

SANFORD LAW OFFICE, PLLC

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October 24, 2022

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

Via Electronic Delivery

Re: Application by Carolina Water Service, Inc. of North Carolina for Fair Value Determination and for Certificate of Public Convenience and Necessity to Serve Carteret County Water System
NCUC Docket No. W-354, Sub 398
Rebuttal Testimony of Donald H. Denton, III and Gerald C. Hartman

Dear Ms. Dunston:

Attached please find the following Rebuttal Testimony, offered by Carolina Water Service, Inc., of North Carolina ("CWSNC"), pursuant to the Commission's Scheduling Order in this docket:

- Donald H. Denton, State President, CWSNC, and
- Gerald C. Hartman, Hartman Consultants, LLC

I hereby certify that a copy of this filing has been served on the Public Staff and on Carteret County.

As always, we thank you and your staff for your assistance; please feel free to contact me if there are questions or if additional information is required.

Electronically Submitted

/s/Jo Anne Sanford

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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,	)	REBUTTAL TESTIMONY OF
Inc. of North Carolina For Election to	)	DONALD H. DENTON III ON
Establish Rate Base for Carteret County	)	BEHALF OF CAROLINA WATER
Water System Under Fair Value	)	SERVICE, INC. OF NORTH
Methodology Authorized by N.C.G.S. §	)	CAROLINA
62-133.1A))

October 24, 2022

1 **INTRODUCTION**

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

3 A. My name is Donald H. Denton III and my business address is 4944 Parkway
4 Plaza Boulevard, Suite 375, Charlotte, North Carolina 28217.

5 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN THIS MATTER?**

6 A. Yes. I prefiled direct testimony as part of the “Fair Value”¹ application of
7 Carolina Water Service, Inc. of North Carolina (“CWSNC” or “Company”) in
8 Docket No. W-354, Sub 398, on July 26, 2022.

9 **Q. PLEASE STATE THE PURPOSE OF YOUR REBUTTAL TESTIMONY.**

10 A. My rebuttal testimony responds to the Public Staff’s testimonies and
11 affidavit, filed on October 14, 2022. The Public Staff recommends that the
12 North Carolina Utilities Commission (“NCUC” or “Commission”) either deny
13 the CWSNC Fair Value application or, in the alternative, adjust the fair value
14 downward from \$10,935,667 to \$2,444,347. This downward adjustment of
15 \$8,491,320 produces a fair value figure that is significantly lower than: the
16 average of the three fair value appraisals; the purchase price that was derived
17 from an open bid process; and the fair value appraisal submitted by the Public
18 Staff’s own chosen valuation expert. I believe the Public Staff recommendation

¹ References herein to “fair value” are to the valuation provisions contained in N. C. Gen. Statute § 62-133.1A, captioned “Fair value determination of government-owned water and wastewater systems”.

1 is both unreasonable and inconsistent with what CWSNC understands to be
2 the purpose of the Fair Value statute, N.C. Gen. Stat. § 62-133.1A.

3 **Q. WHY DO YOU ASSERT THAT THE PUBLIC STAFF**
4 **RECOMMENDATION IS UNREASONABLE AND INCONSISTENT WITH**
5 **THE STATUTE?**

6 A. CWSNC has engaged in an open bid process, authorized by statute² and
7 duly conducted by Carteret County, to purchase the County's water system.
8 CWSNC, in a transparent, "upset bid" process and against a competing
9 bidder, made the "winning bid" of \$9.5 million. Consistent with G.S. § 62-
10 133.1A, CWSNC now requests the Commission to apply the plain language
11 of that statute to establish the rate base value for CWSNC upon acquisition
12 of the assets and CPCN for the Carteret County water system. CWSNC
13 requests recognition of a rate base value that is the lower of the average of
14 the three appraisals and the purchase price³, as the statute allows. That
15 number is the purchase price of \$9.5 million, which is \$1,435,667 lower than
16 the average of the three appraisals.

