

**STATE OF NORTH CAROLINA  
UTILITIES COMMISSION  
RALEIGH**

DOCKET NO. W-354, SUB 360

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

|   |                                      |
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| In the Matter of<br>Application by Carolina Water Service, Inc., of<br>North Carolina, 4944 Parkway Plaza Boulevard,<br>Suite 375, Charlotte, North Carolina 28217, for<br>Authority to Adjust and Increase Rates for<br>Water and Sewer Utility Service in All of its<br>Service Areas in North Carolina, Except Corolla<br>Light and Monteray Shores Service Area | )<br>)<br>)<br>)<br>)<br>)<br>)<br>) |
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HEARD:      Tuesday, August 28, 2018, at 7:00 p.m., in the Craven County Courthouse,  
Courthouse Annex, Courtroom #4, 302 Broad Street, New Bern, North  
Carolina

Wednesday, August 29, 2018, at 7:00 p.m., in Courtroom 317,  
New Hanover County Courthouse, 316 Princess Street, Wilmington, North  
Carolina

Wednesday, September 19, 2018, at 7:00 p.m., in the Mecklenburg County  
Courthouse, Courtroom 5350, 832 East 4th Street, Charlotte,  
North Carolina

Tuesday, September 25, 2018, at 7:00 p.m., in the Watauga County  
Courthouse, Courtroom #1, 842 W. King Street, Boone, North Carolina

Wednesday, September 26, 2018, at 7:00 p.m., in the Buncombe County  
Courthouse, Courtroom 1A, 60 Court Plaza, Asheville, North Carolina

Monday, October 8, 2018, at 7:00 p.m., and Tuesday, October 16, 2018, at  
10:00 a.m., in Commission Hearing Room 2115, Dobbs Building, 430 North  
Salisbury Street, Raleigh, North Carolina

BEFORE:      Chairman Edward S. Finley, Jr., Presiding, and Commissioners ToNola D.  
Brown-Bland, Jerry C. Dockham, James G. Patterson, Lyons Gray, Daniel  
G. Clodfelter, and Charlotte A. Mitchell

APPEARANCES:

For Carolina Water Service, Inc. of North Carolina:

Jo Anne Sanford, Sanford Law Office, PLLC, Post Office Box 28085,  
Raleigh, North Carolina 27611

Robert H. Bennink, Jr., Bennink Law Office, 130 Murphy Drive, Cary,  
North Carolina 27513

For Corolla Light Community Association, Inc.:

Brady W. Allen, Allen Law Offices, PLLC, 1514 Glenwood Ave., Suite 200,  
Raleigh, North Carolina 27608

For the Using and Consuming Public:

Gina C. Holt, William E. Grantmyre, and John Little, Staff Attorneys, Public  
Staff – North Carolina Utilities Commission, 4326 Mail Service Center,  
Raleigh, North Carolina 27699

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

BY THE COMMISSION: On March 23, 2018, in the above-captioned proceeding,  
pursuant to Commission Rule R1-17(a), Carolina Water Service, Inc., of North Carolina  
(CWSNC or Company) submitted notice of its intent to file a general rate case application.

On April 6, 2018, CWSNC filed a procedural request proposing that the impact of  
the Federal Tax Cuts and Jobs Act (the Tax Act) on the Company's rates be addressed  
and resolved in this docket, rather than in the Commission's generic tax docket (Docket  
No. M-100, Sub 148).

On April 27, 2018, CWSNC filed its verified application for a general rate increase  
(Application), seeking authority to: (1) increase and adjust its rates for water and sewer  
utility service in all of its service areas in North Carolina, except for the Company's Corolla  
Light/Monteray Shores service area (CLMS); and (2) pass through any increases in  
purchased bulk water rates, subject to CWSNC providing sufficient proof of the increases,  
as well as any increased costs of wastewater treatment performed by third parties and  
billed to CWSNC. Included with this filing were certain information and data required by  
NCUC Form W-1. The Company stated in its Application that it presently has  
approximately 34,871 water customers and 21,531 sewer customers in North Carolina

(including water and sewer availability customers).<sup>1</sup> The present rates for water and sewer service have been in effect since November 8, 2017, pursuant to the Commission's Order Approving Stipulations, Granting Partial Rate Increase and Requiring Customer Notice in CWSNC's last general rate case in Docket No. W-354, Sub 356 (Sub 356 Order).<sup>2</sup>

On May 16, 2018, the Company filed an Amendment to its Application, revising Page 4 of 7 to Appendix A-1.

On May 22, 2018, the Commission issued an Order Establishing General Rate Case, Suspending Rates, Scheduling Hearings, and Requiring Customer Notice. By that Order, the Commission declared this matter to be a general rate case pursuant to N.C.G.S. § 62-137, suspended the effect of the proposed new rates for up to 270 days pursuant to N.C.G.S. § 62-134, and required the parties to prefile testimony and exhibits. That Order also scheduled customer hearings in New Bern, Wilmington, Charlotte, Boone, Asheville, and Raleigh, North Carolina, set the evidentiary hearing in Raleigh, North Carolina, and required notice to all affected customers. On May 30, 2018, CWSNC filed its Ongoing Three-Year Water and Sewer Improvement Charges (WSIC/SSIC) Plan.

On July 27, 2018, CWSNC filed a certificate of service demonstrating that the Applicant sent the notices to customers as required by the Commission's Order issued in this proceeding on May 22, 2018.

Public hearings were held as scheduled. The following public witnesses testified at the public hearings in this proceeding:

|                    |            |   |
|--------------------|------------|---|
| August 28, 2018    | New Bern   | Ted Warnock, Simon Lock, Diana Viglianese, Jim Brown, Mike Shannon, Ralph Tridico, Irving Joffe, Michael Kaplan, John Gumbel, and Benny Thompson                            |
| August 29, 2018    | Wilmington | David Holsinger   |
| September 19, 2018 | Charlotte  | Patricia Marquardt, William Colyer, Nicoline Howell, Griffin Rice, Margaret Quan, Deborah Atkinson, Nicholas Stephen Kirkley, Tom Moody, Karen Cynowa, and Michael Tepedino |

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<sup>1</sup> The Company did not indicate the specific date related to its present number of customers stated in the Application. The number of customers presented in Finding of Fact No. 13 herein is based on the final revised detailed billing analysis prepared by Public Staff witness Casselberry for the 12-month period ended December 31, 2017, and is not disputed by the Company.

<sup>2</sup> The Elk River Development was excluded from the general rate increase application filed in Docket No. W-354, Sub 356, as the rates for those customers had increased effective September 20, 2016, pursuant to a rate increase application approved in Docket No. W-1058, Sub 7, for Elk River Utilities, Inc.

|                    |           |   |
|--------------------|-----------|---|
| September 25, 2018 | Boone     | Harvey Bauman, Sid E. Von Ropeunt, George Hall, and Tim Presnell                      |
| September 26, 2018 | Asheville | Jack Zinselmair, Phil Reitano, Gerard Worster, Chuck Van Rens, and Connie Brown       |
| October 8, 2018    | Raleigh   | William Stanley Glance, Vincent Roy, Judith Bassett, Vicki Smith, and Benjamin Farmer |

CWSNC responded to public witness testimony by its filings of September 18, October 4, October 15, October 17, and October 25, 2018.

On September 4, 2018, CWSNC filed the direct testimony and exhibits of Company witnesses Richard Linneman, Financial Planning and Analysis Manager, CWSNC;<sup>3</sup> Dylan W. D'Ascendis, Director, ScottMadden, Inc.; and Deborah Clark, Communications Coordinator, CWSNC.

On September 24, 2018, the Corolla Light Community Association, Inc. (Corolla Light HOA) filed a Petition to Intervene, which the Commission granted by Order issued on October 11, 2018.

On September 25, 2018, the Public Staff filed a motion for an extension of time for the parties to file testimony and exhibits, which was granted by Commission Order issued September 26, 2018.

On September 26, 2018, the North Carolina Attorney General's Office (AGO) filed a Notice of Intervention in this proceeding. The Commission recognizes the AGO's intervention pursuant to N.C.G.S. § 62-20.

The Public Staff's participation in this proceeding is recognized pursuant to N.C.G.S. § 62-15(d) and Commission Rule R1-19.

On October 3, 2018, the Public Staff filed the direct testimony and exhibits of Public Staff witnesses Gina Y. Casselberry, Advanced Utilities Engineer, Public Staff Water, Sewer, and Telephone Division; John R. Hinton, Director, Public Staff Economic Research Division; Lynn Feasel, Staff Accountant, Public Staff Accounting Division<sup>4</sup>; and Sonja R. Johnson, Staff Accountant, Public Staff Accounting Division.

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<sup>3</sup> CWSNC witness Dante DeStefano, Financial Planning and Analysis Manager, CWSNC, adopted the direct testimony initially submitted by CWSNC witness Richard Linneman. Hereafter, for convenience, the Commission will refer only to the testimony of witness DeStefano in this Order.

<sup>4</sup> Public Staff witness Henry adopted the direct testimony initially submitted by Public Staff witness Feasel. Hereafter, for convenience, the Commission will refer only to the testimony of witness Henry in this Order.

On October 4, 2018, the Public Staff filed the direct testimony of Michelle M. Boswell, Staff Accountant, Public Staff Accounting Division.

On October 5, 2018, the Public Staff filed the supplemental testimony of witness Johnson.

On October 11 and 12, 2018, the Public Staff filed the supplemental testimony and exhibits of witnesses Casselberry; Boswell; Windley E. Henry, Accounting Manager, Water/Communications Section, Public Staff Accounting Division; Hinton; and the second supplemental testimony of witness Johnson.

Also on October 12, 2018, CWSNC filed the rebuttal testimony and exhibits of witnesses J. Bryce Mendenhall, Vice President of Operations, CWSNC; D'Ascendis; and DeStefano.

The evidentiary hearing began as scheduled at 10:00 a.m. on October 16, 2018, in Commission Hearing Room 2115, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina, and concluded that same day.

On October 19, 2018, CWSNC and the Public Staff filed a Partial Joint Settlement Agreement and Stipulation (Stipulation). On October 23, 2018, CWSNC filed a response to Commissioner Clodfelter's request for a late-filed exhibit addressing the Company's post-test year plant additions.

On October 30, 2018, the Public Staff filed the late-filed exhibits of witnesses Johnson and Casselberry.

On November 19, 2018, the Public Staff filed a motion for extension of time for all parties to file proposed orders or briefs, which was granted by Commission Order issued the same day.

On November 20 and 21, 2018, the Public Staff filed the late-filed exhibits of witness Casselberry and the Revised Supplemental Exhibits I and II of witness Henry.

On November 27, 2018, the Public Staff filed the Revised Late-Filed Exhibits 4, 7, and 9 of witness Casselberry.

Also on November 27, 2018, CWSNC, the Public Staff, and the AGO filed their respective proposed orders or briefs. In conjunction with its proposed order, CWSNC filed the affidavit of Anthony Gray regarding CWSNC's rate case expense and DeStefano Supplemental Exhibits I (Billing Analysis by Service Areas) and II (Calculation of Gross Revenue Impact of Company Adjustments).

Based upon the foregoing, including the verified Application and accompanying NCUC Form W-1, the testimony and exhibits of the public witnesses appearing at the

hearings, the testimony and exhibits of the expert witnesses received into evidence, the Stipulation, and the entire record herein, the Commission makes the following:

## **FINDINGS OF FACT**

### **General Matters**

1. CWSNC is a corporation duly organized under the law and is authorized to do business in the State of North Carolina. CWSNC is a franchised public utility providing water and/or sewer utility service to customers in 38 counties in North Carolina. CWSNC is a wholly-owned subsidiary of Utilities, Inc. (UI).<sup>5</sup>

2. CWSNC is properly before the Commission pursuant to Chapter 62 of the North Carolina General Statutes seeking a determination of the justness and reasonableness of its proposed rates and charges for the water and sewer utility service CWSNC provides to customers in North Carolina, with the exception of the Corolla Light and Monterey Shores Service Area.

3. The appropriate test period for use in this proceeding is the 12-month period ending December 31, 2017, updated for known and measurable changes through the close of the hearing.

4. The present rates for water and sewer service have been in effect since November 8, 2017, pursuant to the Commission's Sub 356 Order, except for the Elk River Development, which rates have been in effect since September 20, 2016, pursuant to a rate general rate increase approved in Docket No. W-1058, Sub 7 for Elk River Utilities, Inc.

### **The Stipulation**

5. On October 19, 2018, CWSNC and the Public Staff (Stipulating Parties) filed the Stipulation, resolving some of the issues between those two parties in this docket. Those issues that were not resolved by the Stipulation are referred to herein as the "Unsettled Issues."

6. The Stipulation is the product of the give-and-take in negotiations between the Stipulating Parties, is material evidence in this proceeding, and is entitled to be given appropriate weight in this case, along with the other evidence of record, including that submitted by the Company, the Public Staff, and the public witnesses that testified at the hearing.

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<sup>5</sup> Utilities, Inc. owns regulated utilities in 16 states, with primary service areas in Florida, North Carolina, South Carolina, Louisiana, and Nevada, which provide water and sewer utility service to approximately 197,732 customers.

7. The Stipulation is a nonunanimous settlement of matters in controversy in this proceeding and was not joined by the other parties.

8. The Stipulation resolves only some of the disputed issues between CWSNC and the Public Staff.

9. The Unsettled Issues, which were not resolved in the Stipulation, include the following:

- 1) Return on equity;
- 2) Public Staff adjustments to ADIT and EDIT;
- 3) Public Staff proposal that CWSNC refund to ratepayers the overcollection of federal taxes related to the decrease in the federal corporate tax rate since January 1, 2018;
- 4) Reduction of executive compensation and benefits, and related payroll taxes, by 50%;
- 5) Reallocation of insurance premium expenses, passed to CWSNC from its parent, UI;
- 6) Public Staff use of composite utility plant depreciation rates for calculating CIAC and PAA amortization expense;
- 7) Removal of purchased water and purchased sewer treatment expense from the cash working capital calculation;
- 8) Implementation of the proposed Consumption Adjustment Mechanism (CAM); and
- 9) Tariff rate design.

The Unsettled Issues are resolved by the Commission and are addressed later in this Order.

### **Acceptance of Stipulation**

10. The Stipulation will provide CWSNC and its ratepayers just and reasonable rates when combined with the rate effects of the Commission's decisions regarding the Unsettled Issues in this proceeding.

11. The provisions of the Stipulation are just and reasonable to all parties to this proceeding and serve the public interest.

12. It is appropriate to approve the Stipulation in its entirety.

## **Customer Concerns and Service**

13. As of the 12-month period ended December 31, 2017, CWSNC served approximately 30,437 water customers and 20,118 wastewater customers, including Elk River Development and CLMS.<sup>6</sup> There are also 3,774 water availability customers in Carolina Forest, Woodrun, Linville Ridge, Sapphire Valley, Connestee Falls, and Fairfield Harbour and 1,401 sewer availability customers in Sapphire Valley, Connestee Falls, and Fairfield Harbour. CWSNC operates 92 water utility systems and 39 sewer utility systems.

14. A total of 35 witnesses testified at the six public hearings held for the purpose of receiving customer testimony. In general, public testimony at those hearings primarily dealt with objections to the rate increase but some customers did express quality of service concerns, including but not limited to, hardness of the water, staining in sinks and toilet bowls, staining of clothing due to flushing, delay in patching asphalt, and frequently pumping out a lift station.

15. As of October 10, 2018, the Public Staff had received approximately 64 written customer statements of position from CWSNC customers, a petition with 27 signatures from Amber Acres North, a petition with approximately 263 signatures from Bradfield Farms, including a resolution expressing objection to the rate increase, and a petition from Yachtmans (Queens Harbour) with approximately 100 signatures. All of the customers objected to the magnitude of the rate increase. Their primary concerns included the high rate of return requested, the increase in rates compared to inflation, the impact of recent federal corporate income tax reductions, the increasing base facility charge, hardness of the water and discolored water. In addition, the Commission received approximately 12 written customer statements via electronic mail, primarily expressing opposition to CWSNC's proposed rate increase.

16. CWSNC filed five verified reports with the Commission addressing the service-related concerns and other comments expressed by the witnesses who testified at the hearings held for the purpose of receiving public witness testimony. Such reports described each of the witnesses' specific service-related concerns and comments, the Company's response, and how each concern and comment was addressed, if applicable.

17. CWSNC has increased its attention to the communications component of service to customers since the last rate case, with an emphasis on more proactive communications and the launching of several social media platforms.

18. The Public Staff's description of the quality of service provided by CWSNC as "good" is supported by the record in this case.

19. The overall quality of service provided by CWSNC is adequate.

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<sup>6</sup> As of December 31, 2017, there were 321 water and 125 sewer customers in Elk River Development and 963 sewer-only customers in the CLMS service area.



### **Rate Base**

20. The appropriate level of rate base used and useful in providing service is \$115,139,509 for CWSNC's combined operations, itemized as follows:

| <b><u>Item</u></b>                             | <b><u>Amount</u></b>        |
|--|-----------------------------|
| Plant in service                               | \$213,005,526               |
| Accumulated depreciation                       | <u>(52,955,117)</u>         |
| Net plant in service                           | 160,050,409                 |
| Cash working capital                           | 2,079,155                   |
| Contributions in aid of construction           | (42,183,408)                |
| Advances in aid of construction                | (32,940)                    |
| Accumulated deferred income taxes              | (3,972,592)                 |
| Customer deposits                              | (342,640)                   |
| Gain on sale and flow back taxes               | (289,628)                   |
| Plant acquisition adjustment                   | (1,052,168)                 |
| Excess book value                              | (456)                       |
| Cost-free capital                              | (261,499)                   |
| Average tax accruals                           | (125,909)                   |
| Regulatory liability for excess deferred taxes | (251,770)                   |
| Deferred charges                               | 1,522,955                   |
| Pro forma plant                                | <u>0</u>                    |
| Original cost rate base                        | <u><u>\$115,139,509</u></u> |

21. It is appropriate to exclude purchased water and sewer expense from the calculation of cash working capital.

22. It is appropriate to update ADIT to include the deferred tax related to the unamortized balance of rate case expense.

23. It is appropriate to adjust ADIT to reflect the deferred tax related to the unamortized balance of deferred maintenance charges.

### **Operating Revenues**

24. It is appropriate to include in miscellaneous revenues allocated proceeds from the sale of utility property.

25. Miscellaneous revenues should be adjusted to correct the allocation of other water/sewer revenues between water and sewer operations for the Company's four rate divisions: (1) CWSNC Uniform Water; (2) CWSNC Uniform Sewer; (3) Bradfield Farms/Fairfield Harbour/Treasure Cove (BF/FH/TC) Water; and (4) Bradfield Farms/Fairfield Harbour (BF/FH) Sewer.

26. It is appropriate to adjust forfeited discounts and uncollectibles using the percentages calculated by the Public Staff based on test year service revenues and the respective test year forfeited discounts and uncollectibles balances.

27. The appropriate level of operating revenues under present rates for use in this proceeding is \$32,575,467, consisting of service revenues of \$32,429,699 and miscellaneous revenues of \$360,163, reduced by uncollectibles of \$214,395.

### **Maintenance and General Expenses**

28. It is appropriate for CWSNC to recover total rate case expenses of \$395,479 related to the current proceeding and \$434,060 of unamortized rate case costs related to the prior proceeding in Docket No. W-354, Sub 356 (Sub 356 Proceeding). It is appropriate to amortize the total rate case costs for the current and prior proceedings over five years resulting in an annual level of rate case expense of \$165,908.

29. It is inappropriate to reduce CWSNC's revenue requirement to reflect the Public Staff's recommendation to allocate to shareholders 50% of the compensation of three UI executive officers in the amount of \$92,359.

30. It is appropriate to allocate automobile insurance based on the number of vehicles utilized for CWSNC's water and sewer operations as a percentage to the total number of UI automobiles.

31. It is appropriate to allocate workers compensation insurance based on the adjusted level of payroll.

32. It is appropriate to allocate property insurance based on the value of CWSNC's property covered by the current insurance policies.

### **Depreciation and Amortization Expense**

33. It is appropriate to calculate CWSNC's ongoing annual level of depreciation expense based on the adjusted amount of plant in service and the depreciation lives for each plant account.

34. It is appropriate to reduce CWSNC's depreciation expense by the annual amortization of excess book value.

35. In calculating CWSNC's amortization expense—CIAC, it is appropriate to use a composite overall CIAC rate based on the actual amortization rates and balances at June 30, 2018, for each applicable account within the CIAC group of accounts.

36. In calculating CWSNC's amortization expense—PAA, it is appropriate to use the actual amortization rate of 2.47% for water operations and 3.53% for sewer operations.

37. The appropriate level of depreciation and amortization expense for combined operations for use in this proceeding is \$4,073,516.

### **Franchise, Property, Payroll, and Other Taxes**

38. The appropriate level of franchise and other taxes for use in this proceeding is (\$49,702) for combined operations.

39. It is appropriate to calculate payroll taxes based on the adjusted level of salaries and wages and the current payroll tax rates.

40. It is inappropriate to reduce CWSNC's revenue requirement to reflect the Public Staff's recommendation to remove 50% of payroll taxes in the amount of \$2,920 to match the adjustment to salaries and wages related to executive compensation.

41. The appropriate level of payroll taxes for use in this proceeding is \$529,195 for combined operations.

42. The appropriate level of franchise, property, payroll, and other taxes for use in this proceeding is \$713,068 for combined operations, consisting of (\$49,702) for franchise and other taxes, \$233,575 for property taxes, and \$529,195 for payroll taxes.

### **Regulatory Fee and Income Taxes**

43. It is appropriate to use the current statutory regulatory fee rate of 0.14% to calculate CWSNC's revenue requirement. The appropriate level of regulatory fee expense for use in this proceeding is \$45,606.

44. It is appropriate to calculate income taxes for ratemaking purposes based on the adjusted level of revenues and expenses and the corporate tax rates for utility operations.

45. The appropriate level of state income taxes for use in this proceeding is \$177,812.

46. The appropriate level of federal income taxes for use in this proceeding is \$1,207,341.

### **The Federal Tax Cuts and Jobs Act**

47. As proposed by the Company in its Application, agreed to by the Public Staff, and not opposed by any other party, CWSNC's revenue requirement shall reflect the reduction in the federal corporate income tax rate from 35% to 21% as enacted in the Tax Act, for the Company's ongoing income tax expense.

48. As outlined in the Stipulation between CWSNC and the Public Staff, the Company's federal protected EDIT should be amortized over a period of time equal to the expected lifespan of the plant, property, and equipment with which they are associated, in accordance with the normalization rules of the United States Internal Revenue Service (IRS).

49. The Company's federal unprotected EDIT should be returned to ratepayers through a levelized rider over a period of four years.

50. The Company's state EDIT recorded pursuant to the Commission's Order Addressing the Impacts of HB 998 on North Carolina Public Utilities issued on May 13, 2014, in Docket No. M-100, Sub 138 (Sub 138 Order) should continue to be amortized in accordance with the Sub 356 Order.

51. The Company's overcollection of federal income taxes in rates related to the decrease in the federal corporate income tax rate for the period beginning January 1, 2018, and corresponding interest, based on the overall weighted cost of capital, should be refunded to ratepayers as a credit for a one-year period beginning when the new base rates become effective in the present docket.

#### **Capital Structure, Cost of Capital, and Overall Rate of Return**

52. The cost of capital and revenue increase approved in this Order is intended to provide CWSNC, through sound management, the opportunity to earn an overall rate of return of 7.75%. This overall rate of return is derived from applying an embedded cost of debt of 5.68%, and a rate of return on equity of 9.75%, to a capital structure consisting of 49.09% long-term debt and 50.91% common equity.

53. A 9.75% rate of return on equity for CWSNC is just and reasonable in this general rate case.

54. A 50.91% common equity and 49.09% long-term debt ratio is a reasonable capital structure for CWSNC in this case.

55. A 5.68% embedded cost of debt for CWSNC is reasonable for the purpose of this case.

56. The rate increase approved in this case, which includes the approved rate of return on equity and capital structure, will be difficult for some of CWSNC's customers to pay, in particular CWSNC's low-income customers.

57. Continuous safe, adequate, and reliable water and wastewater utility service by CWSNC is essential to CWSNC's customers.

58. The rate of return on equity and capital structure approved by the Commission appropriately balances the benefits received by CWSNC's customers from

CWSNC's provision of safe, adequate, and reliable water and wastewater utility service with the difficulties that some of CWSNC's customers will experience in paying the Company's increased rates.

59. The 9.75% rate of return on equity and the 50.91% equity capital structure approved by the Commission in this case result in a cost of capital that is as low as reasonably possible. They appropriately balance CWSNC's need to obtain equity and debt financing with its customers' need to pay the lowest possible rates.

60. The authorized levels of overall rate of return and rate of return on equity set forth above are supported by competent, material, and substantial record evidence, are consistent with the requirements of N.C.G.S. § 62-133, and are fair to CWSNC's customers generally and in light of the impact of changing economic conditions.

### **Revenue Requirement**

61. CWSNC's rates and charges should be changed by amounts which, after pro forma adjustments, will produce the following increases in revenues:

| <b><u>Item</u></b>  | <b><u>Amount</u></b> |
|---------------------|----------------------|
| CWSNC Uniform Water | \$489,336            |
| CWSNC Uniform Sewer | 290,260              |
| BF/FH Water         | 270,044              |
| BF/FH Sewer         | <u>374,448</u>       |
| Total CWSNC         | <u>\$1,424,088</u>   |

These increases will allow CWSNC the opportunity to earn a 7.75% overall rate of return, which the Commission has found to be just and reasonable in this case.

### **Consumption Adjustment Mechanism**

62. In its Application, CWSNC requested Commission approval of a rate adjustment mechanism to account for variability in average monthly consumption per customer, which directly affects revenues.

63. CWSNC failed to demonstrate that its proposed consumption adjustment mechanism is reasonable or justified.

### **Rate Design**

64. It is appropriate to charge customers in Sapphire Valley CWSNC's uniform metered sewer rates and to charge customers in Bradfield Farms and Fairfield Harbour CWSNC's flat sewer rate, as recommended by the Public Staff, agreed to by CWSNC, and not opposed by any party.

65. It is appropriate to charge customers in Linville Ridge and The Ridges at Mountain Harbour CWSNC's uniform metered water rates, as recommended by the Public Staff, agreed to by CWSNC, and not opposed by any party.

66. It is appropriate to charge customers in The Ridges at Mountain Harbour CWSNC's purchased sewer rates, as recommended by the Public Staff, agreed to by CWSNC, and not opposed by any party.

67. It is appropriate for CWSNC's rate design for water utility service for purposes of this proceeding to be a ratio of 52%/48% base charge to usage charge.

68. The rates and charges included in Appendices A-1, A-2, A-3, B-1, and B-2 are just and reasonable and should be approved.

### **Water and Sewer System Improvement Charges**

69. Consistent with Commission Rules R7-39(k) and R10-36(k), CWSNC's WSIC and SSIC surcharges will reset to zero as of the effective date of the approved rates in this proceeding.

70. Pursuant to N.C.G.S. § 62-133.12, the cumulative maximum charges that the Company can recover between rate cases cannot exceed 5% of the total service revenues approved by the Commission in this rate case.

### **Housekeeping on Bonds**

71. It is appropriate that the \$20,000 bond and certificate of deposit from Branch Banking and Trust Company (BB&T) posted for Amherst Subdivision in Wake County, North Carolina and the \$20,000 bond and certificate of deposit surety from BB&T posted for the Carolina Pines Service Area in Craven County, North Carolina be released to UI pursuant to the Commission's Order in Docket Nos. W-354, Sub 326; W-1152, Sub 8; and W-1151, Sub 7.

### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 1 – 4**

The evidence supporting these findings of fact is found in the Application and the accompanying NCUC Form W-1, the testimony and exhibits of the witnesses, and the entire record in this proceeding. These findings are informational, procedural, and jurisdictional in nature and are not contested by any party.

### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 5 – 12**

The evidence supporting these findings of fact is found in the Stipulation and in the testimony of both CWSNC and the Public Staff's witnesses.

On October 19, 2018, CWSNC and the Public Staff jointly filed the Stipulation, which memorializes these parties' agreements on some of the issues in this proceeding. Attached to the Stipulation is Settlement Exhibit 1, which demonstrates the impact of the parties' agreements on the calculation of CWSNC's gross revenue for the test year ended December 31, 2017. Thus, the Stipulation is based on the same test period as CWSNC's Application, adjusted for certain changes in plant, revenues, and costs that were not known at the time the case was filed, but are based upon circumstances occurring or becoming known through the close of the evidentiary hearing. In addition to the parties' agreements on some of the issues in this proceeding, the Stipulation provides that CWSNC and the Public Staff agree that the Stipulation reflects a give-and-take partial settlement of contested issues, that the provisions of the Stipulation do not reflect any position asserted by either CWSNC or the Public Staff, but instead reflect compromise and settlement between them. The Stipulation is binding as between CWSNC and the Public Staff, conditioned upon the Commission's acceptance of the Stipulation in its entirety. No party filed a formal statement or presented testimony indicating opposition to the Stipulation. However, neither have the AGO or Corolla Light HOA indicated their assent to the Stipulation. There are no other parties to this proceeding.

The key provisions of the Stipulation are as follows:

#### Capital Structure

The Stipulating Parties agreed that the capital structure appropriate for use in this proceeding is a capital structure consisting of 50.91% common equity and 49.09% long-term debt at a cost of 5.68%.

#### ADIT

The Company agreed to the Public Staff's proposed adjustments to ADIT regarding unamortized rate case expense. The Stipulating Parties agreed to revise ADIT for any updates made to regulatory commission expense.

#### Deferred Maintenance

The Company has agreed to the amount of unamortized deferred maintenance and annual deferred maintenance and repair expense as calculated by the Public Staff. The Stipulating Parties disagree as to how these amounts should be recovered from ratepayers and this issue will be addressed in the Evidence and Conclusions for Findings of Fact Nos. 47 - 51.

#### Regulatory Commission Expense

The Stipulating Parties agreed to a methodology for calculating regulatory commission expense, also known as rate case expense, and agreed to update the number in Settlement Exhibit 1, Line 46, for actual and estimated costs once supporting

documentation is provided by the Company. The Stipulating Parties further agreed to amortize regulatory commission expense for a five-year period.

### Federal Protected EDIT

The Stipulating Parties agreed that the protected EDIT will be flowed back over a 45-year period using the Reverse South Georgia method, in accordance with tax normalization rules required by Internal Revenue Code (IRC) Section 203(e).

### Deferral Accounting Treatment

The Company agreed to withdraw its request that deferral accounting treatment of costs related to Hurricane Florence be authorized by the Commission in this case and that amortization of such prudently-incurred costs be addressed in the Company's next general rate case.<sup>7</sup>

A stipulation entered into by less than all parties in a contested proceeding under Chapter 62 "should be accorded full consideration and weighted by the Commission with all other evidence presented by any of the parties in the proceeding." State ex rel. Utilities Commission v. Carolina Utility Customers Association, Inc., 348 N.C. 452, 466, 500 S.E. 2d 690, 700 (1998). Further, "[t]he Commission may even adopt the recommendations or provisions of the nonunanimous stipulation as long as the Commission sets forth its reasoning and makes 'its own independent conclusion' supported by substantial evidence on the record that the proposal is just and reasonable to all parties in light of all the evidence presented." Id.

Based upon the foregoing and the entire record herein, the Commission finds that the Stipulation was entered into by the Stipulating Parties after full discovery and extensive negotiations, that the Stipulation is the product of the "give-and-take" of the settlement negotiations between CWSNC and the Public Staff, and that the Stipulation represents a reasonable and appropriate resolution of certain specific matters in dispute in this proceeding. In making this finding, the Commission gives substantial weight to the testimony of CWSNC witness DeStefano and Public Staff witnesses Henry and Casselberry which support the Stipulation, and notes that no party expressed opposition to the provisions of the Stipulation. In addition, when the provisions of the Stipulation are compared to CWSNC's Application and the recommendations included in the testimony of the Public Staff's witnesses, the Stipulation results in a number of downward adjustments to the expenses sought to be recovered by CWSNC, and resolves issues that were more important to CWSNC, and, likewise, issues that were more important to the Public Staff. Therefore, the Commission further finds that the Stipulation is material evidence to be given appropriate weight in this proceeding, along with all other evidence

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<sup>7</sup> On January 17, 2019, in Docket No. W-354, Sub 363, CWSNC filed a Petition for an Accounting Order to Defer Incremental Hurricane Florence Storm Damage Expenses, Capital Investments, and Revenue Loss. That matter is presently pending before the Commission.



of record, including that submitted by CWSNC, the Public Staff, and the public witnesses that testified at the hearings.

In addition, the Commission finds that the Stipulation is a nonunanimous settlement of matters in controversy in this proceeding and that the Stipulation resolves only some of the disputed issues between CWSNC and the Public Staff. The Stipulation leaves the following Unsettled Issues to be resolved by the Commission: (1) return on equity; (2) the Public Staff's proposed adjustments to ADIT and to EDIT, including how the amount of unamortized deferred maintenance expense should be recovered from ratepayers; (3) the Public Staff's proposal to require CWSNC to refund the overcollection of federal taxes related to the January 1, 2018, decrease in the federal corporate income tax rate; (4) the Public Staff's proposed 50% reduction in the Company's recovery of executive compensation, benefits, and payroll taxes; (5) the Public Staff's proposed re-allocation of insurance premiums passed-on to CWSNC by UI; (6) the Public Staff's proposed use of composite utility plant depreciation rates for calculating CIAC and PAA; (7) the Public Staff's proposed removal of purchased water and purchased sewer treatment expense from the calculation of cash working capital; (8) CWSNC's proposed implementation of a consumption adjustment mechanism (CAM); and (9) CWSNC's proposed tariff rate design.

After careful consideration, the Commission finds that when combined with the rate effects of the Commission's decisions regarding the foregoing Unsettled Issues, the Stipulation strikes a fair balance between the interests of CWSNC to maintain its financial strength at a level that enables it to attract sufficient capital, on the one hand, and its customers to receive safe, adequate, and reliable water and sewer service at the lowest reasonably possible rates, on the other. The Commission finds that the resulting rates are just and reasonable to both CWSNC and its ratepayers. In addition, the Commission finds that the provisions of the Stipulation are just and reasonable to all parties to this proceeding and serve the public interest, and that it is appropriate to approve the Stipulation in its entirety.

### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 13 – 19**

The evidence supporting these findings of fact is found in the testimony of the public witnesses appearing at the hearings, in the testimony of Public Staff witness Casselberry, in the testimony and exhibits of CWSNC witnesses DeStefano, Mendenhall, and Clark, and in the verified reports filed by CWSNC in response to the concerns expressed by the public witnesses that testified at the hearings.

On April 27, 2018, CWSNC filed an application for a general rate increase, which was verified by CWSNC's Financial Planning and Analysis Manager. The Application stated that CWSNC presently serves approximately 34,871 water customers and 21,531 sewer customers in North Carolina. The Company's service territory spans 38 counties in North Carolina, from Corolla in Currituck County to Bear Paw in Cherokee County.

The Commission held hearings throughout CWSNC's service territory for the purpose of receiving testimony from members of the public, and particularly from CWSNC's water and wastewater customers, as follows:

| <u>Hearing Date</u> | <u>Location</u> | <u>Public Witnesses</u>   |
|---------------------|-----------------|---|
| August 28, 2018     | New Bern        | Ted Warnock, Simon Lock, Diana Viglianese, Jim Brown, Mike Shannon, Ralph Tridico, Irving Joffee, Michael Kaplan, John Gumbel, and Benny Thompson                           |
| August 29, 2018     | Wilmington      | David Holsinger   |
| September 19, 2018  | Charlotte       | Patricia Marquardt, William Colyer, Nicoline Howell, Griffin Rice, Margaret Quan, Deborah Atkinson, Nicholas Stephen Kirkley, Tom Moody, Karen Cynowa, and Michael Tepedino |
| September 25, 2018  | Boone           | Harvey Bauman, Sid E. Von Ropeunt, George Hall, and Tim Presnell  |
| September 26, 2018  | Asheville       | Jack Zinselmeir, Phil Reitano, Gerrard Worster, Chuck Van Rens, and Connie Brown  |
| October 8, 2018     | Raleigh         | William Stanley Glance, Vincent Roy, Judith Bassett, Vicki Smith, and Benjamin Farmer   |

Of the 10 witnesses who testified in New Bern, eight were CWSNC customers from the Fairfield Harbour service area, and one each were CWSNC customers from the Brandywine Bay and Carolina Pines service areas. Each witness expressed concern about the rate increase, and others addressed water quality issues such as hardness and discoloration.

At the Wilmington hearing, one witness, who is a CWSNC customer in the Belvedere-system service area testified. He objected to the rate increase, particularly so soon after the last one, and he complained of stains on his clothes caused by the water.

Ten CWSNC customers testified at the hearing in Charlotte, including seven from the Bradfield Farms service area, one from the Hemby Acres service area, and two from the Yachtsman, or Queens Harbor, service area. Generally, customers who testified expressed concerns about the proposed percentage increase in rates and about water quality with regard to the presence of particulates and hardness issues. Some witnesses objected to the rate design and others compared CWSNC's rates unfavorably to those in other jurisdictions, including publicly-owned water/wastewater systems, such as that owned by Union County.

Four witnesses testified at the hearing in Boone, including one witness from the Ski Mountain Acres community, two from the Elk River service area, and one from the

Hound Ears service area. These witnesses focused their testimony on the proposed percentage increase in rates, water quality issues, and questions regarding the investments supporting CWSNC's requested rate increase.

At the hearing in Asheville, five witnesses testified, including two witnesses from the Fairfield Mountain of Lake Lure community, two from the Mt. Carmel service area and one from the Woodhaven service area. These witnesses all expressed concern about the proposed percentage increase in rates. In addition, Ms. Connie Brown, a CWSNC customer in the Mt. Carmel service territory, testified regarding the Company's sewer service, stating that a sewer line near her house requires weekly pumping by a septic truck, and that CWSNC has failed to perform needed repairs or upgrades to that sewer line.

At the hearing in Raleigh, five witnesses testified, including two from the Carolina Trace service area, two from the Amber Acres service area, and one from the Jordan Woods service area. Each of these witnesses objected to CWSNC's proposed rate increase. One of the witnesses from the Amber Acres service territory testified she had seen no improvement in service that would warrant a rate increase, that the Company could be more efficient, and that she opposed the flat rate sewer service charge. The witness from the Jordan Woods service territory testified that his bill was 70% higher after the last rate increase. One of the witnesses appearing at the hearing in Raleigh who is a utilities representative of Carolina Trace testified regarding a good working relationship with CWSNC's local employees, concerns about communications with "headquarters" and about the incidence of boil water notices, criticisms of the Company's practice of adjusting charges for wastewater with respect to commercial pools, but not for residential pool owners, anticipation of completion of the Global Positioning System (GPS) mapping project so that all manholes are located, and criticism of the "uniform rate system." The witness recommended that the uniform rate communities be reorganized into smaller, more similar groups, and expressed difficulty understanding CWSNC's proposed CAM, and criticism of the higher base rates as a component of rate design, indicating that this "guarantees" the Company a net profit regardless of performance. This witness requested that the Commission reject CWSNC's request for a rate increase, noting that it is the second request within a year.

After conclusion of each of the public hearings, CWSNC filed verified reports responding to the testimony provided by the public witnesses. In summary, these reports addressed the public witnesses' concerns related to water hardness by stating that hardness is a function of the level of calcium ions in the source water and that it is not a matter subject to regulation. Further, CWSNC observed that many customers either have already made, or wish to make, their own arrangements for water softening, and that CWSNC leaves that matter to its customers' discretion. CWSNC stated its observation that some customers are not inclined to pay for water softening services for other customers, and CWSNC described its flushing protocol, which is designed to address discoloration and particulates in the water. CWSNC also indicated that it seeks to improve its flushing program to address water quality concerns.

Included in the Company's report on the Asheville hearing was a response to the testimony of Ms. Connie Brown in which CWSNC states that it is preparing a capital project to resolve the issue she identified.

