

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. W-354, Sub 398
DOCKET NO. W-354 Sub 399

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 Determination of Fair Value of)
Utility Assets Pursuant to N.C.)
Gen. Stat. § 62-133.1A, for)
Establishing Rate Base for)
Acquisition of the Carteret County)
Water System, and for)
Acquisition of Carteret County)
Water System)

PROPOSED ORDER
ESTABLISHING RATE BASE FOR
ACQUISITION DETERMINED BY
USE OF FAIR VALUATION OF
UTILITY ASSETS

HEARD: Tuesday, October 18, 2022, at 7:00 p.m., in the Carteret County
Courthouse, Commission Board Room, 2nd Floor, 302 Courthouse
Square, Beaufort, North Carolina

Thursday, November 3, 2022, at 1:00 p.m., and Friday, November 4,
2022, at 9:00 a.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:

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Carolina 27611

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For Carteret County:

Claud R. Wheatly, III, Wheatley Law Group, PA, 710 Cedar Street,
Beaufort, North Carolina 28516

For the Using and Consuming Public:

William Grantmyre and William E. H. Creech, Staff Attorneys, Public Staff
– North Carolina Utilities Commission, 4326 Mail Service Center,
Raleigh, North Carolina 27699-4300

BY THE COMMISSION: On July 26, 2022, Carolina Water Service, Inc. of North Carolina (“CWSNC” or “Company”) filed an Application for Determination of Fair Value of Utility Assets Pursuant to N.C. Gen. Stat. § 62-133.1A¹ and Establishing Rate Base for Acquisition of the Carteret County Water System (“Carteret System”) in the above-referenced docket (“Fair Value Application”).

On August 2, 2022, in a related matter, CWSNC filed in Docket No. W-354, Sub 399, an Application for a Certificate of Public Convenience and Necessity and for Approval of Rates to provide water utility service to the Carteret County Water System in Carteret County, North Carolina (“CPCN Application”).

On August 5, 2022, the Public Staff notified CWSNC by letter filed with the North Carolina Utilities Commission (“Commission” or “NCUC”) of its determination that additional enumerated information was necessary to complete the Fair Value Application. This Public Staff review was authorized by Commission Rule R7-41(e), which was adopted pursuant to N.C.G.S. § 62-133.1A.(f).

¹ N.C.G.S. § 62-133.1.A (the “Statute”) was enacted by the General Assembly in 2018 and is titled “Fair value determination of government-owned water and wastewater systems.” This docket is the case of first impression under the Statute.

On August 11, 2022, the Commission issued an Order Finding Application Incomplete, and requiring the Company to file the omitted information and consult with the Public Staff to ensure the completeness of the Fair Value 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 deems the Fair Value Application to be complete.

On August 11, 2022, CWSNC filed Revised Exhibits supplementing its Fair Value 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 Fair Value Application to be complete. N.C.G.S. § 62-133.1A(d) provides that, if the Application meets all the requirements of subsection (c), which enumerates the eight components of an Application, then the Commission shall issue its final order within six months of the date the completed application was filed. The final order shall either approve the Application by determining the rate base value of the acquired property for ratemaking purposes - in a manner consistent with the statute - or deny the application.

On September 13, 2022, the Commission issued an Order Scheduling Hearings, Establishing Discovery Guidelines, and Requiring Customer Notice. This Order applied to both the Fair Value Application (Docket No. W-354, Sub 398) and the related CPCN Application (Docket No. W-354, Sub 399).

On October 6, 2022, the Public Staff filed a Motion to Compel with respect to Public

Staff Data Requests 3 and 4.² On October 14, 2022, the Public Staff filed a Notice of Affidavit and Affidavit of Lynn Feasel and the testimonies and exhibits of Charles Junis and Mike Lane.³

On October 17, 2022, the Commission issued an Order Extending Time for Filing Witness List and Cross-Examination Times.

On October 24, 2022, Carteret County filed the rebuttal testimony of Eugene Foxworth, Assistant County Manager, Carteret County.

On October 24, 2022, CWSNC filed the rebuttal testimonies of Donald H. Denton, III and Gerald C. Hartman.⁴

On October 28, 2022, Carteret County filed a Petition to Intervene.

On October 28, 2022, CWSNC filed the joint Witness List and Time Estimates for Cross-Examination for the Expert Witness Hearing.

On November 3 and 4, 2022, the evidentiary hearing for expert witnesses was held in Raleigh, North Carolina as scheduled. At the outset of the hearing the Commission granted the County's motion to intervene. All pre-filed testimony and exhibits of CWSNC, Carteret County, and Public Staff witnesses were admitted into the record, along with the Fair Value Application, all cross-examination exhibits, and the affidavit of Public Staff

² While the Commission did not issue a formal ruling on the Motion to Compel prior to or during the hearing, it does so now. The Motion to Compel is denied because the hearing testimony adequately addressed the questions raised by the Public Staff, the discovery questions were argumentative in nature, the Public Staff had the opportunity to present its side of the argument through its witnesses, and the Public Staff had ample opportunity to cross-examine CWSNC witness Denton on the meaning of his prefiled testimony.

³ Mr. Lane, a principal in NewGen Strategies (Public Staff's appraiser), is included in the list of Utility Valuation Experts (UVEs) established by order in Docket No. M-100 Sub 60A. See Rule R1-41(c). So is Mr. Walker of Gannett-Fleming, who was retained by the County.

⁴ Mr. Hartmann is the principal in Hartmann Associates, and is the UVE retained by CWSNC in this proceeding.

accountant Feasel. Company witnesses Denton and Hartman, County witnesses Foxworth, Meshaw, and Walker, and Public Staff witnesses Junis and Lane testified in response to questions from the Commission and follow-up questions and cross-examination by counsel. The Commission requested late-filed exhibits from CWSNC.

On November 7, 2022, CWSNC filed a Request for Extension of Time to Complete and File Response to Customer Service Quality Complaints.

Also on November 7, 2022, CWSNC filed its Response to Customer Concerns from the Beaufort North Carolina Public Hearing, held in the Carteret County Courthouse on October 18, 2022.

On November 21, 2022, the Commission issued its 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.

On November 21, 2022, CWSNC filed its Late-Filed Exhibits 1 and 2.

On November 22, 2022, CWSNC filed in Docket No. W-354, Sub 399, its Response to Customer Concerns from the Beaufort North Carolina Public Hearing of October 18, 2022.⁵

On December 16, 2022, the Public Staff requested an “Extension of Time, *Nunc Pro Tunc*” from the December 12, 2022 due date until December 19, 2022, in which to file its verified Response to CWSNC’s Response to Customer Concerns. On December 16, 2022, the Staff filed its Response.

⁵ This was the same response that had been filed in Docket No. W-354 Sub 398 on November 7; the subsequent filing conformed the record to the Commission’s requirement that the public hearings were to address both Subs 398 and 399.