17 The course of conduct in this business transaction has been based
18 on an expectation that G.S. § 62-133.1A would be applied as written --
19 devoid of adjustments based on alternative policy views. The Company's
20 reliance is upon the legislatively created opportunity to value Carteret

² N.C. G.S. §160A-269

³ Plus certain fees and costs, as allowed by G.S. 62-133.1A(1)(b)(3) and (4)

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County’s system --- for purposes of determining rate base --- on a market-based formula and a process that included:

- an open/transparent upset bid process by the County⁴;
- retention of an engineer to perform a study;
- retention of three valuation experts certified by the Commission;
- a filed application, meticulously reviewed by the Public Staff for completion;
- a mathematically correct calculation of the “fair value” (which is the sum of the three appraisals divided by three); and
- a request that the contract price - which is the result of the competitive bid process - be accepted as the rate base value by virtue of being lower than the average of the three valuations.

To deny the Fair Value application, or to adjust the fair value to \$2,444,347 in an impermissible effort to superimpose the regulatory

⁴ See Article 12 of Chapter 160A in the N.C. General Statutes. In particular: **G.S. 160A-269. Negotiated offer, advertisement, and upset bids.**

A city may receive, solicit, or negotiate an offer to purchase property and advertise it for upset bids. When an offer is made and the council proposes to accept it, the council shall require the offeror to deposit five percent (5%) of his bid with the city clerk and shall publish a notice of the offer. The notice shall contain a general description of the property, the amount and terms of the offer, and a notice that within 10 days any person may raise the bid by not less than ten percent (10%) of the first one thousand dollars (\$1,000) and five percent (5%) of the remainder. When a bid is raised, the bidder shall deposit with the city clerk five percent (5%) of the increased bid, and the clerk shall readvertise the offer at the increased bid. This procedure shall be repeated until no further qualifying upset bids are received, at which time the council may accept the offer and sell the property to the highest bidder. The council may at any time reject any and all offers.

1 ratemaking accounting procedures to which G S. §62-133.1A provides an
2 alternative, would have the following unreasonable consequences.

3 First, the Public Staff position would presumably result in a negative
4 “acquisition adjustment” of approximately \$7 million for CWSNC if the sale
5 proceeds. That position risks undermining the ability of this transaction to
6 proceed, and is unfair to CWSNC and Carteret County, who have followed
7 and relied upon G.S § 62-133.1A. It would obviously tend to deter privately-
8 owned utilities from utilizing this statute to attempt to purchase North
9 Carolina municipal systems in the future.

10 Secondly, the Public Staff position would have an unreasonable
11 adverse impact on the public interest of Carteret County, as that interest
12 has been determined by Carteret County elected officials, whose charge is
13 to make decisions that are in the best interest of their constituents.

14 Third, the Public Staff’s recommendation ignores the public interest
15 inherent in consolidations, which is well-recognized by the Company, the
16 Commission, and, in the past, by the Public Staff. The economies of scale
17 and ability to share resources and expertise across a network of systems
18 are obvious benefits that flow from acquisitions of certain systems by well-
19 managed and capable operators like CWSNC. They are benefits both to
20 existing and acquired customers. *(See also the discussion of public interest*
21 *in my Direct Testimony, at pp. 3-6)*

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Further, even though this system has been declared to be “distressed” by the Local Government Commission, there is no requirement in G.S. §62-133.1A that an acquired system be deemed “troubled.”

Fourth, Carteret County followed a competitive bid process. An open, competitive, “upset bid” process with more than one bidder inherently tends to produce a fair market value outcome. As stated in the appraisal submitted by NewGen Strategies and Solutions LLC (“NewGen”) on behalf of the Public Staff, fair value is:

“The price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.”⁵ (emphasis added) *See Section 1, page 5 of Form Application Exhibit 1B.*

Professional appraisals are *estimates* of fair value based on various methodologies. As with the present case, they tend to display a range of results. However, 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. The Public Staff testimony essentially ignores this fact.

⁵ Referenced to “Fair Value as Defined in Treasury Regulation §1.170A-1(c)(2)”

1 Finally, the valuation in the Public Staff testimony is far below the fair
 2 value appraisal of NewGen, which is the Public Staff’s choice of appraiser.
 3 Witness Junis recommends \$2,444,347 and NewGen estimates a fair value
 4 of \$7,332,000 - the Public Staff appears to be at odds with its own appraiser.

