearing in this matter: (i) unemployment rates were declining; (ii) real gross domestic product growth was continuing; (iii) median household income was growing; (iv) total personal income and disposable income was increasing; (v) personal consumption was improving; (vi) wages and salaries were increasing; (vii) the number of mortgages past due decreased; (viii) North Carolina exports were materially increasing; (ix) residential construction permits were increasing; and (x) housing market indicators were positive. No public witnesses appeared at the public hearings held in Gastonia, Asheville, Statesville, and Raleigh.

m. The 9.7% rate of return on equity takes into account the impact of changing economic conditions on consumers. The authorized revenue amount available to pay a return on equity is lower for PSNC because the Amended Stipulation reduced downward PSNC's requested revenue requirement, and this reduction is intertwined with the decision on rate of return on equity in that it affects the earnings available to investors and the rates customers will pay.



n. No party submitted evidence showing that any regulatory commission applies increments or decrements to the return on equity to account for economic conditions or customer ability to pay.

o. PSNC has made significant capital investments since its last rate case in 2008, much of which relates to the Company's integrity management programs in compliance with federal regulations to enhance the safety and integrity of its natural gas transmission facilities. Additionally, the Company plans to make significant capital investments in the future.

p. Access to capital at reasonable rates is critical to PSNC's ability to fund its ongoing capital investment requirements.

q. Establishing an allowed rate of return on common equity at a rate of 9.70% is as low as reasonably possible without unduly jeopardizing PSNC's ability to access capital on reasonable terms.

r. The 9.70% return on equity and the 52.00% equity financing approved by the Commission in this case results in a cost of capital that will enable PSNC by sound management to produce a fair return for its shareholders, considering changing economic conditions, and is reasonable and fair to PSNC's customers. It appropriately balances PSNC's need to obtain financing and maintain a strong credit rating with its customers' need to pay the lowest possible rates.

#### Throughput

19. For the purpose of this proceeding, the appropriate level of adjusted sales and transportation volumes is 937,082,412 therms, which is

comprised of 491,921,582 therms of sales quantities, 316,664,980 therms of transportation quantities, and 128,495,850 therms of special contract quantities. The appropriate level of lost and unaccounted for gas is 7,027,614 therms and company use gas is 870,521 therms, and the appropriate level of purchased gas supply is 499,819,717 therms, consisting of sales volumes and company use and lost and unaccounted for gas.

#### Cost of Gas

20. The total cost of gas reasonable and appropriate for use in this proceeding is \$180,388,055, as described in Paragraph 7 and on Exhibit E to the Amended Stipulation and consisting of \$110,682,356 in commodity costs, \$1,777,080 in company use and lost and unaccounted for costs, and \$67,928,619 in fixed gas costs.

21. The Benchmark reasonable and appropriate for use in this proceeding is \$0.225 per therm, subject to any filed changes in such rate prior to implementation of effective rates in this docket.

22. The fixed gas costs that should be embedded in the proposed rates and used in true-ups of fixed gas costs for periods subsequent to the effective date of rates in this docket, in proceedings under Commission Rule R1-17(k), subject to any filed changes in such costs prior to the effective date of rates in this docket, are those derived from the fixed gas cost allocation percentages discussed in Paragraph 5 and set forth in Exhibit C to the Amended Stipulation.

### Rate Design

23. The rate design and rates, including volumetric rates, fixed monthly charges, and other charges, as described in Paragraph 5 of the Stipulation and reflected in the columns entitled "Monthly Facilities Charges" and "Energy Charges" on Exhibit B of the Amended Stipulation (as the same may be adjusted for any changes in the Company's Benchmark or changes in Demand and Storage Charges prior to the effective date of the rates in this docket), are just and reasonable and appropriate for use in this docket.

### Integrity Management Tracker

24. The IMT attached to the Amended Stipulation as Exhibit H is reasonable and appropriate and consistent with G.S. 62-133.7A, and should be approved and implemented as provided in Paragraph 10 of the Amended Stipulation, and Rider E of the Company's tariffs.

### Customer Usage Tracker Factors

25. The "R" values, baseload and heat sensitive factors set forth on Exhibit D to the Amended Stipulation and reflected in Paragraph 6 of the Amended Stipulation are reasonable and appropriate for use with the Company's Customer Usage Tracker (CUT) mechanism on or after the effective date of rates, and should be approved.

### Amortization of Deferred Regulatory Assets

26. The proposed amortization of certain deferred regulatory assets, as set forth and described in Paragraphs 5(G) through 5(I) of the Amended Stipulation, is reasonable and appropriate and should be approved.

### Implementation of State Income Tax Changes

27. The Stipulating Parties' agreement to decrease the North Carolina corporate income tax reflected in rates pursuant to North Carolina Session Law 2015-241, and as set forth in Paragraph 8 of the Amended Stipulation, is reasonable and appropriate and should be approved.

### Depreciation Rates

28. The Stipulating Parties' agreement to the depreciation rates proposed by the Company as set forth in Paragraph 9 of the Amended Stipulation is reasonable and appropriate and should be approved effective January 1, 2017.

### Changes to Tariff Rules and Regulations

29. PSNC's Tariff and Rules and Regulations included in Paton Exhibit 4; with the exception of the Summary of Rate and Charges, Riders C and E, and the Transportation Pooling agreement; and revised Riders C and E and the revised Transportation Pooling Agreement, as described in Paragraph 11 and Exhibit H of the Amended Stipulation, are reasonable and appropriate and should be approved.

### Excess Deferred Income Taxes

30. The Stipulating Parties agreed to refund excess deferred income taxes (EDIT) as set forth in Paragraph 12 of the Amended Stipulation, and further agreed that any balance remaining after the twelve-months should be transferred to the All Customers' Deferred Account. This proposed treatment is reasonable and appropriate and should be approved.

### Conservation Program Expenditures

31. The Stipulating Parties' agreement to continue funding of conservation programs at a level of \$750,000 per year, as reflected in test year operating expenses and set forth and described in Paragraph 13 of the Amended Stipulation, is reasonable and appropriate and should be approved.

### Gas Technology Institute Research Funding

32. The funding of GTI research and development activities of \$268,631 per year, as discussed in Paragraph 14 of the Amended Stipulation and set forth in the Public Staff Late-filed Exhibit I, is reasonable and appropriate and should be approved.

### Miscellaneous Matters

33. Use of the overall rate of return, adjusted for income taxes, as the Allowance for Funds Used During Construction rate for the Company is reasonable and appropriate, and should be approved.

34. The Stipulating Parties agreed that beginning with the month in which rates become effective in this docket, PSNC will use an interest rate of 6.6% per annum as the applicable interest rate on all amounts over-collected or under-collected from customers reflected in its Sales Customers Only, All Customers, and Hedging Deferred Gas Cost Accounts. The Stipulating parties also agreed that the methods and procedures used by PSNC for the accrual of interest on the Deferred Gas Cost Accounts will remain unchanged. These provisions of the Amended Stipulation are reasonable and appropriate and should be approved.

35. The Stipulating Parties agreed that PSNC shall file its GS-1 Report in a format similar to the ES-1 filed by the electric utilities. This is reasonable and appropriate and should be approved.

36. All of the provisions of the Amended Stipulation are just and reasonable to all parties to this proceeding, serve the public interest, and should be approved.

**EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 1-5**

The evidence supporting these findings is contained in the Company's verified Application, the testimony and exhibits of the Company's witnesses, the Form G-1 that was filed with the Application, the provisions of Chapter 62 of the General Statutes, and the Commission's records as a whole. These findings are jurisdictional and procedural in nature and are not contested by any party.

**EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 6-7**

The Company filed its Application and exhibits using a test period of the twelve months ended December 31, 2015. In its Order of April 26, 2016, the Commission ordered the parties to use a test period of the twelve months ended December 31, 2015, with appropriate adjustments. The Amended Stipulation is based upon the test period ordered by the Commission, and this test period is not contested by any party. In the Amended Stipulation, the Stipulating Parties agreed to make appropriate adjustments to the test period data for circumstances occurring or becoming known through June 30, 2016, or thereafter. These adjustments were not contested by any party.

**EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 8-9**

These findings are supported by the Amended Stipulation and by representations of counsel for the Stipulating Parties at the hearing for this matter. The Amended Stipulation recites that it is filed on behalf of PSNC, the Public Staff, CUCA, and Evergreen. The Amended Stipulation provides that it represents a complete and integrated settlement of all matters at issue between the Stipulating Parties.

The Commission concludes based upon all the evidence presented that the Amended Stipulation that was entered into by the Stipulating Parties after full discovery and extensive negotiations represents a proposed negotiated resolution of the matters in dispute in this docket that is supported, or not opposed, by all parties except the Attorney General.

#### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 10**

These findings are supported by the Application, the Direct Testimony and Exhibits of Company witness Boone, the Supplemental Testimony of Company witness Paton, the Amended Stipulation, the Public Staff's Late Filed Exhibit I, and the Direct Testimony of Public Staff witness Boswell.

Revised Boone Exhibit 6, attached to the Direct Testimony of Company witness Boone, indicates that the Company filed for a total revenue increase in this proceeding of \$41,583,020. The Amended Stipulation, in Exhibit A, indicates that pursuant to the agreement of the Stipulating Parties the Company should be allowed to increase annual revenues by \$19,054,160, of which \$276,576 is recovered through the proposed increase in other operating revenues. This increase in revenues is further reflected in the Supplemental Testimony and Exhibits of Company witness Paton and the Revised Public Staff's Late Filed Exhibit 1. These findings are not contested by any party.