With regard to the public witnesses' concerns regarding the magnitude of the rate increase requested, CWSNC expressed its view of the imperative for rate increases, when the need is demonstrated after a comprehensive audit by the consumer advocate, focusing on the capital-intensive nature of the regulated water and wastewater industry, and on the obligation to maintain safe and reliable service. CWSNC also quoted from published reports that indicate a need for billions of dollars of investment in water and wastewater infrastructure within North Carolina. Finally, CWSNC expressed its view that it is fallacy to compare rates among different kinds of providers, noting that the actual costs to serve customers vary by provider and system, and that companies regulated by the Commission are required to prove their actual cost of service, in the face of skilled examination and audits by the Public Staff and a rigorous review by the Commission.

In these reports, CWSNC also responded to the concerns expressed by the public witnesses who complained about specific issues or questions in the Ski Mountain Acres Property Owners' Association, the Elk River system, the Hound Ears Club and Fox Club communities, the Fairfield Mountain system, the Amber Acres community, the Jordan Woods community, and the Carolina Trace community. In some instances, CWSNC responded to concerns by stating that it would revisit the issues or questions raised by contacting the customers involved. The Commission encourages CWSNC to complete the customer outreach contemplated in these reports.

The Commission also recognizes the efforts of the public witnesses and appreciates their participation in this proceeding. The Commission has carefully considered the testimony provided at the hearings in reaching its conclusions in this Order.

Public Staff witness Casselberry testified that her investigation included review of the customer complaints filed in this proceeding, contacts with the North Carolina Department of Environmental Quality (DEQ), including the Water Quality and Public Water Supply Sections of the Division of Water Resources (DWR), review of CWSNC's records, and analysis of revenues at existing and proposed rates. Witness Casselberry testified that she had contacted representatives of all DEQ regional offices regarding the operation of the CWSNC water and sewer systems. Tr. Vol. 7, p. 301. She testified that none of the regional office personnel she contacted expressed any major concerns with the water and sewer systems serving CWSNC customers or identified any major water quality concerns. Id.

In addition, witness Casselberry testified that she had reviewed approximately 64 customer statements received from CWSNC's customers in connection with this proceeding. Witness Casselberry testified that the consumer statements received are from customers in the following service territories with the corresponding number of statements in parentheses:

Abington (1), Amber Acres North (1) and petition with 27 signatures; Bradfield Farms (3) including a resolution objecting to the rate increase from the Bradfield Farms Homeowners Association, Board of Directors, and petition with approximately 263 signatures; Brandywine Bay (9); Carolina Pines (1); Carolina Trace (13); Connetsee Falls (3); Elk River (1); Fairfield Harbour (12); Fairfield Mountain (2); Linville Ridge (1); Nags Head (1); Queens Harbor (1) including a petition with approximately 100 signatures; The Ridges at Mountain Harbor (4); The Villages at Sugar Mountain (1); Wood Haven/Pleasant Hill (2); and unspecified service areas (8). Tr. Vol. 7, p. 318.

Witness Casselberry summarized the customer statements by testifying that all customers objected to the magnitude of the rate increase, and expressed concern with CWSNC's proposed rate of return, the magnitude of the rates compared to inflation, the rates compared to rates of local municipalities, and the treatment of CWSNC's reduced federal corporate income tax rate. Tr. Vol. 7, pp. 318-334. Witness Casselberry provided a more detailed response to customer concerns in her supplemental testimony.

Witness Casselberry also testified with regard to the service and water quality complaints registered by customers at each of the six public hearings. Tr. Vol. 7, pp. 324-334. She testified that she had read each of the reports CWSNC filed after the hearings, and that there were a few isolated service issues, which the Company addressed or was in the process of resolving. She further testified that she had no additional comments or recommendations. Tr. Vol. 7, p. 333. Witness Casselberry concluded that CWSNC's quality of service had improved since its last general rate case, that, overall, CWSNC's service was good, and that the quality of water meets the standards set forth by the Safe Drinking Water Act and is satisfactory. Tr. Vol. 7, p. 333-334.

CWSNC witness Clark also testified in response to the public witness testimony and the consumer statements. She testified that CWSNC has increased its efforts to engage with and improve customers' overall interaction and experience with the Company. She further testified that the Company implemented multiple new social media and other types of communication, including the use of Facebook, Twitter, Instagram, "Carolina Water Drop" podcasts, bill inserts, phone calls, and face-to-face meetings. She also described a program of CWSNC personnel attending homeowners' association and property-owners' association meetings and the Company's design of a series of free Word Press sites with information about service, personnel, projects, and usage tips.

Based upon the foregoing and the entire record herein, the Commission finds that CWSNC's level of service has improved since its last rate case, and that, overall, the quality of service provided by CWSNC to its North Carolina customers is adequate. In reaching this conclusion, the Commission gives substantial weight to the testimony of Public Staff witness Casselberry, who testified that none of the North Carolina environmental agency regional office personnel she contacted expressed any major concerns with the water and sewer systems serving CWSNC customers or identified any

major water quality concerns. In addition, after having carefully weighed the comments and concerns expressed by the public witnesses appearing at the hearing and the verified reports filed by the Company, the Commission determines that CWSNC has adequately addressed these comments and concerns, or has appropriately committed to do so outside of the formal proceeding. Finally, while the Commission has determined that CWSNC has met its quality of service obligations to its customers for the purpose of this case, the Commission further determines that these efforts should continue and should be considered again in CWSNC's next general rate case through similar investigative efforts by the Public Staff, testimony from the Company and the Public Staff, and reports in response to the public witnesses' concerns. In particular, the Commission is interested in obtaining information about the resolution of the concerns expressed by Ms. Brown at the hearing in Asheville. Therefore, the Commission will require CWSNC to report to the Commission on the progress of the capital project that is intended to resolve the issue identified by Ms. Brown.

### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 20 – 23**

The evidence supporting these findings of fact is found in the Application and the accompanying NCUC Form W-1, the testimony of Company witness DeStefano, and of Public Staff witness Henry, and the Stipulation.

The following table summarizes the differences between the Company's level of rate base from its Application and the amounts recommended by the Public Staff:

| <b><u>Item</u></b>                 | <b><u>Company<br/>Application</u></b> | <b><u>Public Staff</u></b> | <b><u>Difference</u></b> |
|------------------------------------|---------------------------------------|----------------------------|--------------------------|
| Plant in service                   | \$206,614,909                         | \$ 213,005,526             | \$6,390,617              |
| Accumulated depreciation           | <u>(51,498,888)</u>                   | <u>(52,955,117)</u>        | <u>(1,456,229)</u>       |
| Net plant in service               | 155,116,021                           | 160,050,409                | 4,934,388                |
| Cash working capital               | 2,222,369                             | 2,067,611                  | (154,758)                |
| Contributions in aid of construct. | (42,813,916)                          | (41,895,670)               | 918,246                  |
| Advances in aid of construction    | (32,940)                              | (32,940)                   | 0                        |
| Accum. deferred income taxes       | (5,167,701)                           | (3,972,592)                | 1,195,109                |
| Customer deposits                  | (306,974)                             | (342,640)                  | (35,666)                 |
| Gain on sale and flow back taxes   | (425,537)                             | (289,628)                  | 135,909                  |
| Plant acquisition adjustment       | (1,062,767)                           | (1,029,202)                | 33,565                   |
| Excess book value                  | (448)                                 | (456)                      | (8)                      |
| Cost-free capital                  | (261,499)                             | (261,499)                  | 0                        |
| Average tax accruals               | 112,327                               | (125,909)                  | (238,236)                |
| Regulatory liability for EDIT      | (251,770)                             | (251,770)                  | 0                        |
| Deferred charges                   | 2,538,827                             | 1,522,955                  | (1,015,872)              |
| Pro forma plant                    | <u>5,149,664</u>                      | <u>0</u>                   | <u>(5,149,664)</u>       |
| Original cost rate base            | <u>\$114,815,656</u>                  | <u>\$115,438,669</u>       | <u>\$623,013</u>         |

On the basis of the Stipulation and revisions made by the Public Staff in its supplemental testimony, Henry Supplemental Exhibit I, and Henry Revised Supplemental Exhibits I and II, the Company does not dispute adjustments recommended by the Public Staff to plant in service, accumulated depreciation, contributions in aid of construction, customer deposits, gain on sale and flow back taxes, plant acquisition adjustment, excess book value, average tax accruals, deferred charges, and pro forma plant. Therefore, the Commission finds that the adjustments recommended by the Public Staff to plant in service, accumulated depreciation, contributions in aid of construction, customer deposits, gain on sale and flow back taxes, plant acquisition adjustment, excess book value, average tax accruals, deferred charges, and pro forma plant, which are not contested, are appropriate adjustments to be made to rate base in this proceeding.

Based on the testimony of Company witness DeStefano, CWSNC disagrees with Public Staff adjustments to cash working capital and ADIT.

### Cash Working Capital

Public Staff witness Henry testified that cash working capital provides the Company with the funds necessary to carry on the day-to-day operations of the Company. He testified that his calculation of cash working capital, included 1/8<sup>th</sup> of total adjusted operating and maintenance (O&M) and general and administrative (G&A) expenses, less purchased water and sewer expenses. Public Staff witness Henry testified that the calculation implemented by the Public Staff is defined as the “formula method” of calculating cash working capital. Tr. Vol. 8, p. 109. Witness Henry also explained the Public Staff’s rationale for excluding purchased water and sewer expenses from cash working capital is that in general there is no lag time between the time the service is being provided and the time the Company pays for the cost of its purchased water and sewer expenses. Tr. Vol. 8, pp. 110-111.

On cross-examination, witness Henry testified that based on his research, the formula method had been used by the Commission for years to set rates in the water, electric, and natural gas industries before lead lag studies were used to calculate cash working capital. Witness Henry noted that in its filed rate case application, CWSNC also excluded purchased water and sewer expenses from its cash working capital calculation. Tr. Vol. 8, p. 110.

On re-direct, witness Henry testified that the Public Staff has been consistent on how it calculates cash working capital from rate case to rate case during the period of time he has been employed by the Public Staff.

Company witness DeStefano accepted the commonly used formula method of applying a 1/8<sup>th</sup> factor to O&M expenses as a measure of cash working capital; however, he argued that it is improper to remove purchased water and sewer expenses from the calculation, as they are cash expenses and are no different in nature from the remaining O&M expenses. As such, he requested that the purchased water and sewer expenses be included in cash working capital in this proceeding.

Witness DeStefano testified that it may be likely that purchased water and sewer expenses are excluded from the cash working capital calculation because there is currently a means (pursuant to N.C.G.S. § 62-133.11) to prospectively update recovery levels between base rate cases. He contended that this is only true for a portion of such expenses incurred by the Company; that is, only those systems that are supplied 100% by third-party suppliers. Further, he contended that this process only allows a change in rate recovery after the increase in expense has been experienced by the Company. Therefore, witness DeStefano requested that purchased water and sewer expenses be included in the cash working capital calculation in this proceeding.

During cross-examination, witness Henry was questioned concerning the pass-through application process allowed by N.C.G.S. § 62-133.11, in which water and sewer utilities may seek to adjust their rates, outside a general rate case proceeding, to reflect changes in costs based solely upon changes in rates imposed by third-party suppliers. In particular, witness Henry was asked whether there was still a lag in such pass-through application process. Witness Henry responded that there is a lag; however, the Company could prepare its schedules and calculations ahead of time in anticipation of an increase from a third-party supplier and also noted that the Public Staff processes these pass-through applications “pretty quickly.” Tr. Vol. 8, p. 113.

When asked on cross-examination whether the Company can file for pass-through recovery of purchased water costs if the system is not 100% purchased water, witness Henry stated that he did not know, and that there was no evidence provided to explain how many CWSNC systems are not 100% purchased water versus how many would be able to file a pass-through and recover costs.

The Commission has carefully reviewed the evidence in this docket and concludes that it is appropriate to exclude purchased water and sewer expenses from the calculation of cash working capital. This treatment is consistent with Commission practice in other cases,<sup>8</sup> and recognizes the fact that there is no lag between the time a Company collects revenues from its customers for the provision of water and sewer utility service purchased from others and the time the Company pays for the purchased water and sewer expenses, since purchased water and sewer expenses are not due until after the service is provided, the meter has been read, and the Company has been billed by its supplier for the service. The Public Staff provided persuasive evidence supporting its use of the formula method for calculating cash working capital. The Public Staff testified and the Company confirmed that the Company’s as-filed case used the formula method.

Further, the Commission finds that it is clear from the evidence that, notwithstanding the existence of a lag between the time the Company incurs a change in rates imposed by third-party suppliers of purchased water or sewer and receives authorization to pass through the increase in costs to its customers, the time lag is shorter than obtaining recovery through a general rate case proceeding. Additionally, the

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<sup>8</sup> See Recommended Order issued on February 10, 2006, in Docket No. W-176, Sub 32, et al. (and Order Overruling Exceptions and Affirming Recommended Order issued on April 17, 2006), a general rate case proceeding for Scientific Water and Sewerage Corporation.



Commission determines that it is incumbent upon the Company to take measures to anticipate increases when possible and to take the time and effort to prepare pass-through applications and file them as quickly as possible. The Commission determines that the testimony of company witnesses regarding purchased water systems that did not purchase 100% of their water was of no import, as there was no evidence of how many systems were prevented from filing pass-through applications due to this situation and the amount of purchased water expense that was not recoverable via the pass-through process. The Commission therefore finds, for the reasons stated above, that it is inappropriate to include purchased water and sewer expenses in the calculation of cash working capital.

### ADIT

The difference in the level of ADIT is due to the differing levels of unamortized rate case expense, unamortized deferred maintenance, and EDIT recommended by the Company and the Public Staff. Based on the conclusions reached elsewhere in this Order regarding the levels of rate case expense, deferred maintenance, and EDIT, the Commission concludes that the appropriate level of ADIT for use in this proceeding is \$3,972,592.

### Summary Conclusion

Based on the foregoing, the Commission concludes that the appropriate level of rate base for combined operations for use in this proceeding is as follows:

| <u>Item</u>                                    | <u>Amount</u>        |
|--|----------------------|
| Plant in service                               | \$ 213,005,526       |
| Accumulated depreciation                       | <u>(52,955,117)</u>  |
| Net plant in service                           | 160,050,409          |
| Cash working capital                           | 2,079,155            |
| Contributions in aid of construction           | (42,183,408)         |
| Advances in aid of construction                | (32,940)             |
| Accumulated deferred income taxes              | (3,972,592)          |
| Customer deposits                              | (342,640)            |
| Gain on sale and flow back taxes               | (289,628)            |
| Plant acquisition adjustment                   | (1,052,168)          |
| Excess book value                              | (456)                |
| Cost-free capital                              | (261,499)            |
| Average tax accruals                           | (125,909)            |
| Regulatory liability for excess deferred taxes | (251,770)            |
| Deferred charges                               | 1,522,955            |
| Pro forma plant                                | <u>0</u>             |
| Original cost rate base                        | <u>\$115,139,509</u> |

## **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 24 – 27**

The evidence supporting these findings of fact is found in the testimony of Public Staff witnesses Henry and Casselberry, and Company witness DeStefano. The following table summarizes the differences between the Company's level of operating revenues under present rates from its Application and the amounts recommended by the Public Staff:

| <b><u>Item</u></b>     | <b><u>Company Application</u></b> | <b><u>Public Staff</u></b> | <b><u>Difference</u></b> |
|------------------------|-----------------------------------|----------------------------|--------------------------|
| Service revenues       | \$32,435,554                      | \$32,429,699               | (\$5,855)                |
| Miscellaneous revenues | 351,867                           | 360,163                    | 8,296                    |
| Uncollectible accounts | <u>(193,143)</u>                  | <u>(214,395)</u>           | <u>(21,252)</u>          |
| Total                  | <u>\$32,594,278</u>               | <u>\$32,575,467</u>        | <u>(\$18,811)</u>        |

On the basis of the Stipulation and the revisions made by the Public Staff in its supplemental testimony and Henry Supplemental Exhibit I, and Henry Revised Supplemental Exhibits I and II, the Company does not dispute the following Public Staff adjustments to operating revenues under present rates:

| <b><u>Item</u></b>                          | <b><u>Amount</u></b> |
|---|----------------------|
| Reflect pro forma level of service revenues | (\$5,855)            |
| Adjustment to forfeited discounts           | 7,387                |
| Adjustment to other water/sewer revenues    | (2)                  |
| Adjustment to sale of utility property      | 911                  |
| Adjustment to uncollectible accounts        | <u>(21,252)</u>      |
| Total                                       | <u>(\$18,811)</u>    |

For reasons discussed elsewhere in this Order, the Commission has found that the adjustments listed above, which are not contested, are appropriate adjustments to be made to operating revenues under present rates in this proceeding.

### **Summary Conclusion**

Based on the foregoing, the Commission concludes that the appropriate level of operating revenues under present rates for combined operations for use in this proceeding is as follows:

| <b><u>Item</u></b>       | <b><u>Amount</u></b> |
|--------------------------|----------------------|
| Service revenues         | \$32,429,699         |
| Miscellaneous revenues   | 360,163              |
| Uncollectible accounts   | <u>(214,395)</u>     |
| Total operating revenues | <u>\$32,575,467</u>  |

## **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 28 – 32**

The evidence supporting these findings of fact is found in the Application and the accompanying NCUC Form W-1; the testimony of Public Staff witnesses Henry, Johnson, Boswell, and Casselberry; and Company witnesses DeStefano, Mendenhall, and Clark; the Public Staff's exhibit filed on October 30, 2018.

The following table summarizes the differences between the Company's requested level of maintenance and general expenses and the amounts recommended by the Public Staff:

| <b><u>Item</u></b>                  | <b><u>Company<br/>Application</u></b> | <b><u>Public Staff</u></b> | <b><u>Difference</u></b> |
|-------------------------------------|---------------------------------------|----------------------------|--------------------------|
| <b><u>Maintenance Expenses:</u></b> |                                       |                            |                          |
| Salaries and wages                  | \$4,908,936                           | \$4,765,636                | (\$143,300)              |
| Purchased power                     | 1,934,268                             | 1,932,358                  | (1,910)                  |
| Purchased water and sewer           | 2,059,238                             | 1,972,527                  | (86,711)                 |
| Maintenance and repair              | 3,129,187                             | 2,749,845                  | (379,342)                |
| Maintenance testing                 | 470,830                               | 544,360                    | 73,530                   |
| Meter reading                       | 225,963                               | 225,867                    | (96)                     |
| Chemicals                           | 628,209                               | 632,415                    | 4,206                    |
| Transportation                      | 449,313                               | 447,271                    | (2,042)                  |
| Oper. expenses charged to plant     | (707,831)                             | (673,065)                  | 34,766                   |
| Outside services – other            | <u>482,562</u>                        | <u>455,369</u>             | <u>(27,193)</u>          |
| Total                               | <u>\$13,580,675</u>                   | <u>\$13,052,583</u>        | <u>(\$528,092)</u>       |
| <b><u>General Expenses:</u></b>     |                                       |                            |                          |
| Salaries and wages                  | \$2,112,000                           | \$1,972,000                | (\$140,000)              |
| Off. supplies & other office exp.   | 563,875                               | 560,363                    | (3,512)                  |
| Regulatory commission expense       | 436,013                               | 165,908                    | (270,105)                |
| Pension and other benefits          | 1,379,548                             | 1,340,118                  | (39,430)                 |
| Rent                                | 233,928                               | 227,339                    | (6,589)                  |
| Insurance                           | 572,345                               | 429,335                    | (143,010)                |
| Office utilities                    | 744,196                               | 742,300                    | (1,896)                  |
| Miscellaneous                       | <u>215,612</u>                        | <u>23,469</u>              | <u>(192,143)</u>         |
| Total                               | <u>\$6,257,517</u>                    | <u>\$5,460,832</u>         | <u>(\$796,685)</u>       |

On the basis of the Stipulation and revisions made by the Public Staff in its supplemental testimony and Henry Supplemental Exhibit I, and Henry Revised Supplemental Exhibits I and II, the Company does not dispute adjustments recommended by the Public Staff to maintenance salaries and wages, purchased power, maintenance and repair, maintenance testing, meter reading, chemicals, transportation, operating expenses charged to plant, outside services – other, office supplies and other office expenses, rent, office utilities, and miscellaneous. For reasons detailed elsewhere in this Order, the Commission finds that the adjustments recommended by the Public Staff to

maintenance salaries and wages, purchased power, maintenance and repair, maintenance testing, meter reading, chemicals, transportation, operating expenses charged to plant, outside services – other, office supplies and other office expenses, rent, office utilities, and miscellaneous expense, which are not contested, are appropriate adjustments to be made to maintenance and general expenses in this proceeding.

Based on the testimony of Company witnesses Clark, Mendenhall, and DeStefano, which was filed prior to the Stipulation and prior to the filing of Henry Revised Supplemental Exhibits I and II by the Public Staff, the Company disagreed with the Public Staff adjustments to (1) regulatory commission expense, (2) general salaries and wages/pensions and benefits, and (3) insurance.

#### Regulatory Commission Expense

With the Stipulation and revisions made by the Public Staff in its supplemental testimony and Henry Revised Supplemental Exhibit I, the Parties have agreed to total rate case costs of \$395,479 for this current proceeding and \$434,060 of unamortized rate case costs from the Sub 356 Proceeding. Amortization of the total rate case costs for the current and prior proceedings over five years results in an annual expense amount of \$165,908.

The Commission now addresses the contested issues that have an impact on maintenance and general expenses.

Based on the foregoing the Commission finds that the regulatory commission expenses, agreed to by the Stipulating Parties and reflected in Henry Revised Supplemental Exhibit I, are just and reasonable and should be approved.

#### General Salaries and Wages/Pensions and Benefits

Public Staff witness Johnson testified that the Public Staff has proposed an adjustment to CWSNC's revenue requirement reflecting the removal of 50% of the compensation, including pension and benefits, of the top three executive officers of Utilities, Inc. Witness Johnson testified that the three UI executive officers whose compensation and benefits are the subject of the Public Staff's proposed adjustment are the Vice President & General Counsel, the President and Chief Executive Officer (CEO), and the President of Shared Services (Company Executives). She asserted that the Public Staff's recommendation is not based on the premise that the compensation of the Company Executives the Public Staff selected are excessive or should be reduced. Instead, witness Johnson testified that the Public Staff's recommendation is based on the Public Staff's belief that it is reasonable and appropriate for the shareholders of the large water and wastewater utilities to bear some of the cost of compensating those individuals who are most closely linked to furthering shareholder interests, which are not always the same as those of the ratepayers.

Witness Johnson testified that the Company Executives have fiduciary duties of care and loyalty to the shareholder, but not to customers. Consequently, witness Johnson maintained that the Company Executives are obligated to direct their efforts not only to minimizing the costs and maximizing the reliability of CWSNC's service to customers, but also to maximizing the Company's earnings and the value of its shares. Further, witness Johnson testified that it is reasonable to expect that management will serve the shareholder as well as the ratepayers; therefore, she argued that a portion of management compensation and pension and benefits should be borne by the shareholder.

On cross-examination, witness Johnson conceded that she: (1) had not specifically looked at the duties and responsibilities of the UI executive team, outside of an informal phone call; (2) could not say which of the named executives' specific duties were solely for the benefit of the shareholder and completely not for the benefit of the ratepayer; (3) was not sure whether any of the named executives provided communications or information for evaluation of investment by shareholders, though she noted that this sounded like a CEO function; (4) agreed that because the shareholders provide the capital necessary to operate the company, the management was required to be advertent to the interest of shareholders to provide service to customers; (5) agreed that such an adjustment had not been made by the Public Staff for CWSNC previously; and (6) agreed that a range of Corix<sup>9</sup> corporate costs, such as directors' fees, tax, and corporate legal costs, were not included for recovery in this case.

Witness Johnson testified that the compensation of the Company Executives allocated to CWSNC totaled \$185,196, of which the Public Staff recommends 50%, totaling \$92,598, be removed as shareholder expense. Tr. Vol. 8, p. 75. As shown In Johnson Late-Filed Exhibit I, Schedule 1, filed on October 30, 2018, witness Johnson updated her adjustment to remove 50% of the Company Executives' compensation to an amount totaling \$92,359. She also recommended decreasing CWSNC's revenue requirement by \$2,920 to remove 50% of payroll taxes to match the adjustment to salaries and wages related to executive compensation. Witness Johnson clarified in the cover letter to her late-filed exhibit that "[t]here was no adjustments made to pensions and incentive plans of the three executives, as these costs were not included by CWSNC for recovery."

On redirect examination, witness Johnson testified that in each of the respective recent general rate cases, both Duke Energy Progress LLC, (DEP) in Docket No. E-2, Sub 1142, and Duke Energy Carolinas LLC (DEC) in Docket No. E-7, Sub 1146, excluded in their E-1 filings 50% of the compensation of their top four executive officers. Tr. Vol. 8, p. 137. She testified that DEP and the Public Staff (in the DEP case) and DEC and the Public Staff (in the DEC case) stipulated to removing 50% of the compensation and benefits of five top officers in recognition of the work done on behalf of shareholders.

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<sup>9</sup> Corix Utilities (Illinois) LLC (Corix), acquired 100% of the membership interest of Hydro Star, LLC, which through its wholly owned subsidiary, Hydro Star Holdings Corporation, owned 100% of the issued and outstanding stock of UI, CWSNC's parent company. See Order Approving Acquisition of Stock and Requiring Customer Notice, N.C.U.C. Docket No. W-1000, Sub 14 (2012).

Witness Johnson maintained that it is the Public Staff's principled position that work and loyalties are divided between shareholders and customers, which was the basis for her adjustment. Tr. Vol. 8, p. 130. Additionally, when questioned by the Commission, witness Johnson testified that the Company Executives received bonuses as a direct result of increasing the earnings per share, which directly benefitted shareholders. Tr. Vol. 8, p. 132.

CWSNC witness DeStefano testified that the function of the Company Executives is not the equivalent of publicly-traded parent company corporate executives whose job focus may be much more focused on benefits to the shareholders. Witness DeStefano stated UI is more of an operating company, as demonstrated by the roles of the three individuals at issue. Additionally, he stated that since UI is not a publicly-traded company, time spent on shareholder related activities is limited to that which is required to make sure risks are mitigated and capital is secured. Witness DeStefano testified that UI has only one shareholder and argued that dealing with that single investor requires comparable effort as working with the Company's debt holders.

With respect to the role of the Vice President & General Counsel, witness DeStefano testified that this position provides legal support to the regulated companies such as CWSNC, including, for example, on issues involving human resources matters, health, safety and environmental issues, contract review, litigation support, and review of various legal issues. He stated that such legal support includes regulatory and transactional matters, including rate filings, easement and right-of-way issues, and mandatory regulatory and legal policies such as record retention, privacy, and cybersecurity. He maintained that these are the basic legal functions of any regulated utility, which are discharged to the direct benefit of CWSNC's customers.

With regard to the role of the President of Shared Services, witness DeStefano stated that this position focuses on the delivery of services essential to local operations and customers, including: customer service; human resources; health, safety and environmental compliance; information technology; billing; insurance; accounting; and facilities management. Witness DeStefano rejected the Public Staff's assertion that any of the President of Shared Services' role supports the shareholder in any other manner than simply facilitating a well-run utility. On cross-examination, he reiterated his view that this officer oversees these local operations functions as his primary and key duty.

Witness DeStefano described the role of the CEO as having close interaction with local CWSNC leadership in evaluating capital investment plans and operating budgets, as well as providing expertise on and leadership with addressing customer concerns, industry "best practices," setting short- and long-term operating strategies, and generating company initiatives and policies such as safety, environmental, and business transformation programs. He maintained that the CEO assesses risks so that risks are addressed and mitigated to ensure that the Company provides safe, reliable, and cost-effective service. In addition, witness DeStefano testified that the CEO works closely with the single shareholder and lenders to secure capital and debt for improvements that directly address customer needs.

Witness DeStefano testified that a regulated utility exists solely to provide service to its customers and that it cannot exist without debt and equity funding. In summary, he argued that the functions of the Company Executives differ from those of publicly-traded parent company corporate executives whose job focus may very well be much more on benefits to the shareholders. He explained that UI is more of an operating company, as demonstrated by the roles of the three individuals at issue. Witness DeStefano asserted that since UI is not a publicly-traded company, time spent on shareholder-related activities is limited to that which is required to make sure risks are mitigated and capital is secured.

Witness DeStefano rejected as unfair Public Staff witness Johnson's representation that the Company Executives did not have fiduciary duties of care and loyalty to customers, but only to shareholders. Witness DeStefano observed that when the fundamental focus of the shareholder is ensuring customer satisfaction and welfare by providing the best service at the most reasonable possible price — which the management of these regulated utilities is required by statute to do — then the interests of the shareholder and the Company's ratepayers are understood to be exactly aligned. He maintained that this alignment becomes clearer when one considers the necessity, for the customers' benefit, for a utility to attract both high-quality human resources for management and leadership purposes, and to attract financial capital to support the capital-intensive industry.

Witness DeStefano explained that attracting capital from investors is vital to fund needed improvements in aging systems and, as other regulators have recognized, one of the great benefits to a local utility being part of a larger utility company is access to capital that the parent is able to provide. He contended that the ability to maintain and support proper service to customers at a reasonable cost is inextricably linked to the Company Executives' ability to meet shareholder expectations. Witness DeStefano opined that without the Company Executives' support and services, the Company would neither be positioned to meet the needs of its customers nor be eligible to achieve financial returns that attract debt and equity capital needed for the financial welfare of the utility. Therefore, in his view executive base compensation is an integral and necessary part of the Company's overall cost of service to meet the needs of its customers.

Witness DeStefano further contended that the Public Staff's recommendation to exclude from the cost of service 50% of CWSNC's share of the costs of compensation for the Company Executives is arbitrary and lacks support either in the facts or the reality of the functions of this executive team, whose contributions should be fully supported in rates as they focus on direct benefits to customers.

Moreover, witness DeStefano testified that Corix, a corporate level above UI, has provided beneficial services and support to UI and its affiliates, including CWSNC, since its acquisition of UI. Witness DeStefano pointed out that those Corix corporate costs (such as director fees, tax and corporate legal costs) have not been included for recovery in CWSNC's rates even though they are part of the overall costs to support the services provided to the Company.

After considering all of the evidence of record, and for the reasons discussed below, the Commission finds that the Public Staff's proposed adjustment to CWSNC's revenue requirement, representing the removal of 50% or \$92,359, of the Company Executives' compensation is inappropriate. Consequently, the Commission concludes that the Public Staff's proposed adjustment should be rejected. In reaching this conclusion, the Commission gives great weight to the testimony of witness DeStefano that, because UI is not a publicly-traded company, time spent on shareholder-related activities is limited to that which is required to ensure risks are mitigated and capital is secured. The Commission is also persuaded by witness DeStefano's assertion that because UI has only one shareholder, dealing with that single investor requires comparable effort as working with debt holders. Moreover, the Commission gives significant weight to the testimony of witness DeStefano that Corix's corporate costs (such as director fees, tax and corporate legal costs) have not been included for recovery in CWSNC's rates. The Commission notes that Public Staff witness Johnson confirmed that Corix's corporate costs have not been included for recovery in this proceeding.

The Commission also gives substantial weight to the testimony of witness DeStefano in which he described the roles of the three Company Executives at issue. In particular, witness DeStefano pointed out that the Company Executives focus on local operations and have close interaction with local CWSNC leadership for the direct benefit of customers. Based upon the evidence in this proceeding, the Commission agrees with witness DeStefano that the functions of the Company Executives differ from those functions of similar corporate officers within a publicly-traded parent company in that the functions of corporate executives in a publicly-traded parent company may tend to focus more on benefitting the shareholders rather than focusing on interacting with local subsidiary operations for the benefit of customers.

The Commission is not persuaded by the Public Staff's observation that the Commission approved 50% adjustments for executive compensation for DEP in its Order Accepting Stipulation, Deciding Contested Issues and Granting Partial Rate Increase issued on February 23, 2018, in Docket No. E-2, Sub 1142, and for DEC in its Order Accepting Stipulation, Deciding Contested Issues, and Requiring Revenue Reduction issued on June 22, 2018, in Docket No. E-7, Sub 1146. Both DEC and DEP originally filed their rate cases reflecting removal of 50% of the executive compensation of the top four executive officers and, later in the proceedings, the Company and the Public Staff reached a stipulation to remove 50% of the executive compensation for the top five executive officers. Thus, the Commission did not resolve the issue through litigation in either case.

The Commission acknowledges that in its recent Order Approving Partial Settlement Agreement and Stipulation, Granting Partial Rate Increase, and Requiring Customer Notice issued on December 18, 2018, in Docket No. W-218, Sub 497 (December 18, 2018 Order), for Aqua North Carolina, Inc. (Aqua NC), the Commission determined that it was appropriate to allocate 25% of the executive compensation, including pensions and incentive plans of the top five Aqua America executives to Aqua NC's shareholders (as proposed as an alternative recommendation of Aqua NC's



witness) and not to ratepayers through inclusion of those expenses in the revenue requirement. That decision is consistent with the Commission's decision in Aqua NC's 2011 general rate case (Docket No. W-218, Sub 319). The Commission notes that, unlike Aqua NC, Public Staff witness Johnson testified that an adjustment to remove any portion of executive compensation has not been made for CWSNC in a past rate case proceeding.

The Commission determines that there are distinct differences between CWSNC and Aqua NC that justify allowing CWSNC to include in its revenue requirement the full amount of compensation allocated to CWSNC for the Company Executives. As noted in the December 18, 2018 Order, Aqua America, Inc., the parent company of Aqua NC, is the second largest investor-owned water and wastewater utility in the United States with its shares traded on the New York Stock Exchange and a \$6.709 billion market capitalization at the August 17, 2018 market close as reported by Morningstar. In contrast, as witness DeStefano testified, the parent company of CWSNC, UI, is more of an operating company and its shares are not publicly-traded. Further, the Commission observes that Corix, a corporate level above UI, is also a privately held corporation. Finally, with respect to the size of CWSNC in comparison to that of Aqua NC, the Commission is cognizant that Aqua NC provides utility service to significantly more customers in North Carolina than CWSNC, with significantly greater total operating revenues, differences that the Commission determines are material to the resolution of this issue.<sup>10</sup>

The Commission disagrees with the Public Staff's view that shareholders of large water and wastewater utilities must bear some of the cost of compensating those individuals who are most closely linked to furthering shareholder interests should be applied mechanically in every case. Rather, the Commission finds that such an adjustment should be considered based upon all available information and the Commission will, in future general rate cases, continue to consider this issue on a case-by-case basis in light of all the evidence of record.

Based upon the foregoing and the entire record herein, the Commission finds that it is inappropriate to reduce CWSNC's revenue requirement to reflect the Public Staff's recommendation to allocate to shareholders 50% of the compensation, or \$92,359, for the three Company Executives. Therefore, the Commission concludes that the Public Staff's proposed adjustment should be denied.

### Insurance

Public Staff witness Henry testified that he adjusted insurance premiums to reflect the current amount for insurance for UI, the parent company of CWSNC, which was provided by the Company. Witness Henry allocated insurance premiums to CWSNC

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<sup>10</sup> Aqua NC serves approximately 78,739 water customers and 17,940 wastewater customers with over \$59 million in total annual operating revenues; whereas, CWSNC serves approximately 30,437 water customers and 20,233 wastewater customers with over \$33 million in total annual operating revenues.

using the following factors: (1) allocated automobile insurance based on the number of automobiles for CWSNC's water and sewer operations as a percentage to the total number of UI automobiles; (2) allocated workers compensation insurance based on the adjusted level of payroll; (3) allocated property insurance to reflect the value of the property covered by the current insurance policies; and (4) allocated the remaining insurance items to the various entities based on the number of customers.

Witness Henry also testified that he removed two-thirds of the pollution liability insurance premium included in the Company's application since it is a three-year policy and only an annual level of premium expense should be included in operating expenses in this proceeding.<sup>11</sup>

Public Staff witness Henry testified that in cases where the Public Staff cannot directly tie a particular item to North Carolina, it uses an allocation factor based on the number of customers as a last resort. He testified that when there are tangible assets to which a value can be determined, it is reasonable and appropriate to directly assign costs based on that actual known information, as opposed to based on customer count.

On cross-examination, witness Henry testified that customer count was used by the Public Staff to allocate costs in seven out of 10 categories when there was no other means of determining the portion attributable to items in North Carolina. Tr. Vol. 8, p. 118. On cross-examination, in response to the question of whether the Company would ever fully recover through expense and rates its allocated insurance expense if the Public Staff's methodology is adopted, witness Henry stated that ratepayers should not have to bear more costs than necessary due to the Company's methodology of allocating costs based on customer count. Tr. Vol. 8, p. 121. Moreover, witness Henry stated that the Company should not be able to over-recover the insurance costs that are allocated from UI. He contended that the allocation methodology based upon customer count utilized by UI is incorrect and unfair. Tr. Vol. 8, p. 122.

CWSNC disagreed with the Public Staff's methodology of allocating automobile, worker's compensation, and property insurance to CWSNC's water and sewer operations. Company witness DeStefano testified that CWSNC's as-filed allocation method for insurance expenses is the most reasonable and appropriate allocation method. He stated that there are far too many factors in setting policy premiums that were not considered by the Public Staff, to utilize only one factor for each policy when allocating insurance costs. Witness DeStefano also testified that the Company's allocation method avoids "going down the rabbit hole" of attempting to identify a perfect allocation method, and utilizes a single, consistent allocation method in each application. The Company's as-filed position for allocating all insurance cost is based on the percentage of customers in each state that it provides water and sewer utility service.

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<sup>11</sup> Of the Public Staff's total adjustment of (\$143,010) to CWSNC's ongoing annual level of insurance expense, (\$61,008) of this amount relates to its adjustment to correct the Company's overstatement of its annual pollution liability insurance premium.

After careful consideration, the Commission finds that the Public Staff appropriately allocated insurance costs to CWSNC. The Commission is persuaded that the Public Staff method is a more direct allocation methodology than the methodology advocated by the Company, because using vehicle count, payroll, and property covered in CWSNC's service territory ensures that customers are not paying more for cost of service than they would if costs were allocated solely based on customer count. Moreover, the Commission recognizes that there is no perfect methodology for allocating costs, but directly assigning costs to the rate entities that created the cost, is a more reasonable and equitable policy to follow than an allocation based on the number of customers, which does not identify the entity that created the cost. The Commission acknowledges that the Public Staff used customer count when a more accurate allocation method was not available. The Commission agrees with the Public Staff that there is a risk that North Carolina customers could inappropriately incur extra expense resulting from possible over-recovery by the Company of insurance expense due to a single, consistent allocation method, when a more accurate method exists. Therefore, the Commission concludes that the methodology employed by the Public Staff in allocating automobile, worker's compensation, and property insurance to CWSNC's water and sewer operations is just and reasonable and should be approved for this proceeding.

#### Summary Conclusion

Based upon the foregoing, the Commission concludes that the appropriate level of maintenance and general expenses for combined operations for use in this proceeding are as follows:

| <u>Item</u>                     | <u>Amount</u>       |
|---------------------------------|---------------------|
| <u>Maintenance Expenses:</u>    |                     |
| Salaries and wages              | \$4,765,636         |
| Purchased power                 | 1,932,358           |
| Purchased water and sewer       | 1,972,527           |
| Maintenance and repair          | 2,749,845           |
| Maintenance testing             | 544,360             |
| Meter reading                   | 225,867             |
| Chemicals                       | 632,415             |
| Transportation                  | 447,271             |
| Oper. expenses charged to plant | (673,065)           |
| Outside services – other        | 455,369             |
| Total                           | <u>\$13,052,583</u> |

| <u>Item</u>                       | <u>Amount</u>      |
|-----------------------------------|--------------------|
| <u>General Expenses:</u>          |                    |
| Salaries and wages                | \$2,064,359        |
| Off. supplies & other office exp. | 560,363            |
| Regulatory commission expense     | 165,908            |
| Pension and other benefits        | 1,340,118          |
| Rent                              | 227,339            |
| Insurance                         | 429,335            |
| Office utilities                  | 742,300            |
| Miscellaneous                     | 23,469             |
| Total                             | <u>\$5,553,191</u> |

### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 33 – 37**

The evidence supporting these findings of fact is found in the Application and the accompanying NCUC Form W-1 of CWSNC, the testimony of Public Staff witness Henry, and the testimony of Company witness DeStefano. The following table summarizes the differences between the Company's level of depreciation and amortization expenses from its Application and the amounts recommended by the Public Staff:

| <u>Item</u>                 | <u>Company Application</u> | <u>Public Staff</u> | <u>Difference</u>  |
|-----------------------------|----------------------------|---------------------|--------------------|
| Depreciation expense        | \$5,549,406                | \$5,617,382         | \$67,976           |
| Amortization expense – CIAC | (1,480,909)                | (1,776,720)         | (295,811)          |
| Amortization expense – PAA  | (39,197)                   | (77,331)            | (38,134)           |
| Amortization of ITC         | (519)                      | (519)               | 0                  |
| Total                       | <u>\$4,028,781</u>         | <u>\$3,762,812</u>  | <u>(\$265,969)</u> |

With respect to CWSNC's depreciation expense, in light of the agreements reached in the Stipulation and revisions recommended by the Public Staff in its supplemental testimony and reflected in Henry Supplemental Exhibit I, the Company does not dispute the adjustments recommended by the Public Staff to depreciation expense. As detailed elsewhere in this Order, the Commission finds that the adjustments recommended by the Public Staff to depreciation expense, which are not contested, are appropriate adjustments to be made to operating revenue deductions in this proceeding.

