

STATE OF NORTH CAROLINA  
UTILITIES COMMISSION  
RALEIGH

DOCKET NO. W-218, SUB 526

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

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

PREFILED REBUTTAL TESTIMONY OF  
**DEAN R. GEARHART**  
ON BEHALF OF  
AQUA NORTH CAROLINA, INC.

June 12, 2020

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Dean R. Gearhart. My business address is 202 Mackenan  
3 Court, Cary, NC 27511.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am employed by Aqua North Carolina, Inc. ("Aqua", "Aqua North Carolina",  
6 or "Company") as the Manager of Rates and Planning; as such, I provide  
7 financial supervision and guidance to the president of the state organization.

8 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

9 A. My rebuttal testimony will address certain expense related  
10 adjustments made by Public Staff witnesses Henry and Feasel and  
11 comments made by Public Staff witness Junis.

12 **Q. WITH WHICH OF PUBLIC STAFF'S CURRENT, UPDATED**  
13 **ADJUSTMENTS DO YOU AGREE?**

14 A. Aqua and the Public Staff have agreed to a number of updated adjustments,  
15 and they will be reflected in Public Staff's revisions to the Schedules of  
16 Public Staff Henry Exhibit I. These adjustments apply to the following  
17 enumerated line items

18 2- Difference in calculation of revenue requirement based on Company amounts

19 3- Adjust debt cost rate to 4.21%

20 6- Adjustment to allocate vehicle purchased

21 8- Adjustment to remove A/D related to future customers

22 9- Adjustment to A/D for vehicle allocations

23 10- Adjustment to A/D for WSIC/SSIC in service date

24 11- Adjustment to post test year additions to CIAC

- 1 13- Adjustment to post test year additions PAA
- 2 14- Adjustment for Mid South growth related PAA to 03/31/20
- 3 15- Adjustment to post test year additions accumulated amortization - PAA
- 4 16- Adjustment to update advances for construction to 03/31/20
- 5 17- Adjustment to ADIT - post test year additions
- 6 18- Adjustment to ADIT - unamortized rate case expense
- 7 19- Adjustment to ADIT - unamortized repair tax credit
- 8 20- Adjustment to ADIT - protected EDIT
- 9 21- Adjustment to update customer deposits to 03/31/20
- 10 23- Adjustment to cash working capital
- 11 26- Adjustment to depreciation study
- 12 27- Adjustment to repair tax credit
- 13 29- Adjustment to remove JoCO transmission revenue deficit
- 14 31- Adjustment to average tax accruals
- 15 32- Adjustment to service revenues
- 16 33- Adjustment for late payment fees
- 17 34- Adjustment to uncollectibles and abatements
- 18 35- Adjustment to remove capitalize labor
- 19 36- Adjustment to add transportation regular payroll
- 20 37- Adjustment to update salaries and wages March 31, 2020
- 21 38- Adjustment to remove leave without pay
- 22 39- Adjustment to reflect actual standby and overtime salaries and wages
- 23 44- Adjustment to update pensions and benefits to March 31, 2020
- 24 46- Adjustment to remove unqualified benefits from Corporate Sundries
- 25 47- Adjustment to fuel for production
- 26 48- Adjustment to sludge removal
- 27 49- Adjustment to purchased power
- 28 50- Adjustment to materials and supplies

1 51- Adjustment to testing

2 52- Adjustment to contractual services - legal

3 54- Adjustment to contractual services - other- corporate sundries

4 55- Adjustment to contract services - other- accrued expenses

5 58- Adjustment to remove capitalize miscellaneous expense

6 61- Adjustment to remove unqualified misc exp. for Corporate Sundries

7 63- Adjustment to Contra-OH allocations

8 64- Adjustment to amortized EDIT

9 65- Adjustment to payroll taxes

10 67- Adjustment to contract services - other- Temporary labor

11 68- Rounding difference

12 The Company agrees with the items above, although the final dollar  
13 amounts of some line items depend on other factors still to be settled in the  
14 case and may change.