5 **Q. WHY DO YOU STATE THE PUBLIC STAFF POSITION IS**
 6 **INCONSISTENT WITH WHAT CWSNC UNDERSTANDS TO BE THE**
 7 **PURPOSE OF THE FAIR VALUE STATUTE?**

8 A. The “Fair Value” statute (N.C.G.S. § 62-133.1A) provides in relevant part
 9 that:

10 The fair value of a system to be acquired shall be based on
 11 three separate appraisals conducted by accredited, impartial
 12 valuation experts chosen from a list to be established by the
 13 Commission.

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 16 If the Commission finds that the average of the appraisals will
 17 not result in a reasonable fair value, the Commission may
 18 adjust the fair value as it deems appropriate and in the public
 19 interest.

20 My reading of this statute is that the default calculation of fair value
 21 is simply the average of the three appraisals. The Commission’s authority
 22 to adjust that calculation for the public interest remains bounded by the
 23 definition of “reasonable fair value.” The valuation in the Public Staff
 24 testimony departs from the market-based meaning of “fair value.”

25 **Q. PLEASE EXPLAIN HOW THE PUBLIC STAFF TESTIMONY DEPARTS**
 26 **FROM THE DEFINITION OF “FAIR VALUE.”**

1 A. Public Staff witness Junis recommends a rate base valuation of \$2,444,347
2 as his alternative to denying any fair value determination. He arrives at that
3 figure from the averaging of original cost rate base less depreciation and
4 contributions in aid of construction (“CIAC”) as he determines it, weighted
5 twice, and his calculation of system value based on the average rate base
6 per customer of the five CWSNC and Aqua North Carolina water rate
7 divisions. Witness Junis’ version of original cost appears to attempt to
8 conform to the rate base methodology used by the Commission in non-Fair
9 Value cases, which is not a market-based value. In fact, it appears to be an
10 effort to superimpose a form of the historical rate base methodology used
11 by the Commission - a methodology to which G.S.§ 62-133.1A provides a
12 clear alternative. (As a side note, that version of original cost is not the
13 same as the original cost valuation methodology considered by the
14 appraisers in this proceeding.) To be clear, the Fair Value statute is an
15 alternative to the traditional original cost rate base methodology used in
16 North Carolina - that is the point of it. By resting his recommendation on
17 traditional rate base methodology, witness Junis in effect seeks to negate
18 the provisions of the Fair Value statute.

19 The same flaw applies with respect to witness Junis’ use of the
20 average rate base per customer in other water rate divisions. Those rate
21 base per customer amounts are calculated from the traditional original cost

1 rate base methodology. However, the legislature has provided an
2 alternative to that original cost methodology, in the form of the market value
3 approach of the Fair Value statute.

4 The value of rate base per customer for other systems or rate
5 divisions has nothing to do with what a willing buyer and willing seller would
6 pay for a different system. This is especially true where the system under
7 consideration is being valued under the Fair Value statute, where
8 expectation of some certainty in a logically derived market-related rate base
9 may incentivize buyers to make bids that offer opportunities to complete
10 these types of transactions.

11 In summary, my opinion is that the recommendation of the Public
12 Staff is unreasonable because it thwarts the legislative purpose - as
13 evidenced by the plain language of the statute - to create a valuation
14 process based on a balance between professional appraisals and the price
15 a willing seller and willing buyer would agree to, and instead relies on
16 unauthorized and roughly calibrated proxies to traditional original cost rate
17 base. If the North Carolina General Assembly intended the Public Staff
18 approach, there would seem to have been no reason to enact the Fair Value
19 statute.

1 **Q. THE PUBLIC STAFF TESTIMONY DISCUSSES THE PUBLIC INTEREST**
2 **AND CITES TO RULE R7-41(h). WHAT IS YOUR VIEW OF THE PUBLIC**
3 **INTEREST COMPONENT OF THIS PROCEEDING?**

4 **A.** I have discussed the public interest both in my Direct and previously in this
5 Rebuttal; both are responsive to this question.