The Commission now addresses the Public Staff adjustments to amortization expense – CIAC and amortization expense – PAA.

#### **Amortization Expense – CIAC and PAA**

Public Staff witness Henry testified that the Public Staff adjusted CIAC amortization expense and PAA amortization expense to reflect the Public Staff's recommended level of CIAC and PAA, respectively, multiplied by an amortization percentage that is based on

the composite depreciation rate for the Public Staff's adjusted level of direct plant in service.

On cross-examination, witness Henry testified that the Public Staff had previously made this adjustment in every rate case he had worked on involving CWSNC and the other UI utility subsidiaries in North Carolina, such as CWS Systems, Inc. and Transylvania Utilities, Inc. Witness Henry stated that the Public Staff initially adopted and utilized this adjustment to address problems with CWSNC's recording CIAC and PAA in prior years and also the portion of CIAC (tap-on fees) that is not directly allocated to a particular plant account. Witness Henry further testified that "in order for the customer to take advantage of those tap-on fees, the Public Staff calculated a composite depreciation rate to reduce the amount of PAA as well as CIAC." Tr. Vol. 8, p. 123.

During cross-examination, witness Henry acknowledged that the problems associated with errors affecting recordation of CIAC and PAA that existed in the past had been resolved by the Company, although the tap-on fee situation has not changed. According to witness Henry, the Company still has a problem with recording the right amount of tap-on fees in each plant account and, therefore, the Public Staff continues to think that it is necessary to use composite depreciation rates.

Witness Henry also acknowledged that, in theory, there is nothing wrong with the Company's position that CIAC and PAA amortization should use the actual amortization rates for each applicable account within the CIAC and PAA groups and not a proxy of composite depreciation rates. He continued by stating, however, that because of CWSNC's past problems, the Public Staff prefers to continue to use the composite depreciation rates. Witness Henry was not able to quantify the significance of the Public Staff's assertion of continuing tap-on fee problems. He also agreed that, in theory, it is true that what can be directly assigned should match the depreciation rates of the Company.

On cross-examination, witness Henry testified that the Public Staff's PAA adjustment in this case amounts to approximately \$38,000, that the Public Staff's CIAC adjustment is approximately \$296,000, and that the two adjustments total approximately \$334,000. He further testified that the total adjustment is "significant," but added that it is also "appropriate." Witness Henry agreed that these two adjustments reduce the Company's revenue requirement in this case by approximately \$334,000 per year; and that, under the Public Staff's position, CWSNC would not collect that amount of revenue each year that the new rates set in this proceeding remain in effect; and that the Company would never be allowed to recover such disallowed revenue.

CWSNC witness DeStefano disagreed with witness Henry's calculation of the annual amortization expenses for CIAC and PAA utilizing the composite depreciation rate for the Company's direct plant in service. Witness DeStefano testified that the Company believes CIAC and PAA amortization should use the actual amortization rates for each applicable account within the CIAC and PAA groups, and not the proxy of the composite depreciation rate for plant in service. He further testified that the Public Staff's calculation

presumes the mix of asset account values in plant in service, CIAC, and PAA are exactly the same, which they are not. Applying the Company's rates, as witness DeStefano proposed, to the actual balances at June 30, 2018, produce composite CIAC rates of 2.49%, 2.04%, 2.50%, and 2.06% for CWSNC Water, CWSNC Sewer, Bradfield Farms/Fairfield Harbor/Treasure Cove Water, and Bradfield Farms/Fairfield Harbor Sewer, respectively. For PAA, witness DeStefano testified that CWSNC's actual water rate of 2.47% and actual sewer rate of 3.53% should be utilized. Witness DeStefano explained that the Company's actual CIAC and PAA composite rates differ from the composite depreciation rate for plant in service due to a varying asset mix, therefore, he recommended that the aforementioned rates were the more reasonable and supportable calculation for use in this proceeding.

In response to questions from Chairman Finley, witness DeStefano testified that the Company's rebuttal request is that, to the extent there is a one-to-one match between the utility plant account and the CIAC account, the Commission should use the same rate for a particular account's balance, and not just the composite rate for the entire CIAC balance, because the mix of assets is different between plant in service accounts and CIAC accounts. Witness DeStefano further stated that he did not believe that the Public Staff disputed the accuracy of the rates proposed by the Company. Witness DeStefano also acknowledged the existence of certain CIAC accounts that are called "tap fee, reconnect fee, things like that" which probably do not have an equivalent plant account. However, witness DeStefano stated that this lack of equivalency should not preclude the other CIAC balances' amortizations from being calculated based on their one-to-one matches. Witness DeStefano stated that the Company would be amenable to using the composite depreciation rate for tap-fees as a proxy if that is necessary, but not for the entire CIAC balance, just for the accounts that do not have one-to-one matches.

In response to further questions from Chairman Finley, witness DeStefano testified that he disagreed with the Public Staff's position that it is proper to use the composite depreciation rate applied to the Company's total CIAC balance, for the reason that the asset mixes are different, so the composite rates would be different. Witness DeStefano also agreed that the Company's recommendation is more refined than the Public Staff's general recommendation. He stated that the proper utility accounting is to match on the books the CIAC amortization, which is the credit on the income statement, and the depreciation expense, which is a debit on the income statement, so that there is no net benefit or detriment to the Company from contributed property.

In response to questions from Commissioner Brown-Bland, witness DeStefano again emphasized the Company's position that the proper accounting is to match CIAC amortization with the applicable utility plant assets. He stated that, with respect to depreciation and amortization expense, the Company should neither be punished nor benefit from for having received contributed property, which is proper accounting. Witness DeStefano stated that the Public Staff's methodology does not match what the Company is doing on its books; i.e., proper accounting. When asked if the methodology proposed by the Public Staff, which was stated to have been used consistently over many rate cases, would, over time, balance out both ways, witness DeStefano responded that he

did not believe that it will balance out to the extent that the Company's recovery through rates and the entries on its books will not be in sync.

The Commission observes that in the Sub 356 Proceeding, as stated in Paragraph 13 of the Joint Stipulation, there was a difference of opinion between CWSNC and the Public Staff concerning the methodology used to calculate CIAC amortization expense and CIAC accumulated amortization. In that proceeding, CWSNC accepted the Public Staff's adjustment but "reserve[d] the right to request and advocate for a change in methodology in a future general rate case". The Public Staff did not dispute or oppose the Company's right to seek a change in methodology in a subsequent rate case.

In the present proceeding, CWSNC's NCUC Form W-1, Item 10, Schedules B-22 and B-23, demonstrate that CWSNC has proposed utilizing per book amounts for CIAC amortization expense and PAA amortization expense with no pro forma adjustments. In his rebuttal testimony, CWSNC witness DeStefano proposed to utilize the composite CIAC rates of 2.49%, 2.04%, 2.50%, and 2.06% for Uniform Water, Uniform Sewer, Bradfield Farms/Fairfield Harbour/Treasure Cove Water, and Bradfield Farms/Fairfield Harbour Sewer, respectively. According to witness DeStefano, these composite CIAC rates are based upon the actual amortization rates for each applicable account within the CIAC group rather than utilizing the composite depreciation rates for plant in service as recommended by the Public Staff. For the calculation of PAA amortization expense, witness DeStefano recommended using the actual water rate of 2.47% and the actual sewer rate of 3.53% rather than the composite depreciation rates recommended by the Public Staff.

The Commission acknowledges that the Public Staff calculated an annual level of amortization expense for each amortization expense, CIAC and PAA, based on the recommended level of each balance multiplied by the composite depreciation rate for the Company's direct plant in service, consistent with the methodology used by the Public Staff in numerous past general rate case proceedings. However, the Commission determines that the basis of the Public Staff's historical use of the composite depreciation rate is undermined in this proceeding by witness Henry's testimony that the problems associated with errors affecting recordation of CIAC and PAA, which existed in the past with CWSNC, had been resolved. However, based upon the evidence presented in this proceeding, it is unclear whether the correction of these past problems occurred on a going-forward basis or if CWSNC recorded a restatement of historical data on the Company's books and records. Further, the Sub 356 Proceeding was the first general rate case proceeding filed by CWSNC since the merger of the UI entities operating in North Carolina into CWSNC was approved by the Commission on August 17, 2016. The Commission observes that the combined total amount of the Public Staff's adjustment to CIAC amortization expense in that proceeding was higher than in past proceedings, being an increase of \$410,479 per Johnson Exhibit I, Schedules 3(a)–3(d)). The Public Staff's combined total adjustment to PAA amortization expense was a decrease of \$9,459.

Based upon a review of previous general rate case proceedings for the individual pre-merger UI entities, the Commission notes that there have been significant

adjustments recommended by the Public Staff and approved by the Commission for CIAC and PAA amortization expenses in past Commission Orders. For example, in Docket No. W-778, Sub 91, a stipulated general rate case proceeding for CWS Systems, Inc. (Order issued February 24, 2016), the Public Staff's adjustment to CIAC and PAA amortization expense was an increase of \$138,481 and \$7,093, respectively.<sup>12</sup> Similarly, in Docket No. W-354, Sub 344, a stipulated general rate case proceeding for CWSNC (Order issued December 7, 2015), the Public Staff's adjustment for CIAC and PAA amortization expense was an increase of \$51,290 and \$7,489, respectively. Although these general rate case proceedings were stipulated, the Commission finds it relevant that as a result of the Public Staff's audit of these general rate case application filings, significant adjustments to CIAC and PAA amortization expense were recommended by the Public Staff and approved by the Commission. For these reasons, the Commission determines that in CWSNC's next general rate case proceeding, the methodology used to calculate CIAC and PAA amortization expense should be examined and evaluated in greater detail by CWSNC and the Public Staff and the parties should seek to reach agreement on the proper methodology to use on a going-forward basis for the post-merger CWSNC entity in order to ensure that contributed property is depreciated at the same rate that the related CIAC is amortized. The Commission notes that Company witness DeStefano testified that CWSNC is amenable to using the composite depreciation rate as proposed by the Public Staff with respect to tap fees collected by CWSNC.

In the present rate case proceeding, the Public Staff has recommended a total increase to CIAC and PAA amortization expense of \$295,811 and \$38,144, respectively. In light of the significant increases to the Public Staff's adjustment to CIAC and PAA amortization expense in the Sub 356 Proceeding and in the present proceeding, the Commission determines that use of the Public Staff's past methodology may have overstated its recommended adjustments for the post-merger CWSNC entity, particularly since Public Staff witness Henry testified on cross-examination that the problems associated with errors affecting recordation of CIAC and PAA, which existed in the past with CWSNC, had been solved by the Company. Consequently, for purposes of this proceeding, the Commission finds that the methodology recommended by witness DeStefano for calculating the adjustment to CIAC and PAA amortization expenses should be adopted.

In reaching this conclusion, the Commission gives significant weight to Public Staff witness Henry's testimony on cross-examination that, in theory, there is nothing wrong with the Company's position that CIAC and PAA amortization should use the actual amortization rates for each applicable account within the CIAC and PAA groups and not a proxy of composite depreciation rates. On cross-examination, witness Henry also agreed that, in theory, it is true that what can be directly assigned should match the depreciation rates of the Company. The Commission determines that this testimony

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<sup>12</sup> CWS Systems, Inc. had erroneously calculated both CIAC amortization expense and PAA amortization expense by applying the amortization percentage to the amount of CIAC and PAA, net of accumulated amortization, instead of applying the amortization percentage to the amount of CIAC and PAA before amortization. Part of the Public Staff's total adjustment in that proceeding was the correction of CWS Systems, Inc.'s error.



supports and provides justification for CWSNC's position regarding proper accounting for CIAC and PAA amortization and for the Commission's decision for purposes of this proceeding.

Accordingly, for the reasons set forth above, the Commission finds that an adjustment to increase CIAC and PAA amortization expenses by \$8,073 and \$15,168, respectively, based upon the methodology proposed by CWSNC is reasonable and appropriate for use in this proceeding.

Based on the foregoing, the Commission concludes that the appropriate level of depreciation and amortization expense for use in this proceeding is as follows:

| <b><u>Item</u></b>          | <b><u>Amount</u></b> |
|-----------------------------|----------------------|
| Depreciation expense        | \$5,617,382          |
| Amortization expense – CIAC | (1,488,982)          |
| Amortization expense – PAA  | (54,365)             |
| Amortization of ITC         | (519)                |
| Total                       | <u>\$4,073,516</u>   |

#### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 38 – 42**

The evidence supporting these findings of fact is found in the Application and the accompanying NCUC Form W-1 of CWSNC, and in the testimony of Public Staff witness Henry and of Company witness DeStefano. The following table summarizes the differences between the Company's level of franchise, property, payroll, and other taxes from its Application and the amounts recommended by the Public Staff:

| <b>Item</b>               | <b>Company<br/>Application</b> | <b>Public Staff</b> | <b>Difference</b> |
|---------------------------|--------------------------------|---------------------|-------------------|
| Franchise and other taxes | (\$49,700)                     | (\$49,702)          | (\$2)             |
| Property tax              | 233,280                        | 233,575             | 295               |
| Payroll taxes             | <u>538,817</u>                 | <u>526,275</u>      | <u>(12,542)</u>   |
| Total                     | <u>\$722,397</u>               | <u>\$710,148</u>    | <u>(\$12,249)</u> |

With the Stipulation and revisions made by the Public Staff in its supplemental testimony and Henry Supplemental Exhibit I, the Company does not dispute adjustments recommended by the Public Staff to franchise and other taxes and property taxes. Therefore, the Commission finds that the adjustments recommended by the Public Staff to franchise and other taxes and payroll taxes, which are not contested, are appropriate adjustments to be made to operating revenue deductions in this proceeding.

#### **Payroll Tax**

The difference in the level of payroll taxes is due to the differing levels of salaries and wages recommended by the Company and the Public Staff. Based on the conclusions reached elsewhere in this Order regarding the appropriate levels of salaries

and wages, the Commission concludes that the appropriate level of payroll taxes for use in this proceeding is \$529,195.

### Summary Conclusion

Based on the foregoing, the Commission concludes that the appropriate level of franchise, property, payroll, and property other taxes for use in this proceeding is as follows:

| <u>Item</u>               | <u>Amount</u>    |
|---------------------------|------------------|
| Franchise and other taxes | (\$49,702)       |
| Property tax              | 233,575          |
| Payroll taxes             | <u>529,195</u>   |
| Total                     | <u>\$713,068</u> |

### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 43 – 46**

The evidence supporting these findings of fact is found in the testimony of Public Staff witnesses Boswell and Henry, and of Company witness DeStefano. The following summarizes the differences between the Company's level of regulatory fee and income taxes from its Application and the amounts recommended by the Public Staff:

| <u>Item</u>         | <u>Company Application</u> | <u>Public Staff</u> | <u>Difference</u>  |
|---------------------|----------------------------|---------------------|--------------------|
| Regulatory fee      | \$51,800                   | \$45,606            | (\$6,194)          |
| Deferred income tax | 0                          | (83,555)            | (83,555)           |
| State income tax    | 273,392                    | 189,741             | (83,651)           |
| Federal income tax  | <u>1,856,324</u>           | <u>1,288,340</u>    | <u>(567,984)</u>   |
| Total               | <u>\$2,181,516</u>         | <u>\$1,440,132</u>  | <u>(\$741,384)</u> |

With the Stipulation and revisions made by the Public Staff in its supplemental testimony and Henry Supplemental Exhibit I, and in the testimony of witness Boswell and Boswell Exhibit 1, the Company agreed with the Public Staff adjustment to deferred income tax of \$83,555 to reflect the annual amortization of protected federal EDIT.

### Regulatory Fee

The difference in the level of regulatory fee is due to the differing levels of revenues recommended by the Company and the Public Staff. Based on conclusions reached elsewhere in this Order regarding the levels of revenues, the Commission concludes that the appropriate level of regulatory fee for use in this proceeding is \$45,606.

### State Income Taxes

The difference in the level of state income taxes is due to the differing levels of revenues and expenses recommended by the Company and the Public Staff. Based on the conclusions reached elsewhere in the Order regarding the levels of revenues and expenses, the Commission concludes that the appropriate level of state income taxes for use in this proceeding is \$177,812.

### Federal Income Taxes

The difference in the level of federal income taxes is due to the differing levels of revenues and expenses recommended by the Company and the Public Staff. Based on the conclusions reached elsewhere in the Order regarding the levels of revenues and expenses, the Commission concludes that the appropriate level of federal income taxes for use in this proceeding is \$1,207,341.

### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 47 – 51**

The evidence supporting these findings of fact is found in the Application and the accompanying NCUC Form W-1, in the testimony of CWSNC witness DeStefano and of Public Staff witnesses Henry and Boswell, and in the Stipulation.

CWSNC witness DeStefano noted in his direct testimony that on December 22, 2017, President Trump signed into law the Tax Act. Witness DeStefano stated that the most impactful component of the Tax Act to CWSNC was the reduction in the federal corporate income tax rate from 35% to 21%. Witness DeStefano maintained that this component not only impacts the current tax rate for corporations but also impacts the deferred income taxes recorded on the Company's books prior to the Tax Act. Witness DeStefano also noted that the second significant component of the Tax Act is the fact that contributed plant is now treated as a form of income and subject to the federal corporate income tax rate.

Witness DeStefano provided details on how the Company has proposed to implement and address the Tax Act in this proceeding. Witness DeStefano noted that CWSNC has reflected the new federal corporate income tax rate of 21% in its calculation of its proposed revenue requirement as reflected in its Application for a rate increase.

Witness DeStefano further testified that due to the fact that the Tax Act was a singular event occurring outside of the Company's historic test period, it should not be treated as a stand-alone event since many changes occur over the course of time. Witness DeStefano asserted that for that reason, CWSNC recommends that the Tax Act not automatically trigger a refund to customers of revenues collected from January 1, 2018, until a final order is received in this proceeding (a period of time CWSNC identified as the Review Period).

Witness DeStefano asserted that, instead, the Commission should consider all items within the Company's revenue requirement, as it is doing in this rate case, and, if the actual return earned by CWSNC during the Review Period exceeds the authorized return considering the new 21% federal corporate income tax rate, then, and only at that point, should the Commission order CWSNC to refund the revenues collected since January 1, 2018 based on the 35% federal corporate income tax rate. Witness DeStefano testified that should a refund be required, CWSNC suggests that such refund be instituted as a negative surcharge to the customers' bills over a 12-month period.

Witness DeStefano also described the impact of the Tax Act on the deferred income taxes on the Company's books. Witness DeStefano stated that prior to January 1, 2018, deferred taxes were recorded on the Company's books at the federal corporate income tax rate of 35% to normalize the impact of future tax liability or benefit. Witness DeStefano noted that due to the reduction in the corporate income tax rate to 21% on January 1, 2018, the tax liability is expected to be paid back at the new lower federal corporate income tax rate. Witness DeStefano maintained that because of the lower corporate income tax rate, the deferred taxes have been adjusted on the books as of December 31, 2017.

Witness DeStefano stated that CWSNC is proposing the following treatment for the EDIT. Witness DeStefano maintained that for EDIT protected under the IRS normalization rules, CWSNC proposes to apply the flow back in accordance with those rules. Witness DeStefano testified that for EDIT not protected by normalization rules, but related to property, plant, and equipment (PP&E), the Company proposes flow back over a 20-year period. During the evidentiary hearing, Company witness DeStefano clarified the Company's proposal, stating the Company did not have any EDIT related to PP&E. Finally, witness DeStefano stated that for EDIT not protected by normalization rules nor related to PP&E, CWSNC proposes flow back over a five year period.

The Public Staff noted in its proposed order that on December 22, 2017, the Tax Act was signed into law. The Public Staff stated that, among other provisions, the Tax Act reduced the federal corporate income tax rate from 35% to 21%, effective January 1, 2018<sup>13</sup>, and it also repealed the manufacturing tax deduction and eliminated bonus depreciation.

The Public Staff stated that the reduction in the corporate income tax rate in the Tax Act also results in federal EDIT for utilities. The Public Staff explained that EDIT arise from the impact of tax changes on ADIT. The Public Staff explained that ADIT occur because of timing differences between when a utility collects income taxes from ratepayers and when those taxes are paid to the IRS. The Public Staff noted that one of

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<sup>13</sup> The Public Staff noted that in response to the enactment of the Tax Act, on January 3, 2018, the Commission opened a generic rulemaking docket (Docket No. M-100, Sub 148, i.e., the Tax Docket) for the purpose of determining how the Commission should proceed. The Public Staff stated that in the order establishing the Tax Docket, the Commission placed all public utilities on notice that the federal corporate income tax expense component of all existing rates and charges, effective January 1, 2018, would be billed and collected on a provisional rate basis.

the major types of ADIT arises from differing annual depreciation rates applied to the cost of assets purchased by a utility or other business. The Public Staff maintained that under generally accepted accounting principles and, in many cases, under the regulatory accounting principles followed by the Commission, a utility business is allowed to record on its books an annual depreciation expense representing the allocation of the cost of an item of property between its acquisition and the end of its useful life, and determine its annual income tax expense recovered from its ratepayers on that basis. The Public Staff stated that the depreciation expense is in most cases determined by the straight line method; that is, evenly over each year of the property item's life. The Public Staff maintained that, in contrast, the IRC allows accelerated depreciation for purposes of annual income tax determination: the business may deduct from its income, on its tax returns, a larger proportion of the property's value in the initial years of its life and a smaller percentage in the later years. The Public Staff commented that all other things being equal, for example, the tax basis and book basis of the asset, the total depreciation expense over the life of the asset will be the same for ratemaking and income tax purposes.

The Public Staff noted that for accounting and ratemaking purposes, the temporary tax savings that a utility obtains by using accelerated rather than straight-line depreciation for income tax purposes is treated as a deferred tax liability. The Public Staff stated that the total amount of taxes a utility has been able to defer, at any given time, is classified as ADIT. The Public Staff maintained that ADIT is treated as cost-free capital and is deducted from rate base because the source of the funds that have not yet been paid to the IRS or another taxing authority is the ratepayer. The Public Staff asserted that if the income tax rate remains constant, the increased taxes a utility pays in the later years of a property item's life will be equal to the tax benefit of accelerated depreciation received by the utility in the earlier years but not flowed through to the ratepayers in the earlier years; and, if the time value of money is disregarded, the total taxes the utility pays with respect to that property item will not be increased or reduced by the use of accelerated depreciation.

The Public Staff commented that when the federal corporate income tax rate is reduced, as it was in the Tax Act, a portion of the federal ADIT that the utility has accumulated from the ratepayers will never be needed by the utility for the payment of taxes. The Public Staff stated that this portion is classified as federal EDIT. The Public Staff noted that the IRC requires that certain federal EDIT must be normalized, or flowed back, subject to certain limitations and that federal EDIT that is subject to this limitation is classified as federal protected EDIT. The Public Staff stated that all other types of federal EDIT are classified as unprotected, in that there are no limitations placed upon them by the IRS with regard to the length of time over which they can be returned to ratepayers.

In her supplemental testimony, Public Staff witness Boswell presented the Public Staff's proposal regarding the flowback of federal and state EDIT, as well as the flowback of the overcollection of taxes since January 1, 2018. She included three adjustments, based on the information provided by the Company. First, witness Boswell recommended the return of federal protected EDIT based upon the Company's calculation of the net

remaining life of the timing differences, as required under the IRC. For federal unprotected EDIT, witness Boswell recommended removing the entire federal EDIT regulatory liability associated with the unprotected differences from rate base, and placing it in a rider to be refunded to ratepayers over three years on a levelized basis, with carrying costs calculated at the overall weighted average cost of capital. Public Staff witness Boswell stated that the immediate removal of federal unprotected EDIT from rate base increases the Company's rate base and mitigates regulatory lag that may occur from refunds of federal unprotected EDIT not contemporaneously reflected in rate base. Further, witness Boswell noted that the financing cost to the Company will be imposed ratably over the period that the EDIT is returned through the levelized rider.

Additionally, witness Boswell disagreed with the Company's proposal to offset the federal unprotected EDIT and state EDIT against deferred regulatory assets. Witness Boswell stated that the Public Staff deems that offsetting known and measurable reductions in taxes to be paid going forward against either unknown future regulatory assets, or regulatory assets previously approved by the Commission for recovery over a specified period, presents significant intergenerational issues and constitutes inappropriate ratemaking. Witness Boswell stated that existing deferred regulatory assets are the result of accounting adjustments approved or adopted by the Commission, the purpose of which typically is to spread the recovery of incurred costs over a specified period of time known as the amortization period. Witness Boswell maintained that the amortization period for each regulatory asset is approved by the Commission based upon its determination of what is fair and reasonable for the ratepayers with regard to the costs associated with that specific regulatory asset, or other specific factors taken into consideration by the Commission at the time of that approval. Witness Boswell stated that choosing to simply offset the new unprotected EDIT regulatory liability with the remaining unamortized portion of any regulatory asset would effectively override the Commission's prior decision as to the appropriate amortization period for the regulatory asset, by equalizing the remaining amortization period and the amortization period for the new EDIT regulatory liability. Witness Boswell stated that it is the Public Staff's opinion that the amortization periods for existing regulatory assets and the federal unprotected EDIT should be determined separately, based on the specific characteristics of each cost or benefit. Witness Boswell asserted that departing from this transparent process in the course of a general rate case simply to offset flowing through the benefit of reductions in an entirely separate category of costs (income taxes) is neither fair nor reasonable.

Witness Boswell also maintained that in the case of unknown future possible regulatory assets or other costs, currently offsetting them against the EDIT liability would likewise be inappropriate, not only because those costs are not currently known and actual, but also because doing so would be prejudging the appropriate amortization period for those future costs.

For state EDIT, witness Boswell did not recommend an adjustment in this case, as the Company has been amortizing the applicable regulatory liability over a three-year period as approved in the Sub 356 Proceeding.

Finally, witness Boswell recommended that the Commission require the Company to refund to ratepayers the overcollection of federal taxes related to the decrease in federal tax rates for the period beginning January 1, 2018, including the corresponding interest calculated at the overall weighted cost of capital, as a surcharge credit for a one-year period beginning when the new base rates become effective in the current docket. Witness Boswell noted that the Company did not file a proposal to return the overcollection<sup>14</sup>.

Witness Boswell stated that it is the Public Staff's position that the Commission's October 5, 2018 Order in Docket No. M-100, Sub 148 was explicitly clear that the overcollection of taxes since January 1, 2018 should be flowed back to ratepayers. The Public Staff argued that these funds rightfully belong to the ratepayers and should be returned to them as soon as reasonably possible.

Witness Boswell also disagreed with the Company's proposal to retain the overcollection of taxes since January 1, 2018 if the Company has not earned its approved rate of return during the period. Witness Boswell maintained that the approved rate of return in any general rate case represents the amount the Company has the potential to earn, with proper management. She argued that it does not represent guaranteed dollars or return for the Company. Witness Boswell stated that the actual return earned by a utility fluctuates over time, and may fall below the approved rate of return for significant periods of time. Witness Boswell maintained that, nevertheless, it is ultimately the utility's choice as to when it should file for a general rate increase; otherwise, its rates as they exist at any moment in time are generally presumed to recover its costs. Witness Boswell stated that in this particular case even if the Company had not been recovering its currently approved rate of return during 2018, applying the future Commission-mandated refund of overcollected income taxes against that past return deficiency would, in principle, constitute inappropriate retroactive ratemaking. Witness Boswell stated that the tax overcollection in question was to be used to pay taxes that the Company was expected to owe and that as of January 1, 2018, the overcollected taxes are no longer owed. Witness Boswell maintained that the overcollection is ratepayer money that should not be utilized to assist the Company in attaining its return, and thus benefit its shareholders.

Finally, witness Boswell asserted that the appropriate interest rate to apply to the overcollection should be calculated at the overall weighted cost of capital since the same methodology is utilized to calculate the revenue impacts of the collected taxes. Witness Boswell asserted that utilizing a lower rate would shortchange the ratepayers the full value of the refund.

The Public Staff maintained in its proposed order that the Commission's primary concern regarding the effects of the Tax Act should be to ensure that ratepayers receive the full benefit of the reduction in the federal corporate income tax rate. The Public Staff asserted that rates have been set to ensure that the Company has adequate funds with

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<sup>14</sup> CWSNC witness DeStefano did state in his direct testimony that should a refund of these amounts be required, CWSNC suggested a negative surcharge to the customers' bills over a 12-month period.

which to pay taxes; now that the federal income tax rate is reduced, rates should be adjusted accordingly. The Public Staff stated that the question before the Commission is how, and over what length of time, these effects should be implemented.

The Public Staff argued that the evidence shows that there is some agreement regarding how to implement the effects of the Tax Act. The Public Staff noted that the Company and the Public Staff agree upon the revenue requirement effect of the decrease in the corporate income tax rate; additionally, no party disputes the amounts presented by the Company regarding the impact of the Tax Act on these issues. The Public Staff recommended that the Commission find that the revenue requirement changes presented by the Company related to these issues are appropriate and should be approved.

The Public Staff noted that, additionally, the Company and the Public Staff agree, and no party disputes, that federal protected EDIT, which is subject to tax normalization rules, should not be returned to ratepayers any faster than allowed under the IRS rules. Therefore, the Public Staff recommended that the Commission find that it is appropriate for the Company to return federal protected EDIT in the amount, and over the time period, recommended by the Company and the Public Staff.

The Public Staff stated that the evidence shows there is not agreement as to how CWSNC should return to ratepayers the federal unprotected EDIT. The Public Staff noted that CWSNC proposed several solutions for handling the federal unprotected EDIT. The Public Staff maintained that in direct testimony, CWSNC proposed to amortize the balance over a five-year period. The Public Staff also noted that in rebuttal testimony, CWSNC proposed to utilize the federal unprotected EDIT as an offset against the Company's various unamortized deferred maintenance assets in the current proceeding. The Public Staff disagreed with the Company's rebuttal proposal, and proposed refunding the federal unprotected EDIT balance through a levelized rider over a three-year period. The Public Staff further recommended removing the entire federal EDIT balance from rate base in the current case, thus mitigating regulatory lag that may occur from refunds of federal unprotected EDIT not contemporaneously reflected in rate base.

CWSNC amended its Tax Act proposals as outlined in the rebuttal testimony of CWSNC witness DeStefano. Witness DeStefano reiterated that CWSNC has adjusted the federal corporate income tax rate to 21% in its Application. He also asserted that due to the fact that the Tax Act was a singular event occurring outside of the Company's historic test period, the Company contends that it should not be treated as a stand-alone event since many changes occur over the course of time. Witness DeStefano argued that for that reason, CWSNC contends that the Tax Act should not automatically trigger a refund to customers of revenues collected from January 1, 2018, until a final order is issued by the Commission in this proceeding.

Witness DeStefano testified that the Commission should carefully and thoroughly consider all items within the Company's revenue requirement and that indeed is precisely what is occurring in the current proceeding. Witness DeStefano maintained that the Company has updated its original test year of December 31, 2017 with actual data as of



June 30, 2018, which is approximately the midpoint between the Tax Act taking effect and the date the current rate case will likely become effective and reflects a fair representation of the Company's financial status in the Review Period. Witness DeStefano asserted that if the proper revenue requirement as determined by the Commission in this rate case meets or exceeds that of the Company's last rate case, excluding effects of the Tax Act beyond the change in the income tax rate to 21%, such as amortization of EDIT, it will therefore strengthen the claim that the Company did not exceed its authorized return. Consequently, witness DeStefano testified, the Company concludes that it is in a unique position relative to other North Carolina utilities, as the comprehensive financial review in this proceeding would directly support the retention of the Review Period funds by the Company to sustain its just-vetted operating needs. However, witness DeStefano maintained that should a refund be required by the Commission in this rate case, the Company recommends that the credit be offset by the Company's existing deferred asset balances.

Witness DeStefano also noted that the Company has provided supporting workpapers for the federal protected EDIT balance and requests a 45-year amortization of this balance using the Reverse South Georgia method, inclusive of gross up, in accordance with IRS normalization rules.

Witness DeStefano further noted that the Company was authorized in its last rate case to amortize state EDIT realized due to the recent North Carolina corporate income tax rate changes. Witness DeStefano testified that CWSNC proposes combining the remaining state EDIT with the federal unprotected EDIT and offsetting the balance against the Company's various unamortized deferred maintenance assets in this proceeding. Witness DeStefano maintained that the particular deferred assets to be utilized in this calculation are shown in the testimony of Public Staff witness Henry, Exhibit I, Schedule 2-10(a), and are comprised of tank painting, wastewater treatment plant painting, and wastewater pumping and hauling costs. Witness DeStefano argued that CWSNC contends, and the Public Staff's testimony confirms, that there are sufficient deferred assets to offset the combined EDIT credit balance, with a focus on those asset balances closest to conclusion of their amortization period in order to best align this proposal with the Public Staff proposal of a three-year amortization period.

Witness DeStefano testified that this proposal would smooth customer impacts by netting balances due-to and due-from customers immediately, as opposed to initiating offsetting customer rates (recovery in base rates of deferred asset rate base and amortization, versus an EDIT credit rider) with different effective periods, which would result in uneven customer impact over the next several years and mask price signals otherwise considered in rate design, or in other words, a yo-yoing of rates. Witness DeStefano argued that it will also mitigate cash flow concerns for the Company, as the lower tax rate going forward will lead to slower growth in the ADIT balance, which is a source of cash used for continued capital investment. Witness DeStefano argued that limiting interest payments required on refunds will also mitigate negative cash flow impacts. He stated that it will also avoid for both the Company and the Public Staff the additional effort of implementing a new rider, tracking the balances, and potentially

manually calculating interest. Witness DeStefano maintained that a similar proposal was recently accepted by the Regulatory Commission of Alaska (RCA) in Docket U-18-042, Order No. 2.

Witness DeStefano stated that if the Commission does not adopt the Company's proposal as outlined in his rebuttal testimony of offsetting deferred assets against the unprotected EDIT, the Company alternatively reiterates its position articulated in the direct testimony presented by witness DeStefano, with a five-year amortization of unprotected non-PP&E EDIT.

Finally, witness DeStefano testified that, should a sur-credit be implemented for revenues recorded in the Review Period, the Company proposes to offset this credit balance with the unamortized deferred assets approved in this proceeding until the deferred assets are exhausted before implementing a sur-credit. Witness DeStefano maintained that any amount determined to be refunded should be credited to customers over one year, and accrue interest at an appropriate short-term interest rate, especially if refunds commence at or before January 1, 2019. Witness DeStefano argued that using an appropriate short-term interest rate is more reasonable than applying the cost of capital rate due to the funds being returned to customers approximately one year or less since they were billed. Witness DeStefano maintained that the Company proposes that any calculation of Review Period revenues to be refunded should identify the percent revenue reduction due to the decrease in income tax expense for each tariff group. He stated that this percentage would then be multiplied by the actual applicable revenues booked for the Review Period to determine the level of refund.

Witness DeStefano also noted that the Commission issued an Order on October 5, 2018 in Docket No. W-100, Sub 57, which initiated a generic proceeding to review the impacts of the Tax Act on water and wastewater utilities, specifically CIAC, in North Carolina. He noted that comments were due on October 25, 2018. Witness DeStefano stated that CWSNC plans on providing comments in the generic proceeding and will, in the interim, comply with the Commission's requirement that the full gross-up method be utilized, excepting circumstances where the present value method is authorized by the Commission.

The AGO stated in its post-hearing brief that ratepayers should promptly enjoy the benefits of CWSNC's cost savings resulting from recent changes in the federal tax law. The AGO asserted that recent reductions in federal and state corporate income tax rates result in lower operating expenses for utilities, with a favorable impact on the cost of public utility service, and produce an excess accumulation of funds for deferred income taxes that may be returned to ratepayers. The AGO noted that the Commission determined in a recent order in a generic proceeding that the issue of how to reflect the changes in federal tax rates in new utility rates would be determined for CWSNC in this general rate case proceeding. See Order Addressing the Impacts of the Federal Tax Cuts and Jobs Act on Public Utilities in Docket No. M-100, Sub 148 issued on October 5, 2018 at p. 58. The AGO stated that it supports rate adjustments to flow through the benefits of tax changes to ratepayers as soon as possible.

The AGO noted that the change in the federal corporate income tax rate results in five impacts: (1) the federal corporate income tax rate reduction from 35% to 21% is reflected in the Company's proposed operating expenses; (2) the Company proposes not to return the amount of tax expense that was overcollected in rates from January 1, 2018 until new rates take effect; (3) the Company proposes that the return of EDIT associated with the recent reductions in the state corporate income tax rate decided in the Company's last general rate case proceeding be modified in this case and treated similarly to the Company's proposal for federal unprotected EDIT; (4) the Company proposes to use the federal unprotected EDIT as an offset to existing deferred asset balances, instead of returning it to ratepayers; and (5) CWSNC proposes to return the federal protected EDIT through rates over the period required by federal tax provisions, which it shows to be a 45-year period.

The AGO stated that it does not object to the first and fifth impacts noted above, but objects to the second, third, and fourth.

The AGO noted that, first, the federal corporate income tax rate reduction from 35% to 21% is reflected in the Company's proposed operating expenses and that this proposed impact is not disputed.

Second, the AGO maintained that the Company proposes not to return the amount of tax expense that was overcollected in rates from January 1, 2018 until new rates take effect. The AGO stated that that amount has been booked as a regulatory liability as required by the Commission's January 3, 2018 Order in Docket No. M-100, Sub 148 and will amount to approximately \$1.26 million for the calendar year. The AGO noted that if not allowed to keep the amount, CWSNC asks the Commission to allow the amount to be used as an offset by the Company to existing deferred asset balances.

The AGO asserted that CWSNC's argument that it should be allowed to keep the provisional amount that was collected since January 1, 2018 lacks merit. The AGO noted that the Commission considered arguments in its October 5, 2018 Order in Docket No. M-100, Sub 148, and concluded on page 55 that it is "appropriate to require an immediate reduction in the base rates (for the expense piece) of affected utilities to reflect the 21% federal corporate income tax rate mandated by the Tax Act, effective January 1, 2018." The AGO further noted that the Commission explained on pages 55 and 56 of the Order that "the federal corporate income tax rate reduction mandated by the Tax Act is material and substantial," and concluded that "ratepayers should not be forced to continue paying base rates that were set to recover a 35% federal corporate income tax rate that has been reduced to 21% until the utility's next general rate case proceeding."

The AGO argued that there is no justification for allowing CWSNC to retain the provisional amount collected after the federal corporate income tax rate was reduced on January 1, 2018. The AGO stated that the Public Staff has proposed that the amounts overcollected for taxes since January 1, 2018 be returned to customers in a rider over a

one-year period with carrying costs calculated using the weighted cost of capital approved in this case. The AGO stated that it agrees with the Public Staff's proposal in this regard.

The AGO stated that, third, the appropriate treatment of the state EDIT was addressed in the Company's last general rate case proceeding. The AGO noted that CWSNC proposed in rebuttal testimony in this proceeding that the return of the state EDIT be modified and treated similarly to the Company's proposal for federal unprotected EDIT.

The AGO stated that it does not support such a change and agrees with the recommendation of Public Staff witness Boswell that no adjustment be made to the provision for return of state EDIT from what was proposed and approved in the Company's prior rate case proceeding. The AGO asserted that the Company's vague proposal would offset the state EDIT against either unknown future regulatory assets or known regulatory assets that have been reviewed and approved with particular treatment in previous cases and that it is not appropriate to override such prior determinations or to set aside ratepayer funds for possible future uses.

