

For the Using and Consuming Public:

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BY THE COMMISSION: On July 26, 2022, Carolina Water Service, Inc. of North Carolina (CWSNC or the Company) filed an Application for Determination of Fair Value of Utility Assets Pursuant to N.C. Gen. Stat. § 62-133.1A and Establishing Rate Base for Acquisition of the Carteret County Water System (Fair Value Application or Application) in Docket No. W-354, Sub 398 (the Fair Value Docket). The Fair Value Application was supported by the prefiled testimony of Donald H. Denton, III.

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

On August 5, 2022, the Public Staff notified CWSNC by letter filed with the Commission of its determination that additional enumerated information was necessary to complete its Fair Value Application as required by Commission Rule R7-41 and N.C.G.S. § 62-133.1A. On August 11, 2022, the Commission issued an Order Finding Application Incomplete, requiring the Company to file the omitted information and consult with the Public Staff to ensure 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 deemed 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.

On September 13, 2022, in both the Fair Value Docket and the CPCN Docket, the Commission issued the Order Scheduling Hearings, Establishing Discovery Guidelines, and Requiring Customer Notice (Scheduling Order). Among other things, the Scheduling Order ordered a public witness hearing to be held in both the Fair Value Docket and the CPCN Docket on October 18, 2022.

On October 6, 2022, the Public Staff filed a Motion to Compel, requesting the Commission to compel CWSNC to fully respond to certain Public Staff data requests. The parties subsequently informed the Commission informally that the Motion to Compel had been resolved.

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

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

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

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

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 petition to intervene. All prefiled testimony and exhibits of CWSNC, the County, and the Public Staff were admitted into the record, along with the Fair Value Application, all cross-examination and redirect exhibits, and the affidavit of Public Staff 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, requesting an extension of time to file the Customer Report until November 8, 2022. Also on November 7, 2022, the Company filed its Response to Customer Concerns – Beaufort, NC Public Hearing October 18, 2022.

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

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

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

On December 22, 2022, the Commission issued an Order Granting Public Staff's Motion for Extension of Time and Directing Further Utility Reporting.

On January 17, 2023, the Company filed CWSNC Supplemental Response to Customer Concerns from Beaufort, NC Public Hearing.

On January 25, 2023, CWSNC submitted support for additional fees and costs incurred in connection with the Application. Also on January 25, 2023, the Public Staff filed a response to the Company's submission. Included in the Public Staff's response

was an update to the Public Staff's calculation of the impact of the application of the Fair Value Statute to the proposed acquisition of the System on customer rates.

No objection having been received, the Late-Filed Exhibits 1 and 2, filed by CWSNC on November 21, 2022, and the January 25, 2023 submissions of both CWSNC and the Public Staff relating to fees and costs are hereby admitted into evidence.

INTRODUCTION

This is the first proceeding under N.C.G.S. § 62-133.1A (the Fair Value Statute), which became law on June 25, 2018. The Fair Value Statute states that when acquiring an existing water system owned by a local unit of government, a public utility may elect to establish rate base by using the fair value of the utility property instead of original cost. N.C.G.S. § 62-133.1A(a). As directed by the statute, N.C.G.S. § 62-133.1A(f), in Docket No. W-100, Sub 60, the Commission adopted Commission Rules R7-41 and R10-28 to implement the Fair Value Statute. Commission Rule R7-41(h) places the burden of proof on the utility electing a fair value application process "regarding all aspects of the proceeding . . . and for demonstrating that the acquisition of the Local Government Utility is in the public interest."

Determining the rate base under N.C.G.S. § 62-133.1A is a multi-stage process.

First, "[t]he acquiring public utility and selling utility shall jointly retain a licensed engineer to conduct an assessment of the tangible assets of the system to be acquired, and the assessment shall be used by the three appraisers in determining fair value." N.C.G.S. § 62-133.1A(b)(2). Pursuant to Commission Rule R7-41(d), the public utility must utilize Form FV1(a) for the assessment.

Second, the fair value is determined. The fair value is "based on three separate appraisals conducted by accredited, impartial valuation experts chosen from a list to be established by the Commission," one appraiser representing the public utility acquiring the system, another appraiser representing the utility selling the system, and another appraiser representing the Public Staff. N.C.G.S. § 62-133.1A(b). Each appraiser must determine fair value in compliance with the uniform standards of professional appraisal practice, employing the cost, market, and income approaches to assess value. N.C.G.S. § 62-133.1A(b)(1)(b). The statute provides that fair value, for ratemaking purposes under N.C.G.S. § 62-133, is the average of the three appraisals. N.C.G.S. § 62-133.1A(b)(1)(c). Additionally, "[i]f 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." N.C.G.S. § 62-133.1A(e).