6 Further, it is useful to note that multiple views and applications of the
7 public interest are raised in these two dockets, W-354 Subs 398 and 399.
8 Witness Junis at page 6, footnote 1, refers to Rule R7-41(h) of the
9 Commission's Fair Value rule which speaks to the demonstration that the
10 acquisition of the local government utility "...is in the public interest."

11 The County has clearly made the demonstration that the sale is in
12 the public interest, from the County's perspective and on behalf of its
13 constituents. Mr. Wheatly's presentation at the public hearing in Beaufort is
14 the latest of such demonstrations and Mr. Foxworth's Rebuttal reinforces
15 that position. This determination is the County's to make as defined in
16 NCGS 153A-176. Based on the information I have reviewed, the County
17 has a distressed water system, it has lost money for many years, it required
18 subsidies from taxpayers not served by the water system, and it currently
19 requires CWSNC's operating expertise to support its day-to-day operations.

20 More narrowly, for the present docket, Sub 398, I believe the public
21 interest determination should be limited to the description in the statute: "the

1 Commission may adjust the fair value as it deems appropriate and in the
 2 public interest.” That is, “public interest” does not mean discretion to reject
 3 the appraisal average because it may cause rate base per customer to
 4 increase compared to proxies, or because original cost rate base as used
 5 in traditional ratemaking may be lower. That type of “public interest”
 6 consideration would make the statute meaningless by reverting to a
 7 variation on the original cost rate base valuation used in ratemaking, in lieu
 8 of a market value.

9 Rather, public interest regarding the Fair Value statute is best
 10 understood to be a review of whether there is evidence that the average of
 11 the appraisals is an unreasonable deviation from the price to which a willing
 12 seller and a willing buyer would agree. No such evidence has been
 13 presented by the Public Staff. In fact, clear evidence as to the price upon
 14 which a willing buyer and a willing seller would transact, in an open and
 15 entirely transparent bid process with competing bidders, is the transaction
 16 price agreed upon by the County and CWSNC in this docket. In accordance
 17 with the statute, that price should translate into the rate base value (modified
 18 by certain transaction costs and fees).

19 **Q. DO YOU HAVE ANY OTHER COMMENTS ON PUBLIC INTEREST?**

20 **A.** Yes. First, the \$9.5 million purchase price for the Carteret County system is
 21 below the \$10.9 million average of the three appraisals. That in itself is an

1 indication of fairness to customers, given that rate base will be the lower of
2 the purchase price or the appraisal average.

3 Second, CWSNC is proposing to hold the rates for this water system
4 constant at the level approved in the most recent County Fee Schedule for
5 a number of years. Carteret County makes no such promise. The public
6 interest is served by locking in rates rather than risking a series of potential
7 rate increases under County ownership.

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

9 A. Yes.

**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,	)	REBUTTAL TESTIMONY OF
Inc. of North Carolina For Election to	)	GERALD C. HARTMAN ON
Establish Rate Base for Carteret County	)	BEHALF OF CAROLINA WATER
Water System Under Fair Value	)	SERVICE, INC. OF NORTH
Methodology Authorized by N.C.G.S. §	)	CAROLINA
62-133.1A))

October 24, 2022

Rebuttal Testimony of Gerald C. Hartman

1 **INTRODUCTION**

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

3 **A.** My name is Gerald C. Hartman, and my business address is 637 North Park
4 Avenue, Winter Park, FL 32789.

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

6
7 **A.** I am an Accredited Senior Appraiser for Hartman Consultants, LLC,
8 regarding public utilities with the machinery and technical specialties
9 designated and a specialty in water and wastewater.