15 **Q. DO YOU AGREE WITH THE PUBLIC STAFF'S ADJUSTMENT TO**  
16 **INSURANCE EXPENSE?**

17 A. No. There is one element of the Public Staff adjustment that the Company  
18 contends is incorrectly calculated and needs to be adjusted. The corporate  
19 allocation factors used to allocate insurance expense to its states is  
20 recalculated by the Public Staff in rate cases to validate their approved  
21 amounts for recovery. Witness Feasel's independent check to recalculate  
22 and validate the payroll allocation factors is incorrect.

23 Insurance costs are allocated to Aqua North Carolina based on *total* payroll  
24 dollars. In Feasel Exhibit I Schedule 6-1(a), witness Feasel recalculates  
25 payroll allocation factors based only upon the expense portion of NC payroll

1 (\$8,467,427) and leaves out the direct capital labor portion of NC payroll  
2 (\$2,014,483); this capital labor amount can be seen in Aqua NC's rate case  
3 filing as W-1 Item 10, Exhibit B1/B2-7 (line 6 for overtime labor & line 7 for  
4 regular labor). The sum of the expense and capital components together  
5 represents total NC payroll of \$10,481,909. General liability and worker's  
6 compensation are computed based on total payroll. Feasel Exhibit I  
7 Schedule 6-1(a) fails to consider total NC payroll in her allocation factors  
8 used to calculate their proposed adjustment and, resultantly, understates  
9 the amounts allocated to Aqua North Carolina in her calculation. The  
10 allocation factors recalculated by witness Feasel for Aqua North Carolina  
11 are 7.75% for general liability (line 5) and 8.59% for workers compensation  
12 (line 6).

13 The Company requests that the capital labor amount of \$2,014,483 be  
14 added to witness Feasel's payroll allocation factor calculation – specifically  
15 to Schedule 6-1(a) line 1, column a.

16 If this direct capital labor amount is included, the resulting Aqua North  
17 Carolina's payroll factors would be 9.21% for general liability and 10.21%  
18 for workers compensation (versus the 7.75% and 8.59% calculated by  
19 witness Feasel).

20 The impact of this requested change, as it stands now, would be an  
21 increase in expense recovery of \$28,498. This amount could change if  
22 there are any changes to the final Aqua NC payroll amounts approved in  
23 this proceeding.

1 Discussions between the Company and witness Feasel on this specific  
2 matter are ongoing.

3 **Q. DO YOU AGREE WITH PUBLIC STAFF WITNESS JUNIS' ASSERTIONS**  
4 **RELATED TO AQUA'S REQUEST FOR DEFERRED ASSET / LIABILITY**  
5 **TREATMENT FOR INSURANCE CLAIMS PAID IN EXCESS OF (ASSET)**  
6 **OR LESS THAN (LIABILITY) THE COMMISSION-APPROVED ANNUAL**  
7 **CLAIM EXPENSE IN THIS RATE CASE?**

8 **A.** No. Aqua North Carolina has experienced significant reductions to its  
9 insurance expense recovery of claims expense for workers compensation,  
10 automotive and general liability in past rate cases. The Public Staff's  
11 methodology to calculate the amount of recoverable insurance claims  
12 expense has been to utilize a five-year average of actual claims paid. The  
13 amount of insurance claims expense charged to the Company from  
14 corporate is based on a fully developed claim vs actual claims paid. Since  
15 fully developed claims estimate the total amount of claims to be paid and  
16 actual claims paid are based on history, there is a gap. Aqua's allowed  
17 recovery in past rate cases has been based on the Public Staff's  
18 methodology.

19 In Docket No. W-218, Sub 497, Aqua NC has incurred claims totaling  
20 \$587,076, with an expensed amount (net of the capitalized portion) of  
21 \$490,870. After adjusting to the five-year history of claims paid, the  
22 expense amount that Aqua NC received in the rate order was \$135,606  
23 (Cooper Schedule 3-3(a) Revised lines 13-15). This was a reduction to

1 Aqua NC's insurance expense of \$355,264.

2 In this proceeding, for the first time, the Company included in its filing the  
3 adjustment to reduce its expense for claims to the Public Staff's  
4 methodology using the five-year average of paid claims. During discovery,  
5 the paid claims amounts were updated to include the amounts for the years  
6 2015 through 2019 (5 years). As it stands now, using this five-year average  
7 methodology, Aqua will recover claims expense that will be \$322,000 less  
8 than the actual claims amounts charged to it in 2020. Aqua has agreed in  
9 this case to accept that reduction, but requests that the approved five-year  
10 average, representative of the annual amount of claims paid and allowed in  
11 rates, be trued-up to actual claims paid as a regulatory asset or liability to  
12 be recovered in future rate cases.

