



**NORTH CAROLINA
PUBLIC STAFF
UTILITIES COMMISSION**

December 21, 2022

Ms. A. Shonta Dunston, Chief Clerk
North Carolina Utilities Commission
4325 Mail Service Center
Raleigh, North Carolina 27699-4300

Re: Docket No. W-354, Sub 398
Carolina Water Service, Inc. of North Carolina
Application for Determination of Fair Value of Utility Assets

Dear Ms. Dunston:

Attached for filing please find the Proposed Order of the Public Staff in the above-referenced docket.

By copy of this letter, I am forwarding a copy to all parties of record by electronic delivery.

Sincerely,
Electronically submitted
/s/ William E. H. Creech
Staff Attorney
zeke.creech@psncuc.nc.gov

cc: Parties of Record

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**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. W-354, SUB 398

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of
Application by Carolina Water Service, Inc. of)
North Carolina, 5821 Fairview Road, Suite 401,))
Charlotte, North Carolina 28209, for) PROPOSED ORDER OF
Determination of Fair Value of Utility Assets) THE PUBLIC STAFF
Pursuant to N.C. Gen. Stat. § 62-133.1A and)
Establishing Rate Base for Acquisition of the)
Carteret County Water System)

HEARD: Tuesday, October 18, 2022, in the Carteret County Courthouse,
Commission Board Room, 2nd Floor, 300 Courthouse Square,
Beaufort, North Carolina

HEARD: Thursday, November 3, 2022, at 1:00 p.m., in Commission Hearing
Room 2115, Dobbs Building, 430 North Salisbury Street, Raleigh,
North Carolina

BEFORE: Commissioner Jeffrey A. Hughes, Presiding, Chair Charlotte A.
Mitchell, and Commissioners ToNola D. Brown-Bland, Daniel G.
Clodfelter, Kimberly W. Duffley, Floyd B. McKissick, Jr., and Karen
M. Kemerait

APPEARANCES:

For Carolina Water Service, Inc. of North Carolina:
Jo Anne Sanford, Sanford Law Office, PLLC, 721 North Bloodworth
Street, Raleigh, North Carolina 27604

David Drooz, Fox Rothschild, LLP, 434 Fayetteville Street, Suite
2800, Raleigh, North Carolina 27601

For Carteret County:
Claud R. Wheatly, III, Wheatly Law Group, PA, 710 Cedar Street,
Beaufort, North Carolina 28516

For the Using and Consuming Public:
William E.H. Creech, and William E. Grantmyre, Staff Attorneys,
Public Staff - North Carolina Utilities Commission (Public Staff), 4326
Mail Service Center, Raleigh, North Carolina 27699-4300

FAIR VALUE LEGISLATION AND RULE

BY THE COMMISSION: This is the first proceeding under N.C. Gen. Stat. § 62-133.1A, entitled “An Act authorizing water and wastewater public utilities to elect to use a fair value determination for rate-making purposes when acquiring utilities owned by countries, municipalities, and other government utilities,” which became law on June 25, 2018 (Fair Value Statute).

The Fair Value Statute provides an alternate method for determining the rate base of a water or wastewater utility instead of using the original cost. The utility “may elect to establish rate base by using the fair value of the utility property instead of original cost when acquiring an existing water or wastewater system owned by a municipality or county or an authority or district established under Chapter 162A of the General Statutes.”

Pursuant to section (b) of the Fair Value Statute, the fair value is determined “based on three separate appraisals conducted by accredited, impartial valuation experts chosen from a list to be established by the Commission,” one appraiser representing the public utility acquiring the system, another appraiser representing the utility selling the system, and another appraiser representing the Public Staff. Each appraiser determines fair value in compliance with the uniform standards of professional appraisal practice, employing cost, market, and income approaches

to assess value. Pursuant to subsection c. of section (b) of the Fair Value Statute, fair value, for ratemaking purposes under N.C.G.S. § 62-133, is the average of the three appraisals.

Paragraph (b)(2) of N.C.G.S. 62-133.1A provides that “[t]he acquiring public utility and selling utility shall jointly retain a licensed engineer to conduct an assessment of the tangible assets of the system to be acquired, and the assessment shall be used by the three appraisers in determining fair value.”

Paragraph (b)(4) of N.C.G.S. 62-133.1A states that the rate base of the system to be used for ratemaking in the next general rate case is “the lesser of the purchase price negotiated between the parties to the sale or the fair value plus the fees and costs authorized in subdivision (3) of this subsection.”

The statute provides some protections for ratepayers. N.C.G.S. 62-133.1A(d) provides the Commission the authority to deny a fair value application. Pursuant to section (e) of the Fair Value Statute, the Commission retains its authority to determine rates for the acquired utility in future rate cases, may “classify the acquired system as a separate entity for ratemaking purposes, consistent with the public interest”, and “may adjust the fair value as it deems appropriate and in the public interest” if it “finds that the average of the appraisals will not result in a reasonable fair value.”

On December 30, 2020, in Docket W-100, Sub 60, the Commission adopted Commission Rules R7-41 and R10-28 to implement the Fair Value Statute.

Commission Rule R7-41 (h) places the burden of proof on the utility electing a fair value application process “regarding all aspects of the proceeding... and for demonstrating that the acquisition of the Local Government Utility is in the public interest.” Commission Rule R7-41 (i) requires the acquiring utility to pay the fees of the Utility Valuation Expert representing the Public Staff regardless of the outcome.

PROCEDURAL HISTORY

On July 22, 2022, Carolina Water Service, Inc. of North Carolina (CWSNC or Company) filed with the North Carolina Utilities Commission (Commission) an Application for Determination of Fair Value of Utility Assets Pursuant to N.C.G.S. § 62-133.1A and Establishing Rate Base for Acquisition of the Carteret County Water System in the above referenced docket (Application). The Company’s Application included the testimony of CWSNC State President Donald H. Denton, III and NCUC Form Application FV1, which contained a number of exhibits, including appraisals by three valuation experts.

On August 5, 2022, the Public Staff notified CWSNC by letter filed with the Commission of its determination that additional enumerated information was necessary to complete its Application as required by Commission Rule R7-41 and N.C.G.S. § 62.133.1A.

On August 11, 2022, the Commission issued an Order Finding Application Incomplete requiring the Company to file the omitted information and consult with the Public Staff to ensure the completeness of the Application. The Commission’s

Order also required the Public Staff to file, no later than three business days following the Company's filing of supplemental information, a statement as to whether it deemed the Application to be complete.

On August 11, 2022, CWSNC filed Revised Exhibits supplementing its Application.

On August 16, 2022, the Public Staff notified CWSNC by letter filed with the Commission that it had reviewed the supplemental information provided by CWSNC and deemed the Application to be complete.

On September 13, 2022, the Commission issued its Order Scheduling Hearings, Establishing Discovery Guidelines, and Requiring Customer Notice (Scheduling Order).

On October 6, 2022, the Public Staff filed a Motion to Compel, requesting the Commission to compel CWSNC to fully respond to certain Public Staff data requests.

On October 14, 2022, the Public Staff filed a Notice of Affidavit and Affidavit of Lynn Feasel, and the direct testimonies of Michael G. Lane and Charles Junis.

On October 17, 2022, the Commission issued an Order Extending Time for Filing Witness List and Cross-Examination Times, extending to October 28, 2022, the date for CWSNC to file its witness list, the order of witnesses, and each party's estimated time for cross-examination for the expert witness hearing.

On October 18, 2022, a public hearing for the purpose of receiving testimony of customers regarding this matter was held at the Carteret County Courthouse in Beaufort, North Carolina (Public Hearing), as provided for in the Scheduling Order.

On October 24, 2022, Carteret County (Carteret County or the County) filed the rebuttal testimony of Eugene Foxworth, Assistant County Manager. On October 25, 2022, CWSNC filed the rebuttal testimony of Donald H. Denton, III and Gerald C. Hartman, Senior Appraiser, Hartman Consultants, LLC.

On October 28, 2022, the County, pursuant to an October 27, 2022 email from Commission staff indicating that it was not a party to this docket, filed a Petition to Intervene.

Also, on October 28, 2022, CWSNC filed the Witness List for the November 3, 2022 Expert Witness Hearing, Order, and Estimated Times for Cross-Examination.

The evidentiary hearing was held as scheduled on November 3 and 4, 2022, in Raleigh, North Carolina.

On November 7, 2022, the Company filed a Motion for Extension of Time to file a response to customers' service-related complaints.

Also on November 7, 2022, the Company filed the Response to Customer Concerns from the Public Hearing.

On November 21, 2022, the Commission issued a notice, setting the due date for filing proposed orders and briefs as December 21, 2022, pursuant to the ruling of Commissioner Hughes in open hearing on November 4, 2022.

Also on November 21, 2022, the Commission issued an Order Extending Time for Filing Response to Customer Concerns, Allowing Public Staff Response, and Directing Both to be Filed in CPCN Docket and Fair Value Docket.

Also on November 21, 2022, the Company filed Late-Filed Exhibits 1 and 2.

On November 22, 2022, CWSNC filed its Response to Customer Concerns-Beaufort NC Public Hearing October 18, 2022.

On December 16, 2022, the Public Staff filed its Motion for Extension of Time Nunc Pro Tunc and filed its Verified Response to CWSNC's Response to Customer Concerns – Beaufort, NC Public Hearing October 18, 2022.

Based upon the evidence presented and the entire record in this proceeding, the Commission makes the following:

FINDINGS OF FACT

Carolina Water Service

1. CWSNC is a corporation duly organized under the laws of, and is authorized to do business in, the State of North Carolina. It is a franchised public utility providing water and sewer utility service to customers in 38 counties in North

Carolina, pursuant to North Carolina General Statutes, Chapter 62. CWSNC is a wholly owned subsidiary of Corix Regulated Utilities, Inc. (Corix).

2. CWSNC serves only one large water system in Carteret County: Brandywine Bay. CWSNC has no plans to interconnect the Brandywine Bay water system with the Carteret County Water System.

3. CWSNC's embedded cost of debt in CWSNC's current rate case proceeding Docket No. W-354, Sub 400 is 4.64%.

4. CWSNC obtains all of its debt from its parent, Corix, which does not have a credit rating issued by Fitch's, Moody's or Standard & Poor's (S&P).

Carteret County Water System

5. The Carteret County Water System, owned by Carteret County, a county established under Chapter 162A of the General Statutes, is a "Local Government Utility" as defined by Commission Rule R7-41(b)(1).

6. The Carteret County Water System, which consists of the two water systems, North River/Mill Creek (PWS ID NC0416197) and Merrimon (PWS ID NC0416198), serves a total of 1,277 water utility customers with over 55 miles of water lines, nearly 600 valves, and 175 hydrants.

7. The Carteret County North River/Mill Creek water system has two water wells, three 200,000-gallon elevated water storage tanks, water treatment

including a greensand filtration system and a softener system, and three water pressure booster stations.

8. The Carteret County North River/Mill Creek water system is interconnected with the Craven County water system to the north and also the Town of Beaufort water system to the southeast to serve the Eastman Creek Subdivision; both for emergency back-up water.

9. The Carteret County Merriman water system is 18 miles from the Carteret County North River/Mill Creek water system and is not interconnected to the Carteret County North River/Mill Creek water system. The Merriman system has a water well and a 10,000-gallon ground level water storage tank.

10. 56.83% of the capital funding for the Carteret County Water System is from CIAC (either in the form of grants or developer contributions).

11. A "Feasibility Study for Water System Merger" was originally obtained by the County from Draper Aden Associates engineering firm (Draper Aden) based upon its application for and receipt of a Water System Merger Grant from the State of North Carolina in 2019. (2019 Feasibility Study)

12. In December 2019, Draper Aden recommended that the County transfer the water systems to the Town of Beaufort for one dollar while the County would continue collection of special water tax district revenues to pay off its water fund debts in the amount of approximately \$2,066,128 (principal only) and

contribute to the Town's upgrades and expansions to the system over the next 11 years.

13. The Town of Beaufort declined to make the acquisition.

14. Carteret County has operated the water fund, before transfers from other funds, at a loss annually from 2003 through 2021. After transfer from other County funds and capital contributions from developers, the audited profit total over the life of the system (2003-2022) is \$3,535,341, and the ending equity through 2022, is \$5,805,173. According to the unaudited fiscal year 2022 data, however, the water fund had a profit of \$39,605, or a 3.7% return.

15. On June 21, 2021, the Carteret County Board of Commissioners voted to increase the water rates by 95% and reduce the water tax district rate from 5.5 cents to 0 cents per one hundred dollars valuation of property effective July 1, 2021.

16. On September 20, 2021, the Carteret County Board of Commissioners voted to decrease the water rates by 25%. On June 20, 2022, the Carteret County Board of Commissioners voted to adopt the county budget ordinance, which maintained the water rates at a basic charge of \$40.25 per month, including the first 1,000 gallons, and a volume charge of \$10.10 per 1,000 gallons after the first 1,000 gallons.

17. Carteret County's FY2023 Adopted Budget includes water fund operating revenues of \$1,085,000 and expenditures of \$1,160,000. The budgeted

deficit of \$75,000 netted against the water fund balance results in a water fund balance of \$5,783,118.

18. Carteret County's embedded cost of debt is 2.61%. Carteret County has not issued publicly traded debt for the water fund and does not have a bond rating for the water fund. Carteret County's general fund, general obligation bond ratings are S & P AA Plus, Fitch AA Plus, and Moody's Aa1.

19. There are no recent environmental violations or enforcement actions against the Carteret County Water System.

20. No deficiencies were identified by the engineering assessment conducted pursuant to N.C.G.S. § 62-133.1A(b)(2).

21. The Carteret County Water System is a well-maintained system that provides safe, reliable, and compliant service to customers.

22. CWSNC has been operating the Carteret County Water System since February 2022.

Bids & Contract

23. Carteret County chose the public bid process and received the following bids: CWSNC bid \$4.9 million on January 13, 2021; Aqua North Carolina, Inc. (Aqua) bid \$7.0 million on February 2021; CWSNC bid \$7.5 million on March 1, 2021; Aqua bid \$7.875 million on March 21, 2021; CWSNC bid \$8.5 million on

March 23, 2021; Aqua bid \$8.925 million on April 18, 2021; and CWSNC made the highest bid of \$9.5 million on April 27, 2021.