Based upon the evidence recited above and the cumulative testimony and evidence supporting the individual components of the stipulated revenue increase discussed throughout this Order, including the discussion and analysis related to the proper rate of overall return and return on common equity for use in



this proceeding, the Commission finds, in the exercise of its independent judgment, that the stipulated revenue increase in this case is just, reasonable, and appropriate for use in this proceeding.

#### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 11**

The reasonable original cost of the Company's used and useful property, or to be used and useful within a reasonable time after the test period, in providing natural gas utility service to the public within North Carolina, less that portion of the cost that has been consumed by depreciation expense, is described and set forth in Paragraph 4 and Exhibit A to the Amended Stipulation, Public Staff Late Filed Exhibit I, and reflected on Schedule 1 hereto. The amounts shown on Exhibit A to the Stipulation are the result of negotiations among the Stipulating Parties in this docket, as described in the Amended Stipulation, the Direct Testimony of Public Staff witness Boswell, and the Supplemental Testimony of Company witness Paton. The stipulated reasonable original cost of the Company's used and useful property, or to be used and useful within a reasonable time after the test period, in providing natural gas service to the public, less depreciation expense, is not contested by any party.

No other party presented evidence on these matters.

The Commission has carefully reviewed these amounts, as well as all record evidence relating to the Company's rate base, which collectively constitute the only evidence in this docket regarding the Company's rate base and concludes that the stipulated amounts are appropriate for use in this docket.

### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 12**

The evidence supporting these findings is set forth in the Amended Stipulation, Public Staff Late Filed Exhibit I, the Supplemental Testimony of Company witness Paton, and the Direct Testimony of Public Staff witness Boswell.

The end of test period *pro forma* revenues under the Company's present and stipulated proposed rates are set forth in Paragraph 5 and Exhibit A to the Amended Stipulation, Public Staff Late Filed Exhibit I, and reflected on Schedule 1 hereto. The amounts shown on Exhibit A to the Amended Stipulation are the result of negotiations among the Stipulating Parties in this docket following an extensive audit of the Company's filed case by the Public Staff and are described in the Amended Stipulation. No other party submitted evidence on the Company's *pro forma* revenues, and the stipulated *pro forma* revenues are not challenged by any party.

The Commission has carefully reviewed these amounts, as well as all record evidence relating to *pro forma* revenues, and concludes based on its own independent judgment that the stipulated *pro forma* revenues are reasonable and appropriate for use in this docket.

### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 13**

The Company's reasonable operating expenses, including actual investment currently consumed through reasonable actual depreciation, is set forth in Exhibit A to the Amended Stipulation, Public Staff Late Filed Exhibit I, and reflected on Schedule 1 hereto. The amounts shown on Exhibit A to the

Amended Stipulation are the result of negotiations among the Stipulating Parties in this docket, as described in the Amended Stipulation and the Supplemental Testimony of Company witness Paton. The stipulated reasonable operating expenses of the Company are not contested by any party.

The Commission has carefully reviewed these amounts, as well as all record evidence relating to the Company's reasonable operating expenses, and concludes that the stipulated reasonable operating expenses, including actual investment currently consumed through reasonable actual depreciation, are appropriate for use in this docket.

#### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 14**

The evidence for this finding is contained in the prefiled Direct Testimony of PSNC witness Jimmy E. Addison, the prefiled Direct and Supplemental Testimony of Company witness Robert B. Hevert, the hearing testimony of Mr. Addison and Mr. Hevert, and the Amended Stipulation.

In the Application, and as explained by PSNC witness Addison in his Direct Testimony, the Company proposed a capital structure reflecting long-term debt of 43.12%, short-term debt of 3.38% and equity of 53.50%. The short-term debt reflected the estimated average of gas inventory for the 13 months ending June 30, 2016, consistent with Commission practice. The long-term debt and equity figures reflected actual balances adjusted for forecasted changes through June 30, 2016. Mr. Addison testified that PSNC planned to issue \$100 million in unsecured long-term debt in June of 2016.

In his Direct Testimony, Mr. Hevert discussed the generally accepted approaches to developing the appropriate capital structure for a regulated natural gas distribution company, and explained how the capital structure affects the cost of capital and overall level of risk for the company. He explained that the capital structure should enable the company to maintain its financial integrity, thereby enabling access to capital at competitive rates under a variety of economic and financial market conditions. Mr. Hevert then presented and provided support for his proxy group, described his analysis of the proxy companies' capital structures, and concluded based on his review that a capital structure consisting of 53.50% common equity, 3.38% short-term debt, and 43.12% long-term debt is reasonable and appropriate for PSNC. Mr. Hevert explained the concept of maturity matching. He stated that, because it is perpetual in nature, adding equity to the capital structure extends the weighted average life of long-term liabilities, and mitigates incremental refinancing risk, but that relying more heavily on debt as the means of financing long-lived assets increases the risk of refinancing maturing obligations during less accommodating market environments. Following settlement negotiations between PSNC, the Public Staff, CUCA and Evergreen, as reflected in Paragraph 5(B) of the Amended Stipulation, the Stipulating Parties propose a capital structure of 52.00% common equity, 3.38% short-term debt and 44.62% long-term debt. The Stipulating Parties agreed to use 5.52% for the cost of long-term debt and agreed to use 0.77% for the cost of short-term debt.

In his Supplemental Testimony and associated exhibits, Mr. Hevert addressed the capital structure agreed to in the Partial Stipulation dated August 18, 2016 among PSNC, the Public Staff, CUCA, and Blue Ridge Paper Products, Inc. (The Stipulating Parties filed two amended stipulations on August 25, 2016 and August 30, 2016, but those amended agreements did not adjust the capital structure reflected in the Partial Stipulation filed on August 18, 2016, to which Mr. Hevert testified.) In his Supplemental Testimony, Mr. Hevert stated that the capital structure ratios agreed upon by the Stipulating Parties fall well within the range of those in place at the proxy companies (from the first calendar quarter of 2014 through the second calendar quarter of 2016), and that on that basis, he believed the Stipulated Capital Structure to be reasonable.

No other party submitted testimony on the issue of the appropriate capital structure for the Company.

The proposed Stipulated Capital Structure was also supported by the hearing testimony of Mr. Hevert and PSNC witness Mr. Addison. At the hearing in this matter, in response to cross-examination by the Attorney General, Mr. Addison confirmed that PSNC issued \$100 million in unsecured long-term debt in June 2016 at a rate of 4.13%. (T5-76) Mr. Addison also explained that PSNC operates in a “lumpy” business, in which it raises both debt and equity capital as needed to make required investments in rate base, which in turn results in different proportions of debt and equity at different points in time for the Company. (T5-74) He explained that, if the debt ratio of capital structure is increased too much, the cost of debt would also increase due to the increased

risk to debt investors. He testified that because PSNC's actual equity component is slightly higher than 53.5%, but it will only receive the 9.70% stipulated ROE on the 52% equity contained in the stipulated capital structure, if the Commission approves the Stipulation the shareholders' actual return will be lower than the Company's authorized return on equity. (T5-84) Mr. Addison also explained the reasons for the differences in capital structure between PSNC and its parent company SCANA. (T5-86-88) In response to questioning from the Commissioners, Mr. Addison explained PSNC's participation in the SCANA Utility Money Pool as a prudent and efficient use of PSNC's capital that allows PSNC, SCE&G and SCANA to take advantage of each company's cash flow or investment abilities at different points in time, such as recently when PSNC has been a net borrower due to the significant capital investments it has been making in its system. (T5-116-118)

Also at the hearing, Mr. Hevert further supported Mr. Addison's discussion of the reasons for higher cost of equity as compared to cost of debt. One of those reasons is that equity holders bear the "residual risk," meaning they are last in line to receive cash flows generated by the Company, and receive what is left after the debt holders, who have a contractual claim on cash flows, are paid. Another reason is that the cost of debt is specified while cost of equity is based on observable market information. (T5-239-40) He also testified that with respect to the proxy companies, the comparison to be made is the extent to which PSNC's capital structure is consistent with the range of the proxy companies, rather than with their average, and that including short-term debt in the capital

structure does not affect his conclusion that 52% equity in PSNC's capital structure is reasonable. (T247-48) He also and in various contexts reiterated the value of using multiple sources of data in order to produce the range for capital structure. (e.g. T6-27) Mr. Hevert also discussed his rationale for looking primarily to the operating company level capital structure, and testified that utilities in general are required to finance very large, essentially irreversible long-lived investments, and have to be able to enter the capital markets at any given point in time, regardless of market conditions, and do not have the ability or option to defer those decisions. (T5-249-50)

Counsel for the Attorney General questioned Mr. Addison and Mr. Hevert about other approaches to viewing capital structure, but did not provide any affirmative evidence that would support a capital structure, particularly any other common equity component of capital structure, other than that proposed in the Amended Stipulation.

On redirect, Mr. Hevert stated that the Value Line common equity ratios for the proxy companies include 55% for Atmos, 58% for New Jersey Resources, 56% for Northwest Natural, and 49% for Laclede. He noted that these data showed that distribution companies had much higher equity ratio expectations from Value Line as compared to SCANA, the holding company, with a 46% equity ratio.

Based upon the evidence described above and the record in this docket as a whole, the Commission concludes that the amended stipulated capital

structure and costs of long-term and short-term debt are fair and reasonable, and appropriate for use in this proceeding.

### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 15-18**

The evidence supporting these findings is contained in the Application, the prefiled Direct and Supplemental Testimony and Exhibits of Company witnesses Addison and Hevert, the hearing testimony of Mr. Addison and Mr. Hevert, and the Amended Stipulation. No other party submitted evidence on the appropriate overall rate of return on rate base (ROR or Overall Return) or allowed rate of return on common equity (ROE) appropriate for use in this proceeding.