13 While the Company did agree, in this rate case filing, to include this claims  
14 adjustment as a decrease to its insurance expense request, the Company  
15 does *not* agree with the *concept* of this adjustment.

16 Aqua America provides insurance coverage for its states' operations at a  
17 greatly reduced cost compared to the actual costs that would be incurred if  
18 the states had to provide said coverage individually.

19 In the Fall of 2019, Aqua North Carolina received a quote for stand-alone  
20 coverage for Workers Compensation, Automotive and General Liability that  
21 was in excess of \$3,000,000. (See Gearhart Exhibit 1 – NC Stand-Alone  
22 Insurance).

1 During 2020, The Company will incur a cost of \$735K for this same  
2 insurance coverage.

3 This comparison demonstrates the reasonableness of the Company's  
4 current approach to insurance coverage and its full recovery. This approach  
5 does have some risk / opportunity due to actual claims being different than  
6 the developed projections done by a claim's adjuster specialist. For that  
7 reason, what Aqua is proposing in this case is the use of a simple over /  
8 under balancing account for these actual claims paid so neither the  
9 Company's ratepayers nor its shareholders "win" or "lose".

10 The Company will incur total claims related charges of approximately \$587K  
11 in 2020, which equates to about \$491K in expense. However, in this rate  
12 case, the Company stands to recover \$136K in expense related to these  
13 policies.

14 The calculations related to claims referenced in this section are attached as  
15 "Gearhart Exhibit 2-Insurance Claims Adjustments"

16 Witness Junis, at page 45 of his prefiled testimony, suggests the following  
17 could happen if the Company were allowed to recover the costs that it  
18 actually incurs:

19 ...Aqua's guaranteed recovery of all workers' compensation  
20 claims would disincentive Aqua's employee safety education  
21 and practices, including the provision of safe work places and  
22 personal protective equipment such as hard hats, safety  
23 glasses, and steel-toed boots. Again, the guarantee would be  
24 a disincentive [to] Aqua to minimize workers' compensation  
25 claims.  
26

27 These suggestions are speculative, unfounded, and should be given zero



1 weight to the discussion at hand. Aqua America and Aqua North Carolina  
2 place an exceptional amount of attention to the safety culture of the utility.  
3 Every Aqua state is responsible for safety initiatives and metrics and none  
4 of them, aside from Aqua North Carolina, are challenged on their insurance  
5 expense recovery in their respective rate cases.

6 **Q. WITNESS FEASEL PROPOSES THAT 17.5% OF BONUSES PAID**  
7 **TO NORTH CAROLINA EMPLOYEES AS WELL AS 50% OF**  
8 **STOCK OPTIONS, RESTRICTED STOCK AND PERFORMANCE**  
9 **SHARES GRANTED TO NORTH CAROLINA EMPLOYEES**  
10 **SHOULD BE ALLOCATED TO SHAREHOLDERS. DO YOU**  
11 **AGREE WITH THIS ASSESSMENT?**

12 A. No. The short-term incentive ("STI") bonuses, stock options,  
13 restricted stock and performance shares are part of the total  
14 compensation package, paid to attract and retain qualified  
15 employees at Aqua North Carolina. The financial metrics that  
16 witness Feasel cites as arguments for this adjustment, actually  
17 reinforce to Aqua employees that it is their responsibility to serve  
18 the Company's customers in a prudent and efficient manner. The  
19 Company's ability to provide reliable service to its customers is  
20 directly related to its financial viability and linking a portion of those  
21 employees' compensation to a financial target encourages  
22 employees to achieve customer-based objectives in a cost-efficient  
23 manner.