On December 21, 2022, the parties filed Proposed Orders in the docket, pursuant to the deadline contained in the Scheduling Order of September 13, 2022. On December [REDACTED], 2022,⁶ after review by the Public Staff of CWSNC's update to the reasonable fees paid to valuation experts, and reasonable transaction and closing costs, allowed under N.C.G.S. § 62-133.1A(b)(3), CWSNC submitted support for its additional reasonable fees and costs.

The late-filed exhibits 1 and 2, filed by CWSNC on November 21, 2022 and the support for update to reasonable fees, transaction costs and closing costs, filed on December [REDACTED], 2022, are hereby deemed included in the evidentiary record.

On the basis of the Fair Value Application and the entire record in these dockets and related proceedings, the Commission makes the following:

FINDINGS OF FACT

1. CWSNC has contracted with Carteret County ("County") to purchase the County's water system. In a related docket, CWSNC has applied for a Certificate of Public Convenience and Necessity ("CPCN") for authority to serve the customers on the Carteret System. See Docket No. W-354, Sub 399.

2. CWSNC is properly before the Commission for a determination of both "fair value" of the assets to be purchased and of rate base, under N.C.G.S. § 62-133.1A and Commission Rule R7-41.

⁶ The Company will submit the support for the calculation of allowable, reasonable fees and costs to the Public Staff and Commission for review.

3. The fair value of the assets, as calculated by averaging the three appraisals submitted with the Fair Value Application, in compliance with N.C.G.S. § 62-133.1A (“Statute”), is \$10,935,667.

4. The purchase price is \$9.5 million, plus reasonable and allowable fees and transaction and closing costs of \$308,726 to date.

5. The Public Staff recommended that the Fair Value Application be denied, or in the alternative that the rate base for the Carteret System be set at \$2,444,347. The Public Staff did not base its recommendation on the testimony of its professional appraiser (Mr. Mike Lane of NewGen Strategies and Solutions). Further, its position is inconsistent with the applicable statute, which provides for a calculation of rate base predicated on the lower of the average of the three appraisals or the purchase price, plus additional allowable, reasonable costs.

6. Because the evidence and arguments advanced by the Public Staff are not in compliance with the Statute or Commission rules, they are not appropriate bases for decision under N.C.G.S. § 62-133.1A and Rule R7-41.

7. The starting point in this Order for a determination of fair value under N.C.G.S. § 62-133.1A is the calculation of the average of the three appraisals⁷. The Commission may then evaluate evidence of appropriateness and public interest concerning fair value within the boundaries set by subsection (e) of the statute, as follows: “If the Commission finds that the average of the appraisals will not result in a reasonable fair value, the Commission may adjust the fair value as it deems appropriate and in the

⁷ All of which are produced by Utility Valuation Experts (UVE’s) selected from a list of consultants approved by the NCUC, in accordance with N.C.G.S. § 62-133.1A.(b)(1)

public interest.” The Commission finds the average of the appraisals in the present case to result in a reasonable determination of fair value, for reasons explained below. Thus, the Commission does not find an adjustment to the average of the appraisals to be appropriate or in the public interest, particularly in the present case where a competitive, public, transparent, upset bid process resulted in a purchase price that is \$1,435,667 less than the average of the appraisals. Not only is the purchase price controlling with respect to establishment of rate base; it also serves as an actual market-based check on the reasonableness---and thus the fairness that is inherent to public interest---in determination of fair value.

8. After determination of the fair value by averaging the three appraisals, the Commission determines rate base by selecting the lesser of that average or the purchase price, per N.C.G.S. § 62-133.1(A)(b)(4), then adding any additional (reasonable), allowable fees or costs. In this case, the foundation of the rate base is the purchase price, because it is less than the fair value, as that value is determined by averaging the three appraisals. Thus, if the CPCN application is approved in Docket No. W-354, Sub 399, the rate base for the Carteret System shall be \$9,808,726, which consists of the \$9,500,000 purchase price plus the aforementioned additional reasonable fees, transaction, and closing costs of \$308,726 incurred by CWSNC.⁸

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NOS. 1 - 2

The evidence for these findings is in the Commission’s records and the Fair Value Application filed in this docket. It is undisputed that CWSNC is a utility company that

⁸ These additional costs include the fees from the Public Staff’s UVE, NewGen and Mr. Lane, in accordance with Commission Rule R7-41(i)

provides water and sewer service for compensation to the public in North Carolina, under the jurisdiction of Chapter 62 of the General Statutes, and that it is regulated by the Commission. CWSNC and the County have executed a contract for the sale of the Carteret System to CWSNC, and CWSNC has applied for a CPCN in Docket No. W-354, Sub 399, to provide service to the customers on the Carteret System.

In conjunction with the proposed sale of the Carteret System to CWSNC, the Company filed a Fair Value Application in Docket No. W-354, Sub 398. In the Fair Value Application CWSNC has elected, as allowed under N.C.G.S. § 62-133.1A and Rule R7-41, to establish rate base for the Carteret System by using the fair value of the property instead of its net original cost.⁹

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NOS. 3 - 4

The evidence for these findings is in the Commission's records and the Fair Value Application filed in this docket. The Fair Value Application includes valuations of the Carteret System from three independent appraisers as required by the Statute, along with the required engineering study.

Draper Aden Associates performed an engineering review of the Carteret System in 2019 in conjunction with a proposed merger of the Carteret System with the Town of Beaufort water system. That review was updated in December of 2021 and March of 2022 for purposes of satisfying N.C.G.S. § 62-133.1A(b)(2). Draper Aden assessed the land,

⁹ G.S. 62-133.1A specifically authorizes an election by the utility between original cost and fair value, in determining rate base in instances such as this, as follows:
"Election. - A water or wastewater public utility, as defined by G.S. 62-3(23)a.2., **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." **Emphasis added.**

physical assets, maintenance, and capital improvement needs of the Carteret System, and concluded that the Carteret System is overall in good condition and not in need of major capital improvements in the near future. Draper Aden performed an engineering cost study to determine the present book value of the physical assets, which it defined as the historical cost minus accumulated depreciation, using straight line depreciation and assuming zero salvage value. (Section 3.1 of the 2019 Draper Aden report) The firm concluded that, as of March 2022, the Carteret System had an estimated present book value of \$12.7 million and an estimated replacement cost of \$24.8 million.

All three appraisers used the Draper Aden engineering report to some extent in their respective estimations of fair value. They all used common industry appraisal principles to estimate the fair value of the Carteret System as a fair market value,¹⁰ which reflects the purchase price that a willing buyer and willing seller would agree upon, with each party being informed of the relevant facts and neither party under compulsion.

The appraiser chosen by Carteret County, Harold Walker, III, of Gannett Fleming, estimated the value of the Carteret System to be \$16,024,799 under his cost approach, \$15,061,795 under his income approach, and \$12,638,497 under his market approach. By giving equal weight to each approach, he concluded that the fair market value was \$14,575,000.

The appraiser chosen by the Public Staff, Mike Lane of NewGen Strategies & Solutions (“NewGen”), estimated the value of the Carteret System to be \$5,750,000 under his Original Cost Less Depreciation (“OCLD”) cost approach, and \$13,032,000 under his

¹⁰ The terms “fair value” and “fair market value” are used interchangeably throughout the testimony and are, for purposes of this decision, interchangeable.