Based upon the evidence and legal analysis set forth below, the Commission concludes, based on its own independent analysis, that the stipulated allowed rate of return on common equity of 9.70% proposed in the Amended Stipulation in this proceeding and the resulting stipulated overall rate of return on rate base of 7.53% are just, reasonable, and fair to the Company, its shareholders and its customers and that such rates of return are fully consistent with the requirements of North Carolina law governing the establishment of public utility rates of overall return and returns on common equity.

#### Summary of the Evidence on Return

PSNC's existing allowed rate of return on common equity, established by the Commission in 2008 in Docket No. G-5, Sub 495, is 10.6%.<sup>4</sup> Its existing approved overall rate of return on rate base is 8.54%.<sup>5</sup> In its Application, PSNC

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<sup>4</sup> See 2008 Rate Order.

<sup>5</sup> See *Id.*



proposed that the allowed rate of return on common equity in this proceeding be established at 10.6%. This proposed rate of return on common equity, in conjunction with the other elements of the Company's proposed capital structure, resulted in a proposed overall rate of return on rate base for the Company of 8.14%.

PSNC's original return on common equity request was supported by the Direct Testimony and Exhibits of PSNC witnesses Addison and Hevert. Mr. Hevert, who holds a Bachelor of Arts degree in business and economics and a Master of Business Administration with a concentration in finance, and is designated as a Chartered Financial Analyst and is a Partner with the ScottMadden, Inc. consulting firm, served as PSNC's cost of equity witness. Mr. Hevert filed Direct Testimony and 13 exhibits in support of PSNC's request for 10.6% return on equity. He explained that the cost of equity is the return that investors require to make an equity investment in a company, that it should reflect the return that investors require in light of the company's risks and the returns available on comparable investments, and that it differs from the cost of debt because it is neither directly observable nor a contractual obligation.

Mr. Hevert's Direct Testimony and Exhibits document the specific analyses he conducted in support of PSNC's rate filing and provides a detailed description of the results of his analyses and resulting cost of equity recommendations. He applied the Constant Growth and Multi-Stage forms of the Discounted Cash Flow (DCF) model, the Capital Asset Pricing Model (CAPM),

and the Bond Yield Plus Risk Premium approach to develop his ROE recommendation.

Mr. Hevert testified that it is important for a utility to be allowed the opportunity to earn a return adequate to attract equity capital at reasonable terms, one that is commensurate with the returns expected elsewhere in the market for investments of equivalent risk, because that enables the utility to provide service while maintaining financial integrity. He stated that the Commission's decision should provide PSNC with the opportunity to earn an ROE that is (1) adequate to attract capital at reasonable terms, thereby enabling it to continue to provide safe and reliable natural gas service; (2) sufficient to ensure its financial integrity; and (3) commensurate with returns on investments in enterprises having corresponding risks. He discussed the need to select a group of proxy companies to determine the cost of equity, and how he selected the proxy group for this case.

According to Mr. Hevert, the results of his Constant Growth DCF analysis produced a range of 8.14% to 11.32% ROE, the results of his Multi-Stage DCF analysis were a range of 8.96% to 10.07%, and the results of his Multi-Stage DCF analysis that used the current proxy group P/E ratio to calculate the terminal value was a range of 9.26% to 11.97%. The results of Mr. Hevert's CAPM analysis showed a range of 9.13% to 11.42%. The results of his Bond Yield Risk Premium analysis indicated an ROE range from 9.98% to 10.39%. Based on his analyses, Mr. Hevert concluded that a rate of return on common equity in the range of 10.00% to 10.75% represents the range of equity investors' required

rate of return for investment in natural gas utilities such as PSNC. Within that range, he recommended an ROE of 10.6%.

Mr. Hevert explained that his ROE recommendation also took into consideration several additional factors, including (1) the combined dilutive effects of operating expense increases and increasing capital investments on the Company's operating income; (2) the Company's relatively high capital expenditure program; (3) the Company's relatively small size; (4) the effect of the proposed infrastructure recovery mechanism on the Company's Cost of Equity; and (5) the regulatory environment in which the Company operates. He also considered equity flotation costs. With regard to the regulatory environment, he noted that North Carolina is generally considered to be a constructive regulatory jurisdiction, and that authorized ROEs tend to be correlated with the degree of regulatory supportiveness (utilities in jurisdictions considered to be more supportive tend to be authorized somewhat higher returns). He did not, however, make any specific adjustment to his ROE estimates for the effect of these factors.

Mr. Hevert also considered the economic conditions in North Carolina in arriving at his ROE recommendation. He noted that the rate of unemployment has fallen substantially in North Carolina and the U.S. generally since late 2009 and early 2010, with December 2015 rates of 5.60% in the state and 5.30% in PSNC's service territory. He also noted that in 2014, the state exceeded the national rate for real gross domestic product growth and that since 2009, median household income in North Carolina has grown at a somewhat faster annual rate

than the national median income. In addition, while housing permits and housing starts experienced a decline from late 2015 to early 2016, total personal income, disposable income, personal consumption, and wages and salaries were generally on an increasing trend. Mr. Hevert also testified to recent business expansions in the state. Based on all of these factors, Mr. Hevert opined that North Carolina and the counties contained within PSNC's service area continue to steadily emerge from the economic downturn that prevailed during the Company's 2008 rate case, and have experienced significant economic improvement during the last several years, that is projected to continue. In his opinion, PSNC's proposed ROE was fair and reasonable to PSNC, its shareholders and its customers, considering the impact of changing economic conditions.

Mr. Hevert also addressed the capital market environment, and reiterated that the current market is one in which it is important to consider a broad range of data and models when determining the cost of equity, as exemplified by his use of the DCF, CAPM and Bond Yield Plus Risk Premium approaches.

In his Direct Testimony, Mr. Addison, who is Executive Vice President and Chief Financial Officer for PSNC, stated that, based on his training, experience, and knowledge of the financial community and how it perceives PSNC, he agreed with Mr. Hevert's conclusion that a 10.60% ROE is appropriate in this case. Mr. Addison explained that adopting an unduly low ROE would ignore the changing economic conditions being experienced nationally and in North

Carolina and could increase the cost of capital, a cost ultimately borne by PSNC's customers.

As reflected in Paragraph 5(C)-(D) of the Amended Stipulation, the Stipulating Parties agreed to a Stipulated ROE of 9.70%. The Stipulating Parties also agreed that PSNC should be allowed to earn an overall rate of return on its rate base of 7.53%.

The overall return on rate base and the proposed allowed rate of return on common equity set forth in the Amended Stipulation were supported by the Supplemental Testimony of PSNC witness Mr. Hevert and the hearing testimony of Mr. Hevert and PSNC witness Mr. Addison.

In his Supplemental Testimony and associated exhibits, Mr. Hevert addressed the agreed-upon ROE and overall rate of return agreed to in the August 18, 2016 Partial Stipulation. As with capital structure discussed above, while the Stipulating Parties filed two amended stipulations on August 25, 2016 and August 30, 2016, those amended agreements did not adjust the stipulated ROE and overall rate of return reflected in the Partial Stipulation filed on August 18, 2016, to which Mr. Hevert testified. Mr. Hevert testified to his understanding that the stipulating parties agreed to an ROE of 9.70%, with an overall rate of return of 7.53%. Mr. Hevert stated that he supported PSNC's decision to agree to the stipulated ROE, explaining that although 9.70% is somewhat below the lower bound of his recommended range (i.e., 10.00%), he recognized that the Partial Stipulation represents a give and take among the Stipulating Parties regarding multiple, otherwise-contested issues. He stated further that if the

Company determined that the terms of the Partial Stipulation, taken as a whole, are such that it will be able to raise the external capital required to continue the investments required to provide safe and reliable service, and that it will be able to do so when needed and at reasonable cost rates, then he appreciated and respected that decision, and viewed the 9.70% Stipulated ROE as a reasonable resolution of an otherwise contentious issue.

In his Supplemental Testimony, Mr. Hevert also updated his cost of capital analysis. He considered the stipulated ROE in the context of authorized returns for other natural gas utilities, finding that since January 1, 2014, a total of 24 of 54 returns authorized for natural gas utilities were 9.70% or above, with the average authorized ROE over all such cases being 9.65%. He again testified that North Carolina is generally considered to have a constructive regulatory environment, and in that context noted that the Stipulated ROE is a reasonable, though conservative, measure of PSNC's cost of equity.

Mr. Hevert also updated his review of economic conditions in North Carolina with respect to those factors for which updated data was available. He found that by 2015, North Carolina's real GDP exceeded its 2010 level by nearly 7.00%, and that from 2013 through 2015 the state's average rate of real GDP growth was somewhat higher than the national average. As to the rate of unemployment, he found that although North Carolina's December 2015 seasonally adjusted unemployment rate of 5.60% was somewhat higher than the U.S. average of 5.00%, by June 2016 both the national and North Carolina unemployment rates fell to 4.90%, with the rate in PSNC's service territory being

only slightly higher at 5.14%. He found that personal income and consumption in the state have continued to expand at the national level. Finally, he reported that in its August 2016 "Snapshot of North Carolina," the Federal Reserve Bank of Richmond concluded that North Carolina's economy strengthened as total employment grew notably, household conditions continued to improve, and housing market indicators were mostly positive. The Richmond Fed also observed that: (1) North Carolina employers added 19,400 jobs in June and almost every industry expanded payrolls that month; (2) the state's unemployment rate fell 0.2 percentage points to 4.90% in June and declined 0.9 percentage points since June 2015, and during the first quarter of 2016, the share of mortgages with payments 90 or more days past due fell 0.2 percentage point to 1.50%; and (3) North Carolina issued 5,210 new residential permits in June, up 7.10% from the prior month and up 11.9% from June 2015. Mr. Hevert also noted that the models used to estimate the cost of equity reflect capital markets and therefore general economic conditions. He noted further that given that changes in economic conditions in North Carolina are related to the domestic economy, it is reasonable to conclude that both are reflected in ROE estimates. In summary, Mr. Hevert stated that it continues to be his view that on balance, the regional economic challenges in the state are substantially similar to those in the rest of the country, and that economic data regarding North Carolina and the United States do not alter the cost of equity estimates, or his recommendation, one way or the other.