24. There was local opposition to the sale of the Carteret County Water System.

25. On October 18, 2021, the Carteret County Board of Commissioners accepted CWSNC's \$9.5 million bid at its regular meeting. The vote of the Board of Commissioners was a divided 4-3 vote in favor of accepting CWSNC's bid.

26. The Utility Asset Purchase Agreement (APA) filed as Exhibit 6A to the Application dated October 18, 2021, was executed by Carteret County and CWSNC. Section 2.04 of the APA states the purchase price of the water utility system assets to be \$9.5 million, excluding cash and accounts receivable.

27. There is no provision in the APA that makes closing or the transfer contingent upon the outcome of the fair value determination.

Engineering Report & Appraisals

28. The engineering assessment (Form Application Exhibit 5B) was prepared by Draper Aden and is entitled "Feasibility Study for Water System Merger," dated December 2019 (2019 Feasibility Study).

29. CWSNC and Carteret County retained Draper Aden "to conduct an assessment of the tangible assets of the system to be acquired" and Draper Aden

produced an “Update to Present Value of Water System” dated December 2021 (Form Application Exhibit 5C) (Engineering Assessment).

30. In addition to what is required by the Fair Value Statute or Commission Rule R7-41, including the Engineering Assessment FORM FV1(a), Draper Aden provided an estimate of the Carteret County Water System assets’ net worth of \$12,335,392, \$10,241,142 of which was an estimate of present book value of existing land, wellhouses, water treatment plant, and piping with no original cost, discount rate, or depreciation.

31. Pursuant to the Fair Value Statute, the Engineering Assessment must provide “an assessment of the tangible assets of the system to be acquired.” However, the Engineering Assessment went outside of the requirements of the Statute and provided its own estimate of a “fair value” for the system.

32. The appraisal process was fundamentally prejudiced by the Engineering Report proactively including a “fair value” at the start of the process that is not authorized by statute and was not requested by the Commission in Commission rules.

33. Each of the three appraisers for the Company, County, and Public Staff, respectively, charged with determining the fair value of the Carteret County Water System were required by N.C.G.S 62-133.1A(b)(1) (b) to employ cost, market, and income approaches to assessment of value.

34. The Company appraiser Hartman Consultants, LLC's (Hartman Consultants) valuation of \$10,900,000 for the Carteret County Water System was not determined through its use of all three requisite approaches to assessment of value, heavily relied upon the valuation of engineering firm Draper Aden, was excessive, and did not result in a fair valuation.

35. County appraiser Gannett Fleming Valuation and Rate Consultants, LLC's (Gannett Fleming) valuation of 14,575,000 for the Carteret County Water System was not determined through its use of all three requisite approaches to assessment of value, heavily relied upon the valuation of engineering firm Draper Aden, was excessive, and did not result in a fair valuation.

36. The Public Staff appraiser NewGen Strategies and Solutions LLC's (NewGen) valuation of \$7,332,000 for the Carteret County Water System considered all three requisite approaches to valuation; however, it gave greater weight to the income approach and did not rely upon the sales comparison approach. For rate base purposes, however, the appraised value does not represent an appropriate fair value in the public interest.

Company Application & Testimony

37. As part of its Application, as required by Commission Rule R7-41, CWSNC calculated and listed the average of the three appraisals (CWSNC, County, and Public Staff) of \$10,935,667.

38. Under the Fair Value Statute, the lesser of the average of the purchase price and the contract price is \$9.5 million.

39. The water rates that CWSNC has applied for are the existing Carteret County rates.

40. CWSNC has agreed with Carteret County that the customers of the Carteret County Water System will remain at Carteret County's current water rates for the next four years.

41. CWSNC stated that in 2027, it plans to apply for the Carteret County Water System customers to be moved into CWSNC uniform water rates.

42. If the Carteret County water customers were brought into CWSNC's uniform water rates today, it would raise the rates of CWSNC's metered uniform water rate customers using 4,000 gallons per month by 4.5%.

43. CWSNC's Application did not identify any deficiencies in the system as contemplated by N.C.G.S. § 62-133.1A and Commission Rule R7-41.

44. The Application did not identify any needed infrastructure improvements for the next five years, though such an identification is contemplated by N.C.G.S. 62-133.1A and Commission Rule R7-41.

Customer Concerns & Service

45. Six of the seven customers who testified at the public witness hearing on October 18, 2022, in Beaufort, North Carolina, opposed the transfer of the

Carteret County Water System to CWSNC because of the anticipated rate increase and attended County Commissioner's meetings to express their opposition.

46. The primary service concerns cited at the public witness hearing were low water pressure, discolored water, and chalky build-up in relatively new appliances.

47. A petition against the proposal was signed by 1,000 Carteret County customers.

48. CWSNC filed its verified Report on Customer Concerns after the public witness hearing.

49. The Public Staff filed its verified response to the Company's Report on Customer Concerns, which concluded that CWSNC's Report on Customer Concerns inadequately addressed the customers' quality of service concerns expressed at the customer hearing, because it failed to give credence to the substance of the customer concerns yet subsequently made changes, which were not disclosed in the Company's verified Report, to address those customer concerns.

Appropriate Fair Value & The Public Interest

50. The Fair Value Statute is replete with safeguards whereby the Commission can protect ratepayers and maintain the public interest.

51. Source of funds can be considered by the Commission under N.C.G.S. § 62-133.1A(e).

52. The forward-looking cost of funds can be considered by the Commission and is not prohibited in N.C.G.S. § 62-133.1A.

53. Regardless of source of funds, a reasonable utility would not have built just a sprawling, low density distribution system.

54. There are no quantified economies of scale associated with the proposed sale.

55. The average of the three appraisals conducted by appraisers for the Company, County, and Public Staff does not result in a fair value that is appropriate and in the public interest.

56. The appropriate fair value of the Carteret County Water System is \$2,444,347 and is consistent with the public interest.

57. The Commission's establishment of fair value in this proceeding does not preempt, estop, or supersede the Commission's authority or discretion in subsequently evaluating the public convenience and necessity of any new franchise proceeding.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 1-4

Carolina Water Service

The evidence supporting these findings of fact is contained in the Company's Application and exhibits and in the testimony of Company witness Denton and County witness Foxworth. The Application states that CWSNC is a wholly owned subsidiary of Corix.

Company witness Denton indicated that the only large water system the Company has in Carteret County is the Brandywine Bay water system, and that CWSNC has no current plans to interconnect the Carteret County Water System with the Brandywine Bay system. Tr. vol. 2, 67-68. On cross-examination, County witness Foxworth acknowledged Public Staff counsel's assertion that CWSNC has thousands of water and wastewater customers in 38 counties from Corolla in Currituck County to Bear Paw in Cherokee County in North Carolina, composed of 93 water systems and 38 wastewater systems. Tr. Vol. 4, 93.

Mr. Denton testified that the Company's embedded cost of debt in its pending rate case in Docket No. W-354, Sub 400 is 4.64%. Tr. Vol. 2, 68. He noted that CWSNC's long-term debt is not held at the CWSNC level, but rather through its parent company, Corix, which does not have a credit rating issued by Fitch's, Moody's or S&P. Tr. vol. 71-72.

These findings and conclusions are informational and are not contested by any party.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 5-22

Carteret County Water System

The evidence supporting these findings is contained in the Company's Application and exhibits, the testimony of Company witness Denton, and the testimony and exhibits of Public Staff witness Junis, and testimony of County witnesses Eugene Foxworth and Dee Meshaw.

The Application states that the Carteret County Water System is owned by Carteret County, a county government pursuant to N.C.G.S. Chapter 162A. Mr. Foxworth testified that the Carteret County Water System serves 1,254 households in a water district that includes 3,875 parcels. Tr. vol. 1, 19.

The County records detail contributions in aid of construction and other funding sources used to construct and improve the system, and as outlined in Junis Exhibit 4. Tr. vol. 3, 133-34. 56.83% of the capital funding for the Carteret County Water System is from CIAC either in the form of grants or developer contributions. Tr. vol. 3, 157-58.

Mr. Foxworth testified that, from 2011 until two years ago, property owners in the Water District paid 5.5 cents per hundred dollars of valuation on both real and personal property, regardless of whether they were water customers or not. Tr. vol. 4, 81 Witness Foxworth indicated that the taxing district was needed to support the system because of the limited number of water customers in the district, served by 54 miles of water lines. Tr. vol. 4, 82

Mr. Foxworth also stated that contributions from the General Fund were needed over the years to subsidize the system. The General Fund is funded by the approximately 70,000 citizens of the County. Tr. vol. 4, 82.

On cross-examination, Mr. Foxworth indicated that the various phases of the system were built in the 1980's through the early 2000's. (Public Staff – Foxworth Cross-Exhibit No. 1)

CWSNC President, Don Denton, testified on cross examination that the low density of customers would increase the necessary main flushings with potable treated water which would increase the operating costs.

CWSNC witness Denton also testified on cross-examination that three elevated water storage tanks of 200,000 gallons each, rather than only two elevated water storage tanks of 300,000 gallons each, increases the cost of maintenance of the tanks in operating the Carteret County Water System.

In his direct testimony Mr. Junis testified that, in his professional opinion, the Carteret County Water System assets are in good condition and well maintained. He further noted that the Engineering Assessment included in CWSNC's Application, indicated in summary "[n]o deficiencies noted." Tr. Vol. 3, 136. Mr. Junis also flagged that CWSNC did not include in its Application a five-year plan for prudent and necessary infrastructure improvements as required by Commission Form FV1. Specifically, he recited that "CWSNC plans no significant improvement above routine O&M, such as tank coatings, which are covered in the

current maintenance contract and chlorine conversion from gas to liquid due to safety concerns.” Tr. Vol. 3, 137.

Further, Mr. Junis noted that CWSNC does not anticipate the need for any major improvements/additions in the next five to ten years, in that, on page 8 of its Application for a Certificate of Public Convenience & Necessity and for Approval of Rates filed in Docket No. W-354, Sub 399, CWSNC states, “[n]o major improvements / additions planned.” Tr. vol. 3, 137.

Finally, Mr. Junis indicated that, according to Public Water Supply Section records available on Drinking Water Watch system, neither of the water systems have had any violations issued or enforcement actions taken for over the last six years, such that, to his knowledge, the County was providing safe, reliable, and compliant service to the North River/Mill Creek and Merrimon water systems.

Mr. Junis indicated that he participated in a Public Staff site visit of the system in April 2022. Mr. Junis indicated that the wellhouses were well maintained and clean. The elevated storage tanks were in various states of acceptable to good condition based on staggered recoating schedules and are regularly inspected, maintained, and recoated pursuant to a water tank management agreement with Southern Corrosion Incorporated. Mr. Junis indicated that the water treatment plant, including greensand filters, water softeners, ortho-polyphosphate feed system, chloramines disinfection, and onsite backup generator, was in good condition. Mr. Junis provided his expert opinion that, overall, the utility assets are in good condition and have been well maintained. Tr. vol. 3, 136.

Mr. Junis, however, indicated that the North River/Mill Creek distribution system is sprawling, including over 55 miles of water lines, nearly 600 valves, 175 hydrants, and interconnections with the Town of Beaufort and Craven County, to serve 1,200 plus customers as of June 2022. The Merrimon system is approximately 18 miles away and serves about 20 customers.

The system is not only without need of substantial improvement, but Mr. Junis also indicated that it is now making a small profit.¹ Tr. vol. 3, 139. He indicated that while the operating losses of the past were concerning, the County has now increased rates to cover its expenses, including debt, and intends to accumulate a reserve in the future. Tr. vol. 3, 139.

Still, Mr. Junis acknowledged that (Attachment 2B of Junis Exhibit 3) Carteret County has operated the water fund, before transfers from other funds, at a loss annually from 2003 through 2021, that, after transfer from other funds and capital contributions from developers, the audited profit total over the life of the system (2003-2022) is \$3,535,341, and the ending equity through 2022, is \$5,805,173. Tr. vol. 3, 139.

Mr. Junis described recent changes in rates that have put the system on far better financial footing. On June 21, 2021, the Carteret County Board of Commissioners voted to increase the water rates by 95% and reduce the water tax district rate from 5.5 cents to 0 cents per one hundred dollars valuation of

¹ According to the unaudited fiscal year 2022 data, the water fund had a profit of \$39,605, or 3.7%.

property effective July 1, 2021. Then on September 20, 2021, the Board voted to decrease the water rates by 25%. Finally, on June 20, 2022, the Board adopted the County budget ordinance and maintained the water rates at a basic charge of \$40.25 per month, including the first 1,000 gallons, and a volume charge of \$10.10 per 1,000 gallons after the first 1,000 gallons. This adopted budget includes water fund operating revenues of \$1,085,000 and expenditures of \$1,160,000; therefore, a budgeted deficit of \$75,000 is netted against the water fund balance resulting in a water fund balance of \$5,783,118. Tr. vol. 3, 140.

The Carteret County Water System loan balances in March 2020 when Carteret County attempted to transfer the Carteret County Water System to the Town of Beaufort were NCDENR – State Revolving Fund, Principal \$124,128 / Interest Rate 5.75%, NCDENR- State Revolving Fund, Principal \$980,000// Interest Rate 2.20%, and USDA – Principal \$962,000.00/ Interest Rate 2.75% (Public Staff Denton Cross-Exhibit No. 3)

The Carteret County loan balances as of October 26, 2022, obtained for use on the Carteret County Water System were: DEQ: State Revolving Fund Principal \$31,032-Interest Rate 5.75%%; DENR: State Revolving Fund Principal \$560,000-Interest Rate 2.205%; and U.S. Department of Agriculture: Principal \$906,000-Interest Rate 2.75%. (Public Staff Denton Cross-Exhibit No. 3)

On cross-examination by the Public Staff, witness Denton agreed the County's weighted and embedded debt cost of these three outstanding loans is 2.61 percent. Tr. vol. 2, 69-70.

CWSNC and the County entered into an operation and maintenance oversight agreement dated January 24, 2022. Under the agreement, CWSNC provides a certified operator to serve as Operator in Responsible Charge (ORC) and provides consultation services to County staff for a maximum of one hour per day pursuant to the terms and conditions. Tr. vol. 3, 138-9.

Distressed and Troubled Systems

Notwithstanding the absence of violations and need for planned improvements, Mr. Junis indicated that as of September 27, 2022, the Carteret County Water System has been designated as “distressed.” by the State Water Infrastructure Authority (SWIA) and the Local Government Commission (LGC).² Tr. vol. 3, 141.