Replacement Cost New Less Depreciation (“RCNLD”) cost approach. He reviewed but did not rely upon a sales comparison approach; his review showed sales of certain other systems resulted in a sales price/OCLD of \$7,527,000 and sales price/customer of \$2,506,000. (See Lane Table 4-2, page 16 of 97, Application Exh. 1B, “NewGen” appraisal, July 7, 2022). Witness Lane used a Discounted Cash Flow analysis to estimate a value of \$7,332,000 under his income approach. He concluded that the fair market value was \$7,332,000. (See Table 5-1, page 20 of 97, Application Exhibit 1B, “NewGen” appraisal, July 7, 2022)

The appraiser chosen by CWSNC, Gerald Hartman of Hartman Consultants, performed a cost approach by starting with the present book value from the Draper Aden report. He then subtracted for “functional obsolescence” to reflect assets not being fully used (*Tr. Vol. 2, 17*), further subtracted the original cost land value used by Draper Aden, and added back in the current market value of the land that was determined by Christopher Mashburn, a certified real estate appraiser with the Mashburn Appraisal Group. The result was a cost approach valuation rounded to \$12,300,000. (See p. 3-5 of Hartman appraisal report, at p. 25 of 311 in Exhibit 1C of the Fair Value Application) In Section 4 of his appraisal report, Hartman determined that the income approach should not be relied upon¹¹, because the System was losing money and, in his opinion, “A non-profitable water utility does not produce credible results in the current context.” (See p. 4-1 of Hartman appraisal report, at p. 28 of 311 in Exhibit 1C of the Application) Witness Hartman conducted a market approach valuation based on the sales of certain other

¹¹ Though Mr. Hartman did not rely on the Income Approach, his appraisal report stated that he considered, then weighed, various distinct approaches and he included Income within the list. See *Section 1.14, page 1.8 of his appraisal, p. 13 of 311 of Exhibit 1C to the Application.*

water utilities that he considered roughly comparable to the Carteret System, and that result was \$8,750,000. In reconciling the different approaches, he weighted the cost approach at one and one-half times the market approach, because the cost approach is more specific to the Carteret System, to conclude that a fair market value for the Carteret System was \$10,900,000.

The Commission notes that the terms “fair value” and “fair market value” are used interchangeably through the docket in the testimony of the expert witnesses and by the parties. This is important to proper interpretation of the Statute. First, the Statute provides that a utility seeking to acquire a municipal system may choose to establish rate base as “the fair value of the utility property instead of original cost.” Secondly, the three appraisers are to provide valuations based on “uniform standards of professional appraisal practice.” N.C.G.S. § 62-133.1A(b)(1)b. Third, all three of these qualified appraisers stated that professional appraisal standards are meant to establish *fair market* value. The Commission determines, that for purposes of these decisions, “fair value” equates to “fair market value.” Public Staff witness Mike Lane of NewGen asserted that his appraisal report was prepared in conformance with the 2020-2021 Edition of the Uniform Standards of Professional Appraisal. He further stated on examination that “fair value” is, generally, the price at which a willing buyer and a willing seller would agree on a price for a sale, and he agreed that was essentially the “fair market value.” See *Tr. Vol 3, p.93, l. 11-22*. The average of the three appraisers’ final valuations is \$10,935,667.

Under N.C.G.S. § 62-133.1A(b)(4), the rate base for the Carteret System is the lesser of the average appraisal (\$10,935,667) or the purchase price, plus reasonable allowable fees and costs. The purchase price is \$9,500,000. Under N.C.G.S. § 62-

133.1A(b)(3), “Reasonable fees, as determined by the Commission, paid to utility valuation experts, may be included in the cost of the acquired system, in addition to reasonable transaction and closing costs incurred by the acquiring public utility.” Reasonable fees were initially estimated by CWSNC to be \$175,000. That amount was not challenged by other parties. The reasonable fees were later updated to \$308,726.00. The purchase price and reasonable fees plus other allowable costs, together, are \$9,808,726.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NOS. 5 – 7

The evidence for these findings is found in the testimony and exhibits of witnesses Denton, Junis, Walker, Lane, and Hartman, as well as the Fair Value Application and the full record in this proceeding.

DIFFERENT VALUATIONS RECOMMENDED BY THE PARTIES

Each appraisal witness had a different dollar estimate for the fair value of the Carteret System. Each of those estimates differed from the purchase price that resulted from a fully competitive, public, transparent, statutory-based, upset bid process conducted by the County.

CWSNC and the County advocated for a fair value rate base of \$9,675,000 on the basis that N.C.G.S. § 62-133.1A provides for a rate base that is the lesser of the appraisal average (\$10,935,667 in this case) or the purchase price plus certain fees and costs (\$9,675,000 in this case, which was later updated to reflect additional allowable fees). CWSNC and the County included all three appraisals in the calculation of fair value; the Public Staff did not rely on any of the statutorily required appraisals, including its own.

The Public Staff advocated for denial of the Fair Value Application, or in the alternative, a rate base of \$2,444,347, based upon a “public interest” conception of rate base, which, generally, substitutes “original cost” principles for rate base determination in place of the alternative method specifically created by N.C.G.S. §. 62-133.1A. The Public Staff did not rely on the testimony of its own valuation expert for a determination of fair value.

INTERPRETATION OF THE FAIR VALUE STATUTE AND RULE

N.C. Gen. Stat. 62-133.1A (a), in pertinent part, provides that, when acquiring an existing water system owned by a county, a public utility may elect to establish rate base by using the fair value of the utility property instead of net original cost. N.C.G.S. § 62-133.1A(e) provides in part: “If the Commission finds that the average of the appraisals will not result in a reasonable fair value, the Commission may adjust the fair value as it deems appropriate and in the public interest.”

NCUC Rule R7-41(d) and (g)(1) also make brief references to the public interest:

In addition to providing the information required pursuant to G.S. 62-133.1A in the completed application form, the application shall contain a narrative explanation of the object and purposes desired by the application and how the public interest is served by the acquisition, along with any other information required by the Commission.

And:

Determination of Rate Base.—The rate base value of the acquired system shall be the lesser of the purchase price reflected in the Asset Purchase Agreement or the average of the three appraisals as required pursuant to G.S. 62-133.1A (b)(1), unless the Commission specifically finds that the average of the appraisals will not result in a reasonable fair value, in which case the Commission may adjust the fair value pursuant to G.S. 62-133.1A(e) as it deems appropriate and in the public interest.

The Public Staff's position, as presented in the testimony of witness Junis rather than the testimony of the Staff's appraiser, reflects its conclusion that certain public interest factors - as the Staff conceives the public interest - rather than an appraisal-based fair value calculation, as conceived and specifically authorized by the Statute, should constitute the proper basis for determination of rate base. That conclusion by the Public Staff leads it to a recommendation that either the Application should be denied, or that a variation of the net original cost methodology for determination of rate base should substitute for the General Assembly's establishment of a methodology which is intentionally and specifically an alternative to net original cost. The circularity of this argument is fatal to the Public Staff's position.