Third, reasonable fees paid to the utility valuation experts, as well as reasonable transaction and closing costs incurred by the public utility, may be included in the cost of the acquired system. N.C.G.S. § 62-133.1A(b)(3).

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

The statute provides various mechanisms for the protection of ratepayers. First, the statute makes clear that the rate base value of the acquired system shall be the lesser of the purchase price or the fair value of system plus the authorized fees and costs. N.C.G.S. § 62-133.1A(b)(3)-(4). It further provides that the normal rules of depreciation shall begin to apply against the rate base value upon purchase of the system by the acquiring public utility, which means the rate base value ultimately reflected in rates charged to customers shall be lower than the rate base value established in the Commission’s order. N.C.G.S. § 62-133.1A(b)(5). Third, the statute makes clear that even if the acquiring public utility submits a complete application meeting all of the requirements of the Fair Value Statute, the Commission may issue an order either approving or denying an application. N.C.G.S. § 62-133.1A(d). In addition, it provides that the Commission “may adjust the fair value as it deems appropriate and in the public interest.” N.C.G.S. § 62-133.1A(e). Finally, the statute states that the Commission retains its authority under Chapter 62 to set rates for the acquired system in future rate cases, N.C.G.S. § 62-133.1A(e), and, in particular, may “classify the acquired system as a separate entity for ratemaking purposes, consistent with the public interest.” *Id.*

In the exercise of the discretion afforded to it by the Fair Value Statute, in consideration of the evidence presented and the entire record in this proceeding and based on the Commission’s findings of fact and conclusions of law set out in this Order, the Commission grants the Application. However, the Commission adjusts the fair value to \$8,416,000, which is lower than the contract price, resulting in a rate base determination equal to \$8,416,000 plus reasonable appraiser fees, transaction costs, and closing costs of \$312,039.

WHEREUPON, the Commission makes the following

FINDINGS OF FACT

1. CWSNC is a corporation duly organized under the laws of, and is authorized to do business in, the State of North Carolina. It is a franchised public utility providing water and sewer utility service to customers in North Carolina, pursuant to North Carolina General Statutes, Chapter 62. CWSNC is a wholly owned subsidiary of Corix Regulated Utilities, Inc. (Corix).

2. CWSNC is properly before the Commission for a determination of whether the rate base for the assets CWSNC has contracted to purchase from the County can be established using the fair value of the utility property, and if so, what amount may be included in rate base, under N.C.G.S. § 62-133.1A and Commission Rule R7-41.

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

4. The System consists of the two water systems, North River/Mill Creek and Merrimon, and serves approximately 1,250 water utility customers.

5. The System is well-maintained and provides safe, reliable, and compliant service to customers.

6. CWSNC and the County entered into an operation and maintenance oversight agreement dated January 24, 2022. Under the agreement, CWSNC provides an Operator in Responsible Charge (ORC) and consultation services to the County staff. During this period of time, service to the customers of the System has been reasonably adequate.

7. The System was not financially self-sufficient on customer rates alone. The System’s operations were supported at times with monies from the County’s General Fund and, additionally, were regularly supported with taxes collected from property owners within the boundary of a special water taxing district (the Water District). The System customers represent less than half of the parcels within the Water District, and they are only a small fraction of the County population.

8. At least as early as 2019, the County no longer wished to own and operate the System and began to explore a potential sale of the System. The County received a Water System Merger Grant from the State of North Carolina in 2019. The County retained the engineering firm of Draper Aden Associates (Draper Aden or DAA), which produced a report entitled “Feasibility Study for Water System Merger” (DAA 2019 Report). The DAA 2019 Report included a section entitled “Estimated Value of the County’s Water Systems” that stated that the “net worth of the water system assets owned by the County was calculated to be approximately \$12,335,392.”

9. In December 2019, Draper Aden recommended that the County transfer the System to the Town of Beaufort for one dollar, and that the County continue collecting Water District taxes to pay off its water fund debts in the amount of approximately \$2 million and contribute to the Town’s upgrades and expansions to the System over the next eleven years. The Town of Beaufort declined to pursue the opportunity.

10. The County received an expression of interest from Aqua North Carolina, Inc. (Aqua) related to the acquisition of the System, leading to a decision by the County to pursue selling the System. Among the contracting options available to it under North Carolina law, the County chose the public upset bid process, as provided for in N.C.G.S. § 160A-269, and received the following bids: CWSNC bid \$4.9 million on January 13, 2021; Aqua bid \$7 million on February 2021; CWSNC bid \$7.5 million on March 1, 2021; Aqua bid \$7.875 million on March 21, 2021; CWSNC bid \$8.5 million on March 23, 2021; Aqua bid \$8.925 million on April 18, 2021; and CWSNC made the highest bid of \$9.5 million on April 27, 2021.