Mr. Junis explained that

“A distressed unit is a public water system or wastewater system operated by a local government unit exhibiting signs of failure to identify or address those financial or operating needs necessary to enable that system to become or to remain a local government unit generating sufficient revenues to adequately fund management and operations, personnel, appropriate levels of maintenance, and reinvestment that facilitate the provision of reliable water or wastewater services.”³

Mr. Junis indicated that Carteret County has received assessment scores of eight based on 2019 data and nine based on 2021 data. He noted that a unit

² Local Government Units Assessment Scores. Available at <https://deq.nc.gov/water-infrastructure/vur-assessment-unit-list-sept-2022/download?attachment> (last visited on October 8, 2022). Tr. vol. 3, 141.

³ N.C.G.S. § 159G-20.(4a).

providing only one utility service, either drinking water or wastewater, is identified as distressed if the total assessment criteria score is equal to or greater than eight. Tr. vol. 3, 141.

Mr. Junis indicated that being designated a “distressed” system can have benefits, in particular access to the state’s Drinking Water State Revolving Fund and Drinking Water Reserve Program, though Carteret County is also eligible to apply for funds from the Viable Utility Reserve and additional construction grants⁴ funded by allocation from the American Rescue Plan Act (ARPA). Tr. Vol. 3, 141-2. Though Mr. Junis did describe the difference between a “distressed” and “troubled” system, the latter is a term more commonly used before the Commission.⁵ He indicated that a relatively small rural system with low rates, especially if revenues are insufficient to cover expenses or supplemented by other sources, will score highly in the assessment.

⁴ Division of Water Infrastructure American Rescue Plan Act (ARPA) Administration Plan-Feb.2022. Available at <https://deq.nc.gov/water-infrastructure/dwi-arpa-administration-plan-feb-2022/download?attachment> (last visited on October 8, 2022). Tr. vol. 3, 142.

⁵ In his direct Testimony, Mr. Junis indicated how Carteret County scored points on “distressed” scorecard for the following criteria:

- Population served of less than 10,000 people;
- Debt service coverage ratio of less than 1.1;
- Transfers of money from other sources into the water fund to cover expenditures in at least 2 or more of the last 5 years;
- Service population of less than 100 people per mile of water lines;
- Monthly water bill for 5,000 gallons in excess of \$50;
- Revenue deficit after expenses and debt service;
- Depreciation of utility assets exceeds 50%; and
- Operating margin less than 0.

Tr. vol. 3, 142-143.

Mr. Junis noted that, even though there are some benefits of the distressed system designation, Carteret County Water System's distressed designation is correctable. Tr. vol. 3, 143. He further noted that Carteret County does not need CWSNC to acquire the system at a cost premium to correct the issues. Tr. vol. 3, 143.

Mr. Junis pointed out that the Carteret County Water System is not troubled in the sense that the utility assets are beyond their useful life, nor are there serious or widespread environmental compliance issues or a lack of capital funding, technical, managerial, and/or financial expertise and capabilities. Tr. vol. 3, 143.

On cross-examination by counsel for CWSNC, Mr. Junis acknowledged that the Carteret County Water System is distressed, but that the County should utilize that designation to its benefit to gain access to certain funds. Mr. Junis refuted the notion that being designated as distressed had an "insidious connotation" and reiterated his view that taking advantage of that designation is a good thing. Tr. vol. 3, pp. 163-164.

Counsel for CWSNC asked Mr. Junis whether the County should seek ways out of the distressed designation over the long run. Mr. Junis indicated that there are certain factors that are up to a county's control that would be beneficial to correct, though there are also factors that are not necessarily in a county's control that will naturally still lead to a point designation on the scorecard. He testified that density of customers is an example, adding "[t]hat requirement is 100 people per mile of main. Well, they're currently at 51 people per mile of main. That density

issue is not completely up to their control. That depends on further development.”
Tr. vol. 3, 164.

In response to Chair Mitchell’s question about the County’s capital reserve, Mr. Junis indicated that it was his understanding that, although there are some restrictions with the fund, the County would be able to appropriate those \$5.8 million in funds.

Tr. vol. 4, pp. 34-35. County witness Meshaw testified that she estimated that the County had \$1.9 million of spendable cash that is not restricted in its capital reserve fund. Tr. vol. 4, 120.

In response to questions from Commissioner McKissick, Mr. Junis explained his understanding of the difference between “distressed” and “troubled” systems; a “troubled” designation occurs when an emergency operator is necessary, instances wherein “compliance, condition of plant, and basically an inability to get back to compliance or financial health on its own.” Whereas “distressed,” he explained, is a designation by the Local Government Commission to allow local governments access to utility reserve funds, which are open to Carteret County at this time. Tr. vol. 4, pp. 42-43) Mr. Junis added that “[t]here are potential monies to facilitate the literal transfer, potentially purchased dollars that could go through the state funding programs. DWI has really expanded its programs, especially specific to the utility reserve. They have a special fund only for the distressed systems, and then the distressed systems are also prioritized for funding.” Tr. vol. 4, 43)

In response to questions from Commissioner McKissick on troubled systems and legislative intent, Mr. Junis stated that:

[B]ased on the documents available to us, including the position of the Companies and the legislative summary, it appears that the intention was, where there is a need for capital investment, where there is a need for expertise, where there is potentially a compliance issue that needs to be addressed, and we're just not seeing those needs with Carteret County. Tr. vol. 4, 44.

Mr. Junis added that the Carteret County Water System is in good shape, the tanks are under a maintenance plan with Southern Corrosion, and CWSNC indicates that no major improvements are planned. Mr. Junis indicated that “this, sort of, ties back to a pragmatic Christmas gift. Is it a need or a want? And this acquisition looks like a want that is highly costly.” Tr. vol. 4, pp. 44-45.

In response to questions from Commissioner McKissick, Mr. Junis indicated that approximately \$6.5 million in grants went towards the approximately \$12 million investment in the system, but that Mr. Junis was not certain if any of those grant funds would need to be paid back upon any sale of the system. Tr. vol. 4, 45-46.

Based on the foregoing evidence, the Commission concludes that the Carteret County Water System is a well-maintained system that provides safe, reliable, and compliant service to customers. While the system is designated as “distressed” by the SWIA and LGC, this designation is not comparable to the Commission’s “troubled” designation, used for systems experiencing operational and/or financial challenges. A “troubled” system is at risk of failing, either financially or operationally, thereby putting customers at risk of losing service or giving rise to

significant environmental compliance issues, or both. In “troubled” instances, the Commission must determine whether appointment of an emergency operator and/or seizure of the bond is necessary. No such conditions exist in this case.

Additionally, Carteret County has the legal authority to establish rates sufficient to ensure continued safe, reliable, and compliant service to its customers and has taken recent action to ensure the water fund is adequately funded. The Carteret County Water System also has access to the Drinking Water State Revolving Fund, the Drinking Water Reserve Program, and the Viable Utility Reserve, in part due to its status as a municipal utility and “distressed” designation. There is no evidence in the record indicating that the Carteret County Water system is financially troubled or is likely to become financially unviable in the foreseeable future. Based on the condition of the system assets, environmental compliance record, historic capital spending, and present revenues, Carteret County has the technical, managerial, and financial capacity to provide adequate water utility service in its service area.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 23-27

Bids & Contract

The evidence supporting these findings is contained in the Company’s Application and exhibits, testimony and exhibits of Public Staff witness Junis, and the testimony of Company witness Denton and County witnesses Eugene Foxworth and Dee Meshaw.

Carteret County presented the testimony of witness Foxworth to explain the process and the County's timeline regarding the sale of the Carteret County Water System. Mr. Foxworth testified that the County's process of exploring options relating to the water system's future began in 2019 when the County received a NCDEQ Water Infrastructure Grant to study a merger with the Town of Beaufort Water System. ⁶ At the conclusion of the study in March 2020, and after representatives of the County, Town of Beaufort, and Draper Aden met and discussed the study results, Mr. Foxworth stated the Beaufort Town Manager informed the County that the Town was not interested in merging water systems. Tr. vol. 4, 80.

Mr. Foxworth testified, however, that in the meantime, Aqua inquired about potentially acquiring the Carteret County Water System. Tr. vol. 4, 80. After receiving Aqua's inquiry, Mr. Foxworth testified that he consulted with the County Commissioners and County Attorney, and they informed Aqua that the "only viable and transparent means of selling the System was under N.C.G.S. 160A-269, the upset bid process."⁷ Tr. vol. 4, 80.

County witness Foxworth testified that in June of 2020, CWSNC contacted the County about purchasing the Carteret County Water System and

⁶ He testified that the initiative by the State is to "encourage water and wastewater utilities to become viable and more proactive in the management and financing of their systems". Tr. vol. 4, 80.

⁷ N.C.G.S. § 160A-266 provides five methods for the County to consider for the transfer: (1) private negotiation and sale; (2) advertisement for sealed bids; (3) negotiated offer, advertisement, and upset bid; (4) public auction; or (5) exchange.

that both Aqua and CWSNC learned of the potential sale of the Carteret County Water System through local newspaper articles. Tr. vol. 4, 80.

Tr. Vol. 3, 135. CWSNC ultimately won the bid process with a \$9.5 million bid in May of 2021. Tr. Vol. 3, 135. Witness Foxworth further testified that the County Commissioners approved the APA with CWSNC at their October 18, 2021 meeting. Tr. vol. 4, 80-81. The Carteret County Commissioners voted 4 to 3 to approve the sale to CWSNC for the \$9.5 million contract purchase price.

Mr. Foxworth shared his view that no one knows better what serves the public interest in their community than local elected officials, as they are elected and live and work in their communities. Tr. vol. 4, 81. Additionally, Mr. Foxworth stated that the sale of the system would allow the debt on the system to be retired and that County citizens would receive approximately \$8 million dollars to help with other public necessities. Tr. vol. 4, 82.

Mr. Foxworth conceded, on cross-examination by counsel for the Public Staff, that he understood that the purview of this NC Utilities Commission was not the sales price of the system, but the impact it would have on rates and how rate base is treated post-closing, including for CWSNC's existing customers in dozens of other counties across the state. Tr. vol. 4, 91.

Mr. Foxworth testified that he believed that the upset bid process is the most fair and equitable method to dispose of public property and that the public participated in this process. Tr. vol. 4, 82. He testified that N.C.G.S. § 160A-269

allows local governments to dispose of property by upset bid and that doing so is very common and broadly and frequently used by local governments. He also testified that it is especially transparent in that every upset bid must be advertised so the public is aware of the bids. Tr. Vol. 4, 82. However, witness Foxworth stated the sealed bid process was also a viable option available to the County, but County chose not to use it. (Tr. vol. 4, 111)

Witness Foxworth acknowledged that a group of citizens expressed opposition to the sale of the Carteret County Water System at several County Commissioner meetings, most of whom attended the October 18, 2022 public customer hearing held in Beaufort. Tr. Vol. 4, 82. On cross-examination, Mr. Foxworth also stated that he was aware of a petition provided in response to a Public Staff data request, which was signed by customers who opposed the transfer. (Public Staff – Foxworth Cross-Exhibit No. 1)

On cross-examination by counsel for the Public Staff, Mr. Foxworth testified that he did not see any condition in the APA that indicated, if this fair value proceeding did not go as CWSNC would like, that the proposed transaction would not go through. Tr. vol. 4, 92.

Counsel for CWSNC asked Mr. Junis whether he was aware of CWSNC's proposal to keep current rates in effect for four years after acquisition. Mr. Junis testified that he was aware of CWSNC's proposal, but that he found it interesting, and highly concerning:

It's interesting that the County then, in the time in between acceptance of that bid and then ultimately the approval of the APA, is detailed in Board of Commissioner minutes that they realize the rates were so low that they were gonna incur losses. And so then they said, on second thought, we can't agree to that holdout.

Then the County raises rates 95 percent. All of a sudden there is some feedback that, okay, that's too high, so they bump it down 25 percent. And then the County goes ahead and accepts the \$9-and-a-half million bid, and then they approve the contract with the hold steady on the rates again.”

Tr. vol. 3, 171.

On additional questions from counsel for CWSNC, Mr. Junis testified that, if the transaction moves forward, there would be accumulated depreciation during the period of time in which rates remain unchanged. But Mr. Junis also pointed out that he was looking at what the rates would be as of today. Tr. vol. 3, 173.

In response to a question from CWSNC's counsel regarding the Public Staff's appraiser Michael Lane's use of a depreciation start date of 1988, Mr. Junis replied that it was his understanding that it doesn't actually change Mr. Lane's calculation of the net plan[t], because he used the County's records. Tr. vol. 3, 186.

In response to additional cross-examination, Mr. Junis did not deny that Carteret County may have a public interest in wanting to receive an \$8 million premium; however, he testified that his focus was on rate impact for Carteret County customers and CWSNC customers across the State. He also pointed to the incentive of Carteret County to access its water reserve funds upon sale. Tr. vol.3, 188-189.

Mr. Junis again stated that he did not believe that the public interest of Carteret County receiving \$8 million outweighed the public interest of all CWSNC ratepayers being asked to pay back a premium price of \$9.5 million and at a higher cost of capital.

When questioned about the appropriateness of his \$2.4 million suggested rate base in light of the appraisals, Mr. Junis testified that the transaction could have occurred at \$2.4 million but that the whole process was influenced by the valuation in the Engineering Assessment that did not factor in \$10 million in depreciation and CIAC and set off "race to the top" bidding by competitors Aqua and CWSNC.

In response to questions from CWSNC counsel regarding whether only getting \$2.4 million in rate base might be an obstacle to the transaction occurring, Mr. Junis testified that would be a business decision for the Company. He also testified that:

"However, we are tasked with, and this Commission is tasked with, is that a reasonable fair value and is it in the public interest. And that is the question that I am responding to.

I'm not trying to do an appraisal. And I think it should be noted, repeatedly, the witnesses before me have mentioned the word "market." The statute uses the word "market" one time, and that is the market approach to appraisals. It does not say the fair value -- the fair market value statute, it is the fair value statute. So I think it's an important designation."

Tr. vol. 3, 166.