The Commission concludes that there are three steps in its fair value determination under N.C. G.S. 62-133.1A. First, under N.C.G.S. 62-133.1A(d) the Commission must decide whether to approve or deny a completed fair value application. There is no explanation in the Statute as to what standard the Commission would have to follow to deny a completed fair value application. However, if a decision to approve or deny were purely discretionary with the Commission, it would render meaningless the statutory wording in N.C.G.S. 62-133.1A(a) that gives utilities the choice to opt for fair value rate base. Similarly, if the decision were completely discretionary, it would undermine the statutory purpose of facilitating certain sales from municipalities to private utilities by use of a fair value calculation of rate base. It thus appears that the only appropriate basis for a denial of a complete fair value application is where the utility fails to meet its burden of proof to provide sufficient evidence from which a reasonable fair market value can be determined.

The second step is for the Commission to decide if the average of the three appraisals results in a reasonable fair value. If so, the lower of (1) the average of the appraisals or (2) the purchase price (plus approved fees and expenses) will be the acquiring utility's rate base.

The third possible step arises only if the Commission determines that the average of the three appraisals does not result in a reasonable fair value. Rule R7-41(g)(1) states that "...unless the Commission specifically finds that the average of the appraisals will not result in a reasonable fair value, in which case the Commission may adjust the fair value pursuant to G.S. 62-133.1A(e) as it deems appropriate and in the public interest..."

In this scenario, the word "reasonable" modifies the words "fair value." That is, if there are errors or deficiencies in the appraisers' valuations, the Commission has authority to adjust the average of the three appraisals to achieve a "reasonable" fair value, if it thinks that action is appropriate and in the public interest. The Public Staff incorrectly maintains that this allows adjustment of the fair value for factors that are not part of the fair value calculus. In contrast, all three appraisers agreed that under the standards of their profession, the appraisals must estimate fair market value. (See Hartman Appraisal, captioned North Carolina Fair Market Value Appraisal of the Carteret County Water System; Tr. Vol. 3, 78-79, 84, 93, 109 – Lane; Tr. Vol. 3, 55 – Walker) Witness Walker testified that "by law, we're required to appraise these systems under a fair market standard, fair market-value standard." N.C.G.S. 62-133.1A(b)(1)b. and c. make clear that the standards of professional appraisers shall be the basis for determining fair value:

b. Each 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.

c. Fair value, for ratemaking purposes under G.S. 62-133, shall be the average of the three appraisals provided for by this subsection.

(Emphasis added.)

Reading the statute as a whole, the Commission concludes that the “public interest” wording, as it refers to the fair value, requires that if the average of the three appraisals is not reasonable, then the Commission may in the public interest adjust the result based on evidence that supports a reasonable fair market value, or if there is insufficient evidence to establish a fair market value then the application may be denied. In this regard the Commission agrees with witness Denton that “public interest regarding the Fair Value statute is best understood to be a review of whether there is evidence that the average of the appraisals is an unreasonable deviation from the price to which a willing seller and a willing buyer would agree.” (Tr. Vol. 4, 147) The policy question of whether fair value is itself in the public interest has already been decided by the legislature and the Commission is bound by that decision.

APPLICATION OF THE FAIR VALUE STANDARD AND RULE

Consistent with the three steps discussed above, the Commission first finds that the parties have presented sufficient, competent, credible, material evidence from which a reasonable fair market value can be determined. Accordingly, there is no basis for denying the Fair Value Application.

The Commission next finds that the average of the three appraisals results in a reasonable fair value. This finding is predicated on the credibility, experience, and testimony of the three appraisers (all of whom are recognized by this Commission as

Utility Valuation Experts) and on the fact that the appraised value and the actual purchase price (determined in an open, transparent bid process and with competitive bidders) are reasonably comparable. This finding obviates the need for the Commission to adjust the average of the appraisals to reach a reasonable fair value.

The finding that the average of the three appraisals results in a reasonable fair value does not require that the Commission agree with the individual numerical results of each of the appraisals. Questions were raised about the accuracy of various elements of each of the appraisers' methodologies, which is to be expected in a vigorous examination of different modes of analysis.

The County's appraiser, witness Walker, was the only appraiser who gave quantitative weight to all three standard valuation approaches in his conclusion. (Gannett Fleming appraisal report, pp. 46-47 and Exh. 19 and 20, attached as Exhibit 1A to the Fair Value Application) Yet for his cost approach land value he used the original cost as determined by Draper Aden¹² rather than the current market value. Also, his \$14,575,000 valuation is more than \$5 million above the competitively bid purchase price – significantly more than the other appraisal valuations.

Witness Walker did appropriately adjust book values that in his opinion understated various asset values. For instance, he observed that the County's audited statements used a 3% depreciation rate on mains and water treatment assets, while the effective depreciation rate should be 1.75%. (Tr. Vol. 3, 43) Witness Walker testified that

¹² See NewGen appraisal report Exh. 3, where the December 2019 Draper Aden report indicates at p. 9 that the present book value is based on historical cost (not current market value) and p. 12 where Table 8 shows a present book value of land at \$369,722.

the financial statements for municipalities typically undercapitalize, meaning that there are more assets than reported, which can happen when an asset is fully depreciated on the books but still providing useful service to the water system.¹³ (Tr. Vol. 3, 44-45) His appraisal report, p. 24, also revealed that “assets included in accounts such as meters, customer services, power generation equipment, water treatment equipment, tools, shop and garage equipment were not included in the Engineering Assessment’s inventory. The modifications made to the Engineering Assessment’s inventory is shown on page 4 of Exhibit 7.” A simple example is that meters were not included in the Draper Aden inventory of Carteret System assets. (Tr. Vol. 3, 48)

With respect to the income approach, witness Walker explained that the estimated stream of revenues was based on a composite of hypothetical buyers rather than the estimated revenues for CWSNC. The former provides a fair market value, as opposed to investment value for one company. Appraisers must follow the fair market value standard. He compared this to a fair market appraisal for a house, which can vary from what a buyer actually pays. (Tr. Vol. 3, 54-56) The Public Staff’s appraiser, witness Lane, recommended a fair value that matches his income approach without any quantitative adjustment for other approaches. As shown on Tables 1, 5, and 6 of the NewGen appraisal report, his income approach uses a calculation of original cost of utility plant, plus working capital, and minus accumulated depreciation, to determine the fair market value based on the revenues that the net original cost might produce. Analytically, this approach biases the fair market value approach toward the original cost because his

¹³ Witness Walker stated that there is nothing wrong with fully depreciating an asset sooner than its useful life; it allows local governments to pay off debt faster because the depreciation is a source of cash. (Tr. Vol. 3, 45-66)

discounted cash flow model assumes revenues will be earned on original cost rate base as a step in determining the fair value rate base. When questioned about the circularity of this approach, witness Lane replied:

...if an entity is going to make a purchase of an asset, this is the approach they would use. They would look at the -- what they consider to be appropriate rate base, what they could earn a return on, which is invested capital. And they would apply their ability to earn a return and an appropriate discount rate, and they would come up with a value or a range of values based on that income approach.