11. There was substantial opposition from current customers of the System to the sale of the System.

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

13. The County and CWSNC entered into the Utility Asset Purchase Agreement (APA) dated October 18, 2021. Section 2.04 of the APA states the purchase price of the System assets is to be \$9.5 million.

14. CWSNC and the County retained Draper Aden to conduct an assessment of the tangible assets of the System to be acquired. Application Ex. 5A.

15. In addition to what is required by the Fair Value Statute or Commission Rule R7-41, including the Engineering Assessment Form FV1(a), CWSNC attached two additional reports from Draper Aden. One was the DAA 2019 Report. Application Ex. 5B. The other was a draft report dated December 2021 entitled "Update to Present Value of Water System – Draft" (DAA 2021 Report). Application Ex. 5C. The DAA 2021 Report stated that the estimated value of the System assets was approximately \$12.7 million. Draper Aden is not on the Commission's list of qualified Utility Valuation Experts maintained pursuant to N.C.G.S. 62-133.1A(b)(1).

16. CWSNC's Application did not identify any deficiencies in the System. The Application did not identify any needed infrastructure improvements for the next five years.

17. Attached to the Application were the appraisal reports of three appraisers: Hartman Consultants, LLC (Hartman Consultants), retained by the Company, valued the System at \$10,900,000; Gannett Fleming Valuation and Rate Consultants, LLC (Gannett Fleming), retained by the County, valued the System at \$14,575,000; and NewGen Strategies and Solutions, LLC (NewGen), retained by the Public Staff, valued the System at \$7,332,000. All three appraisers who testified regarding the appraisals are on the Commission's list of qualified Utility Valuation Experts maintained pursuant to N.C.G.S. § 62-133.1A(b)(1). As part of its Application, as required by Commission Rule R7-41, CWSNC calculated and listed the average of the three appraisals to be \$10,935,667.

18. The average of the three appraisals is not a reasonable fair value.

19. In the public interest, it is appropriate for the Commission to adjust the fair value to \$8,416,000.

20. Acquisition of the System will spread certain of CWSNC's costs over a larger customer base, although it is not possible on the present record to quantify the extent to which this will benefit CWSNC's existing customers or affect CWSNC's future rates.

21. The System assets will not be added to rate base for rate setting purposes until CWSNC's next rate case, which is anticipated to be in four years. As a result, it is difficult to predict the impact of granting the Application on future rates. However, if the rate base were to be set at \$9.5 million plus reasonable transaction fees and costs, the future rate impacts on the System customers, if the Commission set System-specific rates, or on CWSNC's existing customers, if the Commission allowed CWSNC to put the System into uniform rates, will be material.

22. At the fair value, as adjusted by the Commission in its discretion, utilization of the Fair Value Statute is in the public interest.

23. CWSNC's Revised Form Application Exhibit 8, filed on August 11, 2022, provided a list of the actual costs and fees incurred through August 9, 2022, and the estimated costs and fees through closing totaling \$174,439.74. The Update to Revised Form Application Exhibit 8 documents reasonable fees paid to the utility valuation experts in addition to reasonable transaction and estimated closing costs incurred by CWSNC of \$312,039.

24. The water rates reflected in CWSNC's Revised Form Application Exhibit 12 are the existing Carteret County rates. CWSNC has agreed with Carteret County that the customers of the System will remain at Carteret County's current water rates for the next four years. The agreed-upon rate freeze is appropriate and beneficial to the System customers.

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

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

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 5-6

The evidence supporting these findings of fact is found in the testimony of CWSNC witness Denton, Public Staff witness Junis, and the testimony of County witness Foxworth.

Public Staff witness Junis, Director of the Water, Sewer, and Telephone Division of the Public Staff, testified that, according to Public Water Supply Section records available on the Drinking Water Watch system, neither of the water systems comprising the System has had any violations issued or enforcement actions taken over the last six years, such that, to his knowledge, the County was providing safe, reliable, and compliant service to the North River/Mill Creek and Merrimon water systems. Tr. vol. 3, 138-39.

CWSNC and the County entered into an operation and maintenance oversight agreement dated January 24, 2022. Pursuant to the agreement, CWSNC provides a

certified operator to serve as the ORC and provides consultation services to the County. *Id.* CWSNC has been operating the System since early in 2022. Tr. vol. 2, 106.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 7-13

The evidence supporting these findings of fact is found in the Application, the testimony of the seven customers appearing at the October 18, 2022 public hearing, the testimony of Public Staff witness Junis, and the testimony of County witnesses Foxworth and Meshaw.