The AGO noted that, fourth, the Company's initial proposal was to return federal unprotected EDIT to ratepayers over a five-year period. The AGO stated that, however, in rebuttal testimony the Company proposed instead that the money be used as an offset to existing deferred asset balances.

The AGO noted that it recommended a return of the federal unprotected EDIT over a period of two years or less in the recent Duke Energy Carolinas rate case in Docket No. E-7, Sub 1146, so that ratepayers benefit as soon as possible from the amounts they are owed. The AGO asserted that, likewise, in this proceeding, the AGO recommends a two-year period. The AGO stated that the Public Staff's proposal in this case would return the federal unprotected EDIT over a three-year period, as was done under the settlement reached between the Public Staff and Aqua North Carolina in the recent Aqua North Carolina rate case proceeding (Docket No. W-218, Sub 497). The AGO noted that Public Staff witness Boswell testified that although the Public Staff has proposed a three-year period in this proceeding, a two-year time frame is feasible and is within the range that the Public Staff has proposed in other cases. The AGO also noted that the time frame has not been specified in the Stipulation in this case and that the AGO supports a return of the federal unprotected EDIT as soon as possible, but in no event longer than two years. The AGO asserted that with the adoption of a two-year timeframe to return the federal unprotected EDIT, ratepayers will benefit immediately from the use of the amounts they are owed.

The AGO maintained that CWSNC's proposal not to return federal unprotected EDIT to ratepayers and instead to apply the EDIT to unspecified asset balances should be denied because it is unjust and unreasonable. The AGO asserted that it is inappropriate to override prior determinations about the amortization of regulatory assets. The AGO noted that, further, CWSNC has not shown that any harm will fall to the Company by the prompt return of the funds. The AGO maintained that it is time for CWSNC to stop relying on excess revenues from its customers to maintain the overly

flush cash flow that was provided under former tax deferral policies. The AGO asserted that the alternative of not returning dollars to consumers who struggle to pay their bills, or to consumers who would use their money for different purposes if given the opportunity, results in an undue burden on ratepayers and communities in North Carolina.

The AGO stated that, fifth, CWSNC proposes to return the federal protected EDIT associated with the reduction in the federal corporate income tax rate through rates over the period of time required by federal tax provisions, which the Company shows to be a 45-year period. The AGO noted that the Public Staff does not dispute the 45-year time frame based on its investigation and that the Public Staff explained that federal tax provisions do not permit regulators to flow back the EDIT immediately and instead require a flow back that is ratable over the life of the timing differences that gave rise to the excess. The AGO stated that based on the federal requirements and the Public Staff's investigation, the AGO does not object to this proposal.

After reviewing the entire record, the Commission notes that there are five separate issues that need to be addressed for CWSNC in this proceeding concerning the Tax Act. Further, as concluded by the Commission on page 58 of its October 5, 2018 Order in Docket No. M-100, Sub 148, the Commission will address these impacts of the Tax Act on CWSNC in this rate case proceeding.

Based upon the foregoing, and after careful consideration of all of the evidence in this proceeding, the Commission reaches the following findings regarding the issues related to the Tax Act for CWSNC in this proceeding:

1. It is appropriate in this proceeding to reflect the reduction in the federal corporate income tax rate from 35% to 21% on the Company's ongoing federal income tax expense.
2. It is appropriate in this proceeding to amortize CWSNC's federal protected EDIT over 45 years in accordance with the IRC.
3. It is appropriate in this proceeding to implement a four-year levelized rider for the return of federal unprotected EDIT to ratepayers.
4. It is appropriate in this proceeding to maintain the decision reached by the Commission in CWSNC's last general rate case proceeding to amortize over three years the Company's state EDIT recorded pursuant to the Commission's Sub 138 Order.
5. It is appropriate in this proceeding to adopt the Public Staff's recommendation that CWSNC should refund to ratepayers the overcollection of federal income taxes related to the decrease in the federal corporate income tax rate for the period beginning January 1, 2018, including interest at the overall weighted cost of capital, as a credit for a one-year period.

**Federal Income Tax Expense** - First, the Commission notes that the Company reflected the use of the 21% federal corporate income tax rate in calculating its proposed revenue requirement as filed in its Application. No party has disputed reflecting the 21% rate in this proceeding, and the Commission finds that it is appropriate to calculate CWSNC's revenue requirement in this proceeding using the current 21% federal corporate income tax rate.

**Federal Protected EDIT** - Second, the Commission notes that the Public Staff and CWSNC agreed in the Stipulation on the appropriate treatment for the Company's federal protected EDIT. Specifically, Section III, Paragraph G of the Stipulation states as follows:

The Stipulating Parties agree that the protected EDIT will be flowed back over a 45-year period using the Reverse South Georgia method, in accordance with tax normalization rules required by IRC Section 203(e).

As shown on Public Staff witness Boswell Exhibit 1, CWSNC has a regulatory liability of \$4,907,523 for federal protected EDIT.

No party disputed this treatment for CWSNC's federal protected EDIT. Therefore, the Commission finds it appropriate to approve this treatment for CWSNC's federal protected EDIT.

**Federal Unprotected EDIT** – CWSNC's proposed treatment for its federal unprotected EDIT changed during the course of this proceeding. In direct testimony, the Company recommended that EDIT not protected by normalization rules, but related to PP&E be flowed back over a 20-year period and that EDIT not related to PP&E be flowed back over a five-year period. CWSNC witness DeStefano confirmed during cross-examination by the AGO that the Company does not have any PP&E-related federal unprotected EDIT and has approximately \$1 million in non-PP&E federal unprotected EDIT.<sup>15</sup> However, in rebuttal testimony, CWSNC recommended that the federal unprotected EDIT be offset against deferred assets, but that if that proposal is not adopted by the Commission that the federal unprotected EDIT be returned with a five-year amortization period.

On cross-examination by the Public Staff, witness DeStefano agreed that the deferred maintenance assets he referenced in his rebuttal testimony to be used as offsets were already decided and approved in a prior CWSNC rate case. He stated that the balances and the amortization periods were set in a prior case and that CWSNC is proposing to change that in order to smooth out the impacts of the Tax Act. Witness DeStefano maintained that it appears to the Company to be a unique offset situation that could be utilized to smooth out the impact to customers for cost spread to future years. He also stated that he is not aware of a situation wherein the North Carolina Utilities Commission has approved such offsetting treatment.

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<sup>15</sup> Public Staff witness Boswell Exhibit 2 shows \$966,595 in federal unprotected EDIT.

Both the Public Staff and the AGO recommended that the Commission not approve CWSNC's offsetting proposal.

Based upon the record of evidence, the Commission finds that CWSNC's federal unprotected EDIT should be returned to ratepayers through a levelized rider.<sup>16</sup> The Commission finds that this treatment appropriately balances the interests of ratepayers and the Company.

In arriving at its conclusion, the Commission gives substantial weight to the testimony of Public Staff witness Boswell. The Commission agrees with witness Boswell that offsetting known and measurable reductions in taxes to be paid going forward against either unknown future regulatory assets, or regulatory assets previously approved by the Commission for recovery over a specified period, presents significant intergenerational issues and constitutes inappropriate ratemaking. The Commission further agrees with witness Boswell that the amortization period for each regulatory asset is approved by the Commission based upon its determination of what is fair and reasonable for the ratepayers with regard to the costs associated with that specific regulatory asset, or other specific factors taken into consideration by the Commission at the time of that approval. The Commission finds that choosing to simply offset the new unprotected EDIT regulatory liability with the remaining unamortized portion of any regulatory asset would effectively override the Commission's prior decision as to the appropriate amortization period for the regulatory asset, by equalizing the remaining amortization period and the amortization period for the new EDIT regulatory liability. And as CWSNC witness DeStefano testified, he is not aware of a situation wherein the Commission has approved such offsetting treatment.

The Commission further agrees with witness Boswell that the amortization periods for existing regulatory assets and the federal unprotected EDIT should be determined separately, based on the specific characteristics of each cost or benefit. The Commission agrees with witness Boswell that departing from this transparent process in the course of a general rate case simply to offset flowing through the benefit of reductions in an entirely separate category of costs (income taxes) is neither fair nor reasonable. Further, the Commission notes that for customers, a rider will be separately identified on their bills so they can see in dollars and cents the impact of the federal unprotected EDIT flow through. This transparency would not occur with the offsetting proposed by the Company.

Through the years the Commission has set rates at a level to ensure that the Company would be able to pay its taxes, including deferred taxes, when they became due.<sup>17</sup> These funds were paid by ratepayers to the Company to enable the Company to pay its taxes; now that the funds are no longer needed to pay the Company's taxes, they

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<sup>16</sup> The Commission notes that the calculation of the rider should reflect the return on equity approved by the Commission herein.

<sup>17</sup> The Commission notes that the last reduction in the corporate income tax rate occurred in 1986. The evidence in the record shows that the Company in that instance did not propose to create two separate classifications of federal unprotected EDIT, but simply refunded all of its federal unprotected EDIT through amortization over a five-year period.

should be flowed back to ratepayers as quickly as practicable. The fact that the Company has made use of these funds as cost-free capital does not change the fact that these funds are ultimately customer money that is no longer needed for tax payments. The only remaining question for the Commission to decide is what is a reasonable period of time to refund these federal unprotected EDIT to ratepayers.

The Commission has carefully considered the evidence as to the appropriate time period over which to return federal unprotected EDIT. The evidence shows that all of the parties agree that the timeframe should be within a two-year to five-year range. Specifically, the Public Staff recommends three years, the AGO recommends two years, and the Company, if its offsetting proposal is not adopted, recommends five years. The Company no longer needs these funds to pay its taxes, which is why they were collected from ratepayers in the first place. Therefore, based on the evidence in this case, the Commission finds that it is appropriate in this case to return federal unprotected EDIT over a four-year period through a levelized rider. The Commission finds that this decision appropriately balances the interests of ratepayers and the Company. By removing the total amount of the federal unprotected EDIT credit from rate base in the current case, the Company will be provided with an increase in rates to moderate any cash flow issues, to the extent they would exist. Further, the Commission finds that requiring the flowback over four years provides the Company with additional time to return the money and is the appropriate timeframe to balance both the Company's and the ratepayer's interests.

**State EDIT** - Additionally, the Commission does not find it appropriate to adopt witness DeStefano's proposal to utilize the state EDIT to offset various unamortized deferred maintenance assets in the current proceeding. The Commission has previously approved the amortization of state EDIT in the Sub 356 proceeding, and does not find any of the evidence presented in this proceeding persuasive to change the decision reached by the Commission in that docket.

In arriving at its conclusion, the Commission gives substantial weight to the testimony of witness Boswell. The Commission agrees with witness Boswell that CWSNC's proposal to offset the state EDIT against deferred regulatory assets presents significant intergenerational issues and constitutes inappropriate ratemaking. The Commission also agrees with the Public Staff and the AGO that there is no compelling reason to change the amortization of the state EDIT in this proceeding.

Therefore, the Commission finds that the state EDIT regulatory liability should continue to be amortized over a three-year period as approved in the Sub 356 Order.

**Provisional Amount** – Finally, the Commission finds that it is appropriate to require CWSNC to return the overcollection of federal taxes related to the decrease in the federal corporate income tax rate, including interest calculated at the overall weighted cost of capital, as a credit over a one-year period beginning when new base rates become effective. The rates with respect to the federal income tax expense have been provisional based on the Commission's generic order, so retroactive ratemaking is not at issue.



The Commission notes that CWSNC witness DeStefano specified during cross-examination by the AGO that the Company will have approximately \$1.26 million in provisional revenues for the 2018 calendar year. In reaching its conclusion on this issue, the Commission notes that in its generic order issued in Docket No. M-100, Sub 148 on January 3, 2018, the Commission ordered all utility rates based on the federal corporate income tax rate of 35% rather than the Congressionally approved 21%, effective January 1, 2018, to be provisional and required accompanying deferred accounting for the amount of reduced rates. This meant that the Commission in subsequent orders could require refunds of revenues collected after January 1, 2018 to return to customers the portion of rates providing revenues to cover federal income tax expense greater than 21%. The North Carolina Supreme Court in State ex rel. Utilities Com. v. Nantahala Power & Light Co., 326 N.C. 190, 388 S.E.2d 118, 1990 N.C. LEXIS 12, 110 P.U.R.4th 250, ruled that this procedure in a generic rulemaking case is appropriate with respect to a similar federal income tax reduction with respect to the Tax Reform Act of 1986. The Court rejected challenges to the Commission's order requiring generic rate reductions as constituting single-issue rate adjustments. The Court held, however, that should utilities wish to demonstrate that their overall rate level not be reduced to reflect lower federal income tax expense, the remedy was to file a general rate case.

In this case, CWSNC has filed a general rate case, and the cost of service evidence justifies a rate increase, thus offsetting the reduction in cost of service from the tax rate decrease with increases elsewhere.

CWSNC nevertheless wishes to retain the overcollected, provisional revenues from January 1, 2018 to October 16, 2018. CWSNC's theory is that it failed to recover its overall cost of service during that period. The Commission determines that the Company's proposed justification to permit CWSNC to retain the revenues at issue is inapposite. The Commission uses the historic test year as adjusted through the end of the hearing to set rates prospectively, effective as of the date of this rate case Order. The reduction in federal income tax expense to 21% is an ongoing reduction in cost of service. To authorize the Company to effectively add a surcharge in rates beginning on January 1, 2018 with respect to this expense item would be no different than authorizing a surcharge for recovery of rates covering a decrease in labor costs during the test year as adjusted.

In addition, on cross-examination by the Public Staff, witness DeStefano noted that an affiliate of CWSNC pointed him to a recent Order by the RCA wherein that Commission declined to make a portion of the revenues received by two water utilities refundable pursuant to the Tax Act. The Commission gives little weight to witness DeStefano's testimony concerning the August 28, 2018 Order by the RCA. Witness DeStefano agreed during cross-examination that the utilities that were granted the favorable treatment by the RCA are distinguishable from CWSNC's case in this instance. First, the Alaska decision addresses two specific water utilities wherein the RCA opened the dockets and held show cause proceedings to investigate if the rates charged by the two utilities remained just and reasonable given the reduction to the annual revenue requirement caused by the Tax Act. In contrast, in North Carolina, in response to the Tax Act, the

Commission established a generic rulemaking docket (Docket No. M-100, Sub 148) on January 3, 2018, and in the Order establishing the docket, the Commission put the utilities on notice that any revenues collected on and after January 1, 2018, were to be considered provisional pending a final ruling by the Commission. In addition, the two Alaskan utilities had not been in for rate cases since 2014, and both companies are required to file their next rate case by July 1, 2020, if not sooner. Witness DeStefano also stated on cross-examination that he was not aware of any other state besides Alaska to make this decision, although he did not think he had “uncovered every stone” on this issue and that a lot of states are still working through this process. Witness DeStefano also agreed that he is aware of several other states that are ordering their utilities to refund these provisional amounts.

In fact, in North Carolina, the Commission has required other utilities in its October 5, 2018 Order issued in Docket No. M-100, Sub 148 to return the provisional amount collected since January 1, 2018, with interest reflected at each company’s overall weighted cost of capital as approved in the company’s last general rate case proceeding, in each utility’s next general rate case proceeding or in three years, whichever is sooner.

Addressing CWSNC witness DeStefano’s proposal to use a short-term interest rate instead of the overall weighted cost of capital for the provisional amount, the Commission notes that on cross-examination by the Public Staff, witness DeStefano stated that he does not have a proposed short-term interest rate offhand to apply to the provisional amount in question in this proceeding. He specified that the rate could be anything that would reflect the retention of funds for one calendar year or less. Witness DeStefano stated that in this case applying the cost of capital rate seems too high for something that is refunded within a 12-month period from when it was generated. Witness DeStefano specified that the short-term borrowing rate would be less than the overall weighted cost of capital and could be very low, in the 2% range. Both the Public Staff and the AGO disagreed with witness DeStefano on using a short-term interest rate for the provisional amount.

After reviewing the record of evidence on this issue, the Commission finds that the Company’s recommendation that the interest on any refund be calculated using a short-term debt rate is not appropriate or reasonable to ratepayers when the Company earns a return on its rate base, based on the overall weighted cost of capital. In reaching this conclusion, the Commission gives substantial weight to the testimony of the Public Staff’s witness and the arguments of the AGO.

The Commission also notes that it recently required Cardinal Pipeline Company, LLC, to return to ratepayers the provisional amount that it voluntarily decided to return now instead of under the parameters of the October 5, 2018 Order with interest reflected at the company’s overall weighted cost of capital as approved in its last general rate case proceeding (See Docket Nos. G-39, Sub 42 and M-100, Sub 148).

In summary, the Commission finds and concludes that these decisions concerning the Tax Act are appropriate and provide for the full flowback to ratepayers of the effects

of the Tax Act. As noted in Public Staff witness Casselberry's supplemental testimony, many of the public witnesses that testified at the public hearings in New Bern and Charlotte noted the tax reductions due to the Tax Act. The decisions herein address those concerns expressed by the various public witnesses in this proceeding and do provide a full flowback to ratepayers of the decrease in the federal corporate income tax rate resulting from the Tax Act.

## **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 52 – 60**

The evidence supporting these findings of fact and conclusions is found in the Application and the accompanying NCUC Form W-1 of the Company, the testimony and exhibits of the public witnesses, the testimony and exhibits of Company witness D'Ascendis, the testimony and exhibits of Public Staff witness Hinton, and the entire record of this proceeding.

### **Rate of Return on Equity**

In its Application and in the direct testimony of CWSNC witness D'Ascendis, the Company requested approval for its rates to be set using a rate of return on equity in a range of 11.50% to 11.90%. In his rebuttal testimony, witness D'Ascendis reduced his recommended rate of return on equity to a range of 10.80% to 11.20% after updating his analysis and making several changes to the application of his models. For the reasons set forth herein, the Commission finds that a rate of return on equity of 9.75% is just and reasonable.

Rate of return on equity, also referred to as the cost of equity capital, is often one of the most contentious issues to be addressed in a rate case. In the absence of a settlement agreed to by all parties, the Commission must exercise its independent judgment and arrive at its own independent conclusion as to all matters at issue, including the rate of return on equity. See, State ex rel. Utils. Comm'n v. Carolina Utils. Customers Ass'n, 348 N.C. 452, 466, 500 S.E.2d 693, 707 (1998). In order to reach an appropriate independent conclusion regarding the rate of return on equity, the Commission should evaluate the available evidence, particularly that presented by conflicting expert witnesses. State ex rel. Utils. Comm'n v. Cooper, 366 N.C. 484, 491-93, 739 S.E.2d 541, 546-47 (2013) (Cooper I). In this case, the evidence relating to the Company's cost of equity capital was presented by CWSNC witness D'Ascendis and Public Staff witness Hinton. No other rate of return on equity expert evidence was presented by any party.

In addition to its evaluation of the expert evidence, the Commission must also make findings of fact regarding the impact of changing economic conditions on customers when determining the proper rate of return on equity for a public utility. Cooper I, 366 N.C. at 494, 739 S.E.2d at 548. This was a factor newly announced by the Supreme Court in its Cooper I decision and not previously required by the Commission or any appellate courts as an element that must be considered in connection with the Commission's determination of an appropriate rate of return on equity. The Commission's

discussion of the evidence with respect to the findings required by Cooper I is set out in detail in this Order.

Cooper I was the result of the Supreme Court's reversal and remand of the Commission's approval of the agreement regarding the rate of return on equity in a stipulation between the Public Staff and Duke Energy Carolinas, LLC (DEC) in Docket No. E-7, Sub 989. The Commission has had occasion to apply both prongs of Cooper I in subsequent orders, specifically the following:

- Order Granting General Rate Increase, Docket No. E-2, Sub 1023 (May 30, 2013) (2013 DEP Rate Order), which was affirmed by the North Carolina Supreme Court in State ex rel. Utils. Comm'n v. Cooper, 367 N.C. 444, 761 S.E.2d 640 (2014) (Cooper III)<sup>18</sup>;
- Order on Remand, Docket No. E-7, Sub 989 (Oct. 23, 2013) (DEC Remand Order), which was affirmed by the North Carolina Supreme Court in State ex rel. Utils. Comm'n v. Cooper, 367 N.C. 644, 766 S.E.2d 827 (2014) (Cooper IV);
- Order Granting General Rate Increase, Docket No. E-7, Sub 1026 (Sep. 24, 2013) (2013 DEC Rate Order), which was affirmed by the Supreme Court in State ex rel. Utils. Comm'n v. Cooper, 367 N.C. 741, 767 S.E.2d 305 (2015) (Cooper V);
- Order on Remand, Docket No. E-22, Sub 479 (July 23, 2015), which was not appealed to the Supreme Court;
- Order Approving Rate Increase and Cost Deferrals and Revising PJM Regulatory Conditions, Docket No. E-22, Sub 532 (Dec. 22, 2016);
- Order Accepting Stipulation, Deciding Contested Issues and Granting Partial Rate Increase, Docket No. E-2, Sub 1142 (Feb. 23, 2018); and
- Order Accepting Stipulation, Deciding Contested Issues, and Requiring Revenue Reduction, Docket No. E-7, Sub 1146 (June 22, 2018).

In order to give full context to the Commission's decision herein and to elucidate its view of the requirements of the General Statutes as they relate to rate of return on equity, as interpreted by the Supreme Court in Cooper I, the Commission deems it

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<sup>18</sup> An intervening case, State ex rel. Utils. Comm'n v. Cooper, 367 N.C. 430, 758 S.E.2d 635 (2014) (Cooper II), arose from Dominion North Carolina Power's 2012 rate case and resulted in a remand to the Commission, inasmuch as the Commission's Order in that case predated Cooper I.

important to provide in this Order an overview of the general principles governing this subject.

A. Governing Principles in Setting the Rate of Return on Equity

First, there are, as the Commission noted in the 2013 DEP Rate Order, constitutional constraints upon the Commission's rate of return on equity decisions 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 a return on equity, 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" in Bluefield and Hope. Id.

2013 DEP Rate Order, p. 29.

Second, the rate of return on equity is, in fact, a cost. The return that equity investors require represents the cost to the utility of equity capital. In his dissenting opinion in Missouri ex rel. Southwestern Bell Tel. Co. v. Missouri Pub. Serv. Comm'n, 262 U.S. 276 (1923), Justice Brandeis remarked upon the lack of any functional distinction between the rate of return on equity (which he referred to as a "capital charge") and other items ordinarily viewed as business costs, including operating expenses, depreciation, and taxes:

Each is a part of the current cost of supplying the service; and each should be met from current income. When the capital charges are for interest on the floating debt paid at the current rate, this is readily seen. But it is no less true of a legal obligation to pay interest on long-term bonds ... and it is also true of the economic obligation to pay dividends on stock, preferred or common.

Id. at 306 (Brandeis, J. dissenting) (emphasis added). Similarly, the United States Supreme Court observed in Hope, "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 ... [which] include service on the debt and dividends on the stock." Hope at 603.

Leading academic commentators also define rate of return on equity as the cost of equity capital. Professor Charles Phillips, for example, states that “the term ‘cost of capital’ may be defined as the annual percentage that a utility must receive to maintain its credit, to pay a return to the owners of the enterprise, and to ensure the attraction of capital in amounts adequate to meet future needs.” Phillips, Charles F., Jr., The Regulation of Public Utilities (Public Utilities Reports, Inc. 1993), p. 388. Professor Roger Morin approaches the matter from the economist’s viewpoint:

While utilities enjoy varying degrees of monopoly in the sale of public utility services, they must compete with everyone else in the free open market for the input factors of production, whether it be labor, materials, machines, or capital. The prices of these inputs are set in the competitive marketplace by supply and demand, and it is these input prices which are incorporated in the cost of service computation. This is just as true for capital as for any other factor of production. Since utilities must go to the open capital market and sell their securities in competition with every other issuer, there is obviously a market price to pay for the capital they require, for example, the interest on capital debt, or the expected return on equity.

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[T]he cost of capital to the utility is synonymous with the investor’s return, and the cost of capital is the earnings which must be generated by the investment of that capital in order to pay its price, that is, in order to meet the investor’s required rate of return.

Morin, Roger A., Utilities’ Cost of Capital (Public Utilities Reports, Inc. 1984), at pp. 19-21. Professor Morin adds: “The important point is that the prices of debt capital and equity capital are set by supply and demand, and both are influenced by the relationship between the risk and return expected for those securities and the risks expected from the overall menu of available securities.” Id. at 20 (emphasis added).

Changing economic circumstances as they impact CWSNC’s customers may affect those customers’ ability to afford rate increases. For this reason, customer impact weighs heavily in the overall ratemaking process, including, as set out in detail elsewhere in this Order, the Commission’s own decision of an appropriate authorized rate of return on equity. In addition, in the event of a settlement, customer impact no doubt influences the process by which the parties to a rate case decide to settle contested matters and the level of rates achieved by any such settlement.

However, a customer’s ability to afford a rate increase has absolutely no impact upon the supply of or the demand for capital. The economic forces at work in the competitive capital market determine the cost of capital – and, therefore, the utility’s required rate of return on equity. The cost of capital does not go down because some customers may find it more difficult to pay for an increase in water and wastewater prices

as a result of prevailing adverse economic conditions, any more than the cost of capital goes up because some customers may be prospering in better times.

Third, 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. State ex rel. Utils. Comm'n v. Pub. Staff-N. Carolina Utils. Comm'n, 323 N.C. 481, 490, 374 S.E.2d 361, 370 (1988). Further, and echoing the discussion above concerning the fact that rate of return on equity represents the cost of equity capital, the Commission must execute the Supreme Court's command "irrespective of economic conditions in which ratepayers find themselves." (2013 DEP Rate Order, p. 37.) The Commission noted in that Order:

The Commission always places primary emphasis on consumers' ability to pay where economic conditions are difficult. By the same token, it places the same emphasis on consumers' ability to pay when economic conditions are favorable as when the unemployment rate is low. Always there are customers facing difficulty in paying utility bills. The Commission does not grant higher rates of return on equity when the general body of ratepayers is in a better position to pay than at other times, which would seem to be a logical but misguided corollary to the position the Attorney General advocates on this issue.

Id. Indeed, in Cooper I the Supreme Court emphasized "changing economic conditions" and their impact upon customers. Cooper I, at 548.

Fourth, while there is no specific and discrete numerical basis for quantifying the impact of economic conditions on customers, the impact on customers of changing economic conditions is embedded in the rate of return on equity expert witnesses' analyses. The Commission noted this in the 2013 DEP Rate Order: "This impact is essentially inherent in the ranges presented by the return on equity expert witnesses, whose testimony plainly recognized economic conditions – through the use of econometric models – as a factor to be considered in setting rates of return." 2013 DEP Rate Order, p. 38.

Fifth, under long-standing decisions of the North Carolina Supreme Court, the Commission's subjective judgment is a necessary part of determining the authorized rate of return on equity. State ex rel. Utils. Comm'n v. Pub. Staff, 323 N.C. 481, 490, 374 S.E.2d 361, 369 (1988). As the Commission also noted in the 2013 DEP Rate Order:

Indeed, of all the components of a utility's cost of service that must be determined in the ratemaking process, the appropriate [rate of return on equity] is the one requiring the greatest degree of subjective judgment by the Commission. Setting [a return on equity] for regulatory purposes is not simply a mathematical exercise,

despite the quantitative models used by the expert witnesses. As explained in one prominent treatise:

Throughout all of its decisions, the [United States] Supreme Court has formulated no specific rules for determining a fair rate of return, but it has enumerated a number of guidelines. The Court has made it clear that confiscation of property must be avoided, that no one rate can be considered fair at all times and that regulation does not guarantee a fair return. The Court also has consistently stated that a necessary prerequisite for profitable operations is efficient and economical management. Beyond this is a list of several factors the commissions are supposed to consider in making their decisions, but no weights have been assigned.

The relevant economic criteria enunciated by the Court are three: financial integrity, capital attraction and comparable earnings. Stated another way, the rate of return allowed a public utility should be high enough: (1) to maintain the financial integrity of the enterprise, (2) to enable the utility to attract the new capital it needs to serve the public, and (3) to provide a return on common equity that is commensurate with returns on investments in other enterprises of corresponding risk. These three economic criteria are interrelated and have been used widely for many years by regulatory commissions throughout the country in determining the rate of return allowed public utilities.

In reality, the concept of a fair rate of return represents a “zone of reasonableness.” As explained by the Pennsylvania commission:

There is a range of reasonableness within which earnings may properly fluctuate and still be deemed just and reasonable and not excessive or extortionate. It is bounded at one level by investor interest against confiscation and the need for averting any threat to the security for the capital embarked upon the enterprise. At the other level it is bounded by consumer



interest against excessive and unreasonable charges for service.

As long as the allowed return falls within this zone, therefore, it is just and reasonable. . . . It is the task of the commissions to translate these generalizations into quantitative terms.

Charles F. Phillips, Jr., The Regulation of Public Utilities, 3d ed. 1993, pp. 381-82 (Notes omitted.)

2013 DEP Rate Order, pp. 35-36.

Thus, the Commission must exercise its subjective judgment so as to balance two competing rate of return on equity-related factors – the economic conditions facing the Company’s customers and the Company’s need to attract equity financing in order to continue providing safe and reliable service.

The Supreme Court in Cooper V affirmed the 2013 DEC Rate Order, in which this framework was fully articulated. But to the framework we can add additional factors based upon the Supreme Court’s decisions in Cooper III, Cooper IV, and Cooper V. Specifically, the Supreme Court held that nothing in Cooper I requires the Commission to “quantify” the influence of changing economic conditions upon customers (see, e.g., Cooper V, 367 N.C. at 745-46; Cooper IV, 367 N.C. at 650; Cooper III, 367 N.C. at 450), and, indeed, the Supreme Court reiterated that setting the rate of return on equity is a function of the Commission’s subjective judgment: “Given th[e] subjectivity ordinarily inherent in the determination of a proper rate of return on common equity, there are inevitably pertinent factors which are properly taken into account but which cannot be quantified with the kind of specificity here demanded by [the appellant].” Cooper III, 367 N.C. at 450, quoting State ex rel. Utils. Comm’n v. Pub. Staff-North Carolina Utils. Comm’n, 323 NC 481, 490 (1988).

Finally, the Supreme Court discussed with approval the Commission’s reference to and reliance upon expert witness testimony that used econometric models that the Commission had noted “inherently” contained the effects of changing economic circumstances upon customers and also discussed with approval the Commission’s reference to and reliance upon expert witness testimony correlating the North Carolina economy with the national economy. See, e.g., Cooper V, 367 N.C. at 747; Cooper III, 367 N.C. at 451.

It is against this backdrop of overarching principles that the Commission turns to the evidence presented in this case.

## B. Application of the Governing Principles to the Rate of Return Decision

### 1. Evidence from Expert Witnesses on Cost of Equity Capital

Company witness D'Ascendis recommended in his direct testimony a rate of return on equity range of 11.50% to 11.90%. This range was based upon his indicated cost of common equity of 11.50% plus a recommended size adjustment of 0.40%. In his rebuttal testimony, witness D'Ascendis provided an updated analysis including changes in the application of his models and reduced his recommended rate of return on equity to a range of 10.80% to 11.20%.

#### D'Ascendis Direct Testimony

Witness D'Ascendis' recommendation was based upon his Discounted Cash Flow (DCF) model, his Risk Premium Model (RPM), and his Capital Asset Pricing Model (CAPM), applied to market data of a proxy group of six publicly-traded water companies (Utility Proxy Group). He also applied the DCF, RPM, and CAPM to a proxy group of domestic, non-price regulated companies (Non-Price Regulated Proxy Group) which he described as comparable in total risk to his Utility Proxy Group.

The results derived from witness D'Ascendis' analyses in his direct testimony are as follows:

#### Summary of D'Ascendis' Common Equity Cost Rate Analyses in Direct Testimony

|  |                        |
|--|------------------------|
| <u>Utility Proxy Group</u>             |                        |
| Discounted Cash Flow Model             | 9.10%                  |
| Risk Premium Model                     | 12.12                  |
| Capital Asset Pricing Model            | 11.31                  |
| Cost of Equity Models Applied to       |                        |
| <u>Non-Price Regulated Proxy Group</u> | <u>12.63</u>           |
| Indicated Common Equity                |                        |
| Cost Rate Before Adjustments           | 11.50%                 |
| Size Adjustment                        | 0.40                   |
| Range of Common Equity Cost            |                        |
| Rates After Adjustments                | <u>11.50% - 11.90%</u> |

He concluded that a common equity cost rate of 11.50% for CWSNC is indicated before any Company-specific adjustments. He then adjusted upward by 0.40% to reflect CWSNC's smaller relative size as compared with the members of his Utility Proxy Group, resulting in a size-adjusted indicated common equity cost rate of 11.90%.

Witness D'Ascendis testified he used the single-stage constant growth DCF model. He testified his unadjusted dividend yields are based on the proxy companies' dividends as of March 29, 2018, divided by the average of closing market prices for the 60 trading

days ending March 29, 2018.<sup>19</sup> He made an adjustment to the dividend yield because dividends are paid periodically, usually quarterly.

For witness D'Ascendis' DCF growth rate, he testified he used only analysts' five-year forecasts of earning per share (EPS) growth. He testified that the mean result of his application of the single-stage DCF model is 9.12%, the median result is 9.07%, and the average of the two is 9.10% for his Utility Proxy Group.

CWSNC witness D'Ascendis used two risk premium methods. He testified his first method is the Predictive Risk Premium Model (PRPM), while the second method is a RPM using a total market approach. He testified that the inputs to his PRPM are the historical returns on the common shares of each company in the Utility Proxy Group minus the historical monthly yield on long-term U.S. Treasury securities through March 2018. He testified he added the forecasted 30-year U.S. Treasury Bond yield, 3.69% to each company's PRPM-derived equity risk premium to arrive at an indicated cost of common equity. He testified that the mean PRPM indicated common equity cost rate for the Utility Proxy Group is 13.52%, the median is 13.33%, and the average of the two is 13.43%.

Witness D'Ascendis testified that his total market approach RPM adds a prospective public utility bond yield to an average of (1) an equity risk premium that is derived from a beta-adjusted total market equity risk premium, and (2) an equity risk premium based on the S&P Utilities Index. He calculated his adjusted prospective bond yield for the Utility Proxy Group to be 5.00%, and the average equity risk premium to be 5.80% resulting in a risk premium derived common equity of 10.80% for his RPM using his total market approach.

To determine the results of his risk premium method, he testified that he averaged the PRPM result of 13.43% and the RPM results of 10.80% and the indicated cost of equity from his risk premium method was 12.12%.

For his CAPM, witness D'Ascendis testified that he applied both the traditional CAPM and the empirical CAPM (ECAPM) to the companies in his Utility Proxy Group and averaged the results. For his CAPM beta coefficient, he considered two methods of calculation: the average of the beta coefficients of the Utility Proxy Group companies reported by Bloomberg Professional Services, and the average of the beta coefficients of the Utility Proxy Group companies as reported by Value Line resulting in a mean beta of 0.78 and a median beta of 0.74.

Witness D'Ascendis testified that the risk-free rate adopted for both applications of the CAPM is 3.69%. This risk-free rate of 3.69% is based on the average of the *Blue Chip* consensus forecast of the expected yields on 30-year U.S. Treasury bonds for the six quarters ending with the second calendar quarter of 2019, and long-term projections for the years 2019 to 2023 and 2024 to 2028.

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<sup>19</sup> See Schedule DWD-3, page 1, column 1.

Witness D'Ascendis stated that he used three sources of data to determine the risk premium in his CAPM: historical, Value Line, and Bloomberg, that when averaged, result in an average total market equity risk premium of 9.12%. He testified that the mean result of his CAPM/ECAPM analyses is 11.25%, the median is 11.37%, and the average of the two is 11.31%.

Witness D'Ascendis also selected 17 domestic non-price regulated companies for his Non-Price Regulated Proxy Group that he believes are comparable in total risk to his Utility Proxy Group. He calculated common equity cost rates using the DCF, RPM, and CAPM for the Non-Price Regulated Proxy Group. His DCF result was 14.15%, his RPM cost rate was 12.46%, and his CAPM/ECAPM cost rate was 11.78%.

Witness D'Ascendis also made a 0.40% equity cost rate adjustment due to CWSNC's small size relative to the Utility Proxy Group. He testified that the Company has greater relative risk than the average company in the Utility Proxy Group because of its smaller size compared with the group, as measured by an estimated market capitalization of common equity for CWSNC (whose common stock is not publicly-traded).

#### Hinton Direct Testimony

Public Staff witness Hinton recommended a common equity cost rate of 9.20%. He testified that, according to Moody's Bond Survey, yields on long-term "A" rated public utility bonds as of August 2018 were 4.26% and 4.27% for July 2018. Witness Hinton noted that such bonds yielded 4.63% on January 10, 2014 which is the time of filing of the Public Staff and Company Stipulation in Docket No. W-354, Sub 336 that included a 9.75% cost of equity. He further testified that the relative decrease in long-term bond yields since the last rate case is not indicative of an increase in financing costs for utilities; rather, it portends a lowering of financing costs for long-term capital. However, he also testified that there has been an increase in the cost of short-term financing.

Witness Hinton stated that the current lower interest rates and stable inflationary environment of today indicate that borrowers are paying less for the time value of money. He testified that this is significant since utility stocks and utility capital costs are highly interest-rate sensitive relative to most industries. Furthermore, given that investors often view purchases of the common stocks of utilities as substitutes for fixed income investments, the reductions in interest rates observed over the past 10 years or more have paralleled the decreases in investor required rates of return on common equity.

Witness Hinton testified that he generally does not rely on interest rate forecasts. Rather, he considers that relying on current interest rates, especially in relation to yields on long-term bonds, is more appropriate for ratemaking in that, it is reasonable to expect that as investors are pricing bonds, they are based on expectations on future interest rates, inflation rates, etc. He testified that while he has a healthy respect for forecasting, he is aware of the risk of relying on predictions of rising interest rate cases. He presented a case that can be observed in the testimony of Company witness Ahern in the 2013 Aqua NC rate case. In that case, witness Ahern identified several point forecasts of

30-year Treasury Bond yields that were predicted to rise to 4.3% in 2015, 4.7% in 2016, and 5.2% in 2017. He presented a graph of 30-Year US Treasury Bonds yields which showed in 2016 and 2017 the range was approximately 2.25% to 3.10%. Tr. Vol. 7, pp. 136-137.

Witness Hinton testified that he used the DCF model and the RPM to determine the cost of equity for CWSNC. He testified that the DCF model is a method of evaluating the expected cash flows from an investment by giving appropriate consideration to the time value of money. The DCF model is based on the theory that the price of the investment will equal the discounted cash flows of return. The return to an equity investor comes in the form of expected future dividends and price appreciation. He testified that as the new price will again be the sum of the discounted cash flows, price appreciation is ignored and attention is focused on the expected stream of dividends.

Witness Hinton testified that he applied the DCF method to a comparable group of water utilities followed by the Value Line Investment Survey (Value Line). He testified that the standard edition of Value Line covers nine water companies. He excluded Connecticut Water Service, Inc. and the SJW Group because of a merger of the two companies and also excluded Consolidated Water Co. because of its significant overseas operations.

Witness Hinton calculated the dividend yield component of the DCF by using the Value Line estimate of dividends to be declared over the next 12 months divided by the price of the stock as reported in the Value Line Summary and Index sections for each week of the 13-week period June 29, 2018 through September 21, 2018. He testified that a 13-week averaging period tends to smooth out short-term variations in the stock prices. This process resulted in an average dividend yield of 2.1% for his proxy group of water utilities.

To calculate the expected growth rate component of the DCF, Public Staff witness Hinton employed the growth rates of his proxy group in EPS, dividends per share (DPS), and book value per share (BVPS) as reported in Value Line over the past 10 and five years. He also employed the forecasts of the growth rates of his proxy group in EPS, DPS, and BVPS as reported in Value Line. He testified that the historical and forecast growth rates are prepared by analysts of an independent advisory service that is widely available to investors, and should also provide an estimate of investor expectations. He testified that he included both historical known growth rates and forecast growth rates, because it is reasonable to expect that investors consider both sets of data in deriving their expectations.