On cross-examination by counsel for Carteret County regarding whether the transaction is a good deal for Carteret County, Mr. Junis replied that it could also be viewed as a good deal for the Company, because the more the Company pays for the Carteret County Water System, the more it can include in rate base and a higher rate base equates to a higher return, which will ultimately affect the 1200 Carteret County customers or potentially CWSNC's 29,000 customers outside of the County. Tr. vol. 3, 193-194.

Mr. Junis testified that he had been watching this transaction very closely from its inception and monitoring County Commissioner meetings. When asked by counsel for Carteret County about allegations that CWSNC had something to do with the County raising rates after the County learned that CWSNC had decided it could not abide by the rate hold it had promised, Mr. Junis testified that he closely followed the County Commissioner meetings by reviewing meeting minutes as well as recordings and there were details in the minutes regarding CWSNC's plan not to hold the water rates at the County's current level. Witness Junis pointed out that after those specific discussions, the County decided to raise its rates, and CWSNC then agreed to a rate hold. Tr. vol. 3, 195.

When asked by counsel for the County whether his proposed rate base of \$2.4 million was net of the \$1.5 million of the County's existing debt obligation, Mr. Junis testified that it was not, but that he does not dictate business decisions of CWSNC in terms of whether it will be willing to pay more and absorb the premium. Tr. vol. 3, 197.

Mr. Junis testified that it would be up to the County how to spend any proceeds and it's not clear what the County will do other than some discussion of airports, jails, and schools. Tr. vol. 3, 198-199.

Over the course of several questions, Mr. Junis clarified for the County's counsel that, in terms of ratemaking, if CWSNC's and the County's argument is accepted and the entire \$9.5 million purchase price is put into rate base, then the County is effectively making its customers (former customers) and CWSNC's existing customers pay that \$9.5 million back at a cost of capital that is likely higher than the County's. Tr. vol. 3, 199.

When asked by counsel for the County if setting rate base too low might endanger the transaction, Mr. Junis responded that he would not characterize it as a danger, as the County has shown that it can operate the system and provide safe and reliable service and has the ability to raise rates to cover costs. Tr. vol. 3, 202-203.

In response to additional questions from counsel for the County, Mr. Junis testified that the County had various options after the County was unable to transfer the system to the Town of Beaufort for negative \$2 million at the suggestion of Draper Aden. Mr. Junis mentioned potential regionalization funds that could have been used, for example. Tr. vol. 3, 205.

On redirect, Mr. Junis confirmed that his ratemaking analysis was not a concern about what the County might sell it for, but rather how the outcome affects customers that the Public Staff represents before the Commission. Tr. vol. 3, 207.

In response to a question from Commissioner Hughes about the Draper Aden's Engineering Assessment providing an estimate of present book value of \$10,241,142 with no original cost, discount rate, or depreciation, Mr. Junis stated that:

“[I]n terms of this valuation done by Draper Aden, we absolutely have concerns, because it, sort of, fueled a number of the appraisals and seems to have set, sort of, the ceiling here for what everyone was calling a fair value.”

Tr. vol. 4, 20.

In response to Chair Mitchell's questions about transaction history and the transaction with the Town of Beaufort not going through, Mr. Junis expressed concern about how this subsequent proposed transaction has played out. Mr. Junis asked why Aqua would bid \$4.9 million, when the County could not give the system away at a net of negative \$2 million, and when the County's existing debt was around \$1.5 or 1.6 million, when paying it off would also possibly allow the County to access its capital reserve fund of \$5.8 million Tr. vol. 4, 31-2, 35. Mr. Junis also questioned why bidding did not start at the lowest point of \$1.6 million to pay off the County's debt, and instead started at \$4.9 million. Tr. vol. 4, 31-32. County witness Meshaw testified that she estimated that the County had \$1.9 million of spendable cash that is not restricted in its capital reserve fund. Tr. vol. 4, 120.

In response to Chair Mitchell's question about whether this transaction was reverse engineered, whether Mr. Junis was contending that "the deal was struck only after rates were established that were satisfactory to Carolina Water," Mr. Junis expressed that the progression of events and the timing of the County's decision to raise its rates to within the ballpark of CWSNC's current rates could lead to that deduction. Tr. vol. 4, 32-33.

On redirect, Mr. Junis reviewed the County Commission meeting minutes from February, September, and November 2021, which were introduced as Public Staff Junis Redirect Exhibit No. 3. Tr. Vol. 3, 218.

Mr. Junis also discussed the transaction history on redirect, and particularly how the Draper Aden report initially set out a negative \$2 million valuation but then changed to \$12 million, and how the latter set off "race to the top" bidding that occurred over three and half months. Tr. Vol. 3, 220.

The Commission acknowledges that the County has the right to contract in any manner it wishes and negotiate the highest and best price for the sale of its Carteret County Water System, which will ultimately be advantageous to the residents and taxpayers of the County. The sale of the system would allow the debt on the system to be paid in full and that County citizens would receive approximately \$8 million dollars to help with other public necessities. The County chose the bid process and determined it was the best alternative compared to other options it had available and the County is ultimately accountable to its

citizens. It is not the Commission's place to second guess the process used by the County or the ultimate decision reached.

The Commission's role is to determine the fair value of the Carteret County Water System, and importantly, the likely impact on the County's and CWSNC's rate payers. The evidence demonstrates that the upset bidding process led to a bidding war between the two largest Commission regulated water utilities in the State. The evidence shows the ultimate winner of the bid, CWSNC, agreed to pay \$9.5 million for a system the County was willing to give away earlier to the Town of Beaufort. The Commission finds and concludes the bidding process led to an inflated purchase price rather than a fair valuation of the system. While the resulting sales price benefits Carteret County as a whole, it is not in the best interests of its customers or CWSNC's customers should the total sales price be included in its customers' rates.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 28-36

Engineering Report & Appraisals

The evidence supporting these findings is contained in the Company's Application and exhibits, the testimony of Company appraisal witness Gerald Hartman, testimony of County appraisal witness Harold Walker, and the testimony and exhibits of Public Staff witness Junis and Public Staff appraisal witness Michael Lane.

N.C.G.S. § 62-133.1A(b)(1) The Fair Value Statute provides that the fair value of a system to be acquired "shall be based on three separate appraisals

conducted by accredited, impartial valuation experts chosen from a list to be established by the Commission.” Subsection (a) of the statute provide that one appraiser represents the public utility acquiring the system, another appraiser represents the utility selling the system, and another appraiser represents the Public Staff. Subsection (b) of the statute provides that “[e]ach appraiser shall determine fair value in compliance with the uniform standards of professional appraisal practice, employing cost, market, and income approaches to assessment of value.”

In the evidentiary hearing, Mr. Junis vigorously raised concerns about how the Engineering Assessment underlying the Company’s Application and all the appraisals prejudiced the entire process by proactively injecting a “fair value” at the start of the process that is not authorized by statute and was not requested by the Commission in Commission rules. Mr. Junis pointed out that the starting point for the Engineering Assessment is a document (attached as Form Application Exhibit 5B) prepared by Draper Aden entitled “Feasibility Study for Water System Merger” dated December 2019. CWSNC and Carteret County retained Draper Aden “to conduct an assessment of the tangible assets of the system to be acquired” and Draper Aden produced “Update to Present Value of Water System” dated December 2021 (attached as Form Application Exhibit 5C). Tr. vol. 3, 130. The Executive Summary of the Report (Form Application Exhibit 5B, at E1) states that the County retained Draper Aden to evaluate the feasibility of a “merger” of the County’s water systems with the Town of Beaufort’s water system, and that the

proposed “merger” would entail the Town of Beaufort taking over the ownership and operation of the County’s water systems.

Mr. Junis testified that Draper Aden recommended the County transfer the water systems to the Town of Beaufort for one dollar (\$1), though the County would continue collection of special water tax district revenues to pay off its water fund debts in the amount of approximately \$2,066,128 (principal only) and contribute to the Town’s upgrades and expansions to the system over the next 11 years. Mr. Junis testified that this was essentially a negative \$2 million valuation at the outset. Tr. vol. 3, 131.

In his direct testimony, Mr. Junis pointed out, regarding the County’s capital improvement plan, that Draper Aden states:

In 2013, the County completed a \$3.51 million water system improvement project. Since 2013, there has been little need for significant capital projects; there were no capital projects scheduled in FY2019 and the FY2020 budget does not include any. The County continues to fund “pay as you go” capital projects, as needed.

.....

Overall, the water system is in good condition and the County is not expecting any major capital investment in the near future.

Mr. Junis pointed out and raised heightened concerns in direct testimony and in the evidentiary hearing that a significant portion of the document describes Draper Aden’s assumptions, calculations, and development of its estimate of the water system assets’ net worth of \$12,335,392, and that of that amount, \$10,241,142 was an estimate of present book value of existing land, wellhouses,

water treatment plant, and piping with no original cost, discount rate, or depreciation. Tr. vol. 3, 133.

Mr. Junis was very concerned about why Draper Aden undertook this valuation at all, because it was not required to receive the grant.⁸ Tr. vol. 3, 133. Also, he testified that the County has extensive accounting records to establish the original cost less depreciation. Tr. vol. 3, 133. Furthermore, the County has maintained records detailing contributions in aid of construction and funding sources. Tr. vol. 3, 133.⁹

Mr. Denton testified that professional appraisals are estimates of fair value based on various methodologies. As with the present case, they tend to display a range of results. He testified that the result of an actual competitive bid process is arguably the best evidence of fair value because it results in the actual price agreed upon by a willing buyer and willing seller. He testified the Public Staff testimony essentially ignores this fact.

⁸ Eligible projects for Merger/Regionalization Feasibility Grants are described on the North Carolina Department of Environmental Quality (DEQ), Division of Infrastructure (DWI), website as “[s]tudies to evaluate the potential consolidation or two or more systems into one system into one system and the potential physical interconnection with another system for regional wastewater treatment or regional water supply.” Available at <https://deq.nc.gov/about/divisions/water-infrastructure/i-need-funding/mergerregionalization-feasibility-grants> (last visited on October 12, 2022). Tr. vol. 3, 133.

⁹ For example, part of Form Application Exhibit 5A, pages 55 through 61 appears to be a document or partial email chain from approximately 2009 that describes the development of the water systems and finances, including the use of \$2.08 million from the Community Development Block Grant (CDBG) Program, \$3 million in state grants, \$0.1 million in sales tax refunds, and \$2.8 million in debt. In addition, Carteret County provided an Excel spreadsheet detailing infrastructure by funding sources, which shows a breakdown as follows: Grants (\$6,491,452 / 54.27%), Loan (\$4,435,608 / 37.08%), Developer Paid (\$305,944 / 2.56%), Other (\$727,732 / 6.08%), and Total (\$11,960,736 / 100.00%). This clearly shows over half the capital investment was contributions. Shown in Junis Exhibit 4.

Mr. Denton testified that his reading of this statute is that the default calculation of fair value is simply the average of the three appraisals. The Commission's authority to adjust that calculation for the public interest remains bounded by the definition of "reasonable fair value." He testified it was his opinion that the valuation in the Public Staff testimony departs from the market-based meaning of "fair value."

Witness Don Denton further testified on rebuttal it was his opinion that the recommendation of the Public Staff is unreasonable because it thwarts the legislative purpose – as evidenced by the plain language of the statute – to create a valuation process based on a balance between professional appraisals and the price a willing seller and willing buyer would agree to, and instead relies on unauthorized and roughly calibrated proxies to traditional original cost rate base. Mr. Denton testified if the North Carolina General Assembly intended the Public Staff approach, there would seem to have been no reason to enact the Fair Value statute.

In the evidentiary hearing, Mr. Junis elaborated on concerns in his testimony about the prejudicial impact of the proactively offered valuation by Draper Aden that fundamentally prejudiced the ensuing upset bid process. The valuation signaled a \$12 million targeted sales price that incentivized the private utilities to pay more and more to outbid competitors in a "race to the top." Tr. vol. 3, 191 and 220, and Tr. vol. 4, 72. It is the customers, however, Mr. Junis testified, who will be paying more, not CWSNC's shareholders.

In his direct testimony, Mr. Junis summarized the three appraisals: Hartman Consultants on behalf of CWSNC, Gannett Fleming on behalf of Carteret County, and NewGen on behalf of the Public Staff, restating that the appraiser's valuations were as follows: Hartman Consultants – \$10,900,000, Gannett Fleming – \$14,575,000, and NewGen – \$7,332,000, which averages to \$10,935,667. Tr. vol. 3, 144.

As stated above, the Company's appraisal, performed by Hartman Consultants, determined the fair value of the Carteret County Water System as of February 14, 2022, to be \$10,900,000. Company witness Gerald C. Hartman, senior appraiser for Hartman Consultants, stated in his rebuttal testimony on behalf of CWSNC that while he considered the income approach, he primarily relied upon the cost approach and market approach to valuation. Hartman Rebuttal, p.3, Tr. vol. 4, 153. Witness Hartman explained that the cost approach was based on a "present book value of assessment" analysis performed by engineering firm Draper Aden that valued the Carteret County Water System at \$12,300,000. Hartman Rebuttal, p.3, Tr. vol. 4, 153. Witness Hartman stated, "The market approach compared water utility transactions or pending transactions wherein a willing and knowledgeable seller and a willing and knowledgeable buyer agree to a transaction, without compulsion." Hartman Rebuttal, p.3, Tr. vol. 4, 153. Using the market approach, witness Hartman valued the Carteret County Water System at \$8,750,000. Witness Hartman further stated that, "Based upon the work performed by Draper Aden and his experience and training, I weighted the cost approach at approximately one and one-half times the market approach. The result is a

\$10,900,000 fair value opinion of value for the Carteret County Water System as of February 14, 2022.” Hartman Rebuttal, p.3, Tr. vol. 4, 153.

CWSNC Appraiser: Gerald Hartman of Hartman Consultants

Witness Hartman stated he relied on the Draper Aden present book value analysis of the Carteret County utility assets, with adjustments to arrive at its valuation for the original cost new less depreciation (OCNLD) since the County was the only known owner.