Finally, Mr. Hevert considered the stipulated overall rate of return, stating that it is consistent with the average return authorized across the country, but lower than those returns authorized in the top-ranked regulatory jurisdictions, and that the stipulated overall rate of return is like the stipulated ROE a reasonable though in his opinion a conservative estimate of PSNC's overall investor-required rate of return.

At the hearing, in response to cross-examination by the Attorney General, Mr. Addison reiterated that two reasons for the higher cost of equity than cost of debt is that the equity investor requires more return commensurate with the higher risk associated with equity, and that while interest on debt is tax-deductible, equity earnings are not. (T5-80)

Mr. Hevert also responded to cross examination by the Attorney General regarding his use of the DCF, CAPM, and Bond Yield Plus Risk Premium approaches to determining a recommended ROE range for PSNC. Mr. Hevert confirmed the nature of his ROE recommendations in recent electric rate cases in North Carolina. (T5-259-260) He also explained the value of using diverse sources of data for purposes of conducting the constant growth DCF analysis, discussed why he uses projected earnings to determine growth for the same analysis rather than another metric such as projected dividends, and testified that using different sources for the GDP for his multi-stage DCF would produce different results. (T6-23-35) During this discussion he answered questions from the Attorney General related to data on natural gas companies that are comparable to PSNC provided by Value Line. (e.g., T6-11) He also responded to



questioning regarding the source data he used for risk premiums for his CAPM analysis, and testified that use of some alternative sources would result in very low estimated ROEs that would have significant adverse impacts to the Company's financial standing. (T6-38-43) With regard to his Bond Yield Plus Risk Premium approach, Mr. Hevert clarified the nature and value of the numerous authorized rates of return on equity he used in that analysis, which in turn reflect market data. (T6-44-46)

In response to questioning by Chairman Finley, Mr. Hevert confirmed his belief that equity investors make investment decisions based on the risks they observe for the companies in which they are interested. He also clarified the distinction between expected and required returns, such that if the return that an investor requires is higher than the return that investor expects, that investor will choose not to invest. Mr. Hevert testified that, if a company operates in a state with poor economic conditions, such that many of its customers are unable to pay their bills, that company would have a large amount of uncollected revenues for the services it provided, which would in turn cause that company's risk to increase and the cost of equity that the equity investor would require to be higher. He testified further that, if the rate of return on equity was based on current economic conditions, and if in that scenario the investor was penalized during poor economic conditions by giving him less rate of return, symmetry would suggest that a higher return on equity would be provided during robust economic conditions. (T6-51-52) Mr. Hevert also testified that, in comparison to the economic conditions that existed when previous electric rate cases were

decided involving Duke, Progress, and Dominion North Carolina Power that were referenced by the Attorney General, the North Carolina economy has improved. Mr. Hevert explained that the unemployment rate in the state is down considerably and is now approximately equal to the national rate, and that state GDP growth has expanded with projections for continued expansion. He agreed that the investment community looks upon the Commission, together with the state legislature and executive branch, as providing a constructive regulatory environment. He also agreed that the previous cases referenced by the Attorney General were, after remand to the Commission, reapproved at the same rates.

In response to further questioning by Chairman Finley, Mr. Hevert testified that, if it became a permanent requirement in North Carolina that the Commission change the rate of return on equity based on customers' ability to pay, that would have a negative impact on the constructive regulatory environment in the state. He explained that would be a departure from the Commission's past practice and would also be a departure from well-established practice of other regulatory commissions, which added together would add a considerable amount of risk. Mr. Hevert further confirmed in response to questioning by Chairman Finley that while other regulatory commissions will take economic conditions into consideration, he was unaware of any regulatory commissions that apply adjustments to the return on equity to account for economic conditions or customer ability to pay. He testified that, in this way, such commissions balance the interests of investors and ratepayers. (T6-52-55)

No other party presented evidence on the Company's cost of capital or overall rate of return on rate base.

Legal Standards Applicable to Rate of Return Findings by the Commission

The Commission's analysis of and decision on rate of return on rate base and allowed rate of return on common equity in this case is governed by the United States Supreme Court's *Hope* and *Bluefield* decisions,<sup>6</sup> the requirements of G.S. 62-133, and the North Carolina Supreme Court decisions interpreting and applying each of the foregoing to rate of return decisions by the Commission.

In *Bluefield*, the US Supreme Court established the basic framework for rate of return regulation of public utilities. On this subject, the Court held that:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; . . . The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

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<sup>6</sup> *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("*Hope*"); *Bluefield Waterworks & Imp. Co. v. Public Service Comm'n of W. Va.*, 262 U.S. 679 (1923) ("*Bluefield*").

*Bluefield*, 262 U.S. at 692-93. In the subsequent *Hope* decision, the Court expanded on its analysis by stating:

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock.... By that standard the return to the equity owner should be commensurate with the returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

*Hope*, 320 U.S. at 603.

The Commission has looked to the *Hope* and *Bluefield* standards as guidance for setting rates. In Docket No. E-7, Sub 1026, the Commission noted that:

First, there are, as the Commission noted in the DEP Rate Order, constitutional constraints upon the Commission's return on equity decision, established by the United States Supreme Court decisions in *Bluefield Waterworks & Improvement Co., v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923) (*Bluefield*), and *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (*Hope*): To fix rates that do not allow a utility to recover its costs, including the cost of equity capital, would be an unconstitutional taking. In assessing the impact of changing economic conditions on customers in setting an ROE, the Commission

must still provide the public utility with the opportunity, by sound management, to (1) produce a fair profit for its shareholders, in view of current economic conditions, (2) maintain its facilities and service, and (3) compete in the marketplace for capital. *State ex rel. Utilities Commission v. General Telephone Co. of the Southeast*, 281 N.C. 318, 370, 189 S. E.2d 705, 757 (1972). As the Supreme Court held in that case, these factors constitute "the test of a fair rate of return declared" in *Bluefield* and *Hope*. *Id.*<sup>7</sup>

The Commission must balance the interests of investors and customers in setting the Return on Equity. As the Commission has stated, "...the Commission is and must always be mindful of the North Carolina Supreme Court's command that the Commission's task is to set rates as low as possible consistent with the dictates of the United States and North Carolina Constitutions."<sup>7</sup> In that regard, the return should be neither excessive nor confiscatory; it should be the minimum amount needed to meet the *Hope* and *Bluefield* Comparable Risk, Capital Attraction, and Financial Integrity standards.

The Commission also has found that the role of Cost of Capital experts is to recommend to the Commission the investor-required return, not to estimate

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<sup>7</sup> State of North Carolina Utilities Commission, Docket No. E-7, Sub 1026, Order Granting General Rate Increase, Sept. 24, 2013 at 24; see also State of North Carolina Utilities Commission, Docket No. G-9, Sub 631, Order Approving Partial Rate Increase and Allowing Integrity Management Rider at 26, Dec. 17, 2013 (noting North Carolina Supreme Court's determination that the provisions of G.S. 62-133 "effectively require the Commission to fix rates as low as may be reasonably consistent with the requirements of the Due Process Clause of the Fourteenth Amendment to the Constitution of the United States, those of the State Constitution, Art. I, § 19, being the same in this respect"), DNCP Remand Order at 40 ("the Commission in every case seeks to comply with the North Carolina Supreme Court's mandate that the Commission establish rates as low as possible within Constitutional limits.").

increments or decrements of return in connection with consumers' economic environment. As the Commission pointed out:

... adjusting investors' required costs based on factors upon which investors do not base their willingness to invest is an unsupportable theory or concept. The proper way to take into account customer ability to pay is in the Commission's exercise of fixing rates as low as reasonably possible without violating constitutional proscriptions against confiscation of property. This is in accord with the "end result" test of Hope. This the Commission has done.<sup>8</sup>

The Supreme Court agreed, and upheld the Commission's Order on Remand.<sup>9</sup> The Supreme Court has also, however, made clear that the Commission "must make findings of fact regarding the impact of changing economic conditions on customers when determining the proper ROE for a public utility."<sup>10</sup> In *Cooper II*, which addressed an appeal of the Commission's order on Dominion North Carolina Power's previous base rate application, the Supreme Court directed the Commission on remand to "make additional findings of fact concerning the impact of changing economic conditions on customers."<sup>11</sup> The Commission made such additional findings of fact in its order on remand.<sup>12</sup>

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<sup>8</sup> State of North Carolina Utilities Commission, Docket No. E-7, Sub 989, Order on Remand, October 23, 2013, at 34 – 35; see also DNCP Remand Order at 26 (stating that the Commission is not required to "isolate and quantify the effect of changing economic conditions on consumers in order to determine the appropriate rate of return on equity").

<sup>9</sup> State of North Carolina ex rel. Utilities Commission v. Cooper, 766 S.E.2d 827 (2014).

<sup>10</sup> State of North Carolina ex rel. Utilities Commission v. Cooper, 758 S.E.2d 635, 642 (2014) ("Cooper II"); see also State of North Carolina ex rel. Utilities Commission v. Cooper, 366 N.C. 484, 739 S.E.2d 541 (2013) ("Cooper I").

<sup>11</sup> Cooper II, 758 S.E.2d at 643.

