



Committee to Study Rates and Transfers/Public Enterprises

March 26, 2018

Regulated Water Industry Perspective:

Shannon Becker and Matthew Klein

**National Association of Water Companies (NAWC):
Southeast Chapter**



MOVING WATER FORWARD



Shannon Becker
President,
Aqua North Carolina, Inc.



Carolina Water Service
of North Carolina™

Matthew Klein
President,
Carolina Water Service Inc.,
of North Carolina

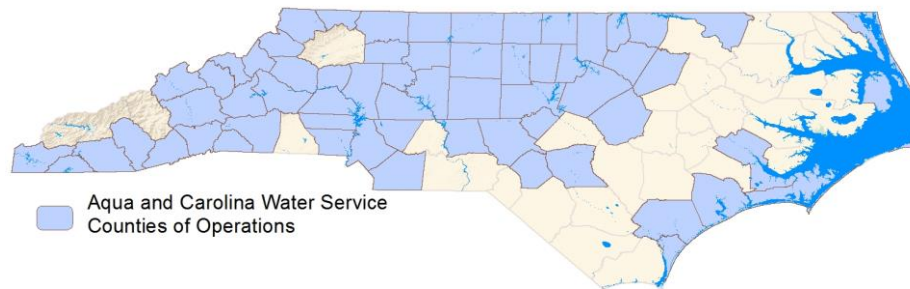


National Association of Water Companies

2

Regulated Water and Wastewater

Aqua and Carolina Water Service own and operate
~900 drinking and wastewater systems in North Carolina



National Association of Water Companies

3

Overview

- Customer expectations for all water service providers
- Regulated water and wastewater services in North Carolina
 - Economic Regulation vs. Environmental and Public Health Regulation
 - Rate Setting
 - Operational and Capital Requirements
- Water and wastewater aging infrastructure crisis
- Suggested policy changes to address the problem

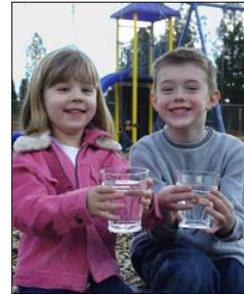


National Association of Water Companies

4

High Customer Expectations for Water Services

- Only utility service physically ingested
- Must be “safe” regardless of cost
- Increasingly stringent water quality standards
- Increasing threats to water supply
- Service largely taken for granted
- High level of service at low cost



National Association of Water Companies

5

Challenges to Meeting Customer Expectations

- Water and wastewater is the most capital-intensive utility
- There is a significant fixed cost that needs to be invested to provide reliable service
- Growth in North Carolina has demonstrated the need for more reliable sources of supply
- Water infrastructure often viewed as “out of sight and out of mind”
- Water rates may not reflect the true cost of service

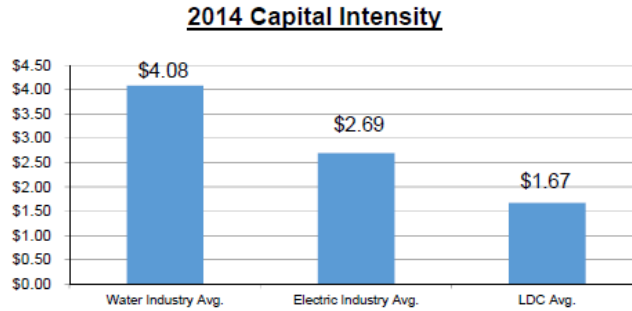


National Association of Water Companies

6

Most Capital Intensive Utility

Capital Invested per \$1 of Revenue



Source: *ScottMadden*; Management Consultants

National Association of Water Companies

7

Regulation of Water and Wastewater in North Carolina

- Environmental and Public Health
- Economic



National Association of Water Companies

8

Economic Regulation of Regulated Water Utilities

- Regulated by the North Carolina Utilities Commission
 - Regulates rates and service
- North Carolina Utilities Commission -- Public Staff
 - Represents the using and consuming public in North Carolina Utilities Commission proceedings



National Association of Water Companies

9

Rate Setting for Regulated Water Utilities

- Rates set in a “Rate Case”
 - Judicial-type proceeding at the North Carolina Utilities Commission
 - Up to 300 day transparent process (filing to order)
- Utility base rates established pursuant to N.C. Gen. Stat. § 62-133
 - Must be **just and reasonable**
 - Based on the **cost of service**
- Future rates reflect historic investment (unlike governmental rate setting)



National Association of Water Companies

10

Oversight of Operational and Capital Expenditures

- Operating expenses are recovered in rates
 - Expenses are required to be reasonable and prudent
- Investments made are capitalized and included in rate base
 - Must be “used and useful”
- Utilities are allowed a rate of return on capital investments
 - Intended to pay back investors for their use of capital and associated risk



National Association of Water Companies

11

Impact of Regulatory Oversight

- Regulatory structure is designed to ensure the utility is operating effectively
(e.g. prudent investments and expenses with rates reflecting cost of service)
- Approximately 40% of government water systems do not generate sufficient revenues from rates to meet operating and capital needs*



* Preliminary results of analysis of 149 utilities by the Environmental Finance Center at the UNC School of Government. Source: Ongoing 2017 NC Water and Wastewater Utility Management Survey