The market approach compares other water utility transactions or pending transactions where a willing and knowledgeable seller and a willing and knowledgeable buyer, both without compulsion, agree to a transaction. Mr. Hartman indicated that he compiled information on other water systems that are roughly comparable to the Carteret County system and calculated the sales price per connection. Given the relatively good condition of the Carteret County system, the extensive system, the location, “the lack of future CIP costs,” immediate compliance costs, and the growth opportunities for the area, Mr. Hartman used the top-half average of those sales prices per connection, which equaled \$6,598 and rounded up to \$7,000 per connection. Hartman Rebuttal p. 4, Tr. vol. 4, 153. That value, multiplied by 1,246 connections, results in a market value of \$8,750,000. Hartman Rebuttal p. 3, Tr. vol. 4, 153. Witness Hartman explained that the concept with this approach is that actual market data on other transactions are indicative of the purchase price that a willing buyer and willing seller could agree on for the Carteret County

Water System due to its characteristics.

Mr. Hartman further stated that his approaches are estimates of the fair value that a willing buyer and willing seller may negotiate. In contrast, he stated the Public Staff's approach is tied to original cost rate base net of depreciation and net of contributions in aid of construction without other typical positive value adjustments but does not reflect market value. Hartman Rebuttal, pp.2 -3, Tr. vol. 4, 153.

As stated by Mr. Hartman, he relied on the Draper Aden present book value analysis of the Carteret County utility assets. The Fair Value Statute requires that, "[t]he acquiring public utility and selling utility shall jointly retain a licensed engineer to conduct an assessment of the tangible assets of the system to be acquired, and the assessment shall be used by the three appraisers in determining fair value."¹⁰ In this case, the starting point for the Engineering Assessment is a document prepared by Draper Aden entitled "Feasibility Study for Water System Merger" dated December 2019.¹¹ For the use of the appraisers, CWSNC and Carteret County retained Draper Aden "to conduct an assessment of the tangible assets of the system to be acquired" and Draper Aden produced "Update to Present Value of Water System" dated December 2021.¹²

¹⁰ N.C.G.S. § 62-133.1A(b)(2).

¹¹ Form Application Exhibit 5B.

¹² Form Application Exhibit 5C.

On cross-examination, witness Hartman was asked about whether he considered using the County's books and records to determine the original cost new of assets in his prior appraisals. Witness Hartman stated that for several of his prior municipal clients throughout the nation, he has restated their original cost; however, he did not accept Carteret County's original cost, but accepted Draper Aden's report instead. Tr. vol. 2, 157-158. In response to the question of why he did not review the County's records, he replied that it would have taken a "long time" (about a year) and would have been expensive to do so. When asked whether he felt obligated to use the engineer's report, witness Hartman further stated that since the [Fair Value] statute requires that an engineer must be hired by [the Company and the County] to produce a report; and since he is a professional engineer (PE) in North Carolina, he believed he could rely on another PE's report. Mr. Hartman stated however that he did not rely upon the engineer's valuation of the land, which is not a subject on which an engineer usually renders an opinion, and he adjusted his valuation accordingly. Tr. vol. 2, 159. Mr. Hartman stated that he engaged a land appraiser, Chris Mashburn, of the Mashburn Group to assess the value of the land. Upon further examination, witness Hartman agreed that the Fair Value Statute does not state that an engineer provides a fair value. Tr. vol. 2, 159.

Witness Hartman distinguished setting a value as opposed to the engineer performing "facilities costing" and contended he merely looked at the engineering estimate and then modified it to arrive at fair value. Tr. vol. 2, 161. Witness Hartman stated that he did not consider Draper Aden's valuation "fair value," but rather

consider it “facilities costing” or an evaluation of facilities relative to permits, etc. and the condition of the County’s facilities. When asked whether it is common for utility valuation experts to rely upon engineers’ reports, Tr. vol. 2, 161. Mr. Hartman said this is how it is done in Virginia and Illinois and contends that fair market states prefer this process. However, he admitted that it is not statutorily required in North Carolina. Tr. vol. 2, 161.

When questioned in detail regarding Hartman Consultant’s review of Draper Aden’s assessment, he noted that Draper Aden had estimated a present book value and added 5%. Witness Hartman stated he assumed it was for inflation and confirmed his assumption with a call to the engineering firm but did not independently verify whether the 5% adder was reasonable. Tr. vol. 2, 165. Witness Hartman stated his valuation included in the OCNLC for intangible cost an ongoing concern value of \$247,000-based on going concern for similar systems not profitable, which was deemed an original cost that has been trended. However, witness Hartman admitted that some jurisdictions where he has provided expert valuation services require that this method be excluded. Tr. vol. 2, 167.

When Mr. Hartman was asked why he did not apply the income approach to valuation, he explained that he discounted this approach, because as of the year ending June 30, 2021, the Carteret County Water System was losing money. Tr. vol. 2, 168. Witness Hartman also testified that because of frequent changes in the market, it is difficult to determine a trend going back five years.

Additionally, Mr. Hartman testified that the income approach was not appropriate because he did not know the rate base of the Carteret County Water System. The witness was also questioned about the existing operating nature of the system and revenue from tax district, and he opined that he was not certain if a private water company (like CWSNC) has a right to receive a revenue stream from a tax district as was the case with Carteret County. Tr. vol. 2, 175. Witness Hartman did not clearly identify in his appraisal any of the difficulties with the income approach he verbally testified to in the hearing. Tr. vol. 2, 178.

As to the other valuation methods, witness Hartman stated he gave the cost approach one and a half times weight of the market approach and weighted his valuation 60% cost approach, 40% market approach. He stated he did not perform the income analysis. Tr. vol. 2, 179.

Witness Hartman was cross-examined on how he implemented the market approach and referred to his Exhibit 5.1 and 5.2, which contained valuations of similar municipal systems with sales throughout the country, and he also stated he chose utility systems that were “relatively new” and in “good condition.”

Exhibit 5.2 showed an average valuation of \$5,047/connection; however, witness Hartman used top half of all the averages of \$6,598/connection and then rounded to \$7,000 to account for anticipated growth of the Carteret County connections. beyond the top half average of other locations. Witness Hartman included in his valuation a growth rate of 500 to 533 connections, which he contended was in his data and files and underlying his analysis; however, witness

Hartman acknowledged that this data was not specifically mentioned in his report. Tr. vol. 2, 184-185. When questioned about how the growth rate was determined, witness Hartman testified he used his judgment to attach a growth rate over an indeterminate period of time. Tr. vol. 2, 182-183.

Public Staff witness Junis expressed concerns about the appraisal performed by Hartman Consultants for the following reasons: the valuation of \$10,900,000 is equivalent to \$8,536 per customer, and that his cost approach heavily relied on the Draper Aden assessment for OCNLD instead of County financial records, and his market approach only relied on the top half average of selected water system sales with significant unsubstantiated, upward rounding. Tr. vol. 3, 145.

The Commission acknowledges the 45 years of expert witness experience Company witness Hartman has in the valuing municipal systems in other states to determine fair value or to render his opinion on estimates of fair value; however, the Commission finds Mr. Hartman's valuation of the Carteret County System to be inflated due to his reliance on an engineering valuation which was not contemplated by the Fair Value Statute and failure to otherwise verify and adequately test the basis upon which the engineers valuation was based. The Commission further takes issue with the failure to make an effort to determine ways to employ an income approach. While Mr. Hartman claimed it would have taken "a long time" to review the County's financial records and would have been expensive to do so," the Commission does not find this explanation convincing or reasonable.

The Fair Value Statute requires a professional appraiser to employ cost, market, and income approaches to assessment of value. The Commission determines Witness Hartman did not make a reasonable attempt to employ the income approach as required by the Fair Value Statute in that the company relied on dated information from June 30, 2021, and ignored County records and data that provided updated information. Witness Hartman's failure to conduct a more complete investigation, selective comparisons to only a few comparable water system sales, and engaging in upward rounding of his valuation amounts without providing a reasoned basis leads the Commission to question the accuracy and reasonableness of Mr. Hartman's valuation. Additionally, as established by the convincing testimony of Public Staff witness Junis, the valuation provided by Mr. Hartman would result in an exorbitant cost of \$8,536 per customer.

In light of the foregoing, the Commission finds and concludes that the Hartman Consultants valuation is inflated and not sufficiently supported by the report, records and testimony of the appraiser. Thereby Mr. Hartman's fair value recommendation is unreasonable and not in the public interest.

County Appraiser: Harold Walker, III of Gannett Fleming

Pursuant to the requirement of the Fair Value Statute, the Company submitted the appraisal performed by Carteret County's appraiser, Gannett Fleming. Gannett Fleming valued the Carteret County system at \$14,575,000.

Public Staff witness Junis provided his assessment of the valuation and stated the valuation amount equated to \$11,413 per customer of the County. In

Mr. Junis' opinion, Gannett Fleming's cost approach also heavily relied on Draper Aden's Engineering Assessment for the original cost new (OCN) instead of calculated "the original cost new (OCN) instead of County financial records and calculated a theoretical accumulated depreciation (24% of OCN), which is significantly lower than the County's records (over 50%)." Tr. vol. 3, 145. Mr. Junis added that Gannett Fleming's method thereby inflated the OCN and original cost less depreciation, which are starting points for the replacement cost method." The market approach relied on a "Comparable Group." In comparison, the Carteret County Water System is a government-owned utility with revenues, customer base, and population of less than 2% of the smallest company of the selected Comparable Group of IOUs." Tr. vol. 3, 145. The original cost new less depreciation of facilities owned by Carteret County was \$12,334,000, which was prepared by Draper Aden. Tr. vol. 2, 163.

Mr. Walker testified that he had been in the financial consulting industry relating to utilities for over 35 years and has been involved in all aspects of rate cases, cost of capital, lead lag, depreciation, touching on all the different aspects of the utility industry regulation. Tr. vol. 3, 29. In response to questions from Commissioner McKissick, Mr. Walker testified that as a Commission-approved "utility valuation expert," he has the fiduciary duty to provide a thorough, objective, and fair valuation by looking at all aspects of the available information, not being swayed by outside influence, and making sure that the appraisal is consistent with USPAP as well as financial theory." Tr. vol. 3, 31. Mr. Walker testified that any "judgment call" would need to be supported by as much outside evidence as

possible, meaning “published evidence, as opposed to my personal opinion or the firm's personal opinion.”

Mr. Walker provided an example relating to the income approach in which he testified that he would typically look at growth from state agencies that provide projections; he testified “that's what we defer to, regardless of what our opinion is.” Tr. vol. 3, 31. Mr. Walker testified that he relied upon the most micro projection available, which was a growth rate put out by the State for the County of 0.29 percent per year, which is about three to three and a half additional customers per year. While he opined there is a lot more pocket for growth based on the system design, he deferred to the population growth put out by the State. Tr. vol. 3, 32.

In response to additional questions from Commissioner McKissick, Mr. Walker discussed his comparable group of water utilities. He testified that he used his comparable group of utilities to gauge the financial and risk characteristics of a system to develop the weighted cost of capital for discounting purposes, and that he used a market multiple method in which the multiples from that group were adjusted downward by 30 percent to account for what he concluded was the “risk difference between the system in question versus the comparable group.” Tr. vol. 3, 35.

Commissioner McKissick asked Mr. Walker about how he developed the comparables listing that he used. Commissioner McKissick indicated that the question was being asked:

“Because every single company on your list has larger revenues, greater number of customers, and serves a much larger population.

For instance, the smallest company by revenues is York Water Company, which has revenues of over \$55 million, which is 43 times the revenue of the County system. And the York Water system also has the smallest number of customers in your comparable list. I think it's 73,144, which is 58 times the number of customers that the Carteret County system has.”

Tr. vol. 3, 36.

Mr. Walker pointed to the selection criteria in which he looked at a market-based group whose stock is publicly traded, and he selected seven of approximately nine publicly traded water companies. Tr. vol. 3, 37. He further testified that in a perfect world a more comparable group would exist, but it does not.

Mr. Walker did, however, look at sources of data for smaller water system transactions. Mr. Walker testified that he was employing two valuation methodologies, the one already discussed – the “market multiples” approach (multiples of stock prices), and the other a “selected transactions” approach, and that his “selected transactions” approach is more comparable to the present transaction in terms of size. Tr. vol. 3, 38. Mr. Walker testified that he looked at eighteen transactions.

He also testified that he had experience valuing small systems, including systems with 2,000 customers or less. Tr. vol. 3, 39. As for purchases under “market fair value rules,” he testified that most of the systems are in excess of 2,000 customers as such transactions are generally cost prohibitive for small systems. For his cost approach, Mr. Walker testified he relied upon the

Engineering Assessment as the beginning point for inventory and that he relied upon the County's depreciation schedule. Tr. vol. 3, 41.

Mr. Walker testified that for mains and water treatment assets, which "clearly" have asset lives far in excess of 33 years, he used an effective depreciation rate of 1.75 % instead of 3% used by the County. Tr. vol. 3, 43. He also testified that his appraisal assigned a value for "services or meters" that were not in the Engineering Assessment "because they are part of the transaction and there is value related to those assets." Tr. vol. 3, 46.

Mr. Walker shared his experience that financial statements of public utilities regulated by public utilities commissions are usually reported on an accrual basis. Tr. Vol. 3, 43. He testified that, in his experience, government entities usually undercapitalize and over depreciate. In response to a clarifying question from Commission McKissick, Mr. Walker testified that he was not saying that municipal financial statements are wrong, but they are just prepared for a different purpose. Tr. vol. 3, 45. While there was some difference in the numbers that he relied upon versus the Engineering Assessment due to recalculating service lives, Mr. Walker testified that he primarily relied upon the Engineering Assessment. Tr. vol 3., 46.

Mr. Walker testified that his original cost new valuation of the assets was "not less than" \$14.9 million, when the Carteret County Water System audited financial information shows gross property plant and equipment in the amount of \$12,195,043, because the County is depreciating assets at 3%, or 33 years. Tr. vol. 3, 50-51.

Commissioner Hughes asked Mr. Walker several questions regarding his use of the income approach and in particular whether the valuation should be from the vantage point of the income the buyer will receive after buying, or the seller will receive if the seller does not sell. Mr. Walker testified that it is not the exact buyer or seller, but a composite of them, so a hypothetical buyer and hypothetical county. Tr. vol. 3, 55.

In response to a question from Commissioner Hughes, Mr. Walker testified that, in his income approach, he disregarded the capitalization earnings analysis and only used the discounted cash flow method. Tr. vol. 3, 56. In response to questions from Commission Hughes about his market approach, Mr. Walker testified that his market multiple methodology uses comparable publicly traded stocks and that his selected transaction methodology are transactions that occur in a process similar to fair value legislation and other regulatory jurisdictions. Tr. vol. 3, 58.