1 **Q. PLEASE EXPLAIN WHAT NC EMPLOYEE BONUS ADJUSTMENTS**  
2 **WERE PROPOSED BY THE PUBLIC STAFF IN THE COMPANY'S**  
3 **2018 RATE CASE AND HOW IT DIFFERS FROM THIS CASE.**

4 In the Company's 2018 Sub 497 rate case, the Public Staff  
5 proposed to allocate 30% of (STI) bonuses paid to Aqua NC  
6 supervisory employees. In this proceeding, the requested  
7 adjustment has been expanded to also include stock options,  
8 restricted stock, and performance share grants. This adjustment  
9 has also been expanded to cover these items for all Aqua North  
10 Carolina employees; not just supervisors. Aqua North Carolina  
11 non-supervisory employees are eligible for bonuses referred to as  
12 "Chairman Awards" and during the test year, these awards were  
13 paid to over one hundred Aqua North Carolina employees.

14 **Q. PLEASE EXPLAIN HOW THE COMMISSION TREATED**  
15 **ADJUSTMENTS TO NC EMPLOYEE BONUSES IN THE**  
16 **COMPANY'S 2018 RATE CASE IN DOCKET NO. W-218, SUB 497.**

17 In the December 2018 SUB 497 Rate Case Order, the Commission  
18 found that adjustments to supervisory employee bonuses was  
19 "unreasonable and inappropriate," concluding that approving the  
20 Public Staff's position on this issue "would send the wrong message  
21 to Aqua NC and its North Carolina supervisory personnel." The  
22 Company believes the Commission should deny the Public Staff's  
23 request in this proceeding for the same reasons set forth in the Rate

1 Case Order in the Sub 497 proceeding, *especially* now that the  
2 proposed adjustment would impact all levels of Aqua North Carolina  
3 employees.

4 **Q. DO YOU AGREE WITH THE PUBLIC STAFF'S ADJUSTMENT TO**  
5 **REGULATORY COMMISSION EXPENSE?**

6 A. No, as this number is not final as of the date of this rebuttal testimony. Aqua  
7 will soon be providing an update of actual and projected rate case expense  
8 through the close of the hearing in this case and requests that the  
9 Commission approve the requested amount for inclusion in rates in this  
10 proceeding. The Company has requested a two-year amortization of the  
11 final rate case expense. This amortization period reflects the fact that the  
12 test year in Aqua NC's current Sub 526 rate case is two years later than the  
13 test year in its previous case (9/30/2019 vs 9/30/2017).

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

15 A. Yes.

# Aqua North Carolina – Optional Guaranteed Cost

October 1<sup>st</sup>, 2019 to October 1<sup>st</sup> 2020

Carrier: Chubb Insurance Group – AM Best Rating A++, XV

General Liability	Auto Liability	Workers Compensation	Total
\$995,514	\$1,015,415	\$1,104,949	\$3,115,878

## Commentary

- Workers' Compensation would be structured on a deductible-retro
- If elected, other coverage would be reduced by the exposure amounts for Aqua NC currently at:
  - \$54,000,000 in revenue
  - \$12,499,061 in payroll
  - 181 autos

**Aqua North Carolina, Inc.**

Calculation of Insurance Expense for Aqua North Carolina  
Test Year Ended September 30, 2019  
Insurance Costs for 2020  
W-218 Sub 526