Witness Hinton incorporated the consensus of various analysts' forecasts of five-year EPS growth-rate projections as reported in Yahoo Finance. He testified that the dividend yields and growth rates for each of the companies and for the average for his comparable proxy group are shown in Exhibit JRH-3.

Witness Hinton concluded based upon his DCF analysis that a reasonable expected dividend yield is 2.1% with an expected growth rate of 6.1% to 7.1%. Thus, he

testified that his DCF analysis produces a cost of common equity for his comparable proxy group of water utilities of 8.20% to 9.20%.

Witness Hinton testified that the equity risk premium method can be defined as the difference between the expected return on a common stock and the expected return on a debt security. The differential between the two rates of return are indicative of the return investors require in order to compensate them for the additional risk involved with an investment in the Company's common stock over an investment in the Company's bonds that involves less risk.

Witness Hinton testified that his method relies on approved returns on common equity for water utility companies from various public utility commissions as reported in a RRA Water Advisory, published by the Regulatory Research Associates, Inc. (RRA), a group within S&P Global Market Intelligence (RRA Water Advisory). In order to estimate the relationship with a representative cost of debt capital, he regressed the average annual allowed equity returns with the average Moody's A-rated yields for Public Utility bonds from 2006 through 2018. His regression analysis, which incorporates years of historical data, is combined with recent monthly yields to provide an estimate of the current cost of common equity.

Witness Hinton testified that the use of allowed returns as the basis for the expected equity return has two strengths over other approaches that involve various models that estimate the expected equity return on common stocks and subtracting a representative cost of debt. He stated that one strength of his approach is that authorized returns on equity are generally arrived at through lengthy investigations by various parties with opposing views on the rate of return required by investors. He testified that it is reasonable to conclude that the approved allowed returns are good estimates of the cost of equity.

Witness Hinton testified that the summary data of risk premiums shown on his Exhibit JRH-4, page 1 of 2, indicates that the average risk premium is 4.95% with a maximum premium of 5.78% and minimum premium of 3.73%, which when combined with the last six months of Moody's A-rated utility bond yields produces yields with an average cost of equity of 9.11%, a maximum cost of equity of 9.94%, and a minimum cost of equity of 7.89%. He performed a statistical regression analysis as shown on Exhibit JRH-4, page 2 of 2 in order to quantify the relationship of allowed equity returns and bond costs. He testified that by applying this relationship to the current utility bond cost of 4.22%, resulted in a current estimate of the cost of equity of 9.70% which reflects a risk premium of 5.48%.

Witness Hinton concluded that based on all of the results of his DCF model that indicate a cost of equity from 8.20% to 9.20% with a central point estimate of 8.70%, and the risk premium model that indicates a cost of equity of 9.70%, he determined that the investor required rate of return on equity for CWSNC is between 8.70% and 9.70%. He concluded that 9.20% is his single best estimate of the Company's cost of common equity.

Witness Hinton testified as to the reasonableness of his recommended return, that he considered the pre-tax interest coverage ratio produced by his cost estimates for the cost of equity. He testified that based on his recommended capital structure, cost of debt, and equity return of 9.20%, the pre-tax interest coverage ratio is approximately 3.2 times. He testified that this pre-tax interest coverage and a funds flow to debt ratio of 26% should allow CWSNC to qualify for a single "A" bond rating.

Witness Hinton testified that his recommended return on common equity takes into consideration the impact of the water and sewer system improvement charges pursuant to N.C.G.S. § 62-113.12 on CWSNC's financial risk. He testified that these improvement charges are seen by debt and equity investors as supportive regulation that mitigates business risk. Witness Hinton stated that he considers this mechanism to be noteworthy and is supportive of his 9.20% return on equity recommendation.

Witness Hinton testified that it is not appropriate to add a risk premium to the cost of equity due to the size of the company. He testified that from a regulatory policy perspective, ratepayers should not be required to pay higher rates because they are located in the franchise area of a utility of a size which is arbitrarily considered to be small. He further testified that if such adjustments were routinely allowed, an incentive would exist for large existing utilities to form subsidiaries when merging or even to split-up into subsidiaries to obtain higher allowed returns. He further testified that CWSNC operates in a franchise environment that insulates the Company from competition and it operates with procedures in place that allow for rate adjustments for eligible capital improvements, cost increases, and other unusual circumstances that impact its earnings.

#### D'Ascendis Rebuttal Testimony

In his rebuttal testimony, CWSNC witness D'Ascendis disagreed with witness Hinton that a 9.20% common equity rate is appropriate for CWSNC and stated that the Public Staff's recommendation would not be sufficient to maintain the integrity of presently invested capital and permit the attraction of needed new capital at a reasonable cost in competition with other firms of comparable risk.

Witness D'Ascendis also disagreed with witness Hinton's exclusion of the CAPM and comparable earnings model (CEM), both of which witness Hinton used as a check on his DCF and RPM in a previous proceeding involving Aqua NC (Docket No. W-218, Sub 319). According to witness D'Ascendis, both the academic literature and the Commission support the use of multiple models in determining a return on common equity. Witness D'Ascendis then attempted to supplement what would have been witness Hinton's analysis with a CAPM and CEM, which indicated results of 10.93% and 12.49%, respectively.

Witness D'Ascendis objected to witness Hinton's DCF analysis and he also took issue with witness Hinton's use of historical growth rates in EPS, DPS, and BVPS as well as his use of projected growth rates in DPS and BVPS. He asserted that it is appropriate

to rely exclusively upon security analysts' forecasts of EPS growth rates in a DCF analysis for multiple reasons.

First, he believed that individual investors who could potentially invest in utility stocks generally have more limited informational resources than institutional investors and are therefore likely to place greater significance on the opinions and projections expressed by financial information services such as Value Line, Reuters, Zacks, and Yahoo! Finance, which are all easily accessible and/or available on the Internet and through public libraries. Witness D'Ascendis testified that security analysts have significant insight into the dynamics of the industries and individual companies they analyze, as well as company's abilities to effectively manage the effects of a changing industry, economic, or market environment. Second, over the long run, there can be no growth in DPS without growth in EPS. Security analysts' earnings expectations have a more significant, but not exclusive, influence upon market prices than dividend expectations, providing a better matching between investors' market price appreciation expectation and the growth component of the DCF model. Third, there is academic support for the superiority of analysts' forecasts of growth in EPS as the growth component in the DCF model. Witness D'Ascendis asserted that witness Hinton should have relied exclusively upon the Value Line and Yahoo! Finance EPS forecasts.

Witness D'Ascendis also disagreed with witness Hinton's application of his RPM because of his use of annual average authorized returns on equity for water companies instead of using individual cases and his use of current interest rates instead of projected interest rates. According to witness D'Ascendis, using current or historical measures, such as interest rates, are inappropriate for cost of capital and ratemaking purposes because they are both prospective in nature.

In addition, witness D'Ascendis disagreed with witness Hinton on risk due to size. Witness D'Ascendis emphasized that because it is the rate base of a specific regulated jurisdictional utility to which a regulatory allowed rate of return will be applied, it is the unique risk of that rate base which needs to be reflected in the allowed rate of return, including any additional risk due to small size. In addition, the corporate structure of the owners of that rate base is irrelevant as it is the use of the funds which gives rise to the investment risk, not the source of those funds. It matters not whether the rate base is held privately, by a municipality, by a large holding company, by a small holding company, by an equity investment fund, multiple shareholders, or a single shareholder. Only the riskiness of the particular rate base is relevant. The size of any given jurisdictional rate base is not arbitrary, it is what it is, and it is imminently relevant relative to the size of any publicly-traded utilities from whose market data a common equity cost rate recommendation is derived. Therefore, there is no incentive for "large existing utilities to form subsidiaries when merging or even to split-up into subsidiaries" because it is the risk of the regulated rate base which is relevant.

Witness D'Ascendis testified that witness Hinton's corrected cost of common equity analysis results in a common equity cost rate of 10.62% for witness Hinton's



comparable group of water utilities before adjustment for CWSNC's increased risk due to size relative to the proxy group.

In his rebuttal testimony, Company witness D'Ascendis also updated his analysis and made certain changes in the application of the models he used to determine the cost of equity in his direct testimony. As a result, he revised his recommended rate of return on equity range to be 10.80% to 11.20%. This range was based upon his indicated cost of common equity of 10.80% plus a recommended size adjustment of 0.40%.

Witness D'Ascendis' rebuttal testimony also updated his original DCF, RPM, and CAPM models with relation to his Utility Proxy Group, as well as his Non-Price Regulated Proxy Group.

The results derived from witness D'Ascendis' analyses in his rebuttal testimony are as follows:

Summary of D'Ascendis' Common Equity Cost Rate Analyses  
in Rebuttal Testimony

|  |                        |
|--|------------------------|
| <u>Utility Proxy Group</u>             |                        |
| Discounted Cash Flow Model             | 9.15%                  |
| Risk Premium Model                     | 10.73                  |
| Capital Asset Pricing Model            | 10.93                  |
| Cost of Equity Models Applied to       |                        |
| <u>Non-Price Regulated Proxy Group</u> | <u>12.43</u>           |
| Indicated Common Equity                |                        |
| Cost Rate Before Adjustments           | 10.80%                 |
| Size Adjustment                        | 0.40                   |
| Range of Common Equity Cost            |                        |
| Rates After Adjustments                | <u>10.80% - 11.20%</u> |

He concluded that a common equity cost rate of 10.80% for CWSNC is indicated before any Company-specific adjustments. He then adjusted upward by 0.40% to reflect CWSNC's smaller relative size as compared with the members of his Utility Proxy Group, resulting in a size-adjusted indicated common equity cost rate of 11.20%.

Witness D'Ascendis testified that his rebuttal testimony provided an updated analysis as of September 28, 2018. In addition, he testified that his rebuttal testimony differed from his direct testimony in the application of his models, which he had changed in May 2018. Witness D'Ascendis listed such changes as follows:

1. In the Predictive Risk Premium Model (PRPM) applicable to the proxy group companies, instead of averaging the spot and long-term average predicted variances, I selected the minimum value for each company;

2. For the beta adjusted equity risk premium (ERP), instead of averaging the ERPs by source (i.e. Ibbotson, Value Line, and Bloomberg), I gave all six ERP measures equal weight;

3. For the Standard & Poor's (S&P) utility-specific ERP, instead of averaging the ERPs by source, I gave all five ERP measures equal weight; and

4. For the market risk premium (MRP) used in the Capital Asset Pricing Model (CAPM), instead of averaging the MRPs by source. I gave all six MRP measures equal weight.

Tr. Vol. 7, p. 184.

#### D'Ascendis Cross-Examination

On cross-examination, witness D'Ascendis testified he was aware that CWSNC has approximately 50,000 customers in North Carolina and that CWSNC is the second largest regulated water and wastewater company in North Carolina. Witness D'Ascendis further testified on cross-examination that CWSNC obtains all of its debt and all of its equity from Utilities, Inc., and in this general rate case both CWSNC and the Public Staff are using Utilities, Inc.'s capital structure and cost of debt.

Witness D'Ascendis testified that Public Staff D'Ascendis Direct Cross-Examination Exhibit 1 lists the market capitalizations for four of the companies in his Utility Proxy Group as shown on D'Ascendis Direct Exhibit No. 1, Schedule DWD-8, page 2, column 6. He testified that this cross-examination exhibit correctly listed the Utilities, Inc. book equity on June 30, 2018, at \$252.2 million and when the Utility Proxy Group market to book ratio of 300.5 was applied to Utilities Inc.'s \$252.2 million book equity, the resulting Utilities, Inc. market capitalization is \$758 million. He testified Utilities, Inc.'s \$758 million market capitalization was larger than two of his Utility Proxy Group companies, Middlesex Water Company at \$600 million and York Water Company at \$399 million.

Witness D'Ascendis also testified that he was aware that as testified to by Public Staff witness Hinton, in the 1990s the Commission specifically rejected a size adjustment for CWS Systems, an affiliate of CWSNC.

CWSNC witness D'Ascendis testified on cross-examination that Public Staff D'Ascendis Cross-Examination Exhibit 2 was his response to a Public Staff data request showing water and wastewater utility general rate cases in which he testified recommending a return on equity range or a specific return on equity. He testified that in the Emporium Water case in Pennsylvania, which was a fully litigated case, he recommended an 11.05% return on equity and the Commission approved a 10.0% return on equity in January 2015, being 105 basis points below his recommendation.

He testified that in the Carolina Water Service, Inc. general rate case in South Carolina with decision on December 22, 2015, he recommended a return on equity range of 10.0% to 10.50% which had a mid-point of 10.25%, and the Commission approved a return on equity of 9.34% which was 91 basis points below his mid-point. He further testified in the Aqua Illinois, Inc. general rate case with decision on March 2, 2018, he recommended a specific return on equity of 10.85%, and the Commission approved a return on equity of 9.60%, which was 125 basis points below his recommendation.

Witness D'Ascendis testified that in the Middlesex Water Company general rate case in New Jersey with decision on March 6, 2018, he recommended a specific return on equity of 10.70% and the Commission approved a return on equity of 9.60%, which was 110 basis points below his recommendation. Witness D'Ascendis testified that in the current Aqua Virginia general rate case, in which he recommended a specific return on equity of 10.60%, Aqua Virginia recently agreed in a settlement to a 9.25% return on equity, which the Hearing Examiner accepted.

Witness D'Ascendis testified that most of the authorized returns on equity on Public Staff D'Ascendis Direct Cross-Examination Exhibit 2 were the result of settlements which the Commissions approved. He testified for the nine cases with approved returns on equity, the average approved return on equity was 142 basis points below his recommendation.

He testified that his most recent litigated and most relevant case was for Carolina Water Service, Inc. in South Carolina where on May 26, 2018, the Commission approved a return on equity of 10.50%, which was within his range of 10.45% to 10.95%.

CWSNC witness D'Ascendis testified that Public Staff Direct Cross-Examination Exhibit 3 is a RRA Water Advisory, S&P Global, dated July 27, 2018, which lists water utility rate case decisions in the years 2014 through 2017, and through June 30, 2018. He testified that in 2018 through June 30, 2018, the average approved return on equity was 9.41%. He testified that if for any reason the South Carolina 10.5% return on equity decision for Carolina Water Service was dropped, the 2018 average would be 9.23% return on equity. He testified that the four 2018 California return on equity decisions have fully forecasted test years, full decoupling, and three year rate plans. He testified that these California decisions dated March 22, 2018, were all fully litigated, and the approved returns on equity were: California America Water — 9.20%, California Water Service — 9.20%, Golden State Water Co. — 8.90%, and San Jose Water Co. — 8.90%. He testified that more relevant than these cases was the recent Duke Energy Carolinas case Docket No. E-7, Sub 1146 with a settlement approved 9.90% return on equity.

CWSNC witness D'Ascendis further testified that in 2014 where the RRA Water Advisory reported 13 water utility rate case decisions with approved returns on equity, none were 10% or above. He testified that in 2015 where the RRA Water Advisory reported 11 water utility decisions with approved returns on equity, only two were 10.0% or above, being Maryland American Water at 10.0% and Kona Water in Hawaii with 10.10% return on equity. He testified that in 2016 where the RRA Water Advisory reported nine water utility rate case decisions with approved returns on equity, only Hawaii Water

Service at 10.10% return on equity, had an approved return on equity at 10.0% or above. He testified that in 2017 where the RRA Water Advisory reported nine water utility rate case decisions with approved returns on equity averaging 9.56%, only Utilities, Inc. of Florida with a formula-based return on equity of 10.40% and a 41.92% approved common equity capital structure, had an approved return on equity at 10.0% or above.

CWSNC witness D'Ascendis further testified on cross-examination as shown on Public Staff D'Ascendis Direct Cross-Examination Exhibit 5, that three of the four California water utilities with the litigated decisions dated March 22, 2018, being California American Water with a 9.20% approved return on equity, California Water Service with a 9.20% approved return on equity, and Golden State Water with an approved 8.90% return on equity, being a subsidiary of American States Water, are companies included in his Utility Proxy Group. CWSNC witness D'Ascendis testified that Public Staff D'Ascendis Cross-Examination Exhibit 5 contained the 2018 return on equity decisions for five of the companies in his Utility Proxy Group and the average approved return on equity was 9.30%.

On cross-examination witness D'Ascendis further testified that there was a backlash in the investment community relating to the four California March 22, 2018, return on equity decisions. He testified that MSN Money is a reliable source for the market prices on Public Staff D'Ascendis Cross-Examination Exhibit 4. This cross-examination exhibit listed the market close prices on March 22, 2018, and October 15, 2018, for American Waterworks, American States Water, California Water Service, and San Jose Water. The respective market price percentage increases between March 22, 2018, and October 15, 2018 were: American Waterworks — 9.80%, American States Water — 8.40%, California Water Service — 7.30%, and San Jose Water — 9.50%. He testified that in comparison the S&P 500 from March 22, 2018 to October 15, 2018 had increased 4.10%, being less than one half the market price gains of the four water companies.

## 2. Evidence of Impact of Changing Economic Conditions on Customers

As noted above, utility rates must be set within the constitutional constraints made clear by the United States Supreme Court in Bluefield and 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 a return on equity, the Commission must nonetheless 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. Utils. Comm'n v. General Telephone Co. of the Southeast, 281 N.C. 318, 370, 189 S.E.2d 705 (1972). As the Supreme Court held in that case, these factors constitute “the test of a fair rate of return” in Bluefield and Hope. Id.

### a. Discussion and Conclusions Regarding Evidence Introduced During the Evidentiary Hearing

In this case, all parties had the opportunity to present the Commission with evidence concerning changing economic conditions as they affect customers. The testimony of witnesses D'Ascendis and Hinton, which the Commission finds entitled to substantial weight, addresses changing economic conditions.

As to the impact of changing economic conditions on CWSNC's customers, Public Staff witness Hinton testified that he reviewed information on the economic conditions in the areas served by CWSNC, specifically, the 2014, 2015, and 2016 data on total personal income from the Bureau of Economic Analysis (BEA) and the Development Tier Designations published by the North Carolina Department of Commerce for the counties in which CWSNC's systems are located. The BEA data indicates that from 2014 to 2016, total personal income weighted by the number of water customers by county grew at a compound annual growth rate (CAGR) of 3.0%.

Witness Hinton testified that the North Carolina Department of Commerce annually ranks the State's 100 counties based on economic well-being and assigns each a Tier designation. The most distressed counties are rated a "1" and the most prosperous counties are rated a "3". The rankings examine several economic measures such as, household income, poverty rates, unemployment rates, population growth, and per capita property tax base. For 2017, the average Tier ranking that has been weighted by the number of water customers by county is 2.6. He testified that both these economic measures indicate that there has been improvement in the economic conditions for CWSNC's service area relative to the three previous CWSNC rate increases in Docket Nos. W-354, Subs 356, 344, and 336 that were approved in 2017, 2015, and 2014, respectively.

CWSNC witness D'Ascendis testified on economic conditions in North Carolina that he reviewed. He testified that he reviewed: unemployment rates from the United States, North Carolina, and the counties comprising CWSNC's service territory; the growth in Gross Domestic [sic] Product (GDP) in both the United States and North Carolina; median household income in the United States and in North Carolina; and national income and consumption trends.

He testified that the rate of unemployment has fallen substantially in North Carolina and the United States since late 2009 and early 2010, when the rates peaked at 10.00% and 12.00%, respectively. He testified that by February 2018, the unemployment rate had fallen to less than one-half of those peak levels: 4.10% nationally; and 4.60% in North Carolina.

He testified that he was also able to review (seasonally unadjusted) unemployment rates in the counties served by CWSNC. At its peak, which occurred in late 2009 into early 2010, the unemployment rate in those counties reached 12.58% (58 basis points higher than the statewide average); by February 2018 it had fallen to 4.87% (27 basis points higher than the statewide average).

Witness D'Ascendis testified that for real GDP growth, there also has been a relatively strong correlation between North Carolina and the national economy (approximately 69%). Since the financial crisis, the national rate of growth at times (during portions of 2010 and 2012) outpaced North Carolina. He testified that since the third quarter of 2015, however, North Carolina has consistently exceeded the national growth rate.

Witness D'Ascendis testified that as to median household income, the correlation between North Carolina and the United States is relatively strong (approximately 88% from 2005 through 2015). Since 2009 (that is, the years subsequent to the financial crisis), median household income in North Carolina has grown at a faster annual rate than the national median income (3.62% vs. 2.47%).

Witness D'Ascendis noted that in the Commission's Order on Remand in Docket No. E-22, Sub 479, the Commission observed that economic conditions in North Carolina were highly correlated with national conditions, such that they were reflected in the analyses used to determine the cost of common equity. He testified that those relationships still hold: Economic conditions in North Carolina continue to improve from the recession following the 2008/2009 financial crisis, and they continue to be strongly correlated to conditions in the United States generally. He testified unemployment, at both the State and county level, continues to fall and remains highly correlated with national rates of unemployment; real GDP recently has grown faster in North Carolina than the national rate of growth, although the two remain fairly well correlated; and median household income also has grown faster in North Carolina than the rest of the country, and remains strongly correlated with national levels.

b. Evidence Introduced During Public Hearings and Further Conclusions

The Commission's review also includes consideration of the evidence presented during the public hearings by public witnesses, almost all of whom presently are customers of CWSNC. The hearings provided 35 witnesses the opportunity to be heard regarding their respective positions on CWSNC's application to increase rates. The Commission held six evening hearings throughout CWSNC's North Carolina service territory to receive public testimony. The testimony presented at the hearings illustrates the difficult economic conditions facing many North Carolina citizens. The Commission accepts as credible, probative, and entitled to substantial weight the testimony of the public witnesses.

c. Commission's Decision Setting Rate of Return and Approving Rate Increase/ Takes Into Account and Ameliorates the Impact of Current Economic Conditions on Customers

As noted above, the Commission's duty under N.C.G.S. § 62-133 is to set rates as low as reasonably possible without impairing the Company's ability to raise the capital needed to provide reliable water and wastewater service and recover its cost of providing

service. The Commission is especially mindful of this duty in light of the evidence in this case concerning the impact of current economic conditions on customers.

Chapter 62 of the North Carolina General Statutes in general, and N.C.G.S. § 62-133 in particular, set forth the formula that the Commission must employ in establishing rates. The rate of return on cost of property element of the formula in N.C.G.S. § 62-133(b)(4) is a significant, but not independent one. Each element of the formula must be analyzed to determine the utility's cost of service and revenue requirement. The Commission must make many subjective decisions with respect to each element in the formula in establishing the rates it approves in a general rate case. The Commission must approve accounting and pro forma adjustments to comply with N.C.G.S. § 62-133(b)(3). The Commission must approve depreciation rates pursuant to N.C.G.S. § 62-133(b)(1). The decisions the Commission makes in each of these subjective areas have multiple and varied impacts on the Decisions it makes elsewhere in establishing rates, such as its decision on rate of return on equity.

Economic conditions existing during the test year, at the time of the public hearings, and at the date of this Commission Order affect not only the ability of CWSNC's consumers to pay water and wastewater utility rates, but also the ability of CWSNC to earn the authorized rate of return during the period rates will be in effect. Pursuant to N.C.G.S. § 62-133, rates in North Carolina are set based on a modified historic test period.<sup>20</sup> A component of cost of service as important as return on investment is test year revenues.<sup>21</sup> The higher the level of test year revenues the lower the need for a rate increase, all else remaining equal. Historically, and in this case, test year revenues are established through resort to regression analysis, using historic rates of revenue growth or decline to determine end of test year revenues.

When costs and expenses grow at a faster pace than revenues during the period when rates will be in effect, the utility will experience a decline in its realized rate of return on investment to a level below its authorized rate of return. Differences exist between the authorized return and the earned or realized return. Components of the cost of service must be paid from the rates the utility charges before the equity investors are paid their return on equity. Operating and administrative expenses must be paid, depreciation must be funded, taxes must be paid, and the utility must pay interest on the debt it incurs. To the extent revenues are insufficient to cover the entire cost of service, the shortfall reduces the return to the equity investor, last in line to be paid. When this occurs, the utility's realized or earned return is less than the authorized return.

This phenomenon, caused by incurrence of higher costs prior to the implementation of new rates to recover those higher costs, is commonly referred to as regulatory lag. Just as the Commission confronts constitutional and statutory restrictions in making discrete decrements to rate of return on equity to mitigate the impact of rates on consumers, it also confronts statutory constraints on its ability to adjust test year

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<sup>20</sup> N.C.G.S. § 62-133(c).

<sup>21</sup> N.C.G.S. § 62-133(b)(3).

revenues to mitigate for regulatory lag. However, the WSIC and SSIC legislation N.C.G.S. § 62-133.12 and Commission Rules R7-39 and R10-26, have mitigated the regulatory lag for CWSNC. The Commission, in its expert experience and judgment and based on evidence in the record, is aware of the effects of regulatory lag in the existing economic environment. However, just as the Commission is constrained to address difficult economic times on customers' ability to pay for service by establishing a lower rate of return on equity in isolation from the many subjective determinations that must be made in a general rate case, it likewise does not address the effect of regulatory lag on the Company by establishing a higher rate of return on equity. Instead, in setting the rate of return, the Commission considers both of these negative impacts in its ultimate decision fixing CWSNC's rates. The Commission keeps all factors affected by current economic conditions in mind in the many subjective decisions it makes in establishing rates. In doing so in the case at hand, the Commission is approving a 9.75% rate of return on equity in the context of weighing and balancing numerous factors and making many subjective decisions. When these decisions are viewed as a whole, including the decision to establish the rate of return on equity at 9.75%, the Commission's overall decision fixing rates in this general rate case results in lower rates to consumers in the existing economic environment.

Consumers pay rates, a charge in dollars per 1,000 gallons for the water they consume and for the metered wastewater that is treated (or a monthly flat rate for certain residential wastewater customers). Investors are compensated by earning a return on the capital they invest in the business. Consumers do not pay a rate of return on equity.

All of the scores of adjustments the Commission approves reduce the revenues to be recovered from ratepayers and the return to be paid to equity investors. Some adjustments reduce the authorized rate of return on investment financed by equity investors. The adjustments are made solely to reduce rates and provide rate stability to consumers (and return to equity investors) to recognize the difficulty for consumers to pay in the current economic environment. While the equity investor's cost was calculated by resort to a rate of return on equity of 9.75% instead of within a range of 10.80% to 11.20% as proposed by the Company, this is only one approved adjustment that reduced ratepayer responsibility and equity investor reward. Many other adjustments reduced the dollars the investors actually have the opportunity to receive. Therefore, nearly all of these other adjustments reduce ratepayer responsibility and equity investor returns in compliance with the Commission's responsibility to establish rates as low as reasonably permissible without transgressing constitutional constraints.

For example, to the extent the Commission makes downward adjustments to rate base, or disallows test year expenses, or increases test year revenues, or reduces the equity capital structure component, the Commission reduces the rates consumers pay during the future period when rates will be in effect. Because the utility's investors' compensation for the provision of service to consumers takes the form of return on investment, downward adjustments to rate base or disallowances of test year expenses or increases to test year revenues, or reduction in the equity capital structure component,



reduce investors' return on investment irrespective of its determination of rate of return on equity.

The rate base, expenses, and revenue adjustments are instances where the Commission makes decisions in each general rate case, including the present case, that influence the Commission's determination on rate of return on equity and cost of service and the revenue requirement. The Commission always endeavors to comply with the North Carolina Supreme Court's requirements that it "fix rates as low as may be reasonably consistent" with U.S. Constitutional requirements irrespective of economic conditions in which ratepayers find themselves. While compliance with these requirements may have been implicit and, the Commission reasonably assumed, self-evident as shown above, the Commission makes them explicit in this case to comply with the Supreme Court requirements of Cooper I.

Based on the changing economic conditions and their effects on CWSNC's customers, the Commission recognizes the financial difficulty that the increase in CWSNC's rates will create for some of CWSNC's customers, especially low-income customers. As shown by the evidence, relatively small changes in the rate of return on equity have a substantial impact on a utility's base rates. Therefore, the Commission has carefully considered the changing economic conditions and their effects on CWSNC's customers in reaching its decision regarding CWSNC's approved rate of return on equity. The Commission also recognizes that the Company is investing significant sums in system improvements to serve its customers, thus requiring the Company to maintain its creditworthiness in order to compete for large sums of capital on reasonable terms. The Commission must weigh the impact of changing economic conditions on CWSNC's customers against the benefits that those customers derive from the Company's ability to provide safe, adequate, and reliable water and wastewater service. Safe, adequate, and reliable water and wastewater service is essential to the well-being of CWSNC's customers.

The Commission finds that these investments by the Company provide significant benefits to CWSNC's customers. The Commission concludes that the return on equity approved by the Commission in this proceeding appropriately balances the benefits received by CWSNC's customers from CWSNC's provision of safe, adequate, and reliable water and wastewater service with the difficulties that some of CWSNC's customers will experience in paying CWSNC's increased rates.

The Commission in every case seeks to comply with the North Carolina Supreme Court mandate that the Commission establish rates as low as possible within constitutional limits. The adjustments the Commission approves in this case comply with that mandate. Nearly all of them reduced the requested return on equity and benefit consumers' ability to pay their bills in this economic environment.

### Summary and Conclusions on the Rate of Return on Equity

The Commission has carefully evaluated the return on equity testimony of CWSNC witness D'Ascendis and Public Staff witness Hinton. The results of each of the models or methods used by these two witnesses to derive the return on equity that each witness recommends is shown below:

|  | <u>D'Ascendis</u> | <u>Hinton</u> |
|--|-------------------|---------------|
| <u>Utility Proxy Group</u>                   |                   |               |
| DCF  | 9.15%             | 8.70%         |
| Risk Premium                                 | 10.73%            | 9.70%         |
| PRPM   | 10.90%            |               |
| Total Market RPM                             | 10.56%            |               |
| CAPM   | 10.93%            | -----         |
| Traditional CAPM                             | 10.67%            |               |
| ECAPM  | 11.18%            |               |
| <u>Non-Price Regulated Proxy Group</u>       | 12.43%            | -----         |
| DCF  | 13.79%            |               |
| Risk Premium                                 | 12.32%            |               |
| CAPM   | 11.52%            |               |
| Indicated Return on Equity Before Adjustment | 10.80%            | 9.20%         |
| Size Adjustment                              | 0.40%             | -----         |
| Recommended Return on Equity                 | 10.8-11.2%        | 9.20%         |

The range of these results is 8.70% to 12.43%. Underlying the low result of 8.70%, is a range of 8.20% to 9.20%, according to witness Hinton's testimony concerning his application of the DCF. Similarly, underlying the high result of 12.43% is a range of 11.52% (CAPM) to 13.79% (DCF), according to witness D'Ascendis' testimony concerning the cost of equity models applied to his Non-Price Regulated Proxy Group. Such a wide range of estimates by expert witnesses is not atypical in proceedings before the Commission with respect to the return on equity issue. Neither is the seemingly endless debate and habitual differences in judgment among expert witnesses on the virtues of one model or method versus another and how to best determine and measure the required inputs of each model in representing the interest of their intervening party. Nonetheless, the Commission is uniquely situated, qualified, and required to use its impartial judgment to determine the return on equity based on the testimony and evidence in this proceeding in accordance with the legal guidelines discussed above.

In so doing, the Commission finds that the testimony of Company witness D'Ascendis regarding the DCF (9.15%), traditional CAPM (10.67%), and total market RPM (10.56%) analyses of his Utility Proxy Group and the DCF (8.70%) and risk premium

(9.70%) analysis testimony of Public Staff witness Hinton are credible, probative, and are entitled to substantial weight as set forth below.

Company witness D'Ascendis, noting that CWSNC is not publicly-traded, first established a group of six relatively comparable risk water companies that are publicly-traded (Utility Proxy Group). He testified that use of relatively comparable risk companies as proxies is consistent with principles of fair rate of return established in the Hope and Bluefield cases, which are recognized as the primary standards for the establishment of a fair return for a regulated public utility. He then applied the DCF, the CAPM, and the risk premium models to the market data of the Utility Proxy Group. Witness D'Ascendis' DCF model indicated a cost of equity of 9.15%, his traditional CAPM model indicated a cost of equity of 10.67%, and his total market RPM model indicated a cost of equity of 10.56%.

Witness Hinton applied a risk premium analysis by performing a regression analysis using the allowed returns on common equity for water utilities from various public utility commissions, as reported in an RRA Water Advisory, with the average Moody's A-rated bond yields for public utility bonds from 2006 through 2018. The results of the regression analysis were combined with recent monthly yields to provide the current cost of equity. According to witness Hinton, the use of allowed returns as the basis for the expected equity return has strengths over other (risk premium) approaches that estimate the expected return on equity and subtract a representative cost of debt. He testified that one strength of his approach is that authorized returns on equity are generally arrived at through lengthy investigations by various parties with opposing views on the rate of return required by investors. Thus, it is reasonable to conclude that the approved returns are good estimates for the cost of equity. Witness Hinton testified that applying the significant statistical relationship of the allowed equity returns and bond yields from the regression analysis and adding current bond cost of 4.22% resulted in a current estimate of the cost of equity of 9.70%.

Witness Hinton also applied the DCF model to a proxy risk group of publicly-traded water utilities. To determine the expected growth rate component in his application of the DCF, witness Hinton testified that he employed both historical and forecasted growth rates of earnings per share (EPS), book value per share (BVPS), and dividends per share (DPS). He concluded that an expected growth rate of 6.10% to 7.10% should be combined with a dividend yield of 2.10% which produced his cost of equity estimate of 8.20% to 9.20% for his comparable risk group based on his DCF analysis, with a specific cost of equity estimate of 8.70%.

The average of witness D'Ascendis' Utility Proxy Group DCF result of 9.15%, traditional CAPM result of 10.67%, total market RPM result of 10.56%, witness Hinton's DCF result of 8.70%, and RPM of 9.70% is 9.75%. The Commission approved return on equity of 9.75% is thus supported by the average of the results of the above-listed cost of equity models which the Commission finds are entitled to substantial weight based on the record in this proceeding.

Witness D'Ascendis used two risk premium methods to estimate the cost of equity to CWSNC. He testified that his first method is the PRPM and the second method is a RPM using a total market approach. In his PRPM, he employed the EvIEWS® statistical software applied to the historical returns on the common shares of each company in his Utility Proxy Group minus the historical monthly yields on long-term U.S. Treasury securities through March 2018 to arrive at a predicted annual equity risk premium. He then added the forecasted 30-year U.S. Treasury yield to each company's PRPM derived equity risk premium. Using this approach, he calculated a cost of equity estimate of 10.90%. In his total market approach RPM, he added a prospective public utility bond yield to an average of (1) an equity risk premium that is derived from a beta-adjusted total market equity risk premium, and (2) an equity risk premium based on the S&P Utilities Index. His RPM result produced a rate of return estimate of 10.56%. Averaging his PRPM result of 10.90% and his total market approach RPM, he determined that the cost of equity is 10.73% using his risk premium methods.

The Commission gives little weight to witness D'Ascendis' PRPM result of 10.90%. This result is considerably lower than his original PRPM result of 13.43%, highlighting the sensitivity of this model to changes in the way it is applied. Further, the Commission is skeptical that investor expectations are influenced by a method analyzing economic time series with time-varying volatility using the statistical software employed by witness D'Ascendis.

Witness D'Ascendis also used two CAPM methods to estimate the cost of equity to CWSNC. He testified that his first method is the traditional CAPM, and the second method is the empirical CAPM approach. The traditional CAPM method adds a risk-free rate to the product of a company specific beta and a market risk premium for each company in the Utility Proxy Group. This approach yields a cost of equity estimate of 10.67%. Witness D'Ascendis' empirical CAPM approach, which assumes a Security Market Line that is less steep than that described by the CAPM formula, produced a cost of equity estimate of 11.18%.

The Commission gives little weight to witness D'Ascendis' ECAPM result of 11.18%. The Commission concludes that, in this instance, witness D'Ascendis' testimony fails to demonstrate how the ECAPM approach is superior to the CAPM approach which is widely accepted by the investment community.

In addition to estimating the cost of equity for his Utility Proxy Group of publicly-traded water utilities, witness D'Ascendis attempted to estimate the cost of equity for another proxy group consisting of 17 domestic, non-price regulated companies. In order to select a proxy group of domestic, non-price regulated companies similar in risk to the Utility Proxy Group, he testified that he relied on the beta coefficients and related statistics derived from Value Line regression analyses of weekly market prices over the last five years. After selecting the 17 unregulated companies, he applied the DCF, RPM, and CAPM in the identical manner used for his Utility Proxy Group, with certain limited expectations. The results of the DCF, RPM, and CAPM applied to the non-price regulated proxy group are 13.79%, 12.32%, and 11.52%, respectively. The Commission concludes

that these results are unreasonably high. Each of these results are higher than witness D'Ascendis' estimates of the cost of equity for his own Utility Proxy Group and deserve no weight, particularly with respect to the DCF. The Commission further concludes that given the difference in these results, the risk of the two groups is not equal and the Utility Proxy Group is more reliable as a proxy for the investment risk of common equity in CWSNC.

After determining that the indicated cost of equity from the DCF, CAPM, and risk premium methods applied to both of his proxy groups equals 10.80%, witness D'Ascendis then adjusted the indicated cost of equity upward by 0.40% to reflect CWSNC's smaller size compared to companies in his Utility Proxy Group. He testified that the size of the company is a significant element of business risk for which investors expect to be compensated through higher returns. Witness D'Ascendis calculated his size adjustment as described in his prefiled direct testimony and stated that even though a 4.61% upward size adjustment is indicated, he applies a 0.40% size premium to CWSNC's indicated common equity cost rate. Witness Hinton testified that he does not believe it is appropriate to add a risk premium to the cost of equity of CWSNC due to size for several reasons. First, from a regulatory policy perspective, witness Hinton stated that ratepayers should not be required to pay higher rates because they are located in the franchise area of a utility which is arbitrarily considered to be small. Further, if such adjustments were routinely allowed, an incentive would exist for large utilities to form subsidiaries or split-up subsidiaries to obtain higher returns. In addition, he noted that CWSNC operates in a franchise environment that insulates the Company from competition with procedures in place for rate adjustments for circumstances that impact its earnings. Finally, while witness Hinton stated that while there are studies that address how the small size of a company relates to higher returns, he is aware of only one study that focuses on the size of regulated utilities and risk and that study concluded that utility stocks do not exhibit a significant size premium. In rebuttal, witness D'Ascendis maintained that a small size adjustment was necessary based on the results of studies he cited and discussed and contended that the study concerning size premiums for utilities discussed by witness Hinton was flawed.

Based upon the foregoing and the entire record in this proceeding, the Commission concludes that a size adjustment of 0.40% is not warranted and should not be approved. The Commission determines there is insufficient evidence to authorize an adjustment to the approved rate of return on equity in this case. The record simply does not indicate the extent to which CWSNC's size alone justifies added risk. While a small water/wastewater utility might face greater risk than a publicly-traded peer group, because for example the service area was confined to a hurricane prone coastal geographic area, evidence of such factual predicates is absent from the record. The Commission notes that the witnesses also disagreed with respect to whether the studies discussed in the testimony concerning size and risk are reliable or even applicable to regulated utilities. The Commission concludes that the testimony regarding these studies is not convincing and does not support a size adjustment. In addition, while witness D'Ascendis calculates and testifies that a 4.61% upward size adjustment is indicated, he applies a size premium of 0.40% to

CWSNC's indicated cost of equity. The Commission thus concludes that the 0.40% adjustment is not supported by his testimony and is rather arbitrary.

Having determined that the appropriate rate of return on equity based upon the evidence in this proceeding is 9.75%, the Commission notes that there is considerable testimony concerning the authorized returns on equity for water utilities in other jurisdictions. While the Commission has relied upon the record in this proceeding and is certainly aware that returns in other jurisdictions can be influenced by many factors, such as different capital market conditions during different periods of time, settlements versus full litigation, the Commission concludes that the rate of return on equity trends and decisions by other regulatory authorities deserve some weight as (1) they provide a check or additional perspective on the case-specific circumstances, and (2) the Company must compete with other regulated utilities in the capital markets, meaning that a rate of return significantly lower than that approved for other utilities of comparable risk would undermine the Company's ability to raise necessary capital, while a rate of return significantly higher than other utilities of comparable risk would result in customers paying more than necessary. Public Staff D'Ascendis Cross-Examination Exhibit 3, the RRA Water Advisory publication showing approved return on equity decisions for water utilities across the country from January 2014 through June 30, 2018, is helpful in illustrating that the average rate of return on equity for water utilities is 9.59% in 2014, 9.76% in 2015, 9.71% in 2016, 9.56% in 2017, and in the only seven cases reported on for the first six months of 2018 the average is 9.41% with a range of 8.9% to 10.5%. This authorized return data is generally supportive of the Commission approved return on equity of 9.75% based upon the evidence in this proceeding. To the extent it is not, the record evidence justifies any such difference.