Chair Mitchell asked Mr. Walker to clarify certain aspects of his income approach, that included both no growth and minimal growth assumptions. As for minimal growth, Mr. Walker testified that the 0.1 percent is a growth rate for cash flows growing into the future. Mr. Walker also clarified that the starting place for earnings is the cost of capital for the comparison group. Tr. vol. 3, 58-59.

Chair Mitchell asked Mr. Walker several questions relating to Mr. Hartman not utilizing an income approach, while Mr. Walker and Mr. Lane utilize the income approach. Mr. Walker defended his use of the income approach in that he included

the 2021 budget that includes the change in the structure of rates, a revenue stream that increased by 95 percent. Tr. vol. 3, 60-61. Mr. Walker testified that previously the system had for years been losing basically between “4 – and \$500,000 a year, and taxes were basically moved over into the water fund, which acted as a subsidization of the rates.” Tr. vol. 3, 62. After the 95% increase in rates by the County, he testified it was a “big starting point, to be able to have revenues to at least have profitability in the system.” Tr. vol. 3, 62.

In response to Commission Clodfelter’s question about why Mr. Walker did not revise his input for the County water rates in light of the County’s rate reduction in September 2021, Mr. Walker testified that he was aware of the change but that his analysis relies upon the 2021 budget; however, if there had been an amendment to the budget, he would have taken into the account the lowered rate. Tr. vol. 3, 63-64.

Mr. Walker also confirmed for Commissioner Clodfelter that he used the County’s original cost and installation dates figures when he had them. Tr. vol. 3, 65. Commissioner Clodfelter asked Mr. Walker why a public entity would want to more quickly depreciate assets, and Mr. Walker responded that he believes the benefit to local government is that debt is paid with cash, and “depreciation is a source of cash.” Tr. vol. 3, 66.

Commissioner Kemerait also asked Mr. Walker about his income approach, following up on Chair Mitchell’s and Commissioner Clodfelter’s questions, and why Mr. Walker’s reliance on his methodology for the income approach remained

valued after the County's rates were lowered. Mr. Walker reiterated that he relied on the County's budget. Tr. vol. 3, 67-68. In response to a question by Company counsel, Mr. Walker testified that his income approach relied on rates that cover costs. Tr. vol. 3, 69.

The Fair Value Statute requires a professional appraiser to employ cost, market, and income approaches to assessment of value. The Commission determines that witness Walker's cost approach heavily relied on the Engineering Assessment for the original cost new (OCN) instead of County financial records and use accumulated depreciation which is significantly lower than the County's records. Witness Walker's market approach relied on a comparable group that is not comparable to the Carteret County Water System.

In light of the foregoing, the Commission finds and concludes that Mr. Walker's valuation is inflated and not sufficiently supported by the report, records and testimony of the appraiser. Thereby Mr. Walker's fair value recommendation is unreasonable and not in the public interest.

Public Staff Appraiser: Michael Lane of NewGen

In his direct testimony, witness, Michael Lane testified that his Fair Value estimate of the Carteret County Water System as of January 1, 2022, is approximately \$7,332,000. Tr. vol. 3, 78. He testified that he relied on the income approach to value "because a buyer, evaluating the System on a purely financial basis, should not be willing to pay more than the income value unless external factors specific to the buyer's situation are influencing the purchase, which would

be at odds with the definition of Fair Value.” Mr. Lane indicated that he did not rely upon the Sales Comparison Approach due to difficulties in comparing transaction data among utilities as “the technologies employed differ; the customer composition, use, and growth all differ; and the regulatory environments sometimes differ.” Tr. vol. 3, 79.

Commissioner Hughes asked Mr. Lane about his use of the income approach, and Mr. Lane confirmed that, while he considered all three approaches, he relied primarily on the income approach. Tr. vol. 3, 80. Witness Lane testified that while all three approaches informed his opinion, he believed the income approach to be the most reliable indicator of value. Tr. vol. 3, 80-81.

In response to a clarifying question by Commissioner Hughes on Mr. Lane’s use of the income approach, Mr. Lane further explained that he does not typically rely on the market approach because “there are so many differences between utilities: customer density, regulatory environment, political environment, general economic area, that it makes it a very difficult exercise to make adjustments to get them to be apples-to-apples.” He added that, more importantly, the publicly available data for transactions don’t tell the whole story, indicating that:

“We don’t know what strategic synergies there were, what strategic incentive there was for a particular purchase price. We know of instances where utilities intentionally overpaid and, you know, had to write down the overpayment simply to keep a competitor out of their backyard.... so we don’t typically use that approach as a primary indicator of value. We use it as a check.” Tr. vol. 3, 81-82.

As for the cost approach, Mr. Lane indicated that he used it to set the lower and upper bounds of value. In Mr. Lane's opinion, no prudent seller would sell for less than original cost depreciated, and no prudent buyer would buy for more than replacement cost depreciated. Tr. vol. 3, 82. Commissioner Hughes asked Mr. Lane to clarify his statement about no willing buyer selling below Original Cost Less Depreciation when there is evidence in the record that Carteret County had explored a merger with the Town of Beaufort. Mr. Lane responded with a caveat to his prior statement, to indicate that "[o]utside some other motivation" or "[o]utside of some other noneconomic consideration," no willing buyer selling below Original Cost Less Depreciation.

Mr. Lane also discussed one of the differences between his and Mr. Walker's appraisals, specifically Mr. Lane testified that he believed that the hypothetical purchaser should be the most likely purchaser and, in this instance, a regulated investor-owned utility. Tr. vol. 3, 84. Mr. Lane further explained that it was based upon the fact that the most likely buyer for the system was a regulated investor-owned utility that Mr. Lane looked for comparable investor-owned utilities. He then used those comparables to develop a return on equity and weighted average cost of capital to apply a return on rate base (using the County's accounting records) to develop revenues. Mr. Lane testified that he received unaudited financial statements from the County to use as rate base. Tr. vol. 3, 84.

Commissioner Hughes asked about possible circularity in Mr. Lane's approach, as this Fair Value proceeding was to determine rate base for ratemaking

purposes. Mr. Lane responded, however, that he believed that “if an entity is going to make a purchase of an asset, this is the approach they would use.” Mr. Lane also confirmed that \$5,904,000 was the assumed rate base he used. Tr. vol. 3, 86.

On cross-examination by counsel for CWSNC, Mr. Lane testified that he used the cost of the assets, regardless of whether contributed or funded in some other way. Mr. Lane also conceded that his approach was different from the approach taken by Public Staff witness Junis; but he also noted that Mr. Junis was not doing an appraisal. Tr. vol. 3, 94-95. Mr. Lane also testified, in response to cross-examination by counsel for CWSNC regarding land value, that he used the original cost of the land. Tr. vol. 3, 96.

Mr. Lane testified that the rate base number he used (of \$5,904,123) was derived from original cost, not replacement cost. Additionally, Mr. Lane testified that he used his lower bound (original cost depreciated) instead of upper bound (replacement cost depreciated), because Mr. Lane was not aware of a utility that was allowed to earn a return on its replacement cost, nor the average of the two. Tr. vol. 3, 102-103.

Mr. Lane also answered cross-examination questions on his sale comparison analysis. Mr. Lane testified that it’s difficult to know whether Carteret County is comparable to any of those utilities as they are “typically not, you know, well publicized, they don’t publish in the paper what their strategy was or why they made the purchase offer that they made. It’s very difficult.” Tr. vol. 3, 106-107.

Mr. Lane testified regarding his concerns with relying on the market comparables approach. Mr. Lane reviewed Public Staff Data Request 8 to CWSNC, admitted as Public Staff Lane Redirect Exhibit No. 1, in which the CWSNC expressed similar concerns, that "purchases of existing systems inherently include a variety of considerations, such as seller type, asset age and condition, compliance issues, capital investment required, contiguity with buyer's service territory, etc." Tr. vol. 3, 116.

In response to questions from Commissioner Duffley, Mr. Lane testified that he did not use actual County revenue, but instead that of a hypothetical third-party purchaser, in his income approach, as County revenue is not how a third-party purchaser would do ratemaking. "They would do ratemaking in front of the Commission determining rate based and a return on rate base," Mr. Lane said. Tr. vol. 3, 118.

Chair Mitchell also asked Public Staff witness Junis how the Commission should reconcile the difference between Mr. Junis' fair value recommendation and the fair value amount determined by Public Staff witness Lane, which was "much more robust". Mr. Junis responded that the numerical difference (of \$4,887,653) between his and Mr. Lane's recommendations is less than of the numerical difference (of \$7,243,000) between Mr. Walker and Mr. Lane. Mr. Junis also emphasized that it is ultimately up to the Commission to determine if the average of the three appraisals provided is reasonable and reiterated his view that he

believes the Commission has the authority to set the value at \$2.4 million. Tr. vol. 4, 36-37.

The Fair Value Statute requires a professional appraiser to employ cost, market, and income approaches to assessment of value. The Commission determines that witness Lane appropriately evaluated but did not give weight to the market comparables approach. For rate base purposes, however, the Commission finds and concludes that, while closer than the other appraisals, Mr. Lane's appraised value does not represent an appropriate fair value in the public interest.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 37-44

Company Application & Testimony

The evidence supporting these findings of fact is found in the Company's Application and exhibits, the testimony of Company witness Denton, the testimony and exhibits of Public Staff witness Junis and the Affidavit of Public Staff witness Feasel, and the entire record in this proceeding.

The Application identified no deficiencies in the system or needed infrastructure improvements for the next five years as contemplated by N.C.G.S. § 62-133.1A(c)(2) and Commission Rule R7-41 (Form FV1 Required Exhibits 2.). CWSNC contended this acquisition would benefit the Carteret County Water System customers and CWSNC's existing uniform water rate customers from the economies of scale realized. However, CWSNC never quantified the asserted economies of scale.

Company witness Donald Denton, III, the President of CWSNC and Vice President, East Operations for Corix, the parent company of CWSNC, testified that the purpose of his direct testimony was to explain the object and aspects of the Company's Application and address how multiple aspects of the public interest are served by CWSNC's acquisition of the Carteret County Water System.

Mr. Denton testified the purpose of the filing is to comply with the statutory and the Commission rule-based requirements for determining the rate base value of a governmental utility, when it is being acquired by a regulated public utility, by use of a "fair value" based methodology, rather than by use of the "original cost" method. Mr. Denton testified that in order to make the transaction feasible, the "fair value" methodology must be employed in order to capture the reasonable, realistic value of this system as it migrates from the ownership by a governmental entity to ownership by a utility regulated by the Commission. He further testified that absent the ability to establish a realistic level of "market" value of such assets, there is an obstacle to purchases of governmental systems by utilities that are regulated under Chapter 62 of the General Statutes.

Witness Denton testified in the event that a governmental unit determines that its water (or wastewater) service can be provided in a more reliable, economical, efficient, and/or compliant way by a regulated public utility, it can be in the public interest of its customers and community to sell the system. Similarly, if a regulated public utility can increase its economies of scale, allocate its overhead more efficiently, grow its systems and revenues, and/or strengthen its

internal capacities by purchasing a governmental utility at reasonable cost, then that too can serve the public interest.

Mr. Denton testified this transfer of ownership is in the public interest of the customers of both Carteret County and CWSNC, and N.C.G.S. § 62-133.1A provides a path through which the interests of all customers can be advanced and safeguarded, the benefits of expanded rate base and economies of scale on the CWSNC system can be realized, and the expertise contained in CWSNC's multi-state, professional, experienced organization can be extended to the various governmental systems to support the provision of safe and reliable service to customers.

Witness Denton testified that the Fair Value Statute is replete with tools whereby the Commission can protect ratepayers and maintain the public interest. Witness Denton acknowledged that the Commission retains the authority to set rates for the acquired system in future rate cases, has the discretion to classify the acquired system as a separate rate entity in future rate cases, and has the authority to adjust the "fair value" as the Commission deems appropriate and in the public interest.

Witness Denton testified CWSNC has a strong local presence in the Carteret County area, with a highly qualified work force to provide an optimal level of service through enhanced efficiency and depth of experience. He testified that CWSNC plans on operational continuity by looking to maintain existing operational support.

Witness Denton testified that Carteret County and the Carteret County Water System customers will benefit from CWSNC's access to financial capital, which can be used to ensure that necessary and prudent investments are made on a timely basis, in order to provide safe, reliable, and compliant service. Mr. Denton added that CWSNC's ability to attract capital to fund investment in infrastructure will benefit the operation of the Carteret County system in other ways. The County's operating expenses have exceeded water service revenues in recent years, and the deficits have been subsidized by tax revenues generated from supplemental taxes. He testified CWSNC's ownership will provide the financial and operational resources needed to manage Carteret County Water System efficiently and safely.

Mr. Denton further testified CWSNC's existing customers will also realize benefits from the acquisition of Carteret County's utility system. The additional customers gained by this transfer will provide economies of scale by spreading existing fixed costs over a larger customer base. Carteret County and CWSNC's customers will also experience the advantages of operating within a uniform group of ratepayers which includes smoother rate adjustments, regulatory and operational cost efficiencies, and shared access to support for vital capital needs.

The \$9.5 million purchase price, plus closing costs divided by the number of customers on the Carteret County Water System yields a rate base per customer of a substantially higher rate base per customer than the average rate base per customer on CWSNC's uniform water rate systems in North Carolina. On

November 21, 2022, CWSNC filed Exhibits 1 & 2 which stated the opening plant in year 1 as \$9,675,000 (9,500,000 purchase price plus \$175,000 closing costs). The \$9,675,000 divided by the 1,277 customers on the Carteret County Water System equals the average of \$7,576 per customer. In comparison, the average of the rate base for CWSNC's uniform rate water customers as stated on the Affidavit filed by Ms. Lynn Feasel, Public Staff Accounting Supervisor, on October 14, 2022, is \$2,337.00.

Public Staff Junis Redirect Exhibit No. 2 by Lynn Feasel, Public Staff Accounting Supervisor, quantified the revenue requirement impact for the \$9.5 million purchase price plus closing costs in rate base and the increase in the revenue requirement for the return on rate base, including debt, return on equity and depreciation, with the first year being a \$1.18 million increase in the revenue requirement. Junis redirect Exhibit 2 stated that the increase in revenue requirements over 25 years, would total \$19.23 million. CWSNC did not present evidence to contest the Public Staff calculation.