(Tr. Vol. 3, 86)

In response to Commissioner McKissick's questions, witness Lane admitted that if he used the \$9.5 million purchase price as the assumed rate base in his income approach, the outcome would have been a fair value in excess of the \$9.5 million. (Tr. Vol. 3, 89-90) He further admitted that fair market value rate base typically is some small multiple higher than original cost rate base (minus depreciation), and that the income approach did result in "some circularity." (Tr. Vol. 3, 103-04) The Commission finds the income approach of witness Lane to be flawed in the present case. A hypothetical "arms-length" buyer of the Carteret System would rely on N.C.G.S. § 62-133.1A to provide a stream of revenue derived from a fair value rate base rather than an original cost rate base. Therefore, witness Lane's premise that CWSNC as a buyer would determine value on the basis of income from an original cost rate base is a flawed. It is indeed a circularity problem that undermines the usefulness of witness Lane's income approach.

Witness Lane also used an "original cost" of the utility's land at \$98,126, for which he cited the Carteret County Audit FY21. (Table 1 of the NewGen appraisal report) However, the Carteret County Audit FY21 shows a land value for Business-Type Activities – which is the water utility – as \$222,608. (CWSNC late-filed exhibit No. 2, Figure 4 on

page 24.) The Draper Aden study shows the “Land Property” components of the Carteret System as having a book value of \$369,722. (Exhibit 3 of the NewGen appraisal report, Table 2 of the March 2022 Draper Aden Update)

Witness Lane simply based his OCLD cost approach on financial statements, instead of using the engineering costs from Draper Aden. (footnote 4 of c; Tr. Vol. 3, 85) The difference is significant, as the NewGen OCLD is \$5,749,589¹⁴ while the March 2022 Draper Aden present book value (depreciated) is \$12,703,798 (Exhibit 3 in the NewGen appraisal report, Draper Aden March 2022 update, pp. 1-4) For his income approach, witness Lane used a rate base amount of \$5,904,123, which consists of his \$5,749,589 OCLD with the addition of working capital and the subtraction of accumulated deferred income tax. (Table 6 in the NewGen appraisal report).

He also showed a 53.7% expired life for every category of depreciable asset, with a footnote indicating this was based on the County’s depreciation schedule. (Table 1 of the NewGen appraisal report) He made no adjustment for the difference between book depreciation and actual useful life, nor for utility assets that were not on the books but were providing service. He further admitted that he used a 1988 installation date for all the distribution system assets, not aware that most were installed after 1988 (meaning less accumulated depreciation to deduct from rate base) because he “didn’t have that data.” (Tr. Vol. 3, 108) Witness Lane agreed that his valuation would change if he accounted for the approximately 10% rate of inflation since his valuation date. (Tr. Vol. 3, 112)

¹⁴ The Carteret County FY21 amount is \$5,759,214, so Witness Lane did make a minor downward adjustment.

Witness Hartman relied on the cost and market comparison approaches, after first evaluating, then declining to give quantitative weight to the income approach. In his opinion, the income approach was too speculative as to the growth rate, the discount factor, and especially because the income approach requires an assumption of the amount of rate base that the Commission has not yet determined. (Tr. Vol. 2, 171)

With respect to the cost approach, he used a real estate appraiser to obtain the current market value, as opposed to some version of original cost or book value, for the land of the Carteret System. He also agreed with witness Walker that the book values maintained by county governments do not provide the fair value of assets because at least some assets are depreciated faster than their useful lives, and some assets are not even shown on the books. (Tr. Vol. 2, 157)

For his market comparison approach, witness Hartman selected sales of water utilities from eight states, over the period of 2018-2022, with customers connections ranging from 700 to 2000. This resulted in a group of 14 sales. He then narrowed the comparable group to the top half of the 14 system sales, based on the Carteret System being in good condition, having relatively new assets, not having high capital requirements, and not having regulatory deficiencies. (Tr. Vol. 2, 177) He rounded the resulting purchase price per connection of \$6,598 to \$7,000, because of growth opportunities, and multiplied that by his figure of 1,246 connections in the Carteret System (other evidence shows 1,254 or 1,277 connections). The result in round numbers is a fair value of \$8,750,000 for the market comparison approach. (Hartman appraisal report pp. 5-1, 5-17 to 5-19 in Exhibit 1C to the Fair Value Application) Witness Hartman then weighted his cost approach at 60% and the market approach at 40%, because the cost

approach is more specific to the Carteret System, to reach his recommended fair market value of \$10,900,000. (Hartman appraisal report p. 6-1; Tr. Vol. 2, 178)

The varying results of the cost, income, and market comparison approaches, and the differences among the valuations from the appraisers, indicate that the process of determining fair market valuation is necessarily imprecise. No single methodology can be called “correct,” to the exclusion of others.¹⁵ The appraiser weighs each of the approaches and reconciles the same to the opinion of value. Having multiple opinions of value allows for a verification and averaging by the Commission

The Commission concludes that the best approach in the present case is to accept the average of the appraisers’ recommended valuations as a reasonable estimate of fair value. An attempt to quantify the vulnerabilities in each valuation would be illusory, but on a qualitative basis it is reasonable to find that the disparities in the various expert valuations are generally off-setting. By providing for use of an average, the General Assembly implicitly accounted for the likelihood that there would be variability in valuations, and adopted an approach that evens the variability.

Accordingly, the Commission finds and concludes that the reasonable fair value of the Carteret System, as established by the average of the appraisals, is \$10,935,667.

The Public Staff asserted that the average of the appraisals was not reasonable, and that various public interest considerations should result in the denial of the Fair Value Application or reduction of fair value rate base to \$2,444,347. The Commission declines to find the Public Staff position appropriate in this case for the following reasons.

¹⁵ The Commission regularly weighs among informed estimates of values, derived from varying methodologies, in making its decisions---most notably in the determination of Return on Equity.

First, N.C.G.S. § 62-133.1A contemplates a calculation of rate base that is predicated on a determination of fair value of the assets. The Public Staff has relied on original cost less Contributions in Aid of Construction (“CIAC”) and on the average rate base per customer for Aqua North Carolina, Inc. (“Aqua”) and CWSNC. (Tr. Vol. 3, 157-58). The Public Staff valuation is a form of original cost rate base, a methodology for which the Statute expressly provides an alternative in the form of a Fair Value approach. Additionally, the Staff’s valuation is not even consistent with original cost, as used by the fair value appraisers. Witness Junis freely admitted that he had no idea whether his use of the County’s financial statements to calculate an “original cost,” as used in his recommendation, was consistent with professional appraisal standards:

A. So this is original cost less depreciation, according to the County's books.

Q. Right. But that's not what an appraiser would arrive at for original cost less depreciation; is that correct?

A. That's up to the appraisers.

Q. That wouldn't be allowed under their uniform standards for professional appraisal practice, right?

A. I'm not an expert on those standards.

Q. Okay.

A. And I don't represent that I'm an appraiser.

(Tr. Vol. 3, 187)

Furthermore, witness Junis deducted CIAC in calculating his rate base recommendation, but N.C.G.S. § 62-133.1A(b)(1)d expressly precludes deduction of CIAC from the original cost: “The original source of funding for all or any portions of the water and sewer assets being acquired is not relevant to an evaluation of fair value.” Nor does the rate base per customer of other Aqua and CWSNC systems establish a fair value original cost for the Carteret System – the rate divisions consist of numerous systems, each of which has its own unique costs.