<sup>12</sup> DNCP Remand Order at 4-10.

With these legal principles in mind, the Commission now turns to the analysis of the evidence in this proceeding relating to a determination of the appropriate overall rate of return on rate base and allowed return on common equity for use in this proceeding.

#### Analysis of the Evidence

The only evidence in this proceeding related to the determination of an overall rate of return on rate base or allowed rate of return on common equity is provided in the Amended Stipulation and in the testimony and exhibits of PSNC's witnesses Mr. Addison and Mr. Hevert. Mr. Hevert indicated in his Supplemental Testimony that, although the stipulated ROE is somewhat below the lower bound of his recommended range (i.e., 10.00%), he views the 9.70% stipulated ROE as a reasonable resolution of an otherwise contentious issue. Mr. Hevert also presented Supplemental Testimony in which he updated his analysis of the changing economic conditions in North Carolina. The analysis included a review of a number of economic statistics regarding the condition of the economy in North Carolina that continue to indicate improving economic conditions. Based on this analysis Mr. Hevert testified that economic conditions in the state do not alter his cost of equity estimates or recommendations one way or the other.

In his Direct Testimony, Mr. Addison testified to the importance of PSNC maintaining its ability to access national capital markets on reasonable terms in this time of financial uncertainty, an ability that ultimately benefits PSNC's ratepayers. He noted that return on equity is a key consideration for investors when assessing whether to invest in a company like PSNC. He highlighted the

Company's significant and ongoing capital needs as well as the important and real financial consequences that the Commission's determinations regarding rate of return can have in the capital markets and the terms under which PSNC can access those markets.

The Attorney General questioned Mr. Hevert about various aspects of his analysis, but did not provide any affirmative evidence that would support a return on common equity lower than the 9.70% proposed in the Amended Stipulation. The Attorney General's cross-examination established only that the outcomes of the DCF and CAPM analyses would have been different had Mr. Hevert, for example, used different sources for the growth estimate in the third stage of the multi-stage DCF analysis, or had he used another approach to the CAPM method. The Commission finds Mr. Hevert to be a credible witness in this case and accepts Mr. Hevert's support of the 9.70% ROE as probative evidence for purposes of establishing a return on common equity for PSNC in this proceeding. The Commission notes that Mr. Hevert's Direct and Supplemental testimony is the only economic rate of return testimony in this case.

The uncontested evidence presented by PSNC in this case – the only evidence other than the Amended Stipulation itself – clearly supports the justness and reasonableness of the Amended Stipulation.

There is no record evidence in this case establishing meaningful customer opposition to the stipulated overall rate of return on rate base of 7.53% or the stipulated rate of return on common equity of 9.70% or suggesting that the stipulated rates are either unfair or would cause substantial hardship to PSNC's



customers. No public witnesses appeared at any of the four public hearings held to receive public testimony.

While the lack of substantive evidence of consumer opposition to PSNC's stipulated rate increase provides no evidentiary basis upon which the Commission could reject the Amended Stipulation, it does not relieve the Commission of its obligation to reach its own independent conclusion as to whether the Amended Stipulation is just and reasonable, fair to customers, the Company and its shareholders in light of changing economic conditions, and otherwise sufficient to satisfy the requirements of G.S. 62-133. Further, even though the record evidence does not establish this fact with respect to any specific PSNC customer, the Commission of its own experience acknowledges and accepts as true the proposition that some percentage of PSNC's customers, particularly those living on fixed incomes, are economically vulnerable and may struggle to pay PSNC's existing rates or any increase to those rates granted in this docket. Likewise, the Commission must keep this in mind as it undertakes to balance the interests of customers with the constitutional requirements of establishing adequate rates for PSNC.

As noted above, the record evidence in this proceeding supports the legitimacy and reasonableness of the levels of return on rate base and allowed rate of return on common equity reflected in the Amended Stipulation. In light of this fact, the question for the Commission becomes whether the Amended Stipulation represents an appropriate balancing of the interests of customer, the Company, and shareholders, by establishing rates that are as low as may be

reasonably consistent with the requirements of due process. As explained below, the Commission concludes, based on its own independent judgment, that the Amended Stipulation satisfies the requirements of North Carolina law in this respect.

First, Mr. Hevert's Supplemental Testimony clearly demonstrates his belief that the stipulated allowed rate of return on common equity of 9.70% is below what he believes to be the reasonable range of possible returns. Mr. Hevert also indicates that his support for the stipulated ROE is based on the fact that the stipulated ROE represents the give and take among the Stipulating parties regarding multiple, otherwise-contested issues. Finally, he presents a detailed updated review of economic conditions in the State, concludes that these data support his initial conclusion that economic conditions in North Carolina continue to improve, and notes that the changing economic conditions in North Carolina do not impact his recommendations in this case.

It is also significant to note that the Direct Testimony of PSNC witnesses Addison and Hevert establish without question that PSNC is actively engaged in a significant capital investment program that will continue for the next several years that is driven by federal pipeline safety and integrity requirements and that access to capital on reasonable terms is critical to PSNC in order to fund that investment.

#### Conclusions on Return

The Commission understands that rate increases are not favored by ratepayers and that some portion of any utility's customer base will find it difficult

to pay their utility bills from time to time. The Commission further acknowledges that it is the Commission's primary responsibility to protect the interests of utility customers in setting rates for public utilities by complying with the legal principles discussed earlier in this Order. It is also the Commission's responsibility to abide by the constitutional requirements of the Hope and Bluefield cases as reflected in the provisions of G.S. 62-133 and to balance the interests of customers and the utilities which the Commission regulates in that process.

The Commission gives substantial weight to Mr. Hevert's supplemental testimony in support of the stipulated 9.70% ROE where he testified that, although the Stipulated ROE is somewhat below the lower bound of his recommended range (i.e., 10.00 percent), he recognized that the Stipulation represents the give-and-take among the Stipulating Parties regarding multiple, otherwise-contested issues. He relied on PSNC's determination that the terms of the Stipulation, taken as a whole, are such that PSNC will be able to raise the external capital required to continue the investments required to provide safe and reliable service, and that it will be able to do so when needed and at reasonable cost rates.

The Commission also gives substantial weight to Mr. Hevert's testimony that although the Stipulated ROE falls within the range of analytical results presented in his Direct Testimony, current capital market conditions are such that the models used to estimate the Cost of Equity continue to produce a wide range of sometimes conflicting estimates.

The Commission finds it credible that although Mr. Hevert's three DCF analyses reflect a range of 8.14% to 11.97%, the average of the nine mean DCF results is 9.78% as stated on page 94 of his Direct Testimony, which is eight basis points higher than the Commission approved 9.70% ROE.

The Commission also gives substantial weight to Mr. Hevert's testimony that it is important to keep in mind that the models used to estimate the Cost of Equity reflect capital markets and, therefore, general economic conditions. Given that changes in economic conditions in North Carolina are related to the domestic economy, it is reasonable to conclude that both are reflected in ROE estimates.

The Commission also finds credible Mr. Hevert's testimony that it is his view that on balance, economic data regarding North Carolina and the United States do not alter the Cost of Equity estimates, or his recommendation, one way or the other.

Consumers pay rates, a charge in cents per therm for the natural gas they consume. They do not pay a rate of return on equity. To the extent the Commission makes downward adjustments to rate base, reduces the approved common equity component of capital structure, disallows test year expenses or increases pro forma test year revenues, the Commission reduces the rates consumers pay during the future period rates will be in effect.

To the extent the Commission makes adjustments to reduce the overall cost of service, the Commission reduces rates consumers otherwise must pay irrespective of its determination of rate of return on equity expressed as a

percentage, in this case 9.70%. To the extent these adjustments reflect current economic conditions, and consumers' ability to pay, these adjustments reduce not only consumers' rates but also the return on equity, expressed in terms of dollars that investors actually earn. This is also in accord with the end result test of Hope.

After a careful review of all the evidence in this case, and adhering to the requirements of the above cited legal precedents, the Commission finds that the overall rate of return on rate base and the allowed rate of return on common equity, as well as the resulting customer rates provided for under the Amended Stipulation, are just and reasonable, fair to both PSNC and its customers, and appropriate for use in this proceeding and should be approved. The rate increase approved herein, as well as the rates of return underlying such rates, are fair to customers considering changing economic conditions, and are required in order to allow PSNC, by sound management, to produce a fair return for its shareholders, maintain its facilities and services in accordance with the reasonable requirements of its customers in the territory covered by its franchise, and to compete in the market for capital funds on terms that are reasonable and that are fair to its customers and existing investors.

#### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 19**

The level of adjusted sales and transportation volumes used in the Amended Stipulation is 937,082,412 therms. The sales and transportation throughput volume level is derived as follows:

Sales	491,921,582
Transportation	316,664,980
Special Contract	<u>128,495,850</u>
Total Throughput	937,082,412

The level of purchased gas supply is 499,819,717 therms is derived as follows:

Sales	491,921,582
Company Use and Lost & Unaccounted For	<u>7,898,135</u>
Purchased Gas Supply	499,819,717

The throughput level and level of purchased gas supply are the result of negotiations among the Stipulating Parties, as described in the Amended Stipulation, and are not opposed by any party. No other party submitted evidence on the Company's throughput.

The Commission has carefully reviewed the evidence regarding the appropriate throughput level in this docket and concludes that the stipulated throughput levels are a fair and reasonable approximation of the Company's *pro forma* adjusted sales and transportation volumes. The Commission has also carefully reviewed the purchased gas supply level and concludes that it is a fair and reasonable approximation of the Company's *pro forma* purchased gas supply level.

**EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 20-22**

The evidence for these findings is contained in the Company's initial filing and the Amended Stipulation.