Mr. Junis testified that the monthly metered residential bill for a Carteret County customer using 4,000 gallons under present rates and after establishing the Carteret County water customers as a system specific rate division of CWSNC, and treating the associated \$9.5 million purchase price and \$0.175 million

estimated fees¹³ and closing costs as rate base, are shown in the table below. Tr. vol. 3, 125.

Table 2

County Present Rates	CWSNC System Specific
\$70.55	\$113.71

Mr. Junis pointed out that Mr. Denton neither quantified the cost impact of the purchase price if established as rate base or cost savings to be passed to customers, nor substantiated the need for additional capital investment in the Carteret County Water System, in either his testimony or in response to discovery. Tr. vol. 3, 129.

Mr. Junis discussed CWSNC's proposal to transfer the County's current customers at existing rates charged by Carteret County and then integrate them into its uniform water rate division as part of its next general rate case. As indicated in Form Application Exhibit 3, Mr. Junis noted that CWSNC projects the present rates to be charged for the next four years and then an increase of 28.19% in the average residential bill in 2027. Mr. Junis also pointed to the APA¹⁴ that states "CWSNC would retain your current rates at the time of APA execution until our next approved rate case, at which time Carteret customers would move into our then current rate structure. We anticipate the next rate case filing would occur in

¹³ The \$175,000 was the most up-to-date figure that Mr. Junis had at the time of filing his testimony, though the sum is likely now materially higher.

¹⁴ Exhibit O to Form Application Exhibit 6B.

July 2022 with new uniform rates becoming effective 12-18 months after filing”. Tr. vol. 3, 14.

Assuming the Carteret County water customers are established as a system specific rate division of CWSNC, and treating the associated \$9.5 million purchase price and \$0.175 million estimated fees and closing costs as rate base, the resulting bill impact to Carteret County water customers would be materially harmful at \$43.16 per month per customer increase, which equates to a 61% increase. If Carteret customers are consolidated into CWSNC uniform rates, the resulting impact to all existing CWSNC customers would be materially harmful at \$3.22 per month per customer, which equates to a 4.5% increase. Thus, the consolidated rates would harm both acquired and existing customers without corresponding benefits to all CWSNC customers. This result is contrary to the public interest and thus CWSNC’s and Carteret County’s proposed fair values should be rejected. The Commission does not find compelling the testimony and late-filed exhibits of CWSNC that decrease the depreciation rate, functionally extending the ratemaking life of the purchase price and associated fees, to minimize the bill impact.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 45-49

Customer Concerns & Service

The evidence supporting these findings of fact is found in the testimony of the seven customers appearing at the October 18, 2022 hearing, the Response to Customer Concerns-Beaufort, NC Public Hearing October 18, 2022 (Response to

Customer Concerns) Report filed by CWSNC on November 7, 2022, the verified Response to CWSNC's Response to Customer Concerns filed by Public Staff witness Junis on December 16, 2022, and the testimony of County witness Foxworth.

Seven customers testified at the October 18, 2022 public hearing in Beaufort, North Carolina. Six of the seven customers testified in opposition to CWSNC acquiring the Carteret County Water System. Tr. vol. 1. The seventh testifying customer only addressed the fire protection issue.

Three of the customers stated that they had attended the Carteret County Commissioner's meeting where the potential sale of the Carteret County Water System was discussed. One customer indicated that, at the County Commissioner's meeting, all the seats in each of the two courtrooms were full and persons were seated on the floor. One customer testified that he collected the signatures of 50 customers on a petition opposing the proposed sale and that there was a second petition against the proposal signed by 1,000 customers. Tr. vol. 1, 63-64. The petition was discussed on cross-examination of County witness Foxworth. (Public Staff – Foxworth Cross-Exhibit No. 1) Tr. vol. 4, 87-88.

Customer Clark Patton testified that the County Commissioners did not listen to the customers attending the County Commissioner meetings and approved the sale in a 4 to 3 vote. Tr. vol. 1, 35.

Mr. Kelly testified that around 8 or 9 o'clock each evening, there is a decrease in the water pressure to half pressure. He testified that in the morning when he wakes up, there is no problem with the water pressure. He testified that he noticed the low pressure in the evenings approximately four months ago. He testified that the low water pressure occurs each evening. Mr. Kelly testified that prior to the low water pressure over the last four months, he never had a problem with his water. Tr. vol. 1, 37-49.

Mr. Kelly testified that he fears the rate increases by a for-profit company. He further testified that he is concerned with CWSNC buying the Carteret County Water System for \$9.5 million when Carteret County only owes \$1.6 million, and Carteret County has not made money on the system. Tr. vol. 1, 49.

Customer John Cawthorn testified and implored the Commission to stop the sale and make the County Commissioners properly manage a necessary public service. Tr. Vol. 1, 49-53.

Customer Lisa Camp testified that when the potential sale to CWSNC came along, the customer consensus was that if customers would pay more for service if it were sold, the customers would rather pay the County. Ms. Camp also testified that the water had gotten yellow and that was a definite change. She testified that the yellow water began in the spring of 2022. Tr. vol. 1, 53-62.

Customer Jennifer Day testified that the water pressure drops every night around 8 o'clock. She testified that at 10 o'clock she can barely flush the toilets,

and that during the middle of the night, the same problem occurs. She testified that the water is definitely yellow, which began this spring. Ms. Day testified that she personally went around neighborhoods and got close to 50 signatures of customers on a petition not to sell the Carteret County Water System. Tr. vol. 1, 63. She testified that she presented to the County Commissioners a petition with close to 1,000 signatures against the sale. Ms. Day testified that during the County Commissioners' meetings regarding the sale, the room, another room nearby, and the hallways were full of people against selling the Carteret County Water System. Tr. vol. 1, 64. Ms. Day further testified that during the two County Commissioner meetings she attended, when public comments were received, no member of the public supported the sale. Tr. vol. 1, 63-69.

Customer Ms. Liz Ponder testified, agreeing with Ms. Day that at the County Commissioner meeting where the Carteret County Water System was discussed, every seat was filled, along with every seat in the neighboring courtroom. She testified people were also sitting on the floor and were in the hallway. Tr. vol. 1, 71. She testified that the people are willing to pay more to keep it a County water system because the payments would be invested back in the County. Ms. Ponder testified that the overwhelming majority of people who participated in the County Commissioner hearings stated that they were willing to pay the additional cost. Ms. Ponder also testified that she experiences low water pressure in the evenings and the water is certainly yellow, which has been going on since late spring. She testified that she wants her water system payments reinvested back into the

community. She further testified that there was a white, chalky build-up in her two-year old dishwasher. Tr. vol. 1, 69-84.

Ms. Ponder further testified that if a private entity acquired the Carteret County Water System for \$9.5 million, not only would that entity want to recoup the cost of buying the system, that entity has shareholders and all the other expenses associated with CEOs, travel, etc., so the entity would need to increase the rates. Ms. Ponder indicated that she had concerns about low-income customers who were going to be impacted regardless of whether the proposed sale went through. Tr. Vol. 1, 77-79.

In response to questions by Commissioner McKissick, Ms. Ponder testified that she has had many conversations with individuals that said if the Carteret County Water System is sold, they already have wells, and they might as well just go back to the wells. Tr. vol. 1, 81.

Customer Daniel Snow testified regarding his concerns about fire protection and the fire hydrants. He did not express an opinion on the possible sale to CWSNC. Tr. Vol. 1, 85-90.

On November 7, 2022, CWSNC filed its Response to Customer Concerns – Beaufort NC Public Hearing October 18, 2022. CWSNC operators visited the customers' homes without pre-scheduled appointments and during the day. The CWSNC operators did not observe yellow water, nor did they observe low water pressure. The CWSNC report stated that the complaints about drops in water

pressure in evening hours “remains a mystery.” CWSNC stated it had ordered and would install, a pressure recorder in the distribution system to record the pressure over a two-to-three-day period.

On December 16, 2022, the Public Staff filed the Public Staff’s Verified Responses to CWSNC’s Response To Customer Concerns Beaufort, NC Public Hearing October 18, 2022. This Public Staff response includes CWSNC’s November 18, 2022 response to a Public Staff data request. Although CWSNC stated the low water pressure “remains a mystery,” the Public Staff response stated the set points for the pumps to pump water into the elevated tanks were increased to provide better pressure and minimize evening pressure drops. The Public Staff response further stated CWSNC, who started operating the system in February 2022 and, for reasons not addressed in CWSNC’s report, has implemented operational changes to the greensand filtration system by increasing the backwash frequencies.

The Public Staff’s response concluded that CWSNC’s response to customer concerns filed on November 7, 2022, inadequately address the customer quality of service concern expressed at the October 18, 2022 customer-only public hearing.

In light of the foregoing testimony of several public witnesses at the public witness hearing and evidence of the petition signed by a significant number of customers, the Commission finds that there is significant customer opposition to the transfer of the Carteret County Water System to CWSNC primarily because of

their belief that their rates will increase. Additionally, the Commission agrees with the Public Staff and finds the Company's Report of Customer Concerns should have information concerning the operational changes made, which appeared to address the concerns raised by customers at the public hearing in Beaufort. While this is not a transfer proceeding, the Commission notes much of the opposition to proposed transfer is based on the perceived upward rate pressure due to the purchase price.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 50-57

Appropriate Fair Value & The Public Interest

The evidence supporting these findings of fact is found in the Company's Application and exhibits, the testimony, affidavits, and exhibits of the witnesses, and the entire record in this proceeding.

Fair Value Statute & Safeguards

Both CWSNC and the Public Staff agree, and the Commission concludes, that the Fair Value Statute provides safeguards to protect ratepayers and the public interest. CWSNC witness Denton testified that the Fair Value Statute is "replete with tools whereby the Commission can protect ratepayers and maintain the public interest." Tr. vol. 2, 26. Witness Junis pointed out that these tools generally mirror those recognized by the Attorney General's Office in its rulemaking reply comments. Tr. vol. 3, 130. The Commission concludes that the safeguards are also in place to ensure that when an acquiring utility elects to establish rate base using the Fair Value Statute, the statutory intent is served. An

additional safeguard is that the burden of proof is on the electing utility “regarding all aspects of the proceeding... and for demonstrating that the acquisition of the Local Government Utility is in the public interest” pursuant to Commission Rule R7-41(h) as adopted in accordance with N.C.G.S. § 62-133.1A(f).

Need & Customer Benefits

The Commission is persuaded that the intent of the Fair Value Statute is to address needs in the delivery of water and wastewater services for the benefit of customers, existing and new. The Commission notes a summary in support of the legislation by Aqua regarding the legislation (Junis Exhibit 6), that states fragmentation and lack of adequate funding “often result in systems that may lack operational expertise and access to capital necessary to fund investments that will keep their systems safe, reliable and in compliance with environmental standards.” The Commission notes a General Assembly legislative bill analysis (Public Staff Junis Redirect Exhibit No. 1) indicated, among other things that an electing utility’s fair value application would identify: (1) deficiencies in the system; (2) needed infrastructure improvements for the next five years; and (3) projected rate impacts for the next five years.

The Commission finds, however, that CWSNC’s Application in this proceeding does not adequately address needs that would be met or customer benefits that would accrue from the proposed transaction. The Commission is persuaded by Mr. Junis’s testimony that the Carteret County Water System does not lack access to capital, there is no substantiated need for additional capital

investment, and the system already provides service that is safe, reliable, and in compliance with environmental standards, and, further, that the projected rate impacts are significant and unreasonable. Tr. vol. 3, 129, Tr. vol. 3, 144, Tr. vol. 3, 169, and Tr. vol. 3, 212. Likewise, the Commission is not persuaded by CWSNC witness Denton's testimony that to deny the Application, or to adjust the fair value to \$2,444,347 as recommended by witness Junis, ignores the public interest inherent in consolidations and the economies of scale and ability to share resources and expertise across systems. Tr. vol. 4, 140. The Commission also finds that this is not a consolidation. Tr. vol. 2, 43.

The Public Staff recommends that the Commission adjust the fair value to \$2,444,347. Tr. vol. 3, 158. The Public Staff also recommends that the Commission deny the Application. Tr. vol. 3, 125. Witness Junis testified that the transaction does not benefit quality of service to customers "because you're not paying for improvements, you're paying for what you already have." Tr. vol. 4, 46-47. Mr. Denton testified, however, that to deny the Application or to adjust the fair value to \$2,444,347 is, in his opinion, an impermissible effort to superimpose the regulatory ratemaking accounting procedures to which N.C.G.S. § 62-133.1A provides an alternative, would have unreasonable consequences. Tr. vol. 4, 140-141. Mr. Denton testified that a denial would presumably result in a negative "acquisition adjustment" of approximately \$7 million for CWSNC if the transaction still occurs, thereby undermining the ability of this transaction to proceed, and that denial would be unfair to CWSNC and Carteret County, as they relied on the Fair Value Statute when entering into the APA. Mr. Denton also testified that the proposal sale

occurred following a transparent open bid process and that denial would impact the public interest of Carteret County and ignore the public interest in consolidations. Mr. Denton testified that the Fair Value Statute does not require that a local government utility be “troubled” for a transaction to proceed. Tr. vol. 4, 140-141. The Commission notes, however, that Mr. Denton testified that CWSNC only had a verbal agreement with Carteret County that CWSNC would keep the County’s water rates in effect for four years, and notes witness Foxworth’s testimony that there is no provision in the contract that makes acquisition closing contingent upon the outcome of CWSNC’s Application. Tr. vol. 4, 92.

The Commission is persuaded that there are factors presented by the Public Staff and CWSNC that must be weighed by the Commission regarding whether to deny an application or arrive at a reasonable fair value in the public interest. In the event the Commission does not deny CWSNC’s Application, the Commission notes Public Staff witness Junis’ recommendation that the Commission exercise its authority under N.C.G.S. § 62-133.1A(e) to find that the average of the three appraisals is not reasonable fair value and adjust the fair value to a reasonable amount consistent with the public interest. Tr. vol. 3, 156-157. Mr. Junis recommended that the Commission adjust the fair value to \$2,444,347. Tr. vol. 3, 158.