In its post-hearing brief, the AGO notes that the 10.80% to 11.20% range for rate of return on equity requested by CWSNC is substantially higher than the 9.6% return on equity stipulated to in the Sub 356 Proceeding. In this case, the AGO, in its role as consumer advocate, argues that the DCF model is relied upon by investors using widely available current market data and the DCF results produced by expert witnesses for CWSNC and the Public Staff show that a 9.2% return on equity is more than sufficient to attract the investment dollars needed for adequate service. However, unlike the AGO, the Commission cannot ignore the other evidence in this proceeding. When other such evidence is considered and weighed by the Commission as discussed hereinabove, the Commission finds that the reasonable and appropriate return on equity is 9.75%.

The Commission notes further that its approval of a rate of return on equity at the level of 9.75% or for that matter at any level, is not a guarantee to the Company that it will earn a rate of return on equity at that level. Rather, as North Carolina law requires, setting the rate of return on equity at this level merely affords CWSNC the opportunity to achieve such a return. The Commission finds, based upon all the evidence presented, that the rate of return on equity provided for herein will indeed afford the Company the opportunity to earn a reasonable and sufficient return for its shareholders while at the same time producing rates that are just and reasonable to its customers.

### Capital Structure

CWSNC witness D'Ascendis recommended the use of the actual capital structure of Utilities Inc., on June 30, 2018 consisting of 49.09% long-term debt and 50.91% common equity.

In his supplemental testimony, Public Staff witness Hinton also recommended a 49.09% long-term debt and 50.91% common equity capital structure based upon updated information provided by CWSNC concerning the capital structure at June 30, 2018. The Partial Stipulation also supports a 49.09% long-term debt, 50.91% common equity capital structure. No other party presented evidence as to a different capital structure.

Accordingly, the Commission finds that the recommended capital structure of 50.91% common equity and 49.09% long-term debt is just and reasonable to all parties in light of all the evidence presented.

### Cost of Debt

In its Application, the Company proposed a cost rate for long-term debt of 6.00%. In supplemental testimony, witness Hinton revised his recommended cost of debt to 5.68%. In addition, the Stipulation includes a cost of debt rate of 5.68%. No intervenor offered any evidence supporting a debt cost rate below 5.68%.

Therefore, the Commission finds that the use of a debt cost rate of 5.68% is just and reasonable to all parties based upon all the evidence presented in this proceeding.

### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 61**

The following schedules summarize the gross revenue and rate of return that the Company should have a reasonable opportunity to achieve based on the increases in revenues approved in this Order for each rate entity. These schedules, illustrating the Company's gross revenue requirements, incorporate the adjustments found appropriate by the Commission in this Order.

# SCHEDULE I

## **Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Net Operating Income for a Return

For the Twelve Months Ended December 31, 2017

Combined Operations

|  | Present<br>Rates   | Increase<br>Approved | After<br>Approved<br>Increase |
|--|--------------------|----------------------|-------------------------------|
| Operating Revenues:                    |                    |                      |                               |
| Service revenues                       | \$32,429,699       | \$1,434,938          | \$33,864,637                  |
| Miscellaneous revenues                 | 360,163            | 3,314                | 363,477                       |
| Uncollectibles                         | <u>(214,395)</u>   | <u>(14,164)</u>      | <u>(228,559)</u>              |
| Total operating revenues               | <u>32,575,467</u>  | <u>1,424,088</u>     | <u>33,999,555</u>             |
| Operating Revenue Deductions:          |                    |                      |                               |
| Salaries and wages – Maintenance       | 4,765,636          | 0                    | 4,765,636                     |
| Purchased power                        | 1,932,358          | 0                    | 1,932,358                     |
| Purchased water and sewer              | 1,972,527          | 0                    | 1,972,527                     |
| Maintenance and repair                 | 2,749,845          | 0                    | 2,749,845                     |
| Maintenance testing                    | 544,360            | 0                    | 544,360                       |
| Meter reading                          | 225,867            | 0                    | 225,867                       |
| Chemicals                              | 632,415            | 0                    | 632,415                       |
| Transportation                         | 447,271            | 0                    | 447,271                       |
| Operating expense charged to plant     | (673,065)          | 0                    | (673,065)                     |
| Outside services – other               | 455,369            | 0                    | 455,369                       |
| Salaries and wages – General           | 2,064,359          | 0                    | 2,064,359                     |
| Office supplies & other office expense | 560,363            | 0                    | 560,363                       |
| Regulatory commission expense          | 165,908            | 0                    | 165,908                       |
| Pension and other benefits             | 1,340,118          | 0                    | 1,340,118                     |
| Rent                                   | 227,339            | 0                    | 227,339                       |
| Insurance                              | 429,335            | 0                    | 429,335                       |
| Office utilities                       | 742,300            | 0                    | 742,300                       |
| Miscellaneous                          | 23,469             | 0                    | 23,469                        |
| Depreciation expense                   | 5,617,382          | 0                    | 5,617,382                     |
| Amortization of CIAC                   | (1,488,982)        | 0                    | (1,488,982)                   |
| Amortization of PAA                    | (54,365)           | 0                    | (54,365)                      |
| Amortization of ITC                    | (519)              | 0                    | (519)                         |
| Franchise and other taxes              | (49,702)           | 0                    | (49,702)                      |
| Property taxes                         | 233,575            | 0                    | 233,575                       |
| Payroll taxes                          | 529,195            | 0                    | 529,195                       |
| Regulatory fee                         | 45,606             | 1,994                | 47,600                        |
| Deferred income tax                    | (83,555)           | 0                    | (83,555)                      |
| State income tax                       | 177,812            | 42,663               | 220,475                       |
| Federal income tax                     | <u>1,207,341</u>   | <u>289,680</u>       | <u>1,497,021</u>              |
| Total operating revenue deductions     | <u>24,739,562</u>  | <u>334,337</u>       | <u>25,073,899</u>             |
| Net operating income for a return      | <u>\$7,835,905</u> | <u>\$1,089,751</u>   | <u>\$8,925,656</u>            |



## SCHEDULE II

### **Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Original Cost Rate Base

For the Twelve Months Ended December 31, 2017

Combined Operations

| <u>Item</u>                                    | <u>Amount</u>        |
|--|----------------------|
| Plant in service                               | \$213,005,526        |
| Accumulated depreciation                       | <u>(52,955,117)</u>  |
| Net plant in service                           | 160,050,409          |
| Cash working capital                           | 2,079,155            |
| Contributions in aid of construction           | (42,183,408)         |
| Advance in aid of construction                 | (32,940)             |
| Accumulated deferred income taxes              | (3,972,592)          |
| Customer deposits                              | (342,640)            |
| Gain on sale and flow back taxes               | (289,628)            |
| Plant acquisition adjustment                   | (1,052,168)          |
| Excess book value                              | (456)                |
| Cost-free capital                              | (261,499)            |
| Average tax accruals                           | (125,909)            |
| Regulatory liability for excess deferred taxes | (251,770)            |
| Deferred charges                               | 1,522,955            |
| Pro forma plant                                | <u>0</u>             |
| Original cost rate base                        | <u>\$115,139,509</u> |

Rates of return:

Present 6.81%

Approved 7.75%

## SCHEDULE III

### **Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Statement of Capitalization and Related Costs

For the Twelve Months Ended December 31, 2017

Combined Operations

|                       | <u>Ratio %</u> | <u>Original Cost<br/>Rate Base</u> | <u>Embedded<br/>Cost %</u> | <u>Net Operating<br/>Income</u> |
|-----------------------|----------------|------------------------------------|----------------------------|---------------------------------|
| <b>PRESENT RATES</b>  |                |                                    |                            |                                 |
| Long-Term Debt        | 49.09          | \$ 56,521,985                      | 5.68                       | \$3,210,449                     |
| Common Equity         | <u>50.91</u>   | <u>58,617,524</u>                  | 7.89                       | <u>4,625,456</u>                |
| Total                 | <u>100.00</u>  | <u>\$115,139,509</u>               |                            | <u>\$7,835,905</u>              |
| <b>APPROVED RATES</b> |                |                                    |                            |                                 |
| Long-Term Debt        | 49.09          | \$ 56,521,985                      | 5.68                       | \$3,210,449                     |
| Common Equity         | <u>50.91</u>   | <u>58,617,524</u>                  | 9.75                       | <u>5,715,207</u>                |
| Total                 | <u>100.00</u>  | <u>\$115,139,509</u>               |                            | <u>\$8,925,656</u>              |

SCHEDULE I-A

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Net Operating Income for a Return

For the Twelve Months Ended December 31, 2017

CWSNC Water Operations

|  | Present<br>Rates   | Increase<br>Approved | After<br>Approved<br>Increase |
|--|--------------------|----------------------|-------------------------------|
| Operating Revenues:                    |                    |                      |                               |
| Service revenues                       | \$16,931,032       | \$490,858            | \$17,421,890                  |
| Miscellaneous revenues                 | 189,225            | 1,325                | 190,550                       |
| Uncollectibles                         | <u>(98,200)</u>    | <u>(2,847)</u>       | <u>(101,047)</u>              |
| Total operating revenues               | <u>17,022,057</u>  | <u>489,336</u>       | <u>17,511,393</u>             |
| Operating Revenue Deductions:          |                    |                      |                               |
| Salaries and wages – Maintenance       | 2,587,126          | 0                    | 2,587,126                     |
| Purchased power                        | 957,880            | 0                    | 957,880                       |
| Purchased water and sewer              | 1,285,290          | 0                    | 1,285,290                     |
| Maintenance and repair                 | 828,186            | 0                    | 828,186                       |
| Maintenance testing                    | 208,965            | 0                    | 208,965                       |
| Meter reading                          | 197,562            | 0                    | 197,562                       |
| Chemicals                              | 224,644            | 0                    | 224,644                       |
| Transportation                         | 238,827            | 0                    | 238,827                       |
| Operating expense charged to plant     | (370,288)          | 0                    | (370,288)                     |
| Outside services – other               | 254,847            | 0                    | 254,847                       |
| Salaries and wages – General           | 1,120,684          | 0                    | 1,120,684                     |
| Office supplies & other office expense | 306,345            | 0                    | 306,345                       |
| Regulatory commission expense          | 90,071             | 0                    | 90,071                        |
| Pension and other benefits             | 713,025            | 0                    | 713,025                       |
| Rent                                   | 123,289            | 0                    | 123,289                       |
| Insurance                              | 233,072            | 0                    | 233,072                       |
| Office utilities                       | 413,686            | 0                    | 413,686                       |
| Miscellaneous                          | 15,929             | 0                    | 15,929                        |
| Depreciation expense                   | 2,877,977          | 0                    | 2,877,977                     |
| Amortization of CIAC                   | (712,658)          | 0                    | (712,658)                     |
| Amortization of PAA                    | (105,674)          | 0                    | (105,674)                     |
| Amortization of ITC                    | (287)              | 0                    | (287)                         |
| Franchise and other taxes              | (21,943)           | 0                    | (21,943)                      |
| Property taxes                         | 134,370            | 0                    | 134,370                       |
| Payroll taxes                          | 287,285            | 0                    | 287,285                       |
| Regulatory fee                         | 23,831             | 685                  | 24,516                        |
| Deferred income tax                    | (35,576)           | 0                    | (35,576)                      |
| State income tax                       | 102,338            | 14,660               | 116,998                       |
| Federal income tax                     | <u>694,876</u>     | <u>99,538</u>        | <u>794,414</u>                |
| Total operating revenue deductions     | <u>12,673,680</u>  | <u>114,883</u>       | <u>12,788,563</u>             |
| Net operating income for a return      | <u>\$4,348,377</u> | <u>\$374,453</u>     | <u>\$4,722,830</u>            |

SCHEDULE II-A

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Original Cost Rate Base

For the Twelve Months Ended December 31, 2017

CWSNC Water Operations

| <u>Item</u>                                    | <u>Amount</u>       |
|--|---------------------|
| Plant in service                               | \$109,412,912       |
| Accumulated depreciation                       | <u>(27,471,271)</u> |
| Net plant in service                           | 81,941,641          |
| Cash working capital                           | 1,017,981           |
| Contributions in aid of construction           | (18,419,357)        |
| Advance in aid of construction                 | (23,760)            |
| Accumulated deferred income taxes              | (1,699,612)         |
| Customer deposits                              | (191,669)           |
| Gain on sale and flow back taxes               | (196,947)           |
| Plant acquisition adjustment                   | (2,282,334)         |
| Excess book value                              | (456)               |
| Cost-free capital                              | (121,791)           |
| Average tax accruals                           | (71,951)            |
| Regulatory liability for excess deferred taxes | (144,323)           |
| Deferred charges                               | 1,116,295           |
| Pro forma plant                                | <u>0</u>            |
| Original cost rate base                        | <u>\$60,923,717</u> |

Rates of return:

|          |       |
|----------|-------|
| Present  | 7.14% |
| Approved | 7.75% |

SCHEDULE III-A

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Statement of Capitalization and Related Costs

For the Twelve Months Ended December 31, 2017

CWSNC Water Operations

|                       | <u>Ratio %</u> | <u>Original Cost<br/>Rate Base</u> | <u>Embedded<br/>Cost %</u> | <u>Net Operating<br/>Income</u> |
|-----------------------|----------------|------------------------------------|----------------------------|---------------------------------|
| <b>PRESENT RATES</b>  |                |                                    |                            |                                 |
| Long-Term Debt        | 49.09          | \$ 29,907,453                      | 5.68                       | \$1,698,743                     |
| Common Equity         | <u>50.91</u>   | <u>31,016,264</u>                  | 8.54                       | <u>2,649,634</u>                |
| Total                 | <u>100.00</u>  | <u>\$ 60,923,717</u>               |                            | <u>\$4,348,377</u>              |
| <b>APPROVED RATES</b> |                |                                    |                            |                                 |
| Long-Term Debt        | 49.09          | \$ 29,907,453                      | 5.68                       | \$1,698,743                     |
| Common Equity         | <u>50.91</u>   | <u>31,016,264</u>                  | 9.75                       | <u>3,024,087</u>                |
| Total                 | <u>100.00</u>  | <u>\$ 60,923,717</u>               |                            | <u>\$4,722,830</u>              |

SCHEDULE I-B

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Net Operating Income for a Return

For the Twelve Months Ended December 31, 2017

CWSNC Sewer Operations

|  | Present<br>Rates   | Increase<br>Approved | After<br>Approved<br>Increase |
|--|--------------------|----------------------|-------------------------------|
| Operating Revenues:                    |                    |                      |                               |
| Service revenues                       | \$12,685,778       | 291,163              | \$12,976,941                  |
| Miscellaneous revenues                 | 110,138            | 815                  | 110,953                       |
| Uncollectibles                         | <u>(74,846)</u>    | <u>(1,718)</u>       | <u>(76,564)</u>               |
| Total operating revenues               | <u>12,721,070</u>  | <u>290,260</u>       | <u>13,011,330</u>             |
| Operating Revenue Deductions:          |                    |                      |                               |
| Salaries and wages – Maintenance       | 1,540,179          | 0                    | 1,540,179                     |
| Purchased power                        | 748,066            | 0                    | 748,066                       |
| Purchased water and sewer              | 687,237            | 0                    | 687,237                       |
| Maintenance and repair                 | 1,606,630          | 0                    | 1,606,630                     |
| Maintenance testing                    | 302,561            | 0                    | 302,561                       |
| Meter reading                          | 0                  | 0                    | 0                             |
| Chemicals                              | 347,986            | 0                    | 347,986                       |
| Transportation                         | 142,640            | 0                    | 142,640                       |
| Operating expense charged to plant     | (219,769)          | 0                    | (219,769)                     |
| Outside services – other               | 154,330            | 0                    | 154,330                       |
| Salaries and wages – General           | 667,170            | 0                    | 667,170                       |
| Office supplies & other office expense | 183,350            | 0                    | 183,350                       |
| Regulatory commission expense          | 53,622             | 0                    | 53,622                        |
| Pension and other benefits             | 424,543            | 0                    | 424,543                       |
| Rent                                   | 73,562             | 0                    | 73,562                        |
| Insurance                              | 138,751            | 0                    | 138,751                       |
| Office utilities                       | 246,763            | 0                    | 246,763                       |
| Miscellaneous                          | 9,931              | 0                    | 9,931                         |
| Depreciation expense                   | 2,271,822          | 0                    | 2,271,822                     |
| Amortization of CIAC                   | (574,609)          | 0                    | (574,609)                     |
| Amortization of PAA                    | (22,136)           | 0                    | (22,136)                      |
| Amortization of ITC                    | (232)              | 0                    | (232)                         |
| Franchise and other taxes              | (17,738)           | 0                    | (17,738)                      |
| Property taxes                         | 79,520             | 0                    | 79,520                        |
| Payroll taxes                          | 171,028            | 0                    | 171,028                       |
| Regulatory fee                         | 17,809             | 407                  | 18,216                        |
| Deferred income tax                    | (39,438)           | 0                    | (39,438)                      |
| State income tax                       | 74,266             | 8,695                | 82,961                        |
| Federal income tax                     | <u>504,263</u>     | <u>59,043</u>        | <u>563,306</u>                |
| Total operating revenue deductions     | <u>9,572,107</u>   | <u>68,145</u>        | <u>9,640,252</u>              |
| Net operating income for a return      | <u>\$3,148,963</u> | <u>\$222,115</u>     | <u>\$3,371,078</u>            |

SCHEDULE II-B

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Original Cost Rate Base

For the Twelve Months Ended December 31, 2017

CWSNC Sewer Operations

| <u>Item</u>                                    | <u>Amount</u>       |
|--|---------------------|
| Plant in service                               | \$84,335,000        |
| Accumulated depreciation                       | <u>(21,353,928)</u> |
| Net plant in service                           | 62,981,072          |
| Cash working capital                           | 802,539             |
| Contributions in aid of construction           | (18,442,146)        |
| Advance in aid of construction                 | (9,180)             |
| Accumulated deferred income taxes              | (1,862,686)         |
| Customer deposits                              | (114,105)           |
| Gain on sale and flow back taxes               | (92,681)            |
| Plant acquisition adjustment                   | 271,225             |
| Excess book value                              | 0                   |
| Cost-free capital                              | (139,708)           |
| Average tax accruals                           | (43,322)            |
| Regulatory liability for excess deferred taxes | (85,491)            |
| Deferred charges                               | 220,825             |
| Pro forma plant                                | <u>0</u>            |
| Original cost rate base                        | <u>\$43,486,342</u> |
| Rates of return:                               |                     |
| Present  | 7.24%               |
| Approved                                       | 7.75%               |

SCHEDULE III-B

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Statement of Capitalization and Related Costs

For the Twelve Months Ended December 31, 2017

CWSNC Sewer Operations

|                       | <u>Ratio %</u> | <u>Original Cost<br/>Rate Base</u> | <u>Embedded<br/>Cost %</u> | <u>Net Operating<br/>Income</u> |
|-----------------------|----------------|------------------------------------|----------------------------|---------------------------------|
| <b>PRESENT RATES</b>  |                |                                    |                            |                                 |
| Long-Term Debt        | 49.09          | \$ 21,347,445                      | 5.68                       | \$1,212,535                     |
| Common Equity         | <u>50.91</u>   | <u>22,138,897</u>                  | 8.75                       | <u>1,936,428</u>                |
| Total                 | <u>100.00</u>  | <u>\$ 43,486,342</u>               |                            | <u>\$3,148,963</u>              |
| <b>APPROVED RATES</b> |                |                                    |                            |                                 |
| Long-Term Debt        | 49.09          | \$ 21,347,445                      | 5.68                       | \$1,212,535                     |
| Common Equity         | <u>50.91</u>   | <u>22,138,897</u>                  | 9.75                       | <u>2,158,543</u>                |
| Total                 | <u>100.00</u>  | <u>\$ 43,486,342</u>               |                            | <u>\$3,371,078</u>              |

SCHEDULE I-C

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Net Operating Income for a Return

For the Twelve Months Ended December 31, 2017

BF/FH/TC Water Operations

|  | Present<br>Rates | Decrease<br>Approved | After<br>Approved<br>Decrease |
|--|------------------|----------------------|-------------------------------|
| Operating Revenues:                    |                  |                      |                               |
| Service revenues                       | \$1,043,134      | \$273,574            | \$1,316,708                   |
| Miscellaneous revenues                 | 46,306           | 492                  | 46,798                        |
| Uncollectibles                         | <u>(15,334)</u>  | <u>(4,022)</u>       | <u>(19,356)</u>               |
| Total operating revenues               | <u>1,074,106</u> | <u>270,044</u>       | <u>1,344,150</u>              |
| Operating Revenue Deductions:          |                  |                      |                               |
| Salaries and wages – Maintenance       | 312,749          | 0                    | 312,749                       |
| Purchased power                        | 70,816           | 0                    | 70,816                        |
| Purchased water and sewer              | 0                | 0                    | 0                             |
| Maintenance and repair                 | 62,128           | 0                    | 62,128                        |
| Maintenance testing                    | 9,286            | 0                    | 9,286                         |
| Meter reading                          | 28,305           | 0                    | 28,305                        |
| Chemicals                              | 32,714           | 0                    | 32,714                        |
| Transportation                         | 32,241           | 0                    | 32,241                        |
| Operating expense charged to plant     | (40,679)         | 0                    | (40,679)                      |
| Outside services – other               | 22,632           | 0                    | 22,632                        |
| Salaries and wages – General           | 135,473          | 0                    | 135,473                       |
| Office supplies & other office expense | 34,624           | 0                    | 34,624                        |
| Regulatory commission expense          | 10,884           | 0                    | 10,884                        |
| Pension and other benefits             | 99,239           | 0                    | 99,239                        |
| Rent                                   | 14,938           | 0                    | 14,938                        |
| Insurance                              | 28,178           | 0                    | 28,178                        |
| Office utilities                       | 40,103           | 0                    | 40,103                        |
| Miscellaneous                          | (1,172)          | 0                    | (1,172)                       |
| Depreciation expense                   | 127,603          | 0                    | 127,603                       |
| Amortization of CIAC                   | (55,682)         | 0                    | (55,682)                      |
| Amortization of PAA                    | 14,897           | 0                    | 14,897                        |
| Amortization of ITC                    | 0                | 0                    | 0                             |
| Franchise and other taxes              | (3,653)          | 0                    | (3,653)                       |
| Property taxes                         | 9,645            | 0                    | 9,645                         |
| Payroll taxes                          | 34,729           | 0                    | 34,729                        |
| Regulatory fee                         | 1,504            | 378                  | 1,882                         |
| Deferred income tax                    | 1,178            | 0                    | 1,178                         |
| State income tax                       | (1,317)          | 8,090                | 6,773                         |
| Federal income tax                     | <u>(8,945)</u>   | <u>54,931</u>        | <u>45,986</u>                 |
| Total operating revenue deductions     | <u>1,012,417</u> | <u>63,399</u>        | <u>1,075,816</u>              |
| Net operating income for a return      | <u>\$61,689</u>  | <u>\$206,645</u>     | <u>\$268,334</u>              |

SCHEDULE II-C

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Original Cost Rate Base

For the Twelve Months Ended December 31, 2017

BF/FH/TC Water Operations

| <u>Item</u>                                    | <u>Amount</u>      |
|--|--------------------|
| Plant in service                               | \$5,924,076        |
| Accumulated depreciation                       | <u>(1,625,325)</u> |
| Net plant in service                           | 4,298,751          |
| Cash working capital                           | 111,557            |
| Contributions in aid of construction           | <u>(1,095,675)</u> |
| Advance in aid of construction                 | 0                  |
| Accumulated deferred income taxes              | 48,827             |
| Customer deposits                              | <u>(18,063)</u>    |
| Gain on sale and flow back taxes               | 0                  |
| Plant acquisition adjustment                   | 22,332             |
| Excess book value                              | 0                  |
| Cost-free capital                              | 0                  |
| Average tax accruals                           | <u>(5,124)</u>     |
| Regulatory liability for excess deferred taxes | <u>(10,756)</u>    |
| Deferred charges                               | 109,634            |
| Pro forma plant                                | <u>0</u>           |
| Original cost rate base                        | <u>\$3,461,483</u> |
| Rates of return:                               |                    |
| Present  | 1.78%              |
| Approved                                       | 7.75%              |

SCHEDULE III-C

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Statement of Capitalization and Related Costs

For the Twelve Months Ended December 31, 2017

BF/FH/TC Water Operations

|                       | <u>Ratio %</u> | <u>Original Cost<br/>Rate Base</u> | <u>Embedded<br/>Cost %</u> | <u>Net Operating<br/>Income</u> |
|-----------------------|----------------|------------------------------------|----------------------------|---------------------------------|
| <b>PRESENT RATES</b>  |                |                                    |                            |                                 |
| Long-Term Debt        | 49.09          | \$ 1,699,242                       | 5.68                       | \$96,517                        |
| Common Equity         | <u>50.91</u>   | <u>1,762,241</u>                   | <u>(1.98)</u>              | <u>(34,828)</u>                 |
| Total                 | 100.00         | <u>\$ 3,461,483</u>                |                            | <u>\$61,689</u>                 |
| <b>APPROVED RATES</b> |                |                                    |                            |                                 |
| Long-Term Debt        | 49.09          | \$ 1,699,242                       | 5.68                       | \$ 96,517                       |
| Common Equity         | <u>50.91</u>   | <u>1,762,241</u>                   | 9.75                       | <u>171,817</u>                  |
| Total                 | 100.00         | <u>\$ 3,461,483</u>                |                            | <u>\$268,334</u>                |

SCHEDULE I-D

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Net Operating Income for a Return

For the Twelve Months Ended December 31, 2017

BF/FH Sewer Operations

|  | Present<br>Rates | Increase<br>Approved | After<br>Approved<br>Increase |
|--|------------------|----------------------|-------------------------------|
| Operating Revenues:                    |                  |                      |                               |
| Service revenues                       | \$1,769,755      | \$379,343            | \$2,149,098                   |
| Miscellaneous revenues                 | 14,494           | 682                  | 15,176                        |
| Uncollectibles                         | <u>(26,015)</u>  | <u>(5,577)</u>       | <u>(31,592)</u>               |
| Total operating revenues               | <u>1,758,234</u> | <u>374,448</u>       | <u>2,132,682</u>              |
| Operating Revenue Deductions:          |                  |                      |                               |
| Salaries and wages – Maintenance       | 325,582          | 0                    | 325,582                       |
| Purchased power                        | 155,596          | 0                    | 155,596                       |
| Purchased water and sewer              | 0                | 0                    | 0                             |
| Maintenance and repair                 | 252,901          | 0                    | 252,901                       |
| Maintenance testing                    | 23,548           | 0                    | 23,548                        |
| Meter reading                          | 0                | 0                    | 0                             |
| Chemicals                              | 27,071           | 0                    | 27,071                        |
| Transportation                         | 33,563           | 0                    | 33,563                        |
| Operating expense charged to plant     | (42,329)         | 0                    | (42,329)                      |
| Outside services – other               | 23,560           | 0                    | 23,560                        |
| Salaries and wages – General           | 141,032          | 0                    | 141,032                       |
| Office supplies & other office expense | 36,044           | 0                    | 36,044                        |
| Regulatory commission expense          | 11,331           | 0                    | 11,331                        |
| Pension and other benefits             | 103,311          | 0                    | 103,311                       |
| Rent                                   | 15,550           | 0                    | 15,550                        |
| Insurance                              | 29,334           | 0                    | 29,334                        |
| Office utilities                       | 41,748           | 0                    | 41,748                        |
| Miscellaneous                          | (1,220)          | 0                    | (1,220)                       |
| Depreciation expense                   | 339,980          | 0                    | 339,980                       |
| Amortization of CIAC                   | (146,033)        | 0                    | (146,033)                     |
| Amortization of PAA                    | 58,548           | 0                    | 58,548                        |
| Amortization of ITC                    | 0                | 0                    | 0                             |
| Franchise and other taxes              | (6,368)          | 0                    | (6,368)                       |
| Property taxes                         | 10,040           | 0                    | 10,040                        |
| Payroll taxes                          | 36,153           | 0                    | 36,153                        |
| Regulatory fee                         | 2,462            | 524                  | 2,986                         |
| Deferred income tax                    | (9,719)          | 0                    | (9,719)                       |
| State income tax                       | 2,525            | 11,218               | 13,743                        |
| Federal income tax                     | <u>17,147</u>    | <u>76,168</u>        | <u>93,315</u>                 |
| Total operating revenue deductions     | <u>1,481,357</u> | <u>87,910</u>        | <u>1,569,267</u>              |
| Net operating income for a return      | <u>\$276,877</u> | <u>\$286,538</u>     | <u>\$563,415</u>              |



SCHEDULE II-D

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Original Cost Rate Base

For the Twelve Months Ended December 31, 2017

BF/FH Sewer Operations

| <u>Item</u>                                    | <u>Amount</u>      |
|--|--------------------|
| Plant in service                               | \$13,333,538       |
| Accumulated depreciation                       | <u>(2,504,593)</u> |
| Net plant in service                           | 10,828,945         |
| Cash working capital                           | 147,078            |
| Contributions in aid of construction           | <u>(4,226,230)</u> |
| Advance in aid of construction                 | 0                  |
| Accumulated deferred income taxes              | (459,121)          |
| Customer deposits                              | <u>(18,803)</u>    |
| Gain on sale and flow back taxes               | 0                  |
| Plant acquisition adjustment                   | 936,609            |
| Excess book value                              | 0                  |
| Cost-free capital                              | 0                  |
| Average tax accruals                           | (5,512)            |
| Regulatory liability for excess deferred taxes | <u>(11,200)</u>    |
| Deferred charges                               | 76,202             |
| Pro forma plant                                | <u>0</u>           |
| Original cost rate base                        | <u>\$7,267,968</u> |
| Rates of return:                               |                    |
| Present  | 3.81%              |
| Approved                                       | 7.75%              |

SCHEDULE III-D

**Carolina Water Service, Inc. of North Carolina**

Docket No. W-354, Sub 360

Statement of Capitalization and Related Costs

For the Twelve Months Ended December 31, 2017

BF/FH Sewer Operations

|                       | <u>Ratio %</u> | <u>Original Cost<br/>Rate Base</u> | <u>Embedded<br/>Cost %</u> | <u>Net Operating<br/>Income</u> |
|-----------------------|----------------|------------------------------------|----------------------------|---------------------------------|
| <b>PRESENT RATES</b>  |                |                                    |                            |                                 |
| Long-Term Debt        | 49.09          | \$ 3,567,845                       | 5.68                       | \$202,654                       |
| Common Equity         | <u>50.91</u>   | <u>3,700,123</u>                   | 2.01                       | <u>74,223</u>                   |
| Total                 | 100.00         | <u>\$ 7,267,968</u>                |                            | <u>\$ 276,877</u>               |
| <b>APPROVED RATES</b> |                |                                    |                            |                                 |
| Long-Term Debt        | 49.09          | \$ 3,567,845                       | 5.68                       | \$ 202,654                      |
| Common Equity         | <u>50.91</u>   | <u>3,700,123</u>                   | 9.75                       | <u>360,761</u>                  |
| Total                 | 100.00         | <u>\$ 7,267,968</u>                |                            | <u>\$ 563,415</u>               |

## **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 62 AND 63**

The evidence supporting these findings of fact is found in the Application and the accompanying NCUC Form W-1, and in the testimony and exhibits of CWSNC witness DeStefano and of Public Staff witness Casselberry.

CWSNC witness DeStefano testified that the Company's experience is consistent with that of the water utility industry in general, as CWSNC continues to experience a decline in consumption. He testified that this decline in consumption, combined with regulatory lag resulting from use of traditional historical test year ratemaking principles, impairs CWSNC's opportunity to achieve its Commission-authorized rate of return on equity. Witness DeStefano further testified that, in its Application, CWSNC requested authority to implement a "consumption band" water and wastewater rate adjustment mechanism within each of the Company's four rate divisions for non-purchased water and wastewater commodity customers. He explained that the proposed CAM is a mechanism that balances the risk and impact on ratepayers and shareholders of levels of water and wastewater consumption that are either significantly higher or significantly lower than those levels of consumption that were used to set rates. He further explained that should actual consumption be greater than 1% less than what was used in designing rates within the rate case, then a surcharge would be placed on the customers' bills for a period not to exceed 12 months to make the Company whole. Conversely, he stated that if actual consumption is greater than 1% higher than the consumption used to design rates within the rate case, then a negative surcharge would be applied to the customers' bills for a period not to exceed 12 months. Witness DeStefano requested that the Commission approve the water and wastewater CAM based on the Commission's inherent regulatory authority to do so in a general rate case, recognizing that a rulemaking proceeding would be required to develop and adopt the terms of such a mechanism, and based on a finding that the proposed CAM serves the public interest. Absent approval of a water and wastewater CAM, witness DeStefano contended the Company and its customers would continue to needlessly experience the vicissitudes of significant variances in consumption over a significant period.

Witness DeStefano further testified that the CAM is a mechanism that balances the risk and impact on ratepayers and shareholders of levels of water and wastewater consumption that are either significantly higher or significantly lower than those levels of consumption that were used to set the Company's base rates. In addition, he testified that, generally, an increased conservation ethic among customers and the proliferation of efficient water fixtures that conform to increasingly strict manufacturing standards, contribute to a persistent and gradual decline in consumption per customer. He testified that these factors are out of the control of the Company and will continue to drive consumption decline for the foreseeable future as older, less-efficient fixtures are replaced with more efficient fixtures and new homes are built at current efficiency standards. Witness DeStefano also testified that the water and sewer industry operates with a cost structure that is mostly fixed; however, the utility's revenues are generated in large portion by the variable consumption component of rates. Additionally, he testified that the Company's revenue requirement is set based on an expected "normal"

consumption level, which does not account for the considerable seasonal weather variations which can occur. He contended that it is highly unlikely that any particular year will result in exactly the level of consumption utilized in the setting of rates.

Witness DeStefano then testified that the proposed CAM helps to alleviate the negative impact to the Company of declining consumption and significant seasonal weather variation and to protect customers from overcollection in an increasing consumption scenario. In addition, he testified that such a mechanism would eliminate the throughput incentive, which currently presents the Company with conflicting motivations inasmuch as the Company is currently incentivized to sell more water to improve its financial performance, yet this would increase costs to customers and fail to promote conservation of a valuable resource. The CAM mechanism, he concluded, would remove this conflict and allow the Company to promote wise water use without concern for the impacts on its financial results, in short, better aligning the interests of customers and the Company.

Public Staff witness Casselberry testified that the Public Staff's position is that any new rate mechanism, such as a CAM, should be authorized by the North Carolina General Assembly (General Assembly) before being considered by the Commission for rulemaking. Witness Casselberry further testified that, assuming the Commission does have the authority or is granted the authority to approve a CAM, the Public Staff still opposes a CAM, based on the Public Staff's concerns with the 1% threshold proposed by CWSNC. More specifically, witness Casselberry testified that the 1% threshold could be triggered by 50 seconds longer in the shower or one additional flush of the commode per day. She argued that an alternate rate design should not be triggered by such an insignificant deviation in normal customer usage. When asked how customer growth may influence consumption, witness Casselberry testified that consumption and customer growth would have to be evaluated annually, that it is possible that customer growth may decrease and consumption increase or some other combination, and that any mechanism that benefits the Company by ensuring it collects its full revenue requirement should also benefit customers by crediting customers with revenue resulting from increased usage due to customer growth.

Witness Casselberry also testified in response to witness DeStefano's testimony that the overall trend of per-capita usage continues to decline, referring to Table 1 in his testimony, which highlighted the Company's average usage for a non-seasonal window. Witness Casselberry testified that the Company's average did not take into account the newly consolidated seasonal customers, such as those who live in Sapphire Valley, Connetsee Falls, and Fairfield Mountain who do not use water in the winter months and use 50% less than the average residential customer. She further testified that the reduction in consumption could also be due to higher rates after consolidation of CWSNC's service areas in the last rate case. Witness Casselberry also testified that water efficient appliances have been on the market for close to 10 years and that many customers have already installed these appliances. She testified that CWSNC's experienced reduction in consumption is more likely due to the age of the Company's meters. Witness Casselberry testified that CWSNC has no meter replacement program,

that many of CWSNC's meters are more than 30 years old, and that it is common knowledge that as meters age, they slow down. Witness Casselberry suggested that more historical data was necessary to determine what the consumption trend will be now that CWSNC's service areas have been consolidated.

In its post-hearing brief, the AGO argued that CWSNC's proposed CAM is not authorized by statute and that CWSNC has not justified the approval of a non-statutory rider. The AGO further argued that the new rider harms consumers by increasing the frequency of changes to rates outside of a general rate proceeding, by shifting business risks from investors to ratepayers, and by discouraging water conservation efforts. Like the Public Staff, the AGO noted that legislation was introduced in the regular session of the General Assembly in 2017 that, if adopted, would have authorized the creation of a rate adjustment mechanism for water and wastewater utilities based on changes in consumption, if the Commission should find such a mechanism to be in the public interest. However, the legislation was not enacted. The AGO concluded that, in light of the General Assembly's decision not to authorize this rate adjustment mechanism, the Commission should reject CWSNC's request that it approve such a mechanism as an exercise of discretion.

The AGO also argued that CWSNC had not justified the approval of a non-statutory rider, citing cases where the State appellate courts have approved non-statutory riders in limited circumstances involving highly variable and unpredictable expense or volume levels, of significant magnitude, that are beyond the control of the utility. The AGO concluded that the evidence adduced in this case does not compel approval of the new mechanism, based upon the following. First, the AGO cites the testimony of witness D'Ascendis, who testified that there is not any statistically significant change in investor-required return before or after the implementation of such a "decoupling" mechanism (i.e. a rate adjustment mechanism for changes in consumption), and that there are many things affecting publicly-traded companies, and this one factor is not measureable. Second, the AGO argued that the CAM is not justified by extreme variability or trends and the witnesses for CWSNC and the Public Staff did not agree about the significance of evidence regarding changes in consumption and whether the evidence indicates a problem of a magnitude requiring a new rate adjustment mechanism. Third, the AGO argued that the proposed mechanism is designed to make rate adjustments for changes in per customer consumption without consideration of other factors that tend to offset the impact, such as growth in the number of customers that CWSNC serves. Thus, the AGO argues that any mechanism that boosts rates relating to changes in per-customer consumption should also credit customers for increased growth in customer count. Fourth, the AGO argued that the CAM proposal would trigger a rate adjustment based on a relatively small departure from normal habits, such as by shortening a daily shower by less than a minute. Fifth, the AGO argued that, contrary to CWSNC's contention that the mechanism would balance the interests of the utility and its consumers, the new rider is harmful to consumers because it increases the frequency of changes to rates outside of general rate proceedings. The AGO contrasted the adjustments required in a general rate case, where CWSNC would be required to "net" all costs and benefits of operation at the time rates are set to take into consideration

offsetting cost decreases as well as other offsetting factors, with the proposed CAM. The AGO argued that the CAM would allow CWSNC to shift normal business risk associated with a single factor from its investors to ratepayers. Finally, the AGO argued that consumers will tend to be discouraged from investing in water conservation measures if their efforts are met with an offsetting rate increase. In sum, the AGO argued that the proposed CAM should be rejected because it is not authorized by statute, is not justified, and is harmful to consumers.