National Association of Water Companies

12

Summary of Regulated Water Providers

- Business Enterprises
 - Access to private markets for capital resources
 - Incentivized to operate and invest in water and wastewater systems prudently and efficiently
- Operate ~900 of North Carolina's water systems
 - It's the only thing we do
 - More than 100 years of experience
- Highly regulated
 - Transparent rate setting process
 - Required to operate and invest for the long-term benefit of customers



National Association of Water Companies

13

State of existing infrastructure



National Association of Water Companies

14

Infrastructure Challenges in North Carolina

- Infrastructure needs over next 20 years*
 - Drinking Water systems = \$10-15 billion
 - Wastewater systems = \$7-11 billion
- Users pay the cost
 - Only ~7% of drinking water needs covered by grants**
 - Only ~8% of wastewater needs covered by grants**



*Environmental Finance Center (EFC) at the University of North Carolina's School of Government evaluation of needs survey
 ** State Water Infrastructure Authority, Department of Environmental Quality FY2017 and FY2018 funding sources for NC water and wastewater system

National Association of Water Companies

15

Suggested Policy Changes to Help Address Needs

- **H. 351**
passed House 89-30
- **H. 752**
passed House 118-0
- **H. 352**
passed House 99-16



National Association of Water Companies

16

Legislation to Enable Acquisition of Systems

- “Fair Market Value” Legislation --- Capital and Expertise from Regulated Water Providers
- **H. 351** (Watford, Collins) SB 339 (Meredith)
- Establishes an alternative process for determining the rate base value of a municipal water or wastewater system that is acquired by a regulated water utility.
 - Enables private capital to be used to help address water infrastructure needs
 - Monetizes a municipal asset that is difficult to operate and maintain
 - Adds to the local tax base
 - Treats regulated utilities similar to municipalities when acquiring water systems
- Passed House last session 89-30



National Association of Water Companies

17

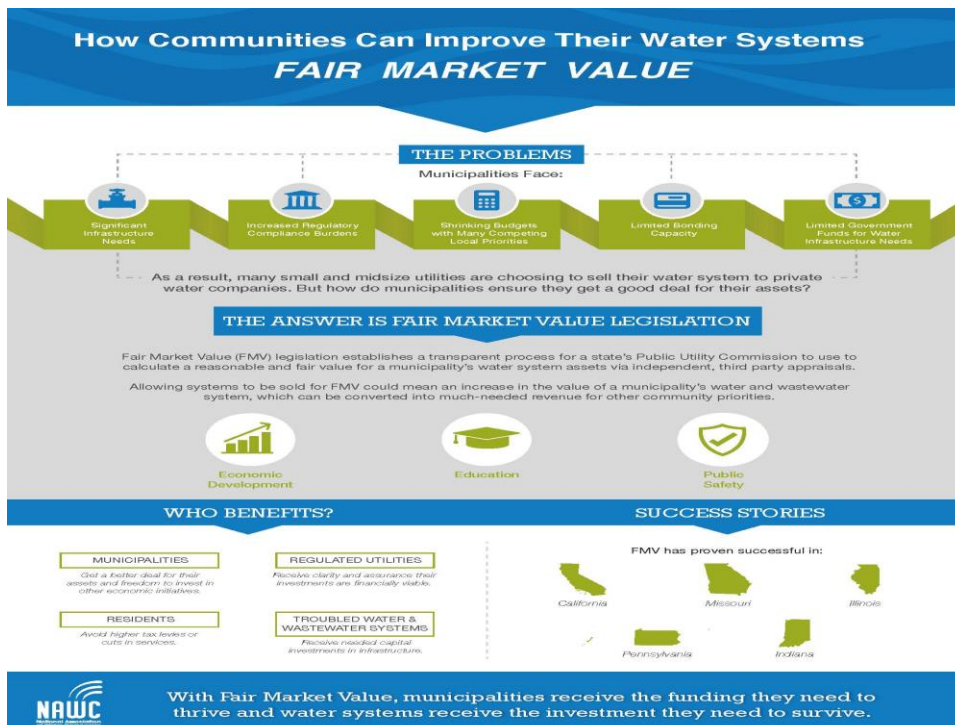
How “Fair Value” Legislation Works

- **Voluntary** for municipalities
- Independent appraisals determine value paid to the municipality
- Safeguards for ratepayers



National Association of Water Companies

18



Legislation to Address Operational Efficiency

- Consumption Adjustments
- H. 752 (Arp)
- Establishes a process for the Commission to adjust rates up or down based on consumption fluctuations.
 - Consumption levels are difficult to set in a rate case
 - Commission could adjust rates up or down to reflect true consumption between rate cases
 - Tracks the same mechanism the Commission uses for natural gas
 - Passed House 118-0

Legislation to Incentivize Investment

- “Future Test Period” Legislation --- Reduce Regulatory Lag and Save Ratepayers Money
- **H. 352** (Watford, Collins) SB 340 (Meredith)
- Establishes an alternative test period for ratemaking in a rate case.
 - Reduces frequency of rate cases which saves ratepayers money
 - More accurately aligns rates with actual capital and operating needs
 - Reduces regulatory lag and encourages private investment
 - Similar to how municipalities set water rates
 - Passed House 99-16



National Association of Water Companies

21

Thank you



Shannon Becker
President,
Aqua North Carolina, Inc.



Carolina Water Service
of North Carolina™

Matthew Klein
President,
Carolina Water Service Inc.,
of North Carolina



National Association of Water Companies

22