First, the Commission finds convincing witness Junis’s testimony that the bid and appraisal process was irreparably biased by a fair value figure being placed in the Engineering Assessment to be relied upon by appraisers. CWSNC

witness Denton agreed that although the engineering report did state a fair value, that there was not a provision in the statute for an engineering report to make a fair value statement. Public Staff witness Junis testified that by the time the Public Staff knew about the issue:

“It was too late in the process. Had we been aware of this document before this system – before they negotiated, before it was put up to interest of Aqua and Carolina Water, then it would have potentially had a material impact, and it would have made sense to get involved in that.”

Tr. vol. 4, 24-25.

The Commission finds that an engineering assessment is intended to serve as an unbiased inventory and assessment of the tangible assets of a system. Instead, once the valuation was proactively and unexplainably provided in the Engineering Assessment, it sent signals to prospective bidders with follow-on impacts for the appraisals that followed such as CWSNC’s Application. Public Staff witness Junis testified that the starting valuation is what sets an expectation for potential buyers, and then going forward, and that the cost of capital in terms of this purchase has a material impact on customers. Tr. vol. 4, 72-73.

Second, the Commission is persuaded by witness Junis’s testimony of considerations that should materially inform the Commission’s decision when determining whether the purchase price is in the public interest. Witness Junis testified that those considerations include the rate base per customer of the acquiring utility, and in this case the other bidder in an upset bid process, the rate impact of the proposed acquisition, the potential benefits to the acquired and

existing customers and how effectively and likely those benefits are to be realized, and the Commission's tried and effective acquisition adjustment criteria. Tr. vol. 3, 151. Mr. Junis testified that: (1) the acquisition cost of approximately \$7,576 per customer is extraordinarily high and if established as rate base would negatively impact both the Carteret County customers to be acquired and CWSNC's existing Uniform Water customers; (2) the Company failed to quantify, let alone guarantee, cost efficiencies that result in cost savings to customers; (3) the Company failed to show the acquisition would provide material benefits to the acquired customers; and (4) the public interest is not served by establishment of rate base under N.C.G.S. § 62-133.1A. Tr. vol. 3, 152-153.

The Commission agrees with witness Denton's testimony that the Fair Value Statute does not require that a system be "troubled" to be acquired. The Commission also finds persuasive Mr. Junis's testimony that, whether distressed or troubled, the Commission should consider the circumstances and, in particular, the benefits to customers. Tr. vol. 3, 169-170.

Cost to Customers

The Commission finds convincing Mr. Junis's testimony regarding the rate impact to customers and the purchase price far exceeding any benefits, regardless of whether Carteret County customers are included in uniform rates. Tr. vol. 3, 149. The Commission finds alarming the projected transaction cost to customers over time as presented by witness Junis. Mr. Junis testified about calculations Ms. Feasel made (Public Staff Junis Redirect Exhibit No. 2) showing that the total

collected would be \$19.2 million on an approximate \$9.675 million purchase price with transaction costs if depreciated over 25 years. Tr. vol. 3, 214. Mr. Junis testified on redirect that the \$19.2 million cost should be taken into account when weighing costs and benefits, as there is a significant cost of capital. Tr. Vol. 3, 214. Mr. Junis also testified that, taking everything into account, this is not the right test case for the Fair Value Statute. Tr. Vol. 3, 220.

Mr. Junis testified that the Company was proposing the use of a two percent depreciation rate. He further testified that the Public Staff used four percent, the difference being that the Public Staff was calculating depreciation over 25 years while the Company was leaving these assets potentially in rates for 50 years. Tr. Vol. 4, 22. Mr. Junis acknowledged the accumulated depreciation during the rate hold period would be lower if the depreciation rate was two percent. Tr. Vol. 4, 23. The Commission recognizes that a lower depreciation rate will reduce the annual depreciation expense and overall revenue requirement on an annual basis, making the cost more palatable in the present but increase the revenue requirement of the cost of capital over the life of the assets; the longer the financing term, the lower the incremental payment but higher total financing costs.

The Commission also acknowledges that, as witness Junis testified, the water and sewer utility industry is already facing immense upward rate pressure from increasing expenses, needed infrastructure improvements and replacements, contributions in aid of construction reaching full amortization, and emerging contaminants, and that incentivizing acquisitions at this magnitude of cost premium

while also lacking material benefits does not serve the public interest. Tr. vol. 3, 156. Mr. Junis also testified that, in response to counsel's question about whether this is a "rising tide sinks all boats" scenario, he was concerned that CWSNC has not yet identified a fair value point that was too high. Mr. Junis apologized for being a little crude but stated that CWSNC had not yet found their "puke point. What was too high, what couldn't they handle." Tr. vol. 3, 222.

The Commission agrees with concerns outlined in Public Staff questions to witness Denton that it is CWSNC customers – not shareholders – who will absorb almost the entire cost of this transaction, even if CWSNC shareholders will absorb the 2% depreciation expense the first four years until CWSNC's next rate case as Mr. Denton testified. The rate hold arrangement is a verbal contractual provision that the Company agreed to but does not persuade this Commission. The Commission also agrees with witness Junis's characterization that if the full purchase price and fees are placed into rate base, that it would be analogous to a loan, to be paid back by ratepayers. Tr. vol. 3, 150-151. The Commission agrees with witness Junis's forecast that, once the transaction closes, the Carteret County Water System (and its customers) will no longer have access to millions of dollars of grants and below-market interest rate loans, with the resulting impact being higher rates for customers associated with CWSNC's higher cost of debt. Tr. vol. 3, 142.

The Commission notes that the fair value of water and sewer systems may almost always be higher than depreciated book value, though we find persuasive

criteria and factors identified by witness Junis to help determine the public interest, including the ability of the local government to provide service, the quality of service being provided, the investment necessary in the near future, and the benefits to customers of any such acquisition. Tr. vol. 4, 14-15.

The Commission is further persuaded by witness Junis's testimony that there must be a quantification of benefits. Mr. Junis testified that issues of consolidation and economies of scale are considerations, and that the Company did not quantify those here. Mr. Junis testified that "[t]heir opportunity for the burden of proof has passed." Tr. vol. 4, 27-28 The Commission notes that fact. Although witness Denton responded to questions in the evidentiary hearing regarding general spreading of fixed costs, such as CWSNC call center, the back-office systems, and some of the overhead associated with his office, Tr. vol. 2, 99., CWSNC has still not truly quantified economies of scale associated with the proposed sale.

The Commission is also persuaded by Mr. Junis's testimony that the source of funds is not a limiting factor to the Commission's authority to establish a reasonable fair value that is appropriate and in the public interest under subsection (e) of the Fair Value Statute. Subsection (b)(1)d. is a requirement of the appraisals and distinct from subsection (e). Tr. vol. 4, 11-13. The Commission does not find Mr. Denton's testimony compelling regarding the limits he contends apply to the Commission's authority granted by the Legislature to set an appropriate fair value in the public interest if the average of three appraisals is unreasonable. The

Commission gives significant weight to the testimony of Mr. Junis and agrees with the Public Staff's interpretation based on subsection (b)(1)d. being a sub-sub-subsection specific to the appraisals, while subsection (e) of the Fair Value Statute pertains to the Commission's authority.

Precedent

The Commission is mindful of witness Junis's testimony that this is not the ideal test case and of the precedential nature of this first proceeding on an application under the Fair Value Statute. To that end, the Commission accepts Mr. Junis's concerns reflected in testimony regarding this test case setting a low bar, if allowed in proposed fashion, for a system that does not have the financial or operational issues the Fair Value Statute intended to address, and the impact on affordability of rates, including if there is a pattern of paying five times book value as in this case. Tr. vol. 3, 223 and Tr. vol. 4, 25-26.

Commissioner Hughes asked Mr. Junis, since fair value of water and sewer systems would almost always be higher than depreciated book value, when would the acquisition of a local government system be in the public interest. Mr. Junis pointed to a number of criteria and factors, including "the ability of the local government to provide service, the quality of service being provided the investment necessary in the near future," though Mr. Junis in particular pointed to the consideration of benefits to customers of any such acquisition. Tr. vol. 4, 14-15.

In response to a question by Commissioner Hughes on the subject, Mr. Junis confirmed that one of the protections for CWSNC's existing customers from

the impact of such an acquisition is system-specific rates for CWSNC's proposed new customers in Carteret County. Tr. vol. 4, 15-16. Mr. Junis went on to say that "these are residents of Carteret County, so the net proceeds should, to some degree, benefit those folks -- then that would be at least one reason for standalone rates. Tr. vol. 4, 16. Witness Junis and County witness Meshaw also confirmed one additional benefit to the County in selling, which is that there is \$1.9 million of unrestricted, spendable cash in the County's capital reserve fund for the County's use post-closing.

Other Tools

The Commission takes note of Mr. Junis's testimony that the Draper Aden report did not even consider capacity issues and that an excess capacity adjustment could be considered. Tr. Vol. 4, 51-52. The Commission recognizes that the acquisition adjustment [mechanism] is one of the tools at the Commission's disposal in resolving imprecise and complex issues of fair value and the public interest, and in particular placing in an acquisition incentive account any premium of the purchase price above Commission-approved fair value. The Commission is persuaded by Mr. Junis's testimony that such an arrangement "would push the public interest, in terms of consolidation of some of these fragmented and troubled systems." Mr. Junis testified, however, that the size of the acquisition incentive account would be at least of some concern to the Public Staff. Tr. vol. 4, 17-19.

Chair Mitchell asked Mr. Junis about why standalone rates for Carteret County customers would not be just and reasonable, when the utility will be incurring costs to provide services to the customers, and why this should not be the County Commission's concern. Mr. Junis reiterated his concern about whether the rates approaching \$100 or more are just and reasonable, but agreed that it should be Carteret County's concern and that any rates ultimately ordered by the Commission would technically be just and reasonable. Tr. vol. 4, 54-56. Mr. Junis testified that the Commission can take into account impacts on CWSNC's existing customers and proposed future Carteret County customers in setting rates. Tr. vol. 4, 57.

The Commission also has additional tools, such as acquisition adjustments due to excess capacity, to provide for appropriate fair value and the public interest. CWSNC witness Denton testified that CWSNC could have applied for an acquisition adjustment, but instead filed the Application for rate base to be established pursuant to N.C.G.S. 62-133.1A. Tr. Vol. 2, 41. Mr. Junis testified that CWSNC had not demonstrated that an acquisition adjustment would provide substantial benefits to all customers, and that benefits outweigh the cost of including the acquisition premium in rate base, he nonetheless discusses acquisition adjustment criteria used by the Commission in prior cases. Tr. vol. 3, 153-156.

The Commission notes Mr. Junis's testimony raising the issue of excessive capacity and that the Company had not made an effort to justify the design of the

system and that “it’s there, it’s providing a service, but is that a level of service that goes beyond the requirement and is contributing to the cost of premium potentially being paid here.” Tr. vol. 4, 63. On cross-examination by counsel for CWSNC, Mr. Junis testified that there have been excess capacity adjustments that have been made in rate cases after rate base has been established. Tr. vol. 4, 64.

The Commission finds that we are not precluded from exercising statutory authority in any CPCN proceeding to follow a fair value proceeding. In other words, the Commission is not required to determine, in a fair value proceeding such as this, whether a proposed fair value transaction would be in the public convenience and necessity at any price; the Commission can, therefore, decide on and deny the CPCN application irrespective of the outcome of a fair value proceeding, in particular one in which there is not a joint evidentiary hearing on both the Fair Value election and the CPCN application. Tr. vol. 4, 57-59. The Commission finds that there is no prohibition in the Fair Value Statute that addresses the CPCN statute. Tr. vol. 4, 61-62.

Conclusions

The Commission concludes that Carteret County Water System is not a troubled system, as there are no deficiencies and no needed or planned infrastructure improvements, as contemplated by the Fair Value Statute. The Commission also concludes that Public Staff’s arguments are convincing, that the lesser of the purchase price or average of the appraisals plus transaction costs

does not represent a reasonable fair value, such that it is appropriate and in the public interest for the Commission to determine fair value.

The Commission concludes the Engineering Assessment irrevocably biased the bid process and appraisals that followed by proactively providing a fair value that is not required by the Fair Value Statute or Commission Rules. While the Commission acknowledges that the public bid process was transparent, it was informed by the Engineering Assessment's valuation and resulted in "race to the top" bidding that is inconsistent with fair value and reasonable rates for ratepayers.

The Commission finds that, regardless of source of funds, this is not the type of sprawling, low density, high storage capacity system that would normally be constructed by a reasonable utility. The Commission also finds that the ongoing cost of funds (debt) can be considered which, after the sale, will far exceed existing cost of funds to ratepayers.

The Commission finds that the Company has not met its burden of proof to demonstrate that its proposed fair value is in the public interest. The Commission concludes it is in the public interest to determine fair value pursuant to N.C.G.S. § 62-133.1A(e) and that Company shareholders should pay any premium in excess of this fair value. The Commission's decision on the rate base of the system in this matter shall not be binding on the Commission for purposes of the Company's CPCN filing in Docket No. W-354, Sub 399.

IT IS, THEREFORE, ORDERED as follows:

1. That the Application filed by Carolina Water Service, Inc. of North Carolina for determination of fair value of utility assets pursuant to N.C.G.S. § 62-133.1A and establishing rate base for acquisition of the Carteret County Water System is hereby denied.

[In the alternative, if the Commission does not deny the Application, the Public Staff offers the following proposed ordering paragraphs:]

1. That the Application filed by Carolina Water Service, Inc. of North Carolina for determination of fair value of utility assets pursuant to N.C.G.S. § 62-133.1A and establishing rate base for acquisition of the Carteret County Water System is hereby approved;

2. That the average of the three appraisals, in the amount of \$10,935,667, will not result in a reasonable fair value;

3. That the fair value of \$2,444,347 for the Carteret County Water System is deemed appropriate and in the public interest pursuant to N.C.G.S. § 62-133.1A(e);

4. That the rate base value of the acquired system shall be the fair value as determined by the Commission plus the fees and costs authorized pursuant to N.C.G.S. § 62-133.1A(b)(4); and

5. That, should CWSNC and Carteret County proceed with the proposed transaction and obtain Commission approval for transfer of the system, CWSNC shall file a schedule detailing the reasonable fees paid to utility valuation experts and transaction and closing costs incurred within thirty days after completion of the acquisition closing.

ISSUED BY ORDER OF THE COMMISSION.

This the ____ day of _____, 2022.

NORTH CAROLINA UTILITIES COMMISSION

A. Shonta Dunston, Chief Clerk