Second, the Public Staff's \$2,444,347 valuation, as presented in the testimony of witness Junis, is at odds with the \$7,332,000 valuation of the Public Staff's own appraiser. As witness Lane himself testified, the valuation advanced by witness Junis is not an appraisal. (Tr. Vol. 3, 95) The Statute emphasizes an appraisal approach to determining fair value, and all three appraisers in this case agree that means fair market value as determined under accepted appraisal methodologies. (See Tr. Vol. 3 – Hartman; Tr. Vol. 3, 78-79, 84, 93, 109 – Lane; Tr. Vol. 3, 55 – Walker)

Third, the Public Staff approach undermines the very purpose of N.C.G.S. § 62-133.1A. The legislature made the policy choice to facilitate private utility acquisitions of governmental systems by allowing calculation of rate base using the fair value methodology, as an alternative to the use of original cost. The Public Staff misconstrues the "public interest" wording in N.C.G.S. § 62-133.1A by (a) divorcing it from the statutory goal of "reasonable fair value" derived from market-based appraisals, and (b) returning to a rate base methodology that is very close to N.C.G.S. § 62-133's "original cost," effectively rendering the enactment of N.C.G.S. § 62-133.1A as pointless.

Witness Junis disagreed that "fair value" in the statute means fair market value (Tr. Vol. 3, 166).¹⁶ He in effect opined that a rate base substantially less than the fair market value was in the public interest and should override appraisals of fair market value (or purchase price where less than fair market value). When asked if it might be an obstacle to county systems being sold to private utilities where a \$9.5 million purchase price resulted in \$2.5 million of rate base, witness Junis replied, "I recognize that it is unlikely

¹⁶ However, the Public Staff's attorney referred to the bill that resulted in N.C.G.S. § 62-133.1A as a "fair market value bill." (Tr. Vol. 2, 30), and the professional appraisers testified that fair value and fair market value were the same.

for a utility to want to, essentially, eat a \$7 million net on its purchase price.” (Tr. Vol. 3, 166) The Commission understands the Public Staff’s desire to limit rate base where appropriate; however, the legislature made a policy decision in enacting N.C.G.S. § 62-133.1A to allow rate base calculated by consideration of fair value. Fair value means fair market value, as even the Public Staff’s own appraiser recognizes. It does not mean original cost net of depreciation and CIAC. The clear benefit of fair value rate base is to facilitate or incentivize transfers of systems from governmental entities to private utilities. Forcing a utility to “eat a \$7 million net on its purchase price” has the opposite effect from facilitating or incentivizing these transfers, is inconsistent with the Statute, and thus is not an appropriate approach to fair value as it is not in the public interest.

Otherwise stated, the Commission understands the importance of not allowing rate base to be “bid up” through repeat purchases of the same assets. This is a fair policy concern of the Public Staff, and a reason behind the Commission’s acquisition adjustment policy on original cost rate base acquisitions. However, the legislature has provided safeguards in N.C.G.S. § 62-133.1A. When a utility system is sold by a governmental entity to a private utility, it occurs only once. Fair value rate base would not apply to any subsequent sale by the private utility. Additionally, the rate base amount is limited to the lesser of purchase price or the fair value appraisal average. The Commission also has the statutory authority to reject the appraisal average if it is not a reasonable estimate of fair market value. These safeguards are balanced against the legislative goal of facilitating the sale of governmental systems to private utilities. This is the balance provided by the legislature when it enacted N.C.G.S. § 62-133.1A.

Fourth, the Public Staff approach ignores another significant public interest. Governmental utility providers at times have good reason to shed responsibility for a utility system that is causing them difficulties. The Carteret System has been designated by the State Water Infrastructure Authority and the Local Government Commission as “distressed”. For many years, the water rates have been subsidized by tax revenues from property owners not connected to the Carteret System. In an effort to manage the needs of the system, the County at one point implemented a 95% rate hike, which it subsequently modified. The County Commissioners voted to sell the Carteret System, which is the proper and binding statement of public interest. Not only did the County determine it was in the public interest to divest itself of the distressed Carteret System, and not only did it follow a statutory procedure for doing so, but testimony also established a local public interest in use of the net proceeds of approximately \$8 million for the benefit of the County’s citizens. (Tr. Vol. 4, 81) Even if the Commission had found the average of the three appraisals to be unreasonable and in need of adjustment based upon evidence in support of a contrary public interest determination, the adjustment proposed by the Public Staff would unfairly and inappropriately depress the fair value rate base because it did not include the public interest to Carteret County and its citizens, nor did it recognize the fact that the purchase price was set by a public, transparent, upset bid process in which two bidders actively participated.

Fifth, the present book value cost that the Public Staff drew from the County’s financial statements fails to recognize the difference between audited financial statements and fair value for appraisal purposes. The book value used by the Public Staff has not been adjusted to reflect the current fair market value of the Carteret System land, or the

difference between the County's depreciation schedule and the actual useful life of assets, or the absence of certain utility assets from the books of the County even though such assets are identified in the record evidence.

The County's appraisal expert highlighted this in testimony: "I'm not saying those – those [County] financial statements are wrong, they're just prepared for a different purpose. . . . They're prepared for a different purpose than what we're using them for, for appraisal purposes." (Tr. Vol. 3, 45)

In conjunction with using the County's financial statements (and then deducting CIAC), Public Staff witness Junis questioned whether the \$12.7 million Draper Aden cost for the Carteret System fully accounted for accumulated depreciation. (Tr. Vol. 4, 65-68) The Draper Aden report is attached to the NewGen appraisal report, and labeled as Exhibit 3 to the NewGen report, that was filed as attachment 1B to the Fair Value Application. Section 3.1 of the Draper Aden report states that the engineering valuation of the Carteret System is a present book value approach using the following equation: "Present BV of Asset (\$) = Historical Cost (\$) – ((**Accumulated Depreciation** (\$) + Current Depreciation (\$))". (Emphasis added.) Following this equation there are two tables showing the values of the Carteret System. Table 7 shows an estimated value for certain listed assets and includes a column for accumulated depreciation. Table 8 shows the other assets, including land that is not depreciable and other assets that are depreciable, and identifies them as "present book value" but does not present columns for design life, useful life, depreciation, accumulated depreciation, etc.¹⁷

¹⁷ Tables 7 and 8 are in the December 2019 Draper Aden report; they correspond to Tables 1 and 2 in the March 2022 update report.