The Commission has carefully evaluated the foregoing evidence presented in this proceeding concerning CWSNC's request to implement a CAM and the entire record in this proceeding. The Commission finds persuasive the evidence presented by the Public Staff, and agrees with the arguments of the Public Staff and the AGO that the proposed CAM is not appropriately structured. More specifically, the Commission agrees with Public Staff witness Casselberry that the 1% threshold is too narrow, and would inappropriately trigger a rate change based on relatively small departures from normal consumption habits, such as shortening a daily shower by less than one minute or one additional flush of the commode. The Commission, therefore, finds that CWSNC has not demonstrated that a consumption adjustment mechanism is reasonable or justified. In making this finding, the Commission gives substantial weight to the arguments of the Public Staff and the AGO that the mechanism was designed to make rate adjustments for changes in per-customer consumption without consideration of other factors that tend to offset the impact, such as growth in the number of customers that the Company serves and periods of warm weather. The Commission concludes that these factors are relevant in determining whether circumstances establish that a decline in consumption denies the Company a reasonable opportunity to earn its authorized rate of return and whether the CAM is reasonable or justified based on the evidence in this case. The Commission finds the testimony of CWSNC witness DeStefano generally unpersuasive. Specifically, witness DeStefano's testimony is unpersuasive because, as witness Casselberry testified, the proposed CAM does not account for customer growth, potentially allowing CWSNC to earn its reasonable revenue requirement in a year when declining consumption is offset by customer growth.

Based upon the foregoing and the entire record herein, the Commission finds that CWSNC has failed to demonstrate that its proposed CAM is reasonable or justified for the purposes of this case. The Commission, therefore, concludes that CWSNC's request for approval to implement its proposed CAM should be denied.

#### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 64 – 68**

The evidence supporting these findings of fact is found in the Application and the accompanying NCUC Form W-1, and in the testimony and exhibits of Public Staff witness Casselberry and CWSNC witness DeStefano.

The water rates proposed by CWSNC in its Application were based on a fixed-to-variable ratio of 47% fixed for the base facility charge and 53% variable for the usage charge. Further, as part of its Application and as a matter of rate design in this

case, CWSNC proposed no rate changes for customers in the CLMS service area. CWSNC stated that its proposal to not increase (but hold constant) the water and sewer rates for those affected customers is consistent with the ratemaking and rate design approved by the Commission in the Company's last three general rate cases (Docket Nos. W-354, Subs 336, 344, and 356) and will continue the orderly process of moving the CLMS service area toward full inclusion in the Company's uniform water and sewer rates in future general rate cases.

With respect to sewer rates, Paragraph 25 of the Company's Application stated that, pursuant to Paragraph No. 15 (entitled, "Metered Sewer Rates") of the Joint Stipulation between CWSNC and the Public Staff filed in the Sub 356 Proceeding on September 9, 2017, the Company agreed to:

...consider implementing metered sewer rates for customers in its Fairfield Harbour, Bradfield Farms, and Sapphire Valley service areas in the Company's next general rate case filing and reserves the right to independently propose metered sewer rates for these systems. (Footnote omitted)

In its Application, CWSNC stated that, after careful consideration, the Company decided to file its Application premised upon continuation of flat rate sewer service for customers in its Fairfield Harbour, Bradfield Farms, and Sapphire Valley service areas, but that the Company was willing to discuss this matter with the Public Staff and reserved the right, after such consultation, to either affirm the current decision to continue flat rates or, instead, propose metered rates for the three service areas in question.

In regard to rate design, CWSNC witness DeStefano testified that, as an alternative proposal to CWSNC's requested CAM, the Company requested that the Commission find it reasonable, necessary, and appropriate to direct the parties to develop a rate design that is based on a 60% to 40% ratio of base facility to volumetric charges for water. He testified that this would be a change from the Company's current ratio of approximately 50%/50%, base to volumetric. According to witness DeStefano, the proposed ratio is needed to more closely align cost recovery with actual costs incurred. He argued that with the current ratio of approximately 50%/50%, base to volumetric, the recovery to actual costs incurred is not properly aligned. Witness DeStefano testified that the Company is currently experiencing an actual cost ratio of approximately 80%/20% fixed to variable, yet rates are designed with an approximately 50%/50% ratio for fixed and variable. He maintained that this misalignment hinders the Company's ability to earn its fair and reasonable return should consumption continue its decline. Witness DeStefano contended that the consumption trend across the industry is currently one of decline due to conservation efforts and the installation of more efficient water fixtures. Witness DeStefano testified that the current rate design reduces the Company's ability to promote conservation efforts without negatively impacting its ability to earn a fair and reasonable return.

Public Staff witness Casselberry testified that in the Sub 356 Proceeding, the Public Staff recommended that CWSNC consider implementing metered sewer rates for customers in its Sapphire Valley, Fairfield Harbour, and Bradfield Farms Subdivision service areas, and reserved the right to independently propose metered sewer rates for these systems. Witness Casselberry stated that as part of the settlement agreement in the Sub 356 Proceeding, CWSNC supported the recommendation and agreed to undertake such consideration in conjunction with its next general rate case. Witness Casselberry noted that, in this proceeding, CWSNC decided not to implement metered sewer rates for customers in those service areas.

Witness Casselberry testified that, since sewer customers in Sapphire Valley were incorporated into CWSNC's uniform sewer rate division, they should be charged the same rate as other metered sewer customers within that rate division. In addition, customers with multiple units behind a master meter should be billed the same way as the other master metered customers, which specifies that commercial customers, including condominiums or other property owner associations who bill their members directly, shall have a separate account set up for each meter and each meter shall be billed separately based on the size of the meter and usage associated with the meter as stated in the schedule of rates for water and sewer service.

Further, witness Casselberry testified that it was also the Public Staff's position that since Bradfield Farms and Fairfield Harbour are in their own separate rate division and all of the customers in that rate division have flat sewer rates and the Public Staff received only one complaint concerning the flat rate, the Public Staff agreed with the Company that the flat rate should remain for the BF/FH rate division. However, she recommended that, in the future, should the BF/FH rate division be eliminated and customers are incorporated into the CWSNC uniform sewer rate division, they too should be charged the metered sewer rate for customers who also have metered water. Witness Casselberry testified that it was also her understanding that the Company agreed with the Public Staff's recommendation that customers in Sapphire Valley should be billed the uniform metered sewer rate and that customers in Bradfield Farms and Fairfield Harbour should be billed a flat sewer rate in this general rate case.

Regarding the customers in the Linville Ridge Subdivision and The Ridges at Mountain Harbour (The Ridges), witness Casselberry testified that the Public Staff recommends uniform metered water rates. The Public Staff also recommended purchased sewer rates for The Ridges. Witness Casselberry testified that since CWSNC's last general rate case, water meters have been installed for all the residential customers in Linville Ridge and The Ridges. Both systems are located in the mountains and are considered seasonal mountain systems, because many of the customers' premises are occupied only during the summer months and during holidays. Witness Casselberry testified that she had evaluated the consumption for the other seasonal mountain systems and determined that the average residential monthly consumption is 1,920 gallons. She stated that it was her understanding that CWSNC has agreed that using 1,920 gallons as the estimated consumption for calculated revenue is reasonable and acceptable for Linville Ridge and The Ridges.

According to witness Casselberry, The Ridges is a purchased sewer system. CWSNC purchases sewage treatment from Clay County Water and Sewer District. Clay County charges a flat bi-monthly rate of \$1,621.24. Based on the billing data provided, there are 44 single-family equivalents (SFEs). The base facility charge per SFE is \$18.42 (\$1621.24/2 months/44 SFE). Witness Casselberry recommended the following base facility charges:

|                       |          |
|-----------------------|----------|
| Residential customers |          |
| < 1" meter            | \$ 18.42 |

|                       |          |
|-----------------------|----------|
| Commercial customers: |          |
| < 1" meter            | \$ 18.42 |
| 2" meter              | \$147.36 |

Witness Casselberry testified that it was her understanding that CWSNC agreed with the Public Staff's recommended base facility charges for The Ridges.

Witness Casselberry testified that Carolina Trace is a purchased water system and the supplier is the City of Sanford (City). She noted that the usage rate is established based on the supplier's rate and that the existing usage charge is \$2.21 per 1,000 gallons. She explained that under the general statutes, utility companies may petition the Commission for a pass-through outside of a general rate case which allows a company to directly pass on to customers the increased cost of purchased water. She observed that in this proceeding, there is no change in the City's usage charge and, therefore, CWSNC is proposing the same usage charge as the existing usage rate. However, witness Casselberry testified that since Carolina Trace is in the uniform water rate division, should the base charge for uniform rates increase, the new rate would apply to Carolina Trace as well.

Witness Casselberry further testified that CWSNC proposed, as an alternative to a CAM, that the Commission should direct the parties to develop a rate design that is based on a 60%/40% ratio of base charge to usage charge for water versus the current ratio of approximately 50%/50%. Witness Casselberry opposed CWSNC's alternative proposal. Witness Casselberry calculated the current ratio as 47%/53% base charge to usage charge based upon the end of period (EOP) residential customers for uniform rates, with meters less than one inch, and actual consumption for the test year period ending December 31, 2017 (not including Elk River or purchased water customers). In regard to rate design and seasonal customers, witness Casselberry testified that in order for seasonal customers to have water and sewer service year round, the water and sewer facilities must remain operational year round. Witness Casselberry explained that the base charge covers those costs to keep the systems operating such as testing, purchased power, maintenance and repairs, chemicals, sludge removal, salaries, and other general fixed costs. Witness Casselberry testified that the Public Staff would like to take the present ratio closer to a range of 40%/60% base charge to usage charge; thus, she recommended a ratio in the range of 45%/55% base charge to usage charge for this



proceeding, which she noted is consistent with what has been recommended by the Public Staff in the past.

Witness Casselberry testified that it is the Public Staff's position that higher usage charges promote conservation and that when the base charge is increased and the consumption charge is reduced, customers have a tendency to use more water and they also have less control over their water bill. She opined that with a higher base charge, customers have less ability to reduce their bills. In addition, witness Casselberry testified that, according to the customer testimony received at the public hearings, base charges are getting extremely high and that it is becoming difficult for some CWSNC customers to pay their base charges.

On cross-examination, witness Casselberry testified that some of the declining consumption that CWSNC has experienced may be attributed to aged meters and that the Company should implement a meter changeout plan to recoup such lost consumption. She commented that many of CWSNC's systems are over 30 years old and some of these systems still have the same meters installed that were in use when CWSNC originally acquired the systems. Witness Casselberry recommended that CWSNC evaluate the status of its current meters and implement an appropriate meter changeout program.

In his rebuttal testimony, witness DeStefano responded to witness Casselberry's view that higher base charges do not encourage conservation. He asserted that witness Casselberry's statement exemplifies the throughput incentive conflict in that the Public Staff believes a lower base charge encourages conservation, which may be reasonable. However, he contended that absent a CAM to stabilize revenues, this adds revenue volatility to the Company due to a higher proportion of revenues being subject to the unpredictability and the unexpected changes of seasonal weather patterns and any conservation measures adopted by customers. Witness DeStefano maintained that the Company is therefore not properly incented to promote conservation, and the Public Staff's position on rate design highlights the need to implement the CAM. Witness DeStefano testified that, if the Commission does not approve implementation of CWSNC's proposed CAM, the Company alternatively requests that the Commission find it reasonable, necessary, and appropriate to direct the parties to develop a rate design that is based on a 60%/40% ratio of base charges to volumetric charges for water.

Based upon the foregoing and the entire record herein, the Commission finds that the following specific rate design proposals recommended by Public Staff witness Casselberry and agreed to by the Company which were not opposed by any party, are reasonable and appropriate:

- That sewer customers in Sapphire Valley, who were incorporated into CWSNC's uniform sewer rate division, should be charged the same rate as other metered sewer customers within that rate division.

- That sewer customers in Bradfield Farms and Fairfield Harbour should continue to be charged a flat rate.
- That CWSNC's uniform metered water rates should be charged to customers in Linville Ridge and at The Ridges at Mountain Harbor based on the Public Staff's estimated usage of 1,920 gallons per EOP customer per month, consistent with the average for CWSNC's other seasonal mountain systems.
- That customers at The Ridges at Mountain Harbor should be charged purchased sewer rates at the Public Staff's recommended base facility charge, which is \$18.42 per SFE. The resulting base facility charges, exclusive of the collection charge that is the same as for customers in all of CWSNC's purchased sewer systems are shown below.

|                       |          |
|-----------------------|----------|
| Residential customers |          |
| < 1" meter            | \$ 18.42 |
| Commercial customers: |          |
| < 1" meter            | \$ 18.42 |
| 2" meter              | \$147.36 |

Further, the Commission concludes, consistent with the recommendation of witness Casselberry, that CWSNC's customers in Carolina Trace, which is a purchased water system in the CWSNC uniform water rate division, should be charged the same base charge as approved in this case for that rate division.

In this case, CWSNC proposed no rate changes for customers in the Company's CLMS service area. CWSNC maintained that its proposal to not increase (but hold constant) the water and sewer rates for its customers in the CLMS service area is consistent with the ratemaking and rate design approved by the Commission in the Company's last three general rate cases (Docket Nos. W-354, Subs 336, 344, and 356) and will continue the orderly process of moving the CLMS service area toward full inclusion in the Company's uniform water and sewer rates in future general rate cases. No party to this case opposed the Company's recommendation to maintain the status quo of rates for the CLMS service area. Accordingly, the Commission finds good cause to not increase (but hold constant) the sewer rates for the CLMS service area.

As discussed in the preceding section, the Commission concluded that CWSNC's request for approval to implement its proposed CAM should be denied. In conjunction with the Company's CAM request, CWSNC also proposed a metered water rate structure for purposes of designing rates in this proceeding consisting of 47%/53% ratio of base charge to usage charge. Alternatively, if the proposed CAM was not approved, the Company proposed a ratio of 60%/40% base charge to usage charge for rate design purposes.

The Public Staff opposed using CWSNC's alternative to a CAM in this proceeding. Witness Casselberry testified that since the Public Staff would like to take the ratio closer to a 40%/60% base charge to usage charge ratio to promote conservation and give customers more control over their bills, she recommended the slightly lower ratio range of 45%/55% base charge to usage charge for this proceeding rather than the present ratio of 47%/53%.

Based upon the foregoing and the entire record herein, the Commission determines that the appropriate ratio of base charge to usage charge for use in this proceeding is 52%/48%. In reaching this conclusion, the Commission gives equal weight to the testimony of CWSNC witness DeStefano and of Public Staff witness Casselberry. Witness DeStefano testified that CWSNC continues to experience a consistent decline in consumption due to conservation efforts by customers and the installation of more water efficient household fixtures, and witness Casselberry's Late-Filed Exhibit 1 lends support to witness DeStefano's assertion concerning declining consumption. Further, the Commission notes that the testimony of witness Casselberry indicated that both CWSNC uniform water rate division and the BF/FH/TC water rate division had a customer growth factor of less than 1% in this proceeding. Tr. Vol. 8, p. 302. Consequently, the Commission recognizes that CWSNC would not have the opportunity to recover any significant portion of its declining consumption through customer growth.

The Commission also agrees with witness DeStefano that the rate design proposed by the Public Staff is weighted too heavily toward variable costs, in light of witness Casselberry's testimony that approximately 75%<sup>22</sup> of the Company's water service costs are fixed. Tr. Vol. 7, p. 343. Both these witnesses generally agreed that CWSNC has a substantial number of seasonal customers who have water and/or sewer service available on-demand year round, but do not contribute to cost recovery through CWSNC's volumetric charges to the same extent as year-round customers. Furthermore, the Commission recognizes the importance of the Public Staff's stated goal to encourage conservation through a decline in consumption, and relying on higher usage charges to provide incentive to customers to do so. However, the Public Staff's proposed rate design could also have the unintended effect of making it even more difficult for the Company to achieve and earn its allowed return and diminishing the Company's incentive to promote conservation of a natural resource by its customers and, ultimately, cause more frequent general rate case filings. The Commission concludes that approving a rate design in this proceeding which should work to reduce the need for CWSNC to file frequent rate case applications would benefit customers in the long term, as customers ultimately pay through monthly rates the reasonable and prudent costs incurred for rate case filings.

Having carefully weighed these competing goals or interests, and having considered the foregoing and the entire record herein, the Commission finds that it is appropriate to utilize a ratio of 52%/48% base charge to usage charge in this proceeding. The Commission concludes that such rate design is fair and reasonable to both CWSNC and its customers as it appropriately balances the competing interests involved, as testified to by the witnesses in this proceeding. Therefore, taking into account the

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<sup>22</sup> CWSNC witness DeStefano testified that 80% of the Company's water service costs are fixed.

foregoing findings and conclusions, the Commission concludes that the rates and charges included in Appendices A-1, A-2, A-3, B-1, and B-2 are just and reasonable and should be approved.

Finally, the Commission notes that CWSNC's requested changes in its rate design, and the Public Staff's opposition thereto, is not unique to this case.<sup>23</sup> The Commission's experience in deciding the issues in this case and other general rate cases has informed the Commission's view that the problems that CWSNC asserts concerning declining consumption and revenue volatility due to the unpredictability and unexpected changes in weather patterns that make it difficult for the Company to generate revenue that is both stable and sufficient to cover its fixed costs of providing service to its customers is one that merits further consideration outside the context of a discrete general rate case. Although the tension between a utility's desire for stable and sufficient revenue generation, on the one hand, and policies that support conservation, on the other, is not a new phenomenon, the Commission acknowledges that there are new tools available to utilities and regulators and new research publications that may support addressing these issues in a more nuanced manner than the Company's proposal in this case. Therefore, the Commission will open a generic docket, by issuance of a forthcoming order, to investigate issues related to rate design, and require CWSNC, the Public Staff, and other specifically selected water utilities to participate in such a proceeding. The Commission's goal in doing so will be to explore and consider rate design proposals that may better achieve the utility's desire for revenue sufficiency and stability, while also sending appropriate price signals to consumers that support and encourage water efficiency and conservation.

### **EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 69 AND 70**

The evidence supporting these findings of fact is found in the Commission's prior Orders approving rulemaking in Docket No. W-100, Sub 54 establishing the procedures for implementing and applying the WSIC and SSIC approved in CWSNC's rate case in Docket No. W-354, Sub 336 and in the Commission's prior Orders approving WSIC and SSIC mechanisms for CWSNC and the other Utilities, Inc. companies that have been merged into CWSNC.

The Commission's previously approved WSIC/SSIC improvement charge rate adjustment mechanism continues in effect, although it has been reset to zero in this rate case. The WSIC/SSIC mechanism is designed to recover, between rate case proceedings, the costs associated with investment in certain completed, eligible projects for water and sewer system or water quality improvements pursuant to N.C.G.S. § 62-133.12. The WSIC/SSIC surcharge is subject to commission approval and to audit and refund provisions. Any cumulative system improvement charge recovered pursuant to the WSIC/SSIC mechanism may not exceed 5% of the total annual service revenues approved by the Commission in this rate case proceeding.

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<sup>23</sup> See, e.g., Docket No. W-218, Sub 497, a general rate case proceeding for Aqua North Carolina, Inc.

Based on the service revenues set forth and approved in this Order, the maximum WSIC/SSIC charges as of the effective date of this Order are:

| <u>Item</u>                    | <u>Service Revenues</u> | <u>Cap %</u> | <u>WSIC &amp; SSIC Cap</u> |
|--------------------------------|-------------------------|--------------|----------------------------|
| CWSNC Uniform Water Operations | \$17,421,890            | X 5% =       | \$871,095                  |
| CWSNC Uniform Sewer Operations | \$12,976,941            | X 5% =       | \$648,847                  |
| BF/FH/TC Water Operations      | \$1,316,708             | X 5% =       | \$65,835                   |
| BF/FH Sewer Operations         | \$2,149,098             | X 5% =       | \$107,455                  |

### **EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 71**

With respect to CWSNC's bonding requirements, CWSNC presently has posted with the Commission a \$3,730,000 bond, secured by a letter of credit from The Toronto-Dominion Bank, New York Branch. Such bond was approved by Commission Order issued on September 27, 2016, in Docket No. W-354, Sub 350, et al. (In the Matter of a Joint Application by Carolina Water Service, Inc. of North Carolina, Bradfield Farms Water Company, Carolina Trace Utilities, Inc., CWS Systems, Inc., Elk River Utilities, Inc., and Transylvania Utilities, Inc. for Approval of Merger). As of the date of this Order, an amount of \$3,690,000 of the approved bond has been assigned to the existing service areas of CWSNC, leaving an amount of \$40,000 of bond and surety unassigned.

Upon review of the Commission's bond files, it was determined that in its Order Approving Merger, issued on August 2, 2010, in Docket Nos. W-354, Sub 326; W-1152, Sub 8; and W-1151, Sub 7, the Commission assigned \$20,000 of CWSNC's unassigned bond to Amherst Subdivision in Wake County, North Carolina and \$20,000 of the unassigned bond to the Carolina Pines Service Area in Craven County, North Carolina and stated that the bonds previously posted by Nero Utility Services, Inc. and Carolina Pines Utility, Inc. would be released to those entities (which were owned by Utilities, Inc.) upon the Commission's receipt of written notification that the merger has been completed.

On September 1, 2010, Utilities, Inc. filed a letter with the Commission providing notification that the merger had been completed. The Commission has determined that neither the \$20,000 bond and certificate of deposit surety from BB&T for Amherst Subdivision nor the \$20,000 bond and certificate of deposit surety from BB&T posted for the Carolina Pines Service Area have been released to UI. The Commission concludes that since UI has satisfied the requirement for the release of these two bonds and sureties as established by a previous Commission Order and that the Commission's bonding requirements for these two service areas are now included in CWSNC's present bond posted with the Commission in Docket No. W-354, Sub 350, et al., the two \$20,000 bonds and sureties relating to Amherst Subdivision and the Carolina Pines Service Area should be released to UI. With the release of these two bonds and sureties, CWSNC has a total bond and surety of \$3,730,000 posted with the Commission, of which \$3,690,000 has been assigned to existing service areas of CWSNC and \$40,000 is unassigned.

IT IS, THEREFORE, ORDERED as follows:

1. That the Partial Joint Settlement Agreement and Stipulation is incorporated by reference herein and is hereby approved in its entirety;
2. That the Partial Joint Settlement Agreement and Stipulation, filed on September 17, 2018, and the parts of this Order pertaining to the contents of that agreement shall not be cited or treated as precedent in future proceedings;
3. That the Schedules of Rates, attached hereto as Appendices A-1, A-2, A-3, and A-4, and the Schedules of Connection Fees for Uniform Water and Uniform Sewer, attached hereto as Appendices B-1 and B-2, are hereby approved and deemed to be filed with the Commission pursuant to N.C.G.S. § 62-138, and are hereby authorized to become effective for service rendered on and after the issuance date of this Order;
4. That the Notices to Customers, attached hereto as Appendices C-1 and C-2 shall be mailed with sufficient postage or hand delivered to all affected customers in each relevant service area, respectively, in conjunction with the next regularly scheduled billing process;
5. That CWSNC shall file the attached Certificate of Service, properly signed and notarized, not later than 10 days after the Notices to Customers are mailed or hand delivered to customers;
6. That CWSNC shall refund to ratepayers the overcollection of federal income taxes related to the decrease in the federal corporate income tax rate for the period beginning January 1, 2018, including interest at the overall weighted cost of capital, as a credit to customers' bills for a one-year period beginning when the new rates become effective in the present docket;
7. That the decision reached by the Commission in CWSNC's Sub 356 Order to amortize over three years the Company's state EDIT recorded pursuant to the Commission's Sub 138 Order shall remain in full force and effect;
8. That the unprotected EDIT associated with the reduction in the federal corporate income tax rate shall be returned by CWSNC to ratepayers through a levelized rider to rates over a four-year period;
9. That the protected federal EDIT shall be amortized by CWSNC over 45 years in accordance with the IRC;
10. That in CWSNC's next general rate case proceeding, CWSNC and the Public Staff shall evaluate in detail and determine the appropriate methodology to calculate CIAC and PAA amortization expense for the post-merger entity on a going-forward basis for ratemaking purposes in order to ensure that contributed property is depreciated at the same rate that the related CIAC is amortized;

11. That, within 180 days of the date of this Order, CWSNC shall file a report with the Commission on the progress of the capital project intended to resolve the quality of service concern identified by Ms. Brown, one of the public witnesses appearing at the public hearing in Asheville, as is discussed in more detail in this Order. Such report shall state whether Ms. Brown has indicated to CWSNC that the final resolution of the issue is satisfactory;

12. That the two certificate of deposit bond sureties previously filed by Utilities, Inc. (as noted above) from BB&T for Amherst Subdivision in Wake County and for the Carolina Pines Service Area in Craven County, North Carolina shall be released to Utilities, Inc. The Chief Clerk shall file a copy of the letter to Utilities, Inc. from the Deputy Clerk releasing the bond sureties in Docket Nos. W-354, Sub 326, W-1152, Sub 8, W-1151, Sub 7, and this docket;

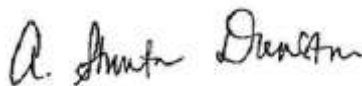
13. That the Chief Clerk shall establish Docket No. W-354, Sub 360A as the single docket to be used for all future WSIC/SSIC filings, orders, and reporting requirements. To that end, the Chief Clerk shall copy CWSNC's WSIC/SSIC pending application filed on January 31, 2019, in Docket No. W-354, Sub 356A and Sub 360 into Docket No. W-354, Sub 360A; and

14. That the Chief Clerk shall close Docket No. W-354, Subs 356A, 344A, and 336A.

ISSUED BY ORDER OF THE COMMISSION.

This the 21<sup>st</sup> day of February, 2019.

NORTH CAROLINA UTILITIES COMMISSION

A handwritten signature in dark ink, appearing to read "A. Shonta Dunston".

A. Shonta Dunston, Deputy Clerk

Commissioner Daniel G. Clodfelter concurring in part and dissenting in part.

## DOCKET NO. W-354, SUB 360

### **Commissioner Daniel G. Clodfelter, concurring in part and dissenting in part:**

On all save one point I join in the Commission's opinion and in the result. My difference is in the matter of rate design and more specifically in the Commission's approval of a rate structure whereby the Company will earn 52% of its revenue requirement from fixed charges and the remaining 48% from volumetric charges. There is no special magic to the 52%/48% ratio of revenues from fixed charges to revenue from volumetric charges settled on by the Commission. The Public Staff advocated for a ratio of 45% revenue from fixed charges to 55% revenue from variable charges for setting rates, while testifying that it would prefer to move as close to a 40% fixed to 60% variable ratio as possible. The Company proposed a revenue ratio of 47% fixed to 53% variable if the requested CAM adjustment mechanism was approved and a ratio of 60% fixed to 40% variable without the CAM.<sup>1</sup> The actual figures for the Company's test year, as calculated by witness Casselberry, were 47% of revenue derived from fixed charges and 53% derived from volumetric rates. Nothing in the evidence presented by any of the witnesses supports a conclusion that any particular one of these ratios or, for that matter, any other ratio within the range of values advocated by the parties will ensure just the right balance between the need for revenue stability to cover fixed costs and a rate design that will encourage water efficiency and conservation.

The tension between the policy goal of providing adequate and stable revenue to cover a high level of fixed costs, a feature inherent in most water and sewer systems, and the second policy goal of encouraging water use reduction is very real and has worsened in recent years as appliances have become more efficient and as drought events have changed public consciousness of the relative abundance or scarcity of water. This tension is not, however, unmanageable, and the academic and research literature together with extensive real world experience by public and private water utilities demonstrate that there are a number of different techniques that have now been adopted, either in general use or as experiments, that can mitigate the conflicts between the competing objectives of revenue stability and water conservation.<sup>2</sup> Some of these mechanisms are more complex than others, and many of them take advantage of increasingly sophisticated data resources concerning customer usage patterns. All of them are more nuanced than the Company's proposals or the Commission's result in this case, and they attempt to accommodate both major goals for rate design without sacrificing or ignoring either one. A "single factor" approach to managing the conflicting

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<sup>1</sup> I agree with and concur in the Commission's refusal to approve the CAM adjustment mechanism for the reasons stated in the Commission's opinion.

<sup>2</sup> See, e.g., "Designing Water Rate Structures for Conservation and Revenue Stability," a 2014 joint study report by the Environmental Finance Center at the University of North Carolina at Chapel Hill and the Sierra Club Lone Star Chapter concerning rate design options in Texas; and "Achieving Revenue Stability through Your Water Rate Structure," a 2017 webinar presentation by, among others, the Environmental Finance Center at the University of North Carolina at Chapel Hill and the American Water Works Association. This is a topic on which the Environmental Finance Center has recognized expertise which could be invaluable to this Commission.



objectives by simply adjusting the ratio of fixed to variable charges ignores this available research and field experience and misses opportunities for the Company to implement rate designs that are tailored to the unique characteristics of its systems, its customers, and their usage patterns.

I fully agree with the Commission majority that it is time to open a generic docket to explore alternative ratemaking options for water and sewer companies regulated by the Commission for the sound reasons articulated in the Commission's order. Where I differ is that I would maintain the existing ratio of fixed to volumetric charges unchanged pending the conclusion of proceedings in that separate docket. This is especially so since I can find nothing in this record that supports picking any one fixed-to-variable ratio rather than any other. I find no persuasive evidence in this record that maintaining the present rate design will unreasonably hinder the Company's operations or its chance to earn its permitted rate of return while the Commission conducts a more thorough examination of the question.

/s/ Daniel G. Clodfelter  
Commissioner Daniel G. Clodfelter

SCHEDULE OF RATES

for

CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA

for providing water and sewer utility service

in

ALL OF ITS SERVICE AREAS IN NORTH CAROLINA

(excluding Corolla Light, Monteray Shores, Fairfield Harbour Service Area, Treasure Cove, Register Place Estates, North Hills and Glen Arbor/North Bend Subdivisions, Bradfield Farms, Larkhaven, Silverton, and Woodland Farms Subdivisions, and Hawthorne at the Green Apartments)

WATER RATES AND CHARGES

Monthly Metered Water Service (Residential and Commercial):

Base Facility Charge (based on meter size with zero usage):

|            |            |
|------------|------------|
| < 1" meter | \$ 27.53   |
| 1" meter   | \$ 68.83   |
| 1½" meter  | \$ 137.65  |
| 2" meter   | \$ 220.24  |
| 3" meter   | \$ 412.95  |
| 4" meter   | \$ 688.25  |
| 6" meter   | \$1,376.50 |

Usage Charge:

|  |         |
|--|---------|
| A. Treated Water, per 1,000 gallons  | \$ 7.08 |
| B. Untreated Water, per 1,000 gallons<br>(Brandywine Bay Irrigation Water) | \$ 4.11 |

Commercial customers, including condominiums or other property owner associations who bill their members directly, shall have a separate account set up for each meter and each meter shall be billed separately based on the size of the meter and usage associated with the meter.

C. Purchased Water for Resale, per 1,000 gallons:

| <u>Service Area</u>                 | <u>Bulk Provider</u>   |    |      |
|-------------------------------------|------------------------|----|------|
| Carolina Forest                     | Montgomery County      | \$ | 3.19 |
| High Vista Estates                  | City of Hendersonville | \$ | 3.25 |
| Riverpointe                         | Charlotte Water        | \$ | 6.30 |
| Whispering Pines                    | Town of Southern Pines | \$ | 2.23 |
| White Oak Plantation/<br>Lee Forest | Johnston County        | \$ | 2.40 |
| Winston Plantation                  | Johnston County        | \$ | 2.40 |
| Winston Point                       | Johnston County        | \$ | 2.40 |
| Woodrun                             | Montgomery County      | \$ | 3.19 |
| Yorktown                            | City of Winston-Salem  | \$ | 5.01 |
| Zemosa Acres                        | City of Concord        | \$ | 5.27 |
| Carolina Trace                      | City of Sanford        | \$ | 2.21 |

When because of the method of water line installation utilized by the developer or owner, it is impractical to meter each unit or other structure separately, the following will apply:

**Sugar Mountain Service Area:**

Where service to multiple units or other structures is provided through a single meter, the average usage for each unit or structure served by that meter will be calculated. Each unit or structure will be billed based upon that average usage plus the base monthly charge for a <1" meter.

**Mount Mitchell Service Area:**

Service will be billed based upon the Commission-approved monthly flat rate.

Monthly Flat Rate Water Service: (Billed in Arrears) \$ 53.58

Availability Rate: (Semiannually)

Applicable only to property owners in Carolina Forest  
and Woodrun Subdivisions in Montgomery County \$ 24.65

Availability Rate: (Monthly)

|   |          |
|---|----------|
| Applicable only to property owners in Linville Ridge<br>Subdivision | \$ 12.35 |
|---|----------|

Availability Rate: (Monthly rate, billed semiannually)

|   |         |
|---|---------|
| Applicable only to property owners in Fairfield Sapphire<br>Valley Service Area | \$ 9.10 |
|---|---------|

Availability Rate: (Monthly rate, billed quarterly)

|   |         |
|---|---------|
| Applicable only to property owners in Connestee Falls | \$ 4.80 |
|---|---------|

|   |          |
|---|----------|
| <u>Meter Testing Fee:</u> <sup>1/</sup> | \$ 20.00 |
|---|----------|

|                                   |          |
|-----------------------------------|----------|
| <u>New Water Customer Charge:</u> | \$ 27.00 |
|-----------------------------------|----------|

Reconnection Charge: <sup>2/</sup>

|  |          |
|--|----------|
| If water service is cut off by utility for good cause  | \$ 27.00 |
| If water service is discontinued at customer's request | \$ 27.00 |

Reconnection Charge: <sup>3/</sup> (Flat-rate water customers)

|   |             |
|---|-------------|
| If water service is cut off by utility for good cause | Actual Cost |
|---|-------------|

Management Fee: (in the following subdivisions only)  
(Per connection)

|  |          |
|--|----------|
| Wolf Laurel                                | \$150.00 |
| Covington Cross Subdivision (Phases 1 & 2) | \$100.00 |

Oversizing Fee: (in the following subdivision only)  
(One-time charge per single-family equivalent)

|           |          |
|-----------|----------|
| Winghurst | \$400.00 |
|-----------|----------|

Meter Fee:

|                         |             |
|-------------------------|-------------|
| For <1" meters          | \$ 50.00    |
| For meters 1" or larger | Actual Cost |

|                                       |             |
|---------------------------------------|-------------|
| <u>Irrigation Meter Installation:</u> | Actual Cost |
|---------------------------------------|-------------|

## SEWER RATES AND CHARGES

### Monthly Metered Sewer Service:

#### A. Base Facility Charge:

|                          |          |
|--------------------------|----------|
| Residential (zero usage) | \$ 46.31 |
|--------------------------|----------|

|  |  |
|--|--|
| Commercial (based on meter size with zero usage) |  |
|--|--|

|            |            |
|------------|------------|
| < 1" meter | \$ 46.31   |
| 1" meter   | \$ 115.78  |
| 1½" meter  | \$ 231.55  |
| 2" meter   | \$ 370.48  |
| 3" meter   | \$ 694.65  |
| 4" meter   | \$1,157.75 |
| 6" meter   | \$2,315.50 |

|  |         |
|--|---------|
| B. Usage charge, per 1,000 gallons<br>(based on metered water usage) | \$ 3.62 |
|--|---------|

Commercial customers, including condominiums or other property owner associations who bill their members directly, shall have a separate account set up for each meter and each meter shall be billed separately based on the size of the meter and usage associated with the meter.

### Monthly Metered Purchased Sewer Service:

|  |          |
|--|----------|
| Collection Charge (Residential and Commercial) | \$ 31.63 |
|--|----------|

|   |  |
|---|--|
| Usage charge, per 1,000 gallons<br>(based on metered water usage from the water supplier) |  |
|---|--|

| <u>Service Area</u>                             | <u>Bulk Provider</u> |         |
|---|----------------------|---------|
| White Oak Plantation/<br>Lee Forest/Winston Pt. | Johnston County      | \$ 5.06 |
| Kings Grant                                     | Two Rivers Utilities | \$ 3.80 |
| College Park                                    | Town of Dallas       | \$ 5.70 |

|   |          |
|---|----------|
| <u>Monthly Flat Rate Sewer Service:</u> | \$ 57.82 |
|---|----------|

|   |          |
|---|----------|
| Multi-residential customers who are served by a master meter shall be charged the flat rate per unit. | \$ 57.82 |
|---|----------|

Mt. Carmel Subdivision Service Area:

|   |          |
|---|----------|
| Monthly Base Facility Charge  | \$ 6.77  |
| Monthly Collection Charge<br>(Residential and Commercial)                                 | \$ 31.63 |
| Usage Charge, per 1,000 gallons<br>(based on metered water usage from the water supplier) | \$ 5.88  |

Regalwood and White Oak Estates Subdivision Service Area:

|                                 |            |
|---------------------------------|------------|
| Monthly Flat Rate Sewer Service |            |
| Residential Service             | \$ 57.82   |
| White Oak High School           | \$1,799.66 |
| Child Castle Daycare            | \$ 223.58  |
| Pantry                          | \$ 119.49  |

Fairfield Mountain/Apple Valley (a.k.a. Rumbling Bald) Service Area and Highland Shores Subdivision:

Monthly Sewer Rates:

|                                       |                  |
|---------------------------------------|------------------|
| Residential                           |                  |
| Collection charge/dwelling unit       | \$ 31.63         |
| Treatment charge/dwelling unit        | \$ 69.50         |
| Total monthly flat rate/dwelling unit | <u>\$ 101.13</u> |

Commercial and Other:

|   |           |
|---|-----------|
| Minimum monthly collection and treatment charge | \$ 101.13 |
|---|-----------|

|  |           |
|--|-----------|
| Monthly collection and treatment charge for customers<br>who do not take water service | \$ 101.13 |
|--|-----------|

Treatment charge per dwelling unit

|  |           |
|--|-----------|
| Small (less than 2,500 gallons per month)  | \$ 78.50  |
| Medium (2,500 to 10,000 gallons per month) | \$ 139.50 |
| Large (over 10,000 gallons per month)      | \$ 219.50 |

|                                       |          |
|---------------------------------------|----------|
| Collection Charge (per 1,000 gallons) | \$ 13.93 |
|---------------------------------------|----------|

The Ridges at Mountain Harbour:

Monthly Sewer Rates:

Collection charge (Residential and Commercial) \$ 31.63

Treatment Charge (Residential and Commercial)  
    < 1" meter \$ 18.42  
    2" meter \$ 147.36

Availability Rate: (Monthly rate, billed semiannually)

Applicable only to property owners in Fairfield Sapphire  
Valley Service Area \$ 8.30

Availability Rate: (Monthly rate, billed quarterly)

Applicable only to property owners in Connestee Falls \$ 4.70

New Sewer Customer Charge: <sup>4/</sup> \$ 27.00

Reconnection Charge: <sup>5/</sup>

If sewer service is cut off by utility for good cause Actual Cost

MISCELLANEOUS UTILITY MATTERS

Charge for Processing NSF Checks: \$ 25.00

Bills Due: On billing date

Bills Past Due: 21 days after billing date

Billing Frequency: Bills shall be rendered monthly in all service areas, except for Mt. Carmel, which will be billed bimonthly.

Availability rates will be billed quarterly in advance for Connestee Falls, semiannually in advance for Carolina Forest, Woodrun, and Fairfield Sapphire Valley, and monthly for Linville Ridge.

Finance Charge for Late Payment:

1% per month will be applied to the unpaid balance of all bills still past due 25 days after billing date.

Notes:

<sup>1/</sup> If a customer requests a test of a water meter more frequently than once in a 24-month period, the Company will collect a \$20.00 service charge to defray the cost of the test. If the meter is found to register in excess of the prescribed accuracy limits, the meter testing charge will be waived. If the meter is found to register accurately or below prescribed accuracy limits, the charge shall be retained by the Company. Regardless of the test results, customers may request a meter test once in a 24-month period without charge.

<sup>2/</sup> Customers who request to be reconnected within nine months of disconnection at the same address shall be charged the base facility charge for the service period they were disconnected.

<sup>3/</sup> The utility shall itemize the estimated cost of disconnecting and reconnecting service and shall furnish this estimate to customer with cut-off notice.

<sup>4/</sup> This charge shall be waived if customer is also a water customer within the same service area.

<sup>5/</sup> The utility shall itemize the estimated cost of disconnecting and reconnecting service and shall furnish this estimate to customer with cut-off notice. This charge will be waived if customer also receives water service from Carolina Water Service within the same service area. Customers who request to be reconnected within nine months of disconnection at the same address shall be charged the base facility charge for the service period they were disconnected.