Eugene Foxworth, Assistant County Manager with Carteret County, and Dee Meshaw, Assistant County Manager and Finance Director for Carteret County, testified on behalf of the County. Among witness Foxworth's duties is overseeing the Public Utilities Department for the County. Tr. vol. 4, 79. He provided an overview of the history and process that led to the County entering into the APA with CWSNC for the sale of the System. He explained that in 2019, the County received an infrastructure grant from the North Carolina Department of Environmental Quality (DEQ) to study the merger of the System with the water system owned and operated by the Town of Beaufort. *Id.* at 80. The County retained Draper Aden to study the merger. *Id.* at 95. In its report, Draper Aden touted the benefits of the merger for the Town as including "acquisition of \$12.3 million worth of infrastructure without any financial investment." Application Ex. 5B, DAA 2019 Report at E2. Draper Aden recommended that the County transfer the System to the Town for \$1, retire the debt over the next eleven years, and fund upgrades and expansions to the System over that same period of time. *Id.* At the conclusion of the study in March of 2020, representatives of the County discussed the results with the Town of Beaufort, and the Town Manager informed the County that the Town was not interested in pursuing the merger. Tr. vol. 4, 80. There was no evidence in the record explaining the reasons why the Town rejected the acquisition in such an apparently summary fashion.

Meanwhile, County witness Foxworth testified that the County was approached by Aqua about potentially acquiring the System in March of 2020. *Id.* The County informed Aqua that "our only viable and transparent means of selling the System" was the upset bid process pursuant to N.C.G.S. § 160A-269. *Id.* Witness Foxworth explained that the upset bid process is transparent because bids are publicly advertised. *Id.* at 83. In response to a question from the Commission, witness Foxworth testified that the County uses the upset bid process whenever it disposes of public property, and to the best of his knowledge and recollection, has never used the sealed bid process. *Id.* at 104. In June of 2020, CWSNC also expressed interest in acquiring the System. *Id.* at 80.

The bids were as follows: on January 13, 2021, CWSNC bid \$4.9 million; in February, Aqua bid \$7 million; on March 1, CWSNC bid \$7.5 million; on March 21, Aqua bid \$7.875; on March 23, CWSNC bid \$8.5 million; on April 18, Aqua bid \$8.925 million; and on April 27, CWSNC bid \$9.5 million. Tr. vol. 3, 135; tr. vol. 4, 102-03.

Public Staff witness Junis characterized the upset bid process as a “race to the top.” Tr. vol 3, 191. In his opinion, the DAA 2019 Report “inappropriately set the table here of what would be a reasonable price to pay” *Id.*

There was strong opposition to the sale of the System. System customers presented a petition signed by nearly 1,000 people opposing the sale to the County Commissioners. Tr. vol. 1, 63-64. The meetings of the County Commission in which the sale was on the agenda were well-attended, with one witness describing them as “standing room only.” *Id.* at 64. Of the seven customers who testified at the October 18, 2022 public hearing in Beaufort, North Carolina, six were in opposition to CWSNC acquiring the System. *Id.* at 33, 37, 50, 54, 63, 70.

By a vote of four to three, the County Commissioners approved the APA during their October 18, 2021 meeting. Tr. vol. 4, 90-91.

The executed APA is attached to the Application as Exhibit 6A. Section 2.04 of the APA states that the purchase price of the System is \$9,500,000.

County witness Foxworth testified that the System serves 1,254 households. Tr. vol. 4, 81. Because of the limited density of the System, which has 54 miles of water lines, the System has been supported by the County General Funds as well as taxes collected from the Water District, which comprises 3,875 parcels. *Id.* Closing the transaction will allow the County to retire the System debt and receive approximately \$8 million to fund other public necessities. *Id.* The County is still in the process of evaluating whether any of the grant funding it received in connection with the System would have to be repaid. *Id.* at 115.

In June of 2021, the tax for the Water District was eliminated, and in July of 2021, the County implemented a 95% increase in rates that were intended to make the System whole; however, after complaints from customers the rates were reduced 25% in September of 2021 to the current rate for an average customer of \$70.55. *Id.* at 100-01, 104; Application Ex. 3. Witness Foxworth and witness Meshaw testified that the County had calculated the rate necessary to cause the System to be self-sustaining to be \$98.77 for a residential customer using 4,000 gallons per month. Tr. vol. 4, 101.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 14-16

The evidence supporting these findings of fact is found in the Application, the testimony of Company witness Denton, and the testimony of Public Staff witness Junis.

An engineer employed by Draper Aden, Dr. Steven R. Gandy, Ph.D., P.E., prepared the Engineering Assessment. Application Ex. 5A.¹ Dr. Gandy generally found the System assets to be in good condition, and he did not anticipate any additional upgrades for the next five years other than typical annual maintenance. *Id.* He did not find any deficiencies

¹ No witness representing Draper