The test period cost of gas is set forth in Paragraph 7 and Exhibit E to the Amended Stipulation. The amounts shown on Exhibit E to the Amended Stipulation are the result of negotiations among the Stipulating Parties in this docket. The Amended Stipulation reflects the following agreements among the parties regarding PSNC's cost of gas:

Commodity Costs	\$110,682,356
Company Use and	
Lost and Unaccounted For	\$1,777,080
Fixed Costs	<u>\$67,928,619</u>
Total Cost of Gas	\$180,388,055

The stipulated cost of gas is not contested by any party to this proceeding. The Commission has carefully reviewed these amounts, as well as all record evidence relating to the *pro forma* cost of gas, and concludes that the stipulated cost of gas is reasonable and appropriate for use in this docket.

Under the Commission's procedures for truing-up fixed gas costs in proceedings under Commission Rule R1-17(k), it is necessary and appropriate to determine the amount of fixed gas costs that are embedded in the rates approved herein. In the Amended Stipulation, the Stipulating Parties agree that for the purpose of this proceeding and future proceedings under Rule R1-17(k) during the effective period of rates approved in this proceeding, the appropriate

amount of fixed gas costs to be allocated to each rate schedule is as set forth in Exhibit C to the Amended Stipulation. No party contests this allocation and no other party submitted evidence supporting a different allocation.

The Commission has carefully examined these amounts, as well as all record evidence on fixed gas cost allocations, and concludes that the stipulated allocations of fixed gas costs are fair and reasonable.

Under the Commission's procedures for establishing rates and true-up commodity gas costs, it is necessary to establish a Benchmark embedded in sales customer rates. The Amended Stipulation provides that in establishing rates for this proceeding, the parties have agreed to use PSNC's current Benchmark of \$0.225 per therm subject to any filed changes in such rate prior to implementation of revised rates in accordance with the order in this docket. No party contests the use of a \$0.225 per therm Benchmark in establishing rates for this proceeding and no other party submitted evidence on this issue. The Commission has carefully examined this proposal and concludes that the use of a \$0.225 per therm Benchmark for purposes of establishing rates in this proceeding is fair and reasonable.

### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 23**

The evidence for this finding is contained in the Amended Stipulation, as supported by the Supplemental Testimony of Company witness Paton and the testimony and revised exhibits of Public Staff witness Larsen.

The stipulated rate design and rates, necessary and appropriate to provide PSNC a reasonable opportunity to recover the stipulated revenue



requirement in this docket, are reflected in Exhibit B to the Amended Stipulation. These computations show that the proposed rates will produce the revenues calculated under the rate design, as well as the proposed gas costs rates approved for use in this proceeding. The Commission has carefully reviewed these rates, as well as all record evidence relating to the proper rates to be implemented in this proceeding, and concludes that the stipulated rates are just and reasonable.

A portion of the rate increase will be recovered through the increase in reconnect fees. At the evidentiary hearing, Public Staff witness Larsen testified that the proposed reconnect fee of \$80 was justified. During questions from the Commission, witness Larsen stated that the Public Staff requested justification of the increase in a data request sent to the Company, and PSNC responded that the increase reflected an annual inflation adjustment since 2006 of approximately two percent per year. Witness Larsen further testified that there was an in-depth analysis performed a number of years ago where all of the components of the cost of reconnecting gas service were analyzed. Witness Larsen cited the various steps and tasks involved in this process. Witness Larsen stated that, in today's dollars, the result is it costs almost \$100 for a reconnect. Witness Larsen concluded that \$80 was reasonable and did not exceed the cost that the Company had to incur to provide that service.

The Commission has carefully reviewed the cost components of the reconnection process and concludes that the proposed reconnect fees proposed by PSNC and agreed upon by the Stipulating Parties are fair and reasonable.

## **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 24**

The evidence supporting this finding is contained in the Application, the Direct Testimony of Company witness Ratchford, the Direct and Supplemental Testimony of Company witness Paton, the Direct Testimony of Public Staff witness Perry, the Amended Stipulation, and Rider E of the Company's tariffs.

In its Application, PSNC indicated that it was incurring substantial and ongoing capital expenses associated with efforts to comply with federal pipeline safety and integrity management requirements. In order to address the magnitude and impact of its capital investments required to comply with federal pipeline safety and integrity requirements on a going-forward basis, and as authorized by G.S. § 62-133.7A, PSNC proposed the adoption of an IMT mechanism in its tariffs. According to PSNC, this mechanism would allow the capital cost of pipeline integrity activities to be recovered in a timelier manner than they would be if PSNC had to wait for a general rate case.

In his Direct Testimony, Company witness Ratchford testified to the Company's ongoing capital investments driven by compliance with federal pipeline safety and integrity requirements and emphasized the importance of pipeline safety to the Company, its customers, and the public in general. Mr. Ratchford set out a detailed description of the federal Transportation Integrity Management Plan (TIMP) and Distribution Integrity Management Plan (DIMP) processes required of the Company. He also described in some detail the Company's evolving techniques and efforts to comply with TIMP and DIMP requirements as well as the Company's future planned compliance activities. In

his testimony, Mr. Ratchford described the nature of TIMP and DIMP compliance activities and the fact that federal regulation was an actively evolving process that could generate substantial additional compliance requirements in the future and that the full scope of those requirements could not be known at this time. Mr. Ratchford also explained that the IMT mechanism proposed by the Company to track these costs would allow the capital cost of pipeline integrity activities to be recovered in a timelier manner than if PSNC were required to wait for a general rate case. He explained that, in this way, the Company's customers are not subjected to a large, one-time rate increase, and the amount of the increase is reduced by minimizing debt expense on the capital necessary to make integrity management improvements, as well as minimizing general rate cases and their associated expenses.

In her Direct Testimony, Witness Paton explained the Company's proposed IMT mechanism and provided a proposed form of such tracker as Paton Exhibit 4.

Witness Paton testified that in broad terms, the IMT provides for PSNC to adjust its rates biannually in order to recover the revenue requirement associated with Integrity Management Plant Investment and associated costs incurred by PSNC resulting from prevailing federal standards for pipeline integrity and safety that are not otherwise included in current base rates.

Public Staff witness Perry testified that after several months of discussions, PSNC and the Public Staff agreed to a modified form of the IMT mechanism filed by the Company. Witness Perry stated that the IMT mechanism

will assist PSNC in the implementation and timely recovery of costs associated with its investment of capital in compliance with the requirements of federal and state laws and regulations regarding pipeline integrity (including both transmission and distribution integrity), reliability and safety.

Witness Perry testified that the Public Staff has had approximately 2 ½ years of experience auditing the Piedmont Natural Gas, Inc. IMR Mechanism<sup>13</sup>, which was very helpful in discussions with PSNC regarding its proposed IMT. The Amended Stipulation includes a provision that sets out how to determine excluded costs from the Company's Integrity Management Plant Investment using both the exclusion percentages based on PSNC's budgeted integrity management (IM) projects, as well as the direct assignment approach for specific IM projects that have a significant non-IM component. Witness Perry testified that the Public Staff and PSNC agreed that the excluded reasonable and prudent costs shall be eligible for inclusion in recoverable rate base in PSNC's next general rate case proceeding.

The Amended Stipulation further stated that the Stipulating Parties agreed that costs incurred for system expansion/improvement or routine maintenance, repair and replacement of system components that are not required to comply with federal gas pipeline safety requirements shall not be included in amounts recovered under the IMT mechanism.

Witness Perry also stated that the Public Staff and PSNC worked hard to determine a fair and reasonable approach to enable the Company to recover its

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<sup>13</sup> See *Order Approving Partial Rate Increase and Allowing Integrity Management Rider* (G-9, Sub 631, December 17, 2013); and *Order Approving Stipulation* (G-9, Sub 631, November 23, 2015).

prudently incurred capital investment and associated costs of complying with federal gas pipeline safety requirements.

No other party submitted evidence on the issue of the proposed IMT mechanism.

The Commission has carefully considered the evidence in this proceeding related to the proposed IMT mechanism and has reached the following conclusions. First, the Commission concludes that the form of IMT mechanism attached as Exhibit H to the Amended Stipulation falls within the scope of G.S. § 62-133.7A. That statute authorizes the Commission to adopt “a rate adjustment mechanism to enable the company to recover the prudently incurred capital investment and associated costs of complying with federal gas pipeline safety requirements, including a return based on the company’s then authorized return.” In this case, the proposed form of IMT attached to the Amended Stipulation provides for the recovery of return, taxes, and depreciation on capital investment associated with federal gas pipeline safety requirements in a manner consistent with the statute and in the same fundamental manner that PSNC is permitted to recover those items of its cost of service in a general rate case proceeding. This approach to IM cost recovery is reasonable and consistent with statutory requirements and normal regulatory practices.

Second, the Commission concludes that the IMT mechanism proposed for adoption and implementation in the Amended Stipulation is beneficial to customers because it provides for the use of both the exclusion percentages

determined using PSNC's budgeted IM projects, as well as the direct assignment approach for specific projects that have a significant non-IM component.

Third, the proposed IMT Rider expressly provides for Commission review of the mechanism at the earlier of PSNC's next general rate case proceeding or four years from the effectiveness of the mechanism and also specifically grants any party the right to apply to the Commission to terminate or modify the mechanism at any time on the grounds that the rider mechanism, as approved by the Commission, is no longer in the public interest.