SCHEDULE OF RATES

for

CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA

for providing sewer utility service

in

COROLLA LIGHT AND MONTERAY SHORES SERVICE AREA

SEWER RATES AND CHARGES

Monthly Metered Sewer Service (Residential and Commercial):

Base Facility Charge (based on meter size with zero usage)

|            |            |
|------------|------------|
| < 1" meter | \$ 52.06   |
| 1" meter   | \$ 130.15  |
| 1½" meter  | \$ 260.31  |
| 2" meter   | \$ 416.49  |
| 3" meter   | \$ 780.92  |
| 4" meter   | \$1,301.54 |
| 6" meter   | \$2,603.07 |

|  |         |
|--|---------|
| Usage Charge, per 1,000 gallons<br>(based on metered water usage per the water supplier) | \$ 6.62 |
|--|---------|

Commercial customers, including condominiums or other property owner associations who bill their members directly, shall have a separate account set up for each meter and each meter shall be billed separately based on the size of the meter and usage associated with the meter.

|                                   |          |
|-----------------------------------|----------|
| <u>New Sewer Customer Charge:</u> | \$ 21.92 |
|-----------------------------------|----------|

Reconnection Charge: <sup>1/</sup>

|  |             |
|--|-------------|
| If sewer service cut off by utility for good cause | Actual Cost |
|--|-------------|

Uniform Connection Fees: <sup>2/</sup>

The following uniform connection fees apply unless specified differently by contract approved by and on file with the North Carolina Utilities Commission.

|  |            |
|--|------------|
| Connection Charge (CC), per SFE (Single-Family Equivalent) | \$ 100.00  |
| Plant Modification Fee (PMF), per SFE                      | \$1,000.00 |

The systems where connection fees other than the uniform fees have been approved and/or allowed to become effective by the North Carolina Utilities Commission are as follows. These fees are per SFE:

| <u>Subdivision</u>                   | <u>CC</u> | <u>PMF</u> |
|--------------------------------------|-----------|------------|
| Corolla Light                        | \$ 700.00 | \$ 0.00    |
| Monteray Shores                      | \$ 700.00 | \$ 0.00    |
| Monteray Shores (Degabrielle Bldrs.) | \$ 0.00   | \$ 0.00    |
| Corolla Bay <sup>3/</sup>            | \$ 100.00 | \$1,000.00 |
| Corolla Bay <sup>4/</sup>            | \$ 700.00 | \$ 0.00    |
| Corolla Shores                       | \$ 700.00 | \$ 0.00    |

One SFE shall equal 360 gallons per day of capacity.

MISCELLANEOUS UTILITY MATTERS

|  |  |
|--|--|
| <u>Charge for Processing NSF Checks:</u> | \$ 24.91   |
| <u>Bills Due:</u>                        | On billing date  |
| <u>Bills Past Due:</u>                   | 21 days after billing date   |
| <u>Billing Frequency:</u>                | Bills shall be rendered monthly  |
| <u>Finance Charge for Late Payment:</u>  | 1% per month will be applied to the unpaid balance of all bills still past due 25 days after billing date. |

Notes:

<sup>1/</sup> The Utility shall itemize the estimated cost of disconnecting and reconnecting service and shall furnish the estimate to customer with cut-off notice.

Customers who request to be reconnected within nine months of disconnection at the same address shall be charged the base facility charge for the service period they were disconnected.

<sup>2/</sup> These fees are only applicable one time, when the unit is initially connected to the system.

<sup>3/</sup> The connection charge of \$100 per SFE and the plant modification fee of \$1,000 per SFE specified herein apply to new wastewater connections requested at Corolla Bay prior to June 4, 2015.

<sup>4/</sup> The connection charge of \$700 per SFE applies to new wastewater connections requested at Corolla Bay on and after June 4, 2015.

SCHEDULE OF RATES

for

CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA

for providing water and sewer utility service

in

TREASURE COVE, REGISTER PLACE ESTATES, NORTH HILLS, GLEN  
ARBOR/NORTH BEND SUBDIVISIONS, FAIRFIELD HARBOUR SERVICE AREA,  
BRADFIELD FARMS SUBDIVISION, LARKHAVEN SUBDIVISION, SILVERTON AND  
WOODLAND FARMS SUBDIVISIONS, AND HAWTHORNE AT THE GREEN  
APARTMENTS

WATER RATES AND CHARGES

Monthly Metered Water Service (Residential and Commercial):

Base Facility Charge (based on meter size with zero usage)

|            |           |
|------------|-----------|
| < 1" meter | \$ 16.74  |
| 1" meter   | \$ 41.85  |
| 1½" meter  | \$ 83.70  |
| 2" meter   | \$ 133.92 |

|                                 |         |
|---------------------------------|---------|
| Usage Charge, per 1,000 gallons | \$ 3.75 |
|---------------------------------|---------|

Availability Rate: (Monthly rate, billed semiannually)

|   |         |
|---|---------|
| Applicable only to property owners in Fairfield<br>Harbour Service Area | \$ 3.28 |
|---|---------|

Connection Charge:

|                                   |           |
|-----------------------------------|-----------|
| Treasure Cove Subdivision         | \$ 0.00   |
| North Hills Subdivision           | \$ 100.00 |
| Glen Arbor/North Bend Subdivision | \$ 0.00   |
| Register Place Estates            | \$ 500.00 |

Fairfield Harbor: <sup>1/</sup>

All Areas Except Harbor Pointe II Subdivision

|                                    |           |
|------------------------------------|-----------|
| Recoupment of capital fees per tap | \$ 335.00 |
| Connection charge per tap          | \$ 140.00 |

Harbor Pointe Subdivision and any area where mains  
have been installed after July 24, 1989

|                                   |           |
|-----------------------------------|-----------|
| Recoupment of capital fee per tap | \$ 650.00 |
| Connection charge per tap         | \$ 320.00 |

Bradfield Farms:

|                           |      |
|---------------------------|------|
| Connection charge per tap | None |
|---------------------------|------|

|   |          |
|---|----------|
| <u>Meter Testing Fee:</u> <sup>2/</sup> | \$ 20.00 |
|---|----------|

|                                   |          |
|-----------------------------------|----------|
| <u>New Water Customer Charge:</u> | \$ 27.00 |
|-----------------------------------|----------|

Reconnection Charge: <sup>3/</sup>

|  |          |
|--|----------|
| If water service is cut off by utility for good cause  | \$ 27.00 |
| If water service is discontinued at customer's request | \$ 27.00 |

|                          |             |
|--------------------------|-------------|
| <u>New Meter Charge:</u> | Actual Cost |
|--------------------------|-------------|

|                                       |             |
|---------------------------------------|-------------|
| <u>Irrigation Meter Installation:</u> | Actual Cost |
|---------------------------------------|-------------|

SEWER RATES AND CHARGES

Monthly Sewer Service:

Residential:

|                              |          |
|------------------------------|----------|
| Flat Rate, per dwelling unit | \$ 50.46 |
| Bulk Flat Rate, per REU      | \$ 50.46 |

Commercial and Other:

|  |          |
|--|----------|
| Monthly Flat Rate<br>(Customers who do not take water service) | \$ 50.46 |
|--|----------|

Monthly Metered Rates  
(based on meter size with zero usage)

|           |          |
|-----------|----------|
| <1" meter | \$ 44.58 |
| 1" meter  | \$111.45 |
| 1½" meter | \$222.90 |
| 2" meter  | \$356.64 |

|                                 |         |
|---------------------------------|---------|
| Usage Charge, per 1,000 gallons | \$ 1.43 |
|---------------------------------|---------|

Bulk Sewer Service for Hawthorne at the Green Apartments: <sup>4/</sup>

|                         |          |
|-------------------------|----------|
| Bulk Flat Rate, per REU | \$ 50.46 |
|-------------------------|----------|

(To be collected from Hawthorne and delivered to Carolina Water Service, Inc. of North Carolina for treatment of the Hawthorne wastewater pursuant to Docket No. W-218, Sub 291)

Availability Rate: (Monthly rate, billed semiannually)

|  |         |
|--|---------|
| Applicable only to property owners in Fairfield Harbour Service Area | \$ 2.65 |
|--|---------|

Connection Charge:

Fairfield Harbour: <sup>1/</sup>

All Areas Except Harbor Pointe II Subdivision

|                                    |           |
|------------------------------------|-----------|
| Recoupment of capital fees per tap | \$ 735.00 |
| Connection charge per tap          | \$ 140.00 |

Harbor Pointe Subdivision and any area where mains have been installed after July 24, 1989

|                                   |            |
|-----------------------------------|------------|
| Recoupment of capital fee per tap | \$2,215.00 |
| Connection charge per tap         | \$ 310.00  |

Bradfield Farms:

|                           |      |
|---------------------------|------|
| Connection charge per tap | None |
|---------------------------|------|

|   |          |
|---|----------|
| <u>New Sewer Customer Charge:</u> <sup>5/</sup> | \$ 27.00 |
|---|----------|

Reconnection Charge:<sup>6/</sup>

If sewer service is cut off by utility for good cause

Actual Cost

MISCELLANEOUS UTILITY MATTERS

Charge for Processing NSF Checks:

\$ 25.00

Bills Due:

On billing date

Bills Past Due:

21 days after billing date

Billing Frequency:

Bills shall be monthly for service in arrears. Availability billings semiannually in advance.

Finance Charge for Late Payment:

1% per month will be applied to the unpaid balance of all bills still past due 25 days after billing date.

Notes:

<sup>1/</sup> The recoupment of capital portion of the connection charges shall be due and payable at such time as the main water and sewer lines are installed in front of each lot, and the tap-on fee for water and sewer shall be payable upon request by the owner of each lot to be connected to the water and sewer lines. With written consent of the company, payment of the recoupment capital portion of the connection charge may be made payable over five-year period following the installation of the water and sewer mains in front of each lot, payment to be made in such a manner and in such installments as agreed upon between lot owner and the company, together with interest on the balance of the unpaid recoupment of capital fee from said time until payment in full at the rate of 6% per annum.

<sup>2/</sup> If a customer requests a test of a water meter more frequently than once in a 24-month period, the Company will collect a \$20.00 service charge to defray the cost of the test. If the meter is found to register in excess of the prescribed accuracy limits, the meter testing charge will be waived. If the meter is found to register accurately or below prescribed accuracy limits, the charge shall be retained by the Company. Regardless of the test results, customers may request a meter test once in a 24-month period without charge.

<sup>3/</sup> Customers who request to be reconnected within nine months of disconnection at the same address shall be charged the base facility charge for the service period they were disconnected.

<sup>4/</sup> Each apartment building will be considered 92.42% occupied on an ongoing basis for billing purposes as soon as the certificate of occupancy is issued for that apartment building.

<sup>5/</sup> This charge shall be waived if customer is also a water customer within the same service area.

<sup>6/</sup> The utility shall itemize the estimated cost of disconnecting and reconnecting service and shall furnish this estimate to customer with cut-off notice. This charge will be waived if customer also receives water service from Carolina Water Service within the same service area. Customers who request to be reconnected within nine months of disconnection at the same address shall be charged the base facility charge for the service period they were disconnected.



CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA

SCHEDULE OF CONNECTION FEES

FOR WATER UTILITY SERVICE UNDER UNIFORM RATES

Uniform Connection Fees: <sup>1/</sup>

The following uniform connection fees apply unless specified differently by contract approved by and on file with the North Carolina Utilities Commission.

|  |           |
|--|-----------|
| Connection Charge (CC), per SFE (Single-Family Equivalent) | \$ 100.00 |
| Plant Modification Fee (PMF), per SFE                      | \$ 400.00 |

The systems where connection fees other than the uniform fees have been approved and/or allowed to become effective by the North Carolina Utilities Commission are as follows. These fees are per SFE:

| <u>Subdivision</u>                    | <u>CC</u>  | <u>PMF</u> |
|---------------------------------------|------------|------------|
| Abington                              | \$ 0.00    | \$ 0.00    |
| Abington, Phase 14                    | \$ 0.00    | \$ 0.00    |
| Amherst                               | \$ 250.00  | \$ 0.00    |
| Bent Creek                            | \$ 0.00    | \$ 0.00    |
| Blue Mountain at Wolf Laurel          | \$ 925.00  | \$ 0.00    |
| Buffalo Creek, Phase I, II, III, IV   | \$ 825.00  | \$ 0.00    |
| Carolina Forest                       | \$ 0.00    | \$ 0.00    |
| Chapel Hills                          | \$ 150.00  | \$ 400.00  |
| Eagle Crossing                        | \$ 0.00    | \$ 0.00    |
| Elk River Development                 | \$1,000.00 | \$ 0.00    |
| Forest Brook/Old Lamp Place           | \$ 0.00    | \$ 0.00    |
| Harbour                               | \$ 75.00   | \$ 0.00    |
| Hestron Park                          | \$ 0.00    | \$ 0.00    |
| Hound Ears                            | \$ 300.00  | \$ 0.00    |
| Kings Grant/Willow Run                | \$ 0.00    | \$ 0.00    |
| Lemmond Acres                         | \$ 0.00    | \$ 0.00    |
| Linville Ridge                        | \$ 400.00  | \$ 0.00    |
| Monterrey (Monterrey LLC)             | \$ 0.00    | \$ 0.00    |
| Quail Ridge                           | \$ 750.00  | \$ 0.00    |
| Queens Harbour/Yachtsman              | \$ 0.00    | \$ 0.00    |
| Riverpointe                           | \$ 300.00  | \$ 0.00    |
| Riverpointe (Simonini Bldrs.)         | \$ 0.00    | \$ 0.00    |
| Riverwood, Phase 6E (Johnston County) | \$ 825.00  | \$ 0.00    |

| <u>Subdivision</u>                    | <u>CC</u>  | <u>PMF</u> |
|---------------------------------------|------------|------------|
| Saddlewood/Oak Hollow (Summey Bldrs.) | \$ 0.00    | \$ 0.00    |
| Sherwood Forest                       | \$ 950.00  | \$ 0.00    |
| Ski Country                           | \$ 100.00  | \$ 0.00    |
| The Ridges at Mountain Harbour        | \$2,500.00 | \$ 0.00    |
| White Oak Plantation                  | \$ 0.00    | \$ 0.00    |
| Wildlife Bay                          | \$ 870.00  | \$ 0.00    |
| Willowbrook                           | \$ 0.00    | \$ 0.00    |
| Winston Plantation                    | \$1,100.00 | \$ 0.00    |
| Winston Pointe, Phase 1A              | \$ 500.00  | \$ 0.00    |
| Wolf Laurel                           | \$ 925.00  | \$ 0.00    |
| Woodrun                               | \$ 0.00    | \$ 0.00    |
| Woodside Falls                        | \$ 500.00  | \$ 0.00    |

Other Connection Fees:

The following connection fees apply unless specified differently by contract approved and/or filed with the North Carolina Utilities Commission.

Amber Acres, Amber Acres North, Amber Ridge, Ashley Hills North, Bishop Pointe, Carriage Manor, Country Crossing, Covington Cross, Heather Glen, Hidden Hollow, Jordan Woods, Lindsey Point, Neuse Woods, Oakes Plantation, Randsdell Forest, Rutledge Landing, Sandy Trails, Stewart's Ridge, Tuckahoe, Wilder's Village, and Forest Hill Subdivisions

Connection Charge:

|                          |                                       |
|--------------------------|---------------------------------------|
| A. 5/8" meter            | \$ 500.00                             |
| B. All other meter sizes | Actual cost of meter and installation |

The systems where other connection fees have been approved and/or allowed to become effective by the North Carolina Utilities Commission are as follows:

| <u>Subdivision</u>  | <u>CC</u> |
|---|-----------|
| Lindsey Point Subdivision   | \$ 0.00   |
| Amber Acres North, Sections II & IV                                   | \$ 570.00 |
| Fairfield Mountain/Apple Valley<br>(a.k.a. Rumbing Bald) Service Area | \$ 500.00 |
| Highland Shores Subdivision   | \$ 500.00 |
| Laurel Mountain Estates   | \$ 0.00   |
| Carolina Trace  | \$ 605.00 |
| Connestee Falls   | \$ 600.00 |

The following connection fees apply unless specified differently by contract approved and/or filed with the North Carolina Utilities Commission.

All Areas Except Holly Forest XI, Holly Forest XIV, Holly Forest XV, Whisper Lake I, Whisper Lake II, Whisper Lake III, Deer Run, Lonesome Valley Phases I and II, and Chattooga Ridge

|   |           |
|---|-----------|
| Recoupment of Capital Fee (RCF) <sup>2/</sup> | \$ 0.00   |
| Connection charge                             | \$ 400.00 |

The systems where other connection fees have been approved and/or allowed to become effective by the North Carolina Utilities Commission are as follows:

| <u>Subdivision</u>                | <u>CC</u> | <u>RCF</u> |
|-----------------------------------|-----------|------------|
| Holly Forest XI                   | \$ 400.00 | \$2,400.00 |
| Holly Forest XIV                  | \$ 400.00 | \$ 250.00  |
| Holly Forest XV                   | \$ 400.00 | \$ 500.00  |
| Whispering Lake Phase I           | \$ 400.00 | \$1,250.00 |
| Whispering Lake Phases II and III | \$ 400.00 | \$2,450.00 |
| Deer Run                          | \$ 400.00 | \$1,900.00 |
| Lonesome Valley Phases I and II   | \$ 0.00   | \$ 0.00    |
| Chattooga Ridge                   | \$ 0.00   | \$ 0.00    |

Notes:

<sup>1/</sup> These fees are only applicable one time, when the unit is initially connected to the system.

<sup>2/</sup> The recoupment of capital portion of the connection charges shall be due and payable at such time as the main water and sewer lines are installed in front of each lot, and the tap-on fee for water and sewer shall be payable upon request by the owner of each lot to be connected to the water and sewer lines. With written consent of the company, payment of the recoupment capital portion of the connection charge may be made payable over five-year period following the installation of the water and sewer mains in front of each lot, payment to be made in such a manner and in such installments as agreed upon between lot owner and the company, together with interest on the balance of the unpaid recoupment of capital fee from said time until payment in full at the rate of 6% per annum.

CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA

SCHEDULE OF CONNECTION FEES FOR

SEWER UTILITY SERVICE UNDER UNIFORM RATES

Uniform Connection Fees: <sup>1/</sup>

The following uniform connection fees apply unless specified differently by contract approved by and on file with the North Carolina Utilities Commission.

|  |            |
|--|------------|
| Connection Charge (CC), per SFE (Single-Family Equivalent) | \$ 100.00  |
| Plant Modification Fee (PMF), per SFE                      | \$1,000.00 |

The systems where connection fees other than the uniform fees have been approved and/or allowed to become effective by the North Carolina Utilities Commission are as follows. These fees are per SFE:

| <u>Subdivision</u>                                       | <u>CC</u>  | <u>PMF</u> |
|--|------------|------------|
| Abington   | \$ 0.00    | \$ 0.00    |
| Abington, Phase 14                                       | \$ 0.00    | \$ 0.00    |
| Amber Acres North (Phases II & IV)                       | \$ 815.00  | \$ 0.00    |
| Ashley Hills   | \$ 0.00    | \$ 0.00    |
| Amherst  | \$ 500.00  | \$ 0.00    |
| Bent Creek   | \$ 0.00    | \$ 0.00    |
| Brandywine Bay   | \$ 100.00  | \$1,456.00 |
| Camp Morehead by the Sea                                 | \$ 100.00  | \$1,456.00 |
| Elk River Development                                    | \$1,200.00 | \$ 0.00    |
| Hammock Place  | \$ 100.00  | \$1,456.00 |
| Hestron Park   | \$ 0.00    | \$ 0.00    |
| Hound Ears   | \$ 30.00   | \$ 0.00    |
| Independent/Hemby Acres/Beacon Hills<br>(Griffin Bldrs.) | \$ 0.00    | \$ 0.00    |
| Kings Grant/Willow Run                                   | \$ 0.00    | \$ 0.00    |
| Kynwood  | \$ 0.00    | \$ 0.00    |
| Mt. Carmel/Section 5A                                    | \$ 500.00  | \$ 0.00    |
| Queens Harbor/Yachtsman                                  | \$ 0.00    | \$ 0.00    |
| Riverpointe  | \$ 300.00  | \$ 0.00    |
| Riverpointe (Simonini Bldrs.)                            | \$ 0.00    | \$ 0.00    |
| Steeplechase (Spartabrook)                               | \$ 0.00    | \$ 0.00    |
| The Ridges at Mountain Harbour                           | \$2,500.00 | \$ 0.00    |

| <u>Subdivision</u>        | <u>CC</u>  | <u>PMF</u> |
|---------------------------|------------|------------|
| White Oak Plantation      | \$ 0.00    | \$ 0.00    |
| Willowbrook               | \$ 0.00    | \$ 0.00    |
| Willowbrook (Phase 3)     | \$ 0.00    | \$ 0.00    |
| Winston Pointe (Phase 1A) | \$2,000.00 | \$ 0.00    |
| Woodside Falls            | \$ 0.00    | \$ 0.00    |

Other Connection Fees:

The systems where other connection fees have been approved and/or allowed to become effective by the North Carolina Utilities Commission are as follows:

| <u>Subdivision</u> |   |
|--------------------|---|
| Carolina Pines     |   |
| Residential        | \$1,350.00 per unit (including single-family homes, condominiums, apartments, and mobile homes) |
| Hotels             | \$750.00 per unit   |
| Nonresidential     | \$3.57 per gallon of daily design of discharge or \$900.00 per unit, whichever is greater       |

| <u>Subdivision</u>                                     | <u>CC</u> |
|--|-----------|
| Fairfield Mountain/Apply Valley (a.k.a. Rumbling Bald) |           |
| Service Area   | \$ 550.00 |
| Highland Shores  | \$ 550.00 |
| Carolina Trace   | \$ 533.00 |
| Connestee Falls  | \$ 400.00 |

The following connection fees apply unless specified differently by contract approved and/or filed with the North Carolina Utilities Commission.

All Areas Except Holly Forest XIV, Holly Forest XV, Deer Run, and Lonesome Valley Phases I and II

|   |           |
|---|-----------|
| Recoupment of Capital Fee (RCF) <sup>2/</sup> | \$ 0.00   |
| Connection Charge                             | \$ 550.00 |

The systems where other connection fees have been approved and/or allowed to become effective by the North Carolina Utilities Commission are as follows:

| <u>Subdivision</u>              | <u>CC</u> | <u>RCF</u> |
|---------------------------------|-----------|------------|
| Holly Forest XIV                | \$ 550.00 | \$1,650.00 |
| Holly Forest XV                 | \$ 550.00 | \$ 475.00  |
| Deer Run                        | \$ 550.00 | \$1,650.00 |
| Lonesome Valley Phases I and II | \$ 0.00   | \$ 0.00    |

Notes:

<sup>1/</sup> These fees are only applicable one time, when the unit is initially connected to the system.

<sup>2/</sup> The recoupment of capital portion of the connection charges shall be due and payable at such time as the main water and sewer lines are installed in front of each lot, and the tap-on fee for water and sewer shall be payable upon request by the owner of each lot to be connected to the water and sewer lines. With written consent of the company, payment of the recoupment capital portion of the connection charge may be made payable over five-year period following the installation of the water and sewer mains in front of each lot, payment to be made in such a manner and in such installments as agreed upon between lot owner and the company, together with interest on the balance of the unpaid recoupment of capital fee from said time until payment in full at the rate of 6% per annum.

STATE OF NORTH CAROLINA  
UTILITIES COMMISSION  
RALEIGH

DOCKET NO. W-354, SUB 360

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of  
Application by Carolina Water Service, Inc. of )  
North Carolina, 4944 Parkway Plaza Boulevard, )  
Suite 375, Charlotte, North Carolina 28217, for ) **NOTICE TO CUSTOMERS**  
Authority to Adjust and Increase Rates for Water )  
and Sewer Utility Service in All of its Service )  
Areas in North Carolina, Except Corolla Light and )  
Monteray Shores Service Area )

NOTICE IS HEREBY GIVEN that the North Carolina Utilities Commission has issued an Order authorizing Carolina Water Service, Inc. of North Carolina (CWSNC) to increase rates for water and sewer utility service in all of its service areas in North Carolina (excluding Corolla Light and Monteray Shores Service Area). The new approved rates are as follows:

WATER RATES AND CHARGES

(Excluding Corolla Light and Monteray Shores Service Area, Fairfield Harbour Service Area, Treasure Cove, Register Place Estates, North Hills and Glen Arbor/North Bend Subdivisions, Bradfield Farms, Larkhaven Subdivision, Silverton and Woodland Farms Subdivisions, and Hawthorne at the Green Apartments)

Uniform Water Customers:

Monthly Metered Water Service (Residential and Commercial):

|  |            |
|--|------------|
| Base Facility Charge (based on meter size with zero usage) |            |
| < 1" meter   | \$ 27.53   |
| 1" meter   | \$ 68.83   |
| 1½" meter  | \$ 137.65  |
| 2" meter   | \$ 220.24  |
| 3" meter   | \$ 412.95  |
| 4" meter   | \$ 688.25  |
| 6" meter   | \$1,376.50 |

Usage Charge:

|  |    |      |
|--|----|------|
| A. Treated Water, per 1,000 gallons  | \$ | 7.08 |
| B. Untreated Water, per 1,000 gallons<br>(Brandywine Bay Irrigation Water) | \$ | 4.11 |
| C. Purchased Water for Resale, per 1,000 gallons:                          |    |      |

| <u>Service Area</u>                 | <u>Bulk Provider</u>   |    |      |
|-------------------------------------|------------------------|----|------|
| Carolina Forest                     | Montgomery County      | \$ | 3.19 |
| High Vista Estates                  | City of Hendersonville | \$ | 3.25 |
| Riverpointe                         | Charlotte Water        | \$ | 6.30 |
| Whispering Pines                    | Town of Southern Pines | \$ | 2.23 |
| White Oak Plantation/<br>Lee Forest | Johnston County        | \$ | 2.40 |
| Winston Plantation                  | Johnston County        | \$ | 2.40 |
| Winston Point                       | Johnston County        | \$ | 2.40 |
| Woodrun                             | Montgomery County      | \$ | 3.19 |
| Yorktown                            | City of Winston-Salem  | \$ | 5.01 |
| Zemosa Acres                        | City of Concord        | \$ | 5.27 |
| Carolina Trace                      | City of Sanford        | \$ | 2.21 |

Commercial customers, including condominiums or other property owner associations who bill their members directly, shall have a separate account set up for each meter and each meter shall be billed separately based on the size of the meter and usage associated with the meter.

When because of the method of water line installation utilized by the developer or owner, it is impractical to meter each unit or other structure separately, the following will apply:

Sugar Mountain Service Area:

Where service to multiple units or other structures is provided through a single meter, the average usage for each unit or structure served by that meter will be calculated. Each unit or structure will be billed based upon that average usage plus the base monthly charge for a <1" meter.

Mount Mitchell Service Area:

Service will be billed based upon the Commission-approved monthly flat rate.

Monthly Flat Rate Water Service: (Billed in Arrears) \$ 53.58



Availability Rate: (Semiannually)

|  |          |
|--|----------|
| Applicable only to property owners in Carolina Forest<br>and Woodrun Subdivisions in Montgomery County | \$ 24.65 |
|--|----------|

Availability Rate: (Monthly)

|   |          |
|---|----------|
| Applicable only to property owners in Linville Ridge<br>Subdivision | \$ 12.35 |
|---|----------|

Availability Rate: (Monthly rate, billed semiannually)

|   |         |
|---|---------|
| Applicable only to property owners in Fairfield Sapphire<br>Valley Service Area | \$ 9.10 |
|---|---------|

Availability Rate: (Monthly rate, billed quarterly)

|   |         |
|---|---------|
| Applicable only to property owners in Connestee Falls | \$ 4.80 |
|---|---------|

## SEWER RATES AND CHARGES

(Excluding Corolla Light and Monteray Shores Service Area, Fairfield Harbour Service Area, Treasure Cove, Register Place Estates, North Hills and Glen Arbor/North Bend Subdivisions, Bradfield Farms, Larkhaven Subdivision, Silverton and Woodland Farms Subdivisions, and Hawthorne at the Green Apartments)

Uniform Sewer Customers:

Monthly Metered Sewer Service:

Base Facility Charge:

|                          |          |
|--------------------------|----------|
| Residential (zero usage) | \$ 46.31 |
|--------------------------|----------|

Commercial (based on meter size with zero usage)

|            |            |
|------------|------------|
| < 1" meter | \$ 46.31   |
| 1" meter   | \$ 115.78  |
| 1½" meter  | \$ 231.55  |
| 2" meter   | \$ 370.48  |
| 3" meter   | \$ 694.65  |
| 4" meter   | \$1,157.75 |
| 6" meter   | \$2,315.50 |

Usage charge, per 1,000 gallons \$ 3.62

Commercial customers, including condominiums or other property owner associations who bill their members directly, shall have a separate account set up for each meter and each meter shall be billed separately based on the size of the meter and usage associated with the meter.

Monthly Metered Purchased Sewer Service:

Collection Charge (Residential and Commercial) \$ 31.63

Usage charge, per 1,000 gallons  
(based on metered water usage from the water supplier)

| <u>Service Area</u>                             | <u>Bulk Provider</u> |         |
|---|----------------------|---------|
| White Oak Plantation/<br>Lee Forest/Winston Pt. | Johnston County      | \$ 5.06 |
| Kings Grant                                     | Two Rivers Utilities | \$ 3.80 |
| College Park                                    | Town of Dallas       | \$ 5.70 |

Monthly Flat Rate Sewer Service: \$ 57.82

Multi-residential customers who are served by a master meter shall be charged the flat rate per unit. \$ 57.82

Mt. Carmel Subdivision Service Area:

Monthly Base Facility Charge \$ 6.77

Monthly Collection Charge  
(Residential and Commercial) \$ 31.63

Usage Charge, per 1,000 gallons \$ 5.88  
(based on metered water usage from the water supplier)

Regalwood and White Oak Estates Subdivision Service Area:

|                                 |            |
|---------------------------------|------------|
| Monthly Flat Rate Sewer Service |            |
| Residential Service             | \$ 57.82   |
| White Oak High School           | \$1,799.66 |
| Child Castle Daycare            | \$ 223.58  |
| Pantry                          | \$ 119.49  |

Fairfield Mountain/Apple Valley (a.k.a. Rumbling Bald) Service Area and Highland Shores Subdivision

Monthly Sewer Rates:

|  |                  |
|--|------------------|
| Residential  |                  |
| Collection charge/dwelling unit  | \$ 31.63         |
| Treatment charge/dwelling unit   | \$ 69.50         |
| Total monthly flat rate/dwelling unit  | <u>\$ 101.13</u> |
| Commercial and Other   | \$ 101.13        |
| Minimum monthly collection and treatment charge  | \$ 101.13        |
| Monthly collection and treatment charge for customers who do not take water service (per single-family unit) | \$ 101.13        |
| Treatment charge per dwelling unit   |                  |
| Small (less than 2,500 gallons per month)  | \$ 78.50         |
| Medium (2,500 to 10,000 gallons per month)   | \$ 139.50        |
| Large (over 10,000 gallons per month)  | \$ 219.50        |
| Collection Charge (per 1,000 gallons)  | \$ 13.93         |

The Ridges at Mountain Harbour:

Monthly Sewer Rates (Residential and Commercial):

|                   |           |
|-------------------|-----------|
| Collection charge | \$ 31.63  |
| Treatment Charge  |           |
| < 1" meter        | \$ 18.42  |
| 2" meter          | \$ 147.36 |

Availability Rate: (Monthly rate, billed semiannually)

|  |         |
|--|---------|
| Applicable only to property owners in Fairfield Sapphire Valley Service Area | \$ 8.30 |
|--|---------|

Availability Rate: (Monthly rate, billed quarterly)

|   |         |
|---|---------|
| Applicable only to property owners in Connestee Falls | \$ 4.70 |
|---|---------|

RATE ADJUSTMENT MECHANISM:

The Commission-authorized water and sewer system improvement charge (WSIC/SSIC) rate adjustment mechanism continues in effect and will now be applicable to all customers in CWSNC's North Carolina service areas. It has been reset at zero in the Docket No. W-354, Sub 360 rate case. On January 31, 2019, in Docket No. W-354, Sub 360A, CWSNC applied, under the Rules and Regulations of the Commission, for a rate surcharge to become effective April 1, 2019. The WSIC/SSIC mechanism is designed to recover, between rate case proceedings, the costs associated with investment in certain completed, eligible projects for system or water quality improvement. The WSIC/SSIC mechanism is subject to Commission approval and to audit and refund provisions. Any cumulative system improvement charge recovered pursuant to the WSIC/SSIC mechanism may not exceed 5% of the total annual service revenues approved by the Commission in this general rate case proceeding. Additional information regarding the WSIC/SSIC mechanism is contained in the Commission's Order and can be accessed from the Commission's website at [www.ncuc.net](http://www.ncuc.net), under Docket Information, using the Docket Search feature for docket number "W-354 Sub 356A" and "W-354 Sub 360A".

CREDIT/REFUNDS DUE TO REDUCTION IN FEDERAL CORPORATE INCOME TAX RATE:

On December 22, 2017, President Donald J. Trump signed into law the Tax Cuts and Jobs Act (The Tax Act), which among other things, reduced the federal corporate income tax rate from 35% to 21%, effective for taxable years beginning after December 31, 2017. In the present rate case proceeding, CWSNC's revenue requirement reflects the reduction in the federal corporate income tax rate from 35% to 21%, on the Company's ongoing federal income tax expense. Further, the Commission is requiring that CWSNC refund to its customers the overcollection of federal income taxes related to the decrease in the federal corporate income tax rate for the period beginning January 1, 2018, and corresponding interest, through a surcharge credit for a one-year period beginning with the effective date of the new rates.

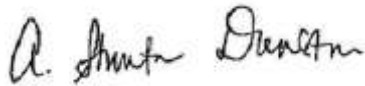
With respect to excess deferred income taxes (EDIT) resulting from the reduction in the federal corporate income tax rate, the Commission is requiring that: (1) CWSNC's Protected Federal EDIT shall be flowed back to customers over a 45-year period using the Reverse South Georgia method, in accordance with tax normalization rules required by Internal Revenue Code Section 203(e) and (2) CWSNC's Unprotected Federal EDIT shall be returned to ratepayers through a levelized rider over a period of four years.

CWSNC will provide the applicable dollar amounts concerning (1) the one-year surcharge credit and (2) the federal EDIT rider (refund) shown as separate line items on individual customers' monthly bills, along with explanatory information.

ISSUED BY ORDER OF THE COMMISSION.

This the 21<sup>st</sup> day of February, 2019.

NORTH CAROLINA UTILITIES COMMISSION

A handwritten signature in dark ink, appearing to read "A. Shonta Dunston". The signature is fluid and cursive, with the first initial "A." being prominent.

A. Shonta Dunston, Deputy Clerk

STATE OF NORTH CAROLINA  
UTILITIES COMMISSION  
RALEIGH

DOCKET NO. W-354, SUB 360

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of  
Application by Carolina Water Service, Inc. ) **NOTICE TO CUSTOMERS**  
of North Carolina, 4944 Parkway Plaza ) **IN TREASURE COVE,**  
Boulevard, Suite 375, Charlotte, North ) **REGISTER PLACE ESATES,**  
Carolina 28217, for Authority to Adjust and ) **NORTH HILLS, AND GLEN**  
Increase Rates for Water and Sewer Utility ) **ARBOR/NORTH BEND**  
Service in All of its Service Areas in North ) **SUBDIVISIONS, FAIRFIELD**  
Carolina, Except Corolla Light and ) **HARBOUR SERVICE AREA,**  
Monteray Shores Service Area ) **BRADFIELD FARMS**  
 ) **SUBDIVISION, LARKHAVEN**  
 ) **SUBDIVISION, SILVERTON**  
 ) **AND WOODLAND FARMS**  
 ) **SUBDIVISIONS, AND**  
 ) **HAWTHORNE AT THE GREEN**  
 ) **APARTMENTS**  
 )

NOTICE IS HEREBY GIVEN that the North Carolina Utilities Commission has issued an Order authorizing Carolina Water Service, Inc. of North Carolina (CWSNC) to charge the following new rates for water and sewer utility service in Treasure Cove, Register Place Estates, North Hills, and Glen Arbor/North Bend Subdivisions, Fairfield Harbour Service Area, Bradfield Farms Subdivision, Larkhaven Subdivision, Silverton and Woodland Farms Subdivisions, and Hawthorne at the Green Apartments:

WATER RATES AND CHARGES

Monthly Metered Water Service (Residential and Commercial):

|  |           |
|--|-----------|
| Base Facility Charge (based on meter size with zero usage) |           |
| < 1" meter   | \$ 16.74  |
| 1" meter   | \$ 41.85  |
| 1½" meter  | \$ 83.70  |
| 2" meter   | \$ 133.92 |

|                                 |         |
|---------------------------------|---------|
| Usage Charge, per 1,000 gallons | \$ 3.75 |
|---------------------------------|---------|

Availability Rate: (Monthly rate, billed semiannually)

|   |         |
|---|---------|
| Applicable only to property owners in Fairfield<br>Harbour Service Area | \$ 3.28 |
|---|---------|

## SEWER RATES AND CHARGES

Monthly Sewer Service:

Residential:

|                              |          |
|------------------------------|----------|
| Flat Rate, per dwelling unit | \$ 50.46 |
| Bulk Flat rate, per REU      | \$ 50.46 |

Commercial and Other:

|  |          |
|--|----------|
| Monthly Flat Rate<br>(Customers who do not take water service) | \$ 50.46 |
|--|----------|

Monthly Metered Rates  
(based on meter size with zero usage)

|           |          |
|-----------|----------|
| <1" meter | \$ 44.58 |
| 1" meter  | \$111.45 |
| 1½" meter | \$222.90 |
| 2" meter  | \$356.64 |

|                                 |         |
|---------------------------------|---------|
| Usage Charge, per 1,000 gallons | \$ 1.43 |
|---------------------------------|---------|

Bulk Sewer Service for Hawthorne at the Green Apartments:

|                         |          |
|-------------------------|----------|
| Bulk Flat Rate, per REU | \$ 50.46 |
|-------------------------|----------|

(To be collected from Hawthorne and delivered to Carolina Water Service, Inc. of North Carolina for treatment of the Hawthorne wastewater pursuant to Docket No. W-218, Sub 291)

Availability Rate: (Monthly rate, billed semiannually)

|   |         |
|---|---------|
| Applicable only to property owners in Fairfield<br>Harbour Service Area | \$ 2.65 |
|---|---------|

RATE ADJUSTMENT MECHANISM:

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With respect to excess deferred income taxes (EDIT) resulting from the reduction in the federal corporate income tax rate, the Commission is requiring that: (1) CWSNC's Protected Federal EDIT shall be flowed back to customers over a 45-year period using the Reverse South Georgia method, in accordance with tax normalization rules required by Internal Revenue Code Section 203(e) and (2) CWSNC's Unprotected Federal EDIT shall be returned to ratepayers through a levelized rider over a period of four years.

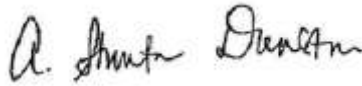


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ISSUED BY ORDER OF THE COMMISSION.

This the 21<sup>st</sup> day of February, 2019.

NORTH CAROLINA UTILITIES COMMISSION

A handwritten signature in black ink, appearing to read "A. Shonta Dunston". The signature is written in a cursive, flowing style.

A. Shonta Dunston, Deputy Clerk

CERTIFICATE OF SERVICE

I, \_\_\_\_\_, mailed with sufficient postage or hand delivered to all affected customers the attached Notices to Customers issued by the North Carolina Utilities Commission in Docket No. W-354, Sub 360, and the Notices were mailed or hand delivered by the date specified in the Order.

This the \_\_\_\_ day of \_\_\_\_\_, 2019.

By: \_\_\_\_\_  
Signature

\_\_\_\_\_  
Name of Utility Company

The above named Applicant, \_\_\_\_\_, personally appeared before me this day and, being first duly sworn, says that the required Notices to Customers were mailed or hand delivered to all affected customers, as required by the Commission Order dated \_\_\_\_\_ in Docket No. W-354, Sub 360.

Witness my hand and notarial seal, this the \_\_\_\_ day of \_\_\_\_\_, 2019.

\_\_\_\_\_  
Notary Public

\_\_\_\_\_  
Printed or Typed Name

(SEAL) My Commission Expires: \_\_\_\_\_  
Date