**GEARHART EXHIBIT 2 - INSURANCE CLAIMS**

Exhibit B3-q-1  
**ORIGINAL**

Line No.	Item	Total Aqua America Insurance Expense	Total Aqua NC Insurance Expense	Percentage To NC	Amount To NC	Percentage to Expense In This Case	Adjusted Insurance Expense	Capitalized	Adjustment from 2020 Ins Exp Budget
(a)	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
1.	Workers compensation premium	\$547,989	\$64,084	11.69%	\$64,084	77.51% [5]	\$49,670	\$14,414	\$0
2.	Automobile premium	173,258	\$28,639	16.53%	28,639	77.51% [5]	22,197	\$6,442	\$0
3.	General liability premium	538,580	\$54,989	10.21%	54,989	100.00%	54,989	(\$0)	\$0
4.	Property insurance	1,500,179	\$143,483	9.56%	143,483	100.00%	143,483	(\$0)	\$0
5.	Umbrella premium	1,850,424	\$188,928	10.21%	188,928	100.00%	188,928	(\$0)	\$0
6.	Employee Practices/Simkiss Fees (fmr Marsh Fees)	368,338	\$37,607	10.21%	37,607	100.00%	37,607	\$0	\$0
7.	Executive risk	604,116	\$61,680	10.21%	61,680	100.00%	61,680	\$0	\$0
8.	Pollution insurance	318,340	\$18,860	5.92%	18,860	100.00%	18,860	(\$0)	\$0
9.	Cyber security	308,929	\$31,542	10.21%	31,542	100.00%	31,542	(\$0)	\$0
10.	Claims handling expense	83,253	\$10,238	12.30%	10,238	100.00%	10,238	(\$0)	\$0
11.	Total allocated costs (Sum of L1 thru L11)	6,293,406	\$640,049	10.17%	640,049		619,194	\$20,855	\$0
12.	Directly assigned costs:								\$0
13.	Workers compensation claims	1,707,698	299,588	17.54%	100,414 [4]	77.51% [5]	77,829	\$22,585	(\$199,174)
14.	Automobile claims	697,947	156,151	22.37%	57,762 [4]	77.51% [5]	44,770	\$12,982	(\$98,389)
15.	General liability claims	2,549,222	131,337	5.15%	26,585 [4]	100.00%	26,585	\$0	(\$104,752)
16.	Surety bonds	139,143	1,300	0.93%	1,326	100.00%	1,326	\$0	\$26
17.	Total insurance per Public Staff (Sum of L13 thru L16)	<u>\$11,387,416</u>	<u>\$1,228,426</u>	<u>10.79%</u>	<u>\$826,136</u>		<u>\$769,704</u>	<u>\$56,432</u>	<u>(\$402,289)</u>
		[1]	[2]	[3]	[4]		[6]	[7]	[8]

[1] From Exhibit B3-q-4, lines 11 and 22

[2] From Exhibit B3-q-4, lines 4 and 15

[3] Column c divided by column b

[4] The claims amounts on lines 13-15 are adjusted to the five-year average of claims paid (calculated in Exhibit B3-q-2, line 7)

[5] Test year utility labor expense percentage from Exhibit B1/B2-7

[6] Column e multiplied by column f to calculate final insurance expense

[7] Column 3 less column h, resulting in the amounts capitalized related to workers compensation and automobile insurance amounts

[8] Column c less less column e, resulting in the adjustment to claims expense by adjusting to the 5-year average of claims paid on Exhibit B3-q-2

**SUPPLEMENTAL W-218 SUB 526**

S1	Workers Compensation/Automobile/General Liability	
S2	Total Cost Allocated/Charged to Aqua NC	\$734,788 lines 1+2+3+13+14+15
S3		
S4	(from lines 12-15 above)	
S5		
S6	Directly assigned costs:	
S7	Workers compensation claims	299,588
S8	Automobile claims	156,151
S9	General liability claims	<u>131,337</u>
S10		<u>587,076</u>
S11		copied from above

**SUPPLEMENTAL W-218 SUB 497**

S15		
S16		2018
S17		Claims
S18		Insurance
S19	Directly assigned costs:	<u>Costs to NC</u>
S20	Workers compensation claims	299,588
S21	Automobile claims	156,151
S22	General liability claims	<u>131,337</u>
S23		<u>587,076</u>

[13] Capitalization rate as shown on NCUC Form W-1, Item 10, Exhibit B1/B2-Labor Summary, Line 17, Column (e).

**SUPPLEMENTAL**

	Feasel	
	Schedule 6-1	
2020	Revised	Reduction to
Claims	Claims	Claims
Insurance	Insurance	Insurance
Expense	Expense	Expense
77.51% [5]	232,204	78,684 (153,520)
77.51% [5]	121,029	54,454 (66,575)
100.00%	131,337	29,651 (101,686)
	<u>484,570</u>	<u>162,789</u> (321,781)
same as above	col c x col f	Impact to Aqua NC Cost Recovery

**Cooper**  
**Schedule 3-39a)**

2018	Revised	Reduction to
Claims	Claims	Claims
Insurance	Insurance	Insurance
NC Expense	Expense	Expense
78.89% [13]	236,345	72,233 (164,112)
78.89% [13]	123,188	38,180 (85,008)
100.00%	131,337	25,193 (106,144)
	<u>490,670</u>	<u>135,606</u> (355,064)

Impact to Aqua NC Cost Recovery