10 **Q. BRIEFLY STATE YOUR QUALIFICATIONS AND PROFESSIONAL**
11 **BACKGROUND.**

12 **A.** In 1975, I received a bachelor's degree in civil engineering from Duke
13 University in North Carolina. In 1976, I also received a master's degree in
14 engineering (specialty water and wastewater/civil) from Duke University. I
15 earned the designation of Accredited Senior Appraiser from the American
16 Society of Appraisers. Accredited Senior Appraisers are required to pass
17 appraisal education classes, to have a minimum of five years full time
18 experience appraising and valuing utility property, and to pass eleven
19 exams, as well as an eight-hour, comprehensive public utility appraisal
20 exam administered by the American Society of Appraisers. Accredited
21 Senior Appraisers are also required to successfully participate in the
22 American Society of Appraiser's reaccreditation program, which involves

1 complying with its continuing education requirements for which I am current
2 through August 15, 2026. I have participated in hundreds of capital charge,
3 impact fee, and installation charge studies involving water, wastewater,
4 stormwater, solid waste, gas, and electric service for various entities and at
5 nine rate regulatory commissions. Similarly, I have been involved in
6 hundreds of utility acquisition/utility appraisals for acquisition and over 600
7 utility negotiations, appraisals, fairness opinions, and review appraisals. I
8 am a qualified expert witness regarding utility rates and charges, utility
9 negotiation, arbitration, and condemnation cases. I have been accepted by
10 order of the North Carolina Utilities Commission as a Utility Valuation Expert
11 in Docket No. W-100, Sub 60A. My resume is in my report previously
12 submitted.

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

14 **A.** My rebuttal testimony compares the validity of my appraisal methodology to
15 the recommended valuation in the testimony of Public Staff witness Junis,
16 filed on October 14, 2022. In brief, the Public Staff recommends that the
17 Commission either deny the CWSNC fair value application or, in the
18 alternative, adjust the fair value to \$2,444,347. I do not believe the adjusted
19 number of the Public Staff reflects fair value. In contrast, the appraisal
20 performed by Hartman Consultants, LLC, of the Carteret County Water

1 System and filed with the application of CWSNC is based on professional
2 appraisal methods and represents, in my opinion, fair value.

3 **Q. CAN YOU PROVIDE A SUMMARY OF HARTMAN CONSULTANT'S**
4 **APPRAISAL?**

5 **A.** Yes. Hartman Consultants reviewed all three approaches to value: cost
6 approach, income approach, and market approach. We relied upon the cost
7 approach and market approach to valuation as of February 14, 2022. The
8 cost approach was based on a "present book value of assessment" analysis
9 performed by Draper Aden Associates that valued the Carteret County
10 Water System at \$12,300,000. The market approach compared water utility
11 transactions or pending transactions where a willing and knowledgeable
12 seller and a willing and knowledgeable buyer agree to a transaction, without
13 compulsion. The market approach valued the Carteret County Water
14 System at \$8,750,000. Based upon the work performed by Draper Aden
15 Associates and my experience and training, I weighted the cost approach
16 at approximately one and one-half times the market approach. The result
17 is a \$10,900,000 fair value opinion of value for the Carteret County Water
18 System as of February 14, 2022.

19 **Q. PLEASE EXPLAIN YOUR COST APPROACH.**

20 **A.** Hartman Consultants relied on the Draper Aden present book value
21 analysis of utility assets, made appropriate adjustments, and arrived at a

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valuation for the original cost new less depreciation (OCNLD) since the county was the only known owner. The concept is that a willing buyer and willing seller could agree on a purchase price for the water system that reflects the current value of the assets.

Q. REGARDING THE MARKET APPROACH, ON WHAT DID YOU BASE YOUR VALUATION?

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. We 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, I used the top-half average of those sales prices per connection, which equaled \$6,598, and rounded up to \$7,000 per connection. That value, multiplied by 1,246 connections, results in a market value of \$8,750,000. 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.

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Q. CAN YOU BRIEFLY DISTINGUISH THE HARTMAN CONSULTANT'S APPRAISAL METHODS FROM THE RECOMMENDATION IN THE PUBLIC STAFF'S TESTIMONY?

A. Yes. My approaches are estimates of the fair value that a willing buyer and willing seller may negotiate. The Public Staff approach appears to be tied to original cost rate base, net of depreciation and net of contributions in aid of construction without other typical positive value adjustments. That approach is used in traditional ratemaking cases, but it does not reflect market value. As an example, the land value is what it was worth when put into public service in 1988 (\$98,126), not the value as of February 14, 2022, as found by Chris Mashburn of the Mashburn Appraisal Group for the fair value of the land holdings (\$425,250).

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

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