The reason for two different tables is explained in Section 3.2 of the Draper Aden report; namely, the first table is based on documented historical costs, while the County did not have such records for the assets in the second table. The source of the value of the assets in the second table is “the County provided financial data that detailed the present book value of the assets as listed in Table 8.” Inherent in the term “present book value” is that accumulated depreciation has been subtracted from the original cost, regardless of whether original cost is an estimate or a documented historical cost. This is supported by the equation Draper Aden used in Section 3.1 to define present book value. It is reasonable to conclude, and the Commission so finds, that both Tables 7 and 8 in the December 2019 Draper Aden report, and Tables 1 and 2 in the Draper Aden March 2022 update, reflect depreciated book values. This present book value from an engineering cost evaluation is much closer to the cost approach appraisal of witness Hartman than to the cost that witness Junis derived from the County’s FY21 financial statements, and provides support for a fair value rate base well above that recommended by witness Junis.

Sixth, the Public Staff’s interpretation of public interest in the Fair Value statute is flawed. For context, the Statute addresses the Commission’s “public interest” authority in two specific ways in subsection (e):

(e) Commission's Authority. – The Commission shall retain its authority under Chapter 62 of the General Statutes to set rates for the acquired system in future rate cases, and shall have the discretion to classify the acquired system as a separate entity for ratemaking purposes, **consistent with the public interest**. If the Commission finds that the average of the appraisals will not result in a reasonable fair value, the Commission may adjust the fair value as it deems **appropriate and in the public interest**.

(Emphasis added.)

The Commission may set rates for the acquired system in future rate cases, and it shall have the discretion to classify the acquired system as a separate entity for ratemaking purposes, “consistent with the public interest.” Further, the Commission may adjust the fair value, if it finds the average of the three appraisals does not result in a reasonable fair value, “as it deems appropriate and in the public interest.”

Next, the public interest factors used by witness Junis to develop his fair value recommendation are (i) rate base per customer, (ii) rate impact of the proposed acquisition, (iii) potential benefits to the acquired and existing customers, and (iv) the Commission’s existing acquisition adjustment criteria. (Tr. Vol. 3, 151, 179) While these factors merit consideration by the Commission, they do not provide sufficient reason to modify the fair market valuation from the average of the appraisals.

With regard to the amount of rate base per customer, the Public Staff compared the cost for 1,277 Carteret System customers at a purchase price of \$9.5 million plus fees to the rate base per customer for the five water rate divisions of CWSNC and Aqua. The Commission finds that the rate base per customer is much higher for the proposed purchase of the Carteret System; however, that is not determinative of what constitutes a reasonable fair value or of what is in the public interest. Every water utility system has its own unique costs determined by many variables such as customer density, quality of water from wells, age of the system, topography and external environmental factors, quality of installation and maintenance by prior owners, etc. It would be unfair to use the rate base per customer, or other comparisons among utility systems, to set rate base for a different system. Just as N.C.G.S. § 62-133 provides for determining rate base solely

on the applicant utility's own costs, and not the costs of other utilities, so too does N.C.G.S. § 62-133.1A provide for determining "the fair value of the utility property" and "The fair value of a system to be acquired" (emphasis added). Similarly, the Public Staff's appraisal expert agreed that "fair value as the price at which a willing seller and a willing buyer with -- both having knowledge of the relevant facts and not being under any compulsion, would agree to a price of the sale of the system...." The statutory and appraisal focus is on the market value of the system being sold, not how it compares to other systems. Moreover, the rate base per customer used by the Public Staff for Aqua and CWSNC uniform water rate divisions is net original cost, which is not properly comparable to fair market value.

Testimony on the next two public interest factors cited by the Public Staff – rate impact of the proposed acquisition, and potential benefits to the acquired and existing customers – was controverted by the witnesses. The Commission finds that when all the record evidence on these factors is considered, there is not sufficient basis to find the average of the three appraisals to be unreasonable as a fair value. One reason for this finding is that the Public Staff significantly overstated the rate impact of the proposed acquisition. Witness Junis testified that the current County average bill of \$70.55 would increase to \$113.71 under CWSNC system-specific rates that incorporated the \$9,675,000 of rate base. This comparison is flawed for multiple reasons:

- CWSNC has not proposed system-specific rates for the Carteret System. CWSNC proposed to include the Carteret System in uniform rates.
- The calculation of \$113.71 average monthly water bill assumes the new rates, yet to be determined or imposed in Docket No. W-354 Sub 400, would go into effect

immediately. However, witness Junis acknowledges that CWSNC plans to not increase rates for Carteret County for at least four years, at which point it projected an *estimated* 5% rate increase in 2027 to bring the average bill to \$93.07.¹⁸ (Tr. Vol. 3, 147). His \$113.71 figure does not account for accumulated depreciation from the present to 2027, which would lower rate base and therefore the average bill. (Tr. Vol. 3, 172-73) CWSNC witness Denton testified that there would be an additional \$880,000 of depreciation expense absorbed over four years by CWSNC shareholders before new rates would be applied to the Carteret System (Tr. Vol. 2, 112).

- Witness Denton also disagreed that the purchase of the Carteret System for \$9.5 million would have an adverse impact on either the Carteret System customers or the other CWSNC customers under uniform rates. Specifically, he testified (a) that Carteret County would have to raise its rate to \$98.77 in order for its water utility revenues to cover its water utility costs (Tr. Vol. 2, 83-84), which was corroborated by Assistant County Manager Meshaw (Tr. Vol. 4, 101); (b) that when the rate freeze for the Carteret System expired, the average bill under uniform rates, assuming a 5% increase is approved in Docket No. W-354, Sub 400, would result in an average monthly bill of \$92.94 (Tr. Vol. 2, 101); and (c) this would not have an impact on other CWSNC customers in the uniform rate structure (Tr. Vol. 2, 100). For comparison, CWSNC late-filed Exhibit 1 shows that if the Carteret System were incorporated into the CWSNC uniform rate structure under the

¹⁸ This calculation is speculative and depends on the uncertain outcome of other matters, including the Commission's decision in the pending, Sub 400 Rate Case.

present Docket No. W-354, Sub 384, rates, the impact would be an increase in the average monthly bill from \$71.37 to \$72.61.

In sum, there is not credible evidence of a material adverse rate impact. The parties agree that CWSNC has agreed to leave the present Carteret System rates unchanged for the next four years.

Likewise, the potential benefit to customers weighs in favor of the transfer. Customers on the Carteret System benefit from having rates frozen at an average bill of \$70.55 for four years, rather than risk having the County raise rates to an average bill of \$98.77 to achieve financial sustainability. Witness Denton's testimony supports a finding that use of rates approved in the pending Docket No. W-354, Sub 400, for the Carteret System after the four-year freeze would not adversely impact the other CWSNC uniform rate customers. This testimony assumes a 5% increase and necessarily has much uncertainty. Of most importance is that customers will experience benefits in the near term, and in the evidence in this case there is not a reliable basis for finding material adverse rate impacts in the long term.

Witness Denton did identify long term benefits to customers from operational economies of scale, although these benefits were not quantified. (Tr. Vol. 2, 27-29) For example, he noted that CWSNC already had staff operating the Carteret System, and that if the County had to assume the cost of operational staff it would be in the range of \$350,000 whereas the incremental cost to CWSNC was much less than that. (Tr. Vol. 2, 78-79). The Commission finds also that these operational efficiencies inure to the benefit of Carteret customers, now and in their future as CWSNC customers, should the acquisition be completed.

Furthermore, the County will receive a significant benefit from the sale of the Carteret System, as noted in the testimony of witness Foxworth (Tr. Vol. 4, 81) and witness Denton (Tr. Vol. 4, 145-47). The County will be relieved of a utility with problematic finances that have led to a “distressed” classification. It will receive approximately \$8 million (net, after paying off debt costs), and that amount can be applied to public purposes.

The Public Staff’s fourth public interest factor is that past Commission decisions on acquisition adjustments provide a policy basis for adjusting fair value. (Tr. Vol. 3, 152-56) When one regulated utility purchases a utility system from another, the Commission normally approves a rate base amount for the acquiring utility that is the lesser of the net original cost of the selling utility or the purchase price. Occasionally, the purchase price is higher than the net original cost. Traditionally, when there is a demonstrated public interest in encouraging the transfer, the Commission has allowed a positive acquisition adjustment to add to the buying utility’s rate base some or all of the difference between the net original cost and the higher purchase price.

However, as indicated in witness Junis’ testimony, the Commission has applied a presumption against acquisition adjustments in past cases. The January 6, 2000, Order Approving Transfer and Denying Acquisition Adjustment in Docket No. W-1000, Sub 5, states: “the Commission indicated a strong general policy against the inclusion of acquisition adjustments in rate base subject to exceptions in appropriate instances.” In that proceeding, the Commission reviewed its variety of past approaches to acquisition adjustments and then announced a policy going forward:

...the Commission should refrain from allowing rate base treatment of an acquisition adjustment unless the purchasing utility establishes, by the greater weight of the evidence, that the price the purchaser agreed to pay for the acquired utility was prudent and that both the existing customers of the acquiring utility and the customers of the acquired utility would be better off [or at least no worse off] with the proposed transfer, including rate base treatment of any acquisition adjustment, than would otherwise be the case.

Witness Junis in effect substitutes some version of the Commission's acquisition adjustment policy decisions for the fair value statute. This is evident from his response to a Commissioner's question:

[Q] You focus so much on the actual depreciated book value in your testimony, and I think you cite the differences between the depreciated book value and the fair value as being one of the arguments against it being in the public interest. So I'm just asking, is it always gonna be against the public interest if we have a fair value that is higher than the depreciated book value?

A. No. And that speaks to -- there is a number of factors, customer benefits, and you're looking at the rate impact to both the acquired customers and the existing customers of the acquiring utility.

(Tr. Vol. 4, 15)

The Commission concludes that its past acquisition adjustment policy – designed and used to evaluate transfers of systems not falling under N.C.G.S. § 62-133.1A - is not an appropriate reason to find the average of the three appraisals in the present case to be unreasonable as a measure of fair value. It is important to note that the traditional acquisition adjustment policy arises in the context of systems regulated by the Commission under net original cost ratemaking. However, N.C.G.S. § 62-133.1A is a law authorizing fair value methods for setting rate base, to be utilized solely in the acquisition of governmental utilities, which do not practice governance, rate-setting, or accounting conventions that are like those of utilities regulated by the Commission. The facts and the

law are different here, and the acquisition adjustment policy to which the Public Staff avers is not relevant to implementation of a clearly worded legislative mandate regarding determination of rate base via an appraisal methodology, when a regulated utility purchases a governmental utility. Witness Denton testified that an inability to establish a market value for acquisitions of governmental utilities, as opposed to original cost value, was an obstacle to such purchases. (Tr. Vol. 2, 24) If the Commission's acquisition adjustment policy provided sufficient opportunity for private utilities to purchase municipal systems, there would have been no need for the legislature to enact N.C.G.S. § 62-133.1A. The Commission has the authority delegated to it by the North Carolina General Assembly. That authority, while broad, does not extend to replacing the statutorily-prescribed fair market value average of expert appraisers with a form of original cost rate base under an acquisition adjustment policy designed for original cost ratemaking.

The Commission agrees with the Public Staff that the average rate base per customer will be increased for CWSNC uniform rate water customers if the transfer is approved at a rate base of \$9,808,726 . However, that fact by itself does not demonstrate an adverse impact on customers, and is counter-balanced by the lower Operating and Maintenance costs per customer of including the County's customers into the Uniform Water rate division. In addition, CWSNC's operational expertise, access to capital, and the demonstrated rate impact for the foreseeable future all portend positive impacts of the proposed transfer as discussed above and in the CWSNC testimony.

It is significant that CWSNC will freeze rates to keep the average customer bill at \$70.55 for the next four years, whereas the County would have to charge rates producing an estimated average bill of \$98.77 to make the Carteret System financially sustainable.

Additional substantial positive impacts would accrue to Carteret County, as stated in the testimony of witness Foxworth.

Moreover, Public Staff concern about increased rate base does not mean the average of the three appraisals of fair market value is unreasonable. The Public Staff's public interest factors are not related to a determination of reasonable fair market value. Legislative enactment of N.C.G.S. § 62-133.1A provides an incentive for private utilities to acquire governmental water and sewer systems by allowing the utility a choice of fair value rate base or original cost rate base. The Public Staff's position would severely undermine the choice of fair value rate base by undermining the efficacy of the Statute.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 8

The evidence for this finding is contained in the testimony of CWSNC witness Denton and the Fair Value Application. CWSNC established, without conflicting evidence from other parties, that the average of the three appraisals required under N.C.G.S. § 62-133.1A is \$10,935,667. The purchase price is \$9,500,000, which is to be increased by the fees paid to the valuation experts and reasonable transaction and closing costs. CWSNC estimated those fees to be \$308,726. The Commission accepts the Company's update of its reasonable fees as filed. The final purchase price and reasonable fee amount is \$308,726. Because this amount is less than the appraisal average of \$10,935,667, fpu under N.C.G.S. § 62-133.1A(b)(4) it is the amount of fair value rate base that will be established for CWSNC if the transfer is approved in Docket No. W-354, Sub 399.

IT IS, THEREFORE, ORDERED as follows:

1. That the Fair Value Application of CWSNC is approved;

2. That the additional reasonable fees, transaction, and contract costs are \$308,726.
3. That the rate base value of the acquired property shall be \$9,500,000 plus the additional reasonable fees, transaction and contract costs, for ratemaking purposes; and
4. That the CWSNC application for a Certificate of Public Convenience and Necessity to acquire and operate the Carteret System, and rates for the Carteret System if a CWSNC franchise is approved, will be decided in Docket No. W-354, Sub 399.

ISSUED BY ORDER OF THE COMMISSION.

This the ___ day of _____, 2023.

NORTH CAROLINA UTILITIES COMMISSION

Erica N. Green, Deputy Clerk