Fourth, consistent with the requirements of G.S. § 62-133.7A, the Commission concludes that adoption and implementation of the IMT mechanism as reflected in Rider E of the Company's tariffs and attached to the Amended Stipulation as Exhibit H is in the public interest. The Commission finds the uncontested evidence of PSNC's required capital expenditures on TIMP/DIMP compliance convincing. It is equally persuaded that regular and repeated general rate case proceedings, otherwise necessary to reflect such investments in PSNC's rate base, would be a detriment to PSNC, its customers, and the Public Staff and would serve no purpose other than to increase regulatory costs paid by ratepayers and the regulatory burden on all parties who participate in PSNC's general rate proceedings, including the Commission. The Commission recognizes that separately accounting for TIMP/DIMP compliance costs and addressing them through the IMT mechanism on an intra-rate case basis effectively isolates those costs from other aspects of PSNC's cost of service. The Commission is satisfied that the public interest is protected from any

potentially adverse impacts from such treatment through a variety of means, including the limited nature of the costs recoverable through the mechanism, using the exclusion percentages determined using PSNC's budgeted IM projects, as well as the direct assignment approach for specific IM projects, the special contract crediting provision contained therein, the mandatory and permissive review provisions contained in the rider, and the Commission's general and continuing oversight of the Company's earnings. The Commission also concludes that the tracker provides an overall benefit to customers since it would allow the capital cost of pipeline integrity activities to be recovered in a timelier manner than if PSNC were required to wait for a general rate case, and therefore avoid subjecting the Company's customers to a large, one-time rate increase. In addition, the amount of the increase is reduced by minimizing debt expense on the capital necessary to make integrity management improvements, as well as minimizing general rate cases and their associated expenses. Finally, the tracker is subject to Commission review after four years.

Finally, the Commission believes that implementation of the proposed IMT mechanism will promote public safety by supporting the timely recovery of costs associated with pipeline safety and integrity expenditures by the Company. Safety and reliability of utility infrastructure is of critical importance to the State and this Commission, and this mechanism facilitates the accomplishment of that goal.

Based on the foregoing, and in the absence of any evidence to the contrary, the Commission finds the Integrity Management Tracker mechanism as

reflected in Rider E of the Company's tariffs and described in Paragraph 10 and attached as Exhibit H to the Amended Stipulation to be fair, reasonable, in the public interest, and appropriate for adoption in this proceeding.

#### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 25**

The evidence for this finding is contained in the Amended Stipulation reflected in Paragraph 6 and Exhibit D.

Under PSNC's CUT mechanism, certain baseload and heat factors, as well as "R" values, are needed in order to make the calculations periodically required under that mechanism. The Stipulating Parties have provided updated factors in this proceeding as reflected in Paragraph 6 and Exhibit D of the Amended Stipulation. These values are not contested and no other party has offered evidence supporting other factors. Based on the Amended Stipulation, and the other record evidence in this proceeding, the Commission concludes that the updated CUT factors identified on Exhibit D to the Amended Stipulation are reasonable and appropriate and should be approved.

#### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 26**

The evidence for this finding is contained in the Company's initial filing and the Amended Stipulation.

In PSNC's Application, supported by the Direct Testimony of Company witness Boone, the Company proposed to amortize and recover a number of previously deferred regulatory assets including PIM and manufactured gas plant (MGP) O&M costs. It also proposed to amortize and recover DIMP O&M costs. In Paragraph 5 of the Amended Stipulation, the Stipulating Parties propose



certain agreed upon changes to the Company's proposed amortizations and recovery of PIM, MGP, and DIMP O&M costs. The Stipulating Parties support the five year amortization periods set forth in Paragraph 5 of the Stipulation and the ongoing interim deferral mechanism for PIM and DIMP O&M costs. No party has opposed the proposals contained in Paragraph 5 of the Amended Stipulation and no other evidence has been submitted regarding these issues.

The Commission has carefully considered the proposed amortization periods and related matters set forth in Paragraph 5 of the Amended Stipulation, as well as all record evidence on the amortization of these regulatory assets, and concludes that the stipulated amortization treatment and specified amortization periods are consistent with the Commission's prior treatment of similar costs and are otherwise fair and reasonable and should be approved. The Commission further concludes that the proposed continuation of the existing regulatory asset treatment for ongoing PIM and DIMP O&M costs is fair and reasonable and should be approved.

#### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 27**

The evidence for this finding is contained in the North Carolina General Statutes, the Amended Stipulation, and the Supplemental Testimony of Company witness Paton.

North Carolina Session Law 2015-241 established a prospective downward adjustment in the North Carolina corporate income tax rates to be effective for tax year 2017. The Stipulating Parties agreed that PSNC will make downward adjustments to its rates to recognize the reduction in the state

corporate income tax rate to 3% beginning January 1, 2017. In the Amended Stipulation, the Stipulating Parties further agree to work together on determining the appropriate revenue requirement reduction and effectuating such reductions and to file notice of such rate reductions with the Commission prior to implementation. No party opposes this plan to adjust PSNC's rates for reductions in income tax expense and no other evidence on this issue was presented to the Commission in this docket.

The Commission has considered the proposed adjustment to corporate income tax set forth in Paragraph 8 of the Amended Stipulation, as well as all record evidence on the corporate tax changes effectuated by North Carolina Session Law 2015-241, and concludes that the stipulated treatment is consistent with the Commission's prior treatment of other tax reductions and is otherwise fair and reasonable and should be approved.

#### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 28**

The evidence for this finding is set forth in the Direct Testimony of Company witnesses Spanos and Boone and in the Amended Stipulation.

In the Amended Stipulation, the Stipulating Parties agreed that the revised depreciation rates should be implemented effective January 1, 2017. No party contested the implementation of PSNC's revised depreciation rates as proposed in the Amended Stipulation and no other party submitted evidence on this issue.

Based on the Direct Testimony of Company witnesses Spanos and Boone and the Amended Stipulation, the Commission concludes that implementation of the revised depreciation rates filed in the instant docket, effective January 1,

2017, as proposed in the Amended Stipulation, is just and reasonable and should be approved.

#### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 29**

The evidence for this finding is contained in the Direct Testimony of Company witnesses Paton and Jackson and the Amended Stipulation.

Company witnesses Paton and Jackson testified to proposed additional changes in the Company's tariffs and service regulations and the reasons underlying those changes. The Stipulating Parties agreed in the Amended Stipulation that the Company's Tariff and Rules and Regulations included in Paton Exhibit 4 with the exception of the Summary of Rates and Charges, Riders C and E, and the Transportation Pooling Agreement should be approved. The changes to Riders C and E and the Transportation Pooling Agreement, which were agreed to among the Stipulating Parties, are reflected in Exhibit H to the Amended Stipulation. No party objected to these changes. The Commission has carefully reviewed these changes to the Company's service regulations and tariffs and concludes that they are fair and reasonable and should be approved.

#### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 30**

The evidence for this finding is contained in the Application, the Direct Testimony of Company witness Paton, and the Amended Stipulation.

In its Application, PSNC proposed to refund over a one-year period the EDIT as set forth in Paton Exhibit 13. In the Amended Stipulation, the Stipulating Parties agreed, in Paragraph 12, that it was appropriate to implement a temporary decrement in rates to refund the EDIT as set forth in Paton Exhibit 13

over a one year period. The parties also agreed that in accordance with North Carolina Session Law 2013-316 (House Bill 998), PSNC agreed to refund the additional EDIT over a one-year period, and any amount remaining after twelve months shall be transferred to the All Customers' Deferred Account. No party has contested the refund of EDIT proposed in the Application and agreed to in the Amended Stipulation and no other party has presented evidence on this issue.

The Commission has carefully considered the refund of EDIT proposed in the Amended Stipulation, and concludes that it is fair and reasonable and should be approved. The Commission further finds any amount remaining after twelve months should be transferred to the All Customers' Deferred Account.

#### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 31**

The evidence supporting this finding is contained in the Amended Stipulation.

In Paragraph 13 of the Amended Stipulation, the Stipulating Parties proposed to continue funding of conservation programs at a level of \$750,000 per year, as reflected in test year operating expenses. No party has contested the continued level of conservation spending or recovery of conservation dollars provided in the Amended Stipulation.

The Commission has carefully considered the proposed continuous level and treatment of conservation funding in the Amended Stipulation and finds it to be fair and reasonable. As a general statement, the Commission believes that energy conservation and efficiency serve the public interest and that

conservation measures provide long-term and year-round benefits to PSNC's customers and to the public as a whole.

Based on the foregoing, the Commission concludes that the amount of conservation spending provided for by the Amended Stipulation, and the recovery of those costs through rates, is appropriate for this docket and should be approved.

### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 32**

The evidence for this finding is contained in the Application, the Direct Testimony of Company witness Ratchford, the Amended Stipulation, Public Staff late-filed Exhibit I, and the Direct Testimony of Public Staff witness Boswell.

In its Application, PSNC proposed to include in its cost of service in this proceeding, \$275,000 for the funding of GTI research into natural gas pipeline safety and reliability. In his Direct Testimony, Company witness Ratchford indicated that the Company's proposal to include a contribution to GTI in this case was targeted at GTI's Operations Technology Development ("OTD") initiative. Witness Ratchford described the OTD initiative as a program specifically targeted towards developing tools and technologies that will assist local distribution companies such as PSNC in meeting the requirements associated with their TIMP and DIMP.

In the Amended Stipulation, the Stipulating Parties agreed, in Paragraph 14, "that the Company may fund research and development activities through annual payments to GTI that have been included in operating expenses in this proceeding."

No party has contested the funding of GTI proposed in the Application and agreed to in the Amended Stipulation and no other party has presented evidence on this issue.

The Commission has carefully considered the GTI funding proposed in the Amended Stipulation, and concludes that the funding of GTI at the level of \$268,631 per year to support the development of new technologies, practices and processes which enhance the safety and reliability of natural gas transmission systems is in the public interest and is also fair and reasonable and should be approved.

#### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 33 – 36**

The evidence supporting these findings is contained in the Amended Stipulation.

As fully discussed above, the provisions of the Amended Stipulation are the product of the give-and-take of settlement negotiations between PSNC, the Public Staff, CUCA, and Evergreen. The end result is that the Stipulation strikes a fair balance between the interests of PSNC and its customers. As discussed above, the Commission has independently evaluated the provisions of the Amended Stipulation and concludes, in the exercise of its independent judgment that the provisions of the Amended Stipulation are just and reasonable to all parties to this proceeding in light of the evidence presented and serve the public interest. Therefore, the Commission approves the Amended Stipulation in its entirety.

IT IS, THEREFORE, ORDERED as follows:

1. That the Amended Stipulation is hereby approved in its entirety.
2. That the Company is hereby authorized to adjust its rates and charges in accordance with the Amended Stipulation and this Order (as such rates may be adjusted for any changes in the Benchmark, and changes in Demand and Storage Charges prior to the effective date of the revised rates) effective for service rendered on and after November 1, 2016.
3. That the Company is authorized to implement the Integrity Management Tracker as described in Paragraph 10 of the Amended Stipulation and Rider E to the Company's tariffs.
4. That the Company is authorized to implement the changes to its Rate Schedules and Service Regulations contained in Paton Exhibit 4 and attached to the Amended Stipulation as Exhibit H for periods effective on and after November 1, 2016.
5. That the Company shall file clean versions of the new and revised tariffs and service regulations to comply with this Order within five (5) days from the date of this Order. Rider E of such filing shall include the appropriate percentages for Section III.(f) and Section IV.(b).
6. That in the true-up of fixed gas costs for periods subsequent to November 1, 2016, in proceedings under Commission Rule R1-17(k), the Company shall use the fixed gas costs allocations set forth in Exhibit C to the Amended Stipulation.

7. That the Customer Usage Tracker mechanism factors set forth on Exhibit D to the Amended Stipulation are approved for use in the implementation of the provisions of that mechanism subsequent to November 1, 2016.

8. That the Company shall refund the EDIT as set forth in Paragraph 12 of the Amended Stipulation, and any balance remaining at the end of twelve months shall be transferred to the All Customers' Deferred Account.

9. That for quarters ending after the effective date of the Order in this docket, the Company shall begin utilizing a revised NCUC GS-1 Earnings Surveillance Report format that is similar to the format of ES-1 Earnings Surveillance Report that is submitted to the Commission by the electric utilities.

10. That beginning November 1, 2016, the Company shall use 6.60% as the applicable interest rate on all amounts over-collected or under-collected from customers reflected in its Sales Customers Only, All Customers, and Hedging Deferred Gas Cost Accounts. The methods and procedures used by the Company for the accrual of interest on the Deferred Gas Cost Accounts shall remain unchanged.

11. That the Company is authorized to implement the other actions, practices, principles, and methods agreed upon in the Amended Stipulation.

12. That the Company shall send the notice attached hereto as Attachment A to its customers beginning with the billing cycle that includes the rate changes approved herein.



ISSUED BY ORDER OF THE COMMISSION.

This the \_\_\_\_\_ day of October, 2016.

NORTH CAROLINA UTILITIES COMMISSION

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Paige J. Morris, Deputy Clerk

**Public Service Company of North Carolina**  
Docket No. G-5, Sub 565  
**STATEMENT OF NET OPERATING INCOME FOR RETURN, RATE BASE AND OVERALL RETURN**  
For The Test Year Ended December 31, 2015

Line No.	Item	Per Company (a)	Settlement Adjustments (b)	After Settlement Adjustments (c)	Rate Increase (d)	After Rate Increase (e)
<b>NET OPERATING INCOME FOR RETURN</b>						
<b>Operating Revenues:</b>						
1	Sales and transportation of gas	\$426,062,649	\$4,063,800	\$430,126,449	\$18,777,584	\$448,904,033
2	Other operating revenues	3,413,176	113,788	3,526,964	276,576	3,803,540
3	Operating revenues, excl special contracts	429,475,825	4,177,588	433,653,413	19,054,160	452,707,573
4	Special Contract Revenues	792,254	0	792,254		792,254
5	Total operating revenues	430,268,079	4,177,588	434,445,667	19,054,160	453,499,827
6	Cost of gas	177,117,745	3,270,310	180,388,055		180,388,055
7	<b>Margin</b>	253,150,334	907,278	254,057,612	19,054,160	273,111,772
<b>Operating Expenses:</b>						
8	Operating and maintenance	112,901,063	(11,298,057)	101,603,006	74,245	\$101,677,251
9	Depreciation	56,496,731	(441,452)	56,055,279		56,055,279
10	General taxes	15,460,053	(171,956)	15,288,097		15,288,097
11	State income tax (4%)	1,794,393	509,332	2,303,725	757,341	3,061,066
12	Federal income tax (35%)	15,072,898	4,278,394	19,351,292	6,361,661	25,712,953
13	Amortization of investment tax credits	0	0	0		0
14	Amortization of EDIT	0	0	0		0
15	Total operating expenses	201,725,138	(7,123,739)	194,601,399	7,193,247	201,794,646
16	Interest on customer deposits <sup>1/</sup>	0	0	0		0
17	Net operating income for return	\$51,425,196	\$8,031,017	\$59,456,213	\$11,860,914	\$71,317,127
<b>RATE BASE</b>						
19	Plant in service	\$1,854,943,639	(\$15,300,074)	\$1,839,643,565	\$0	\$1,839,643,565
20	Accumulated depreciation	(671,500,105)	14,359,017	(657,141,088)	0	(657,141,088)
21	Net plant in service	1,183,443,534	(941,057)	1,182,502,477	0	1,182,502,477
22	Working Capital - Other	(1,885,912)	(5,931,372)	(7,817,284)	0	(7,817,284)
23	Working Capital - Lead Lag	10,009,617	1,847,954	11,857,571	1,856,927	13,714,498
24	Deferred Regulatory Assets	0	0	0		0
25	Deferred Income Taxes	(245,221,651)	3,544,195	(241,677,456)	0	(241,677,456)
26	Original cost rate base	\$946,345,588	(\$1,480,280)	\$944,865,308	\$1,856,927	\$946,722,235
26	Overall Rate of Return on Rate Base	5.43%		6.29%		7.53%

<sup>1/</sup> The interest on customer deposits amount has been reclassified into operating and maintenance expense for purposes of this proceeding.

**STATE OF NORTH CAROLINA  
UTILITIES COMMISSION  
RALEIGH**

DOCKET NO. G-5, SUB 565

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of	)	
Application of Public Service Company of	)	PUBLIC NOTICE
of North Carolina, Inc., for a General Increase	)	
in its Rates and Charges	)	

The North Carolina Utilities Commission (Commission) issued an Order allowing Public Service Company of North Carolina, Inc. (PSNC or the Company) to increase its rates and charges by approximately \$19 million annually, or 4.39% overall, effective November 1, 2016.

On March 31, 2016, PSNC filed an application seeking a general increase in its rates and charges, implementation of a new Integrity Management Tracker mechanism, implementation of new depreciation rates, updates and revisions to the Company's service regulations and tariffs, and proposed funding for gas distribution research activities conducted by the Gas Technology Institute (GTI).

In its application, the Company requested an increase of approximately \$41.6 million annually. The Company stated that the rate increase was needed because it has, since its last general rate case in 2008, greatly expanded natural gas service in its rapidly growing service area by making significant capital improvements to its system, and has invested substantial additional capital in order to comply with federal environmental and pipeline safety and integrity regulations and requirements. In support of its request for a rate increase, the Company explained that the increase is necessary in order to allow PSNC to access capital

markets on reasonable terms, earn a fair return on its investment, and allow the Company to continue investing in the growth, safety, and reliability of its system.

The increase approved by the Commission was the result of a stipulation (Stipulation) entered into between the Company and other parties to the proceeding, including the Public Staff – North Carolina Utilities Commission. The Commission notes that the increase to specific classes of customers will vary in order to have each customer class pay its fair share of the cost of providing service.

Overall, the Commission has approved a residential rate increase for the Company of 4.0%. This represents an increase to the typical residential bill of approximately \$24 per year or \$2.00 per month. These approved increases are associated with allowed expenses and return on investment only and do not contemplate increases or decreases that may occur in association with gas cost adjustments to rates as allowed by North Carolina law.

The Commission has also approved an Integrity Management Tracker mechanism, which will allow the Company to recover the capital related costs of compliance with federal pipeline and distribution integrity management requirements on an intra-rate case basis. This mechanism will facilitate timely recovery of costs related to capital investment mandated by federal law and will help to avoid otherwise unnecessary general rate proceedings.

A list of approved rates can be obtained from the Company's website, [www.psnenergy.com](http://www.psnenergy.com), or at the Office of the Chief Clerk of the Commission, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina, where copies of the Commission's Order and the Stipulation are available for review by any

interested party. The Commission's Order, the Stipulation, and other filings in this docket, can be viewed/printed from the Commission's website at <http://www.ncuc.commerce.state.nc.us> using the Docket Search function.

ISSUED BY ORDER OF THE COMMISSION

This the \_\_\_\_ day of October, 2016.

NORTH CAROLINA UTILITIES COMMISSION

Chief Clerk

(SEAL)

## CERTIFICATE OF SERVICE

I certify that a copy of the foregoing Joint Proposed Order of the Stipulating Parties has been served on all parties of record or their attorneys, or both, by United States mail, first class or better; by hand delivery; or by means of facsimile or electronic delivery upon agreement of the receiving party.

This the 10<sup>th</sup> day of October, 2016.

/s/Mary Lynne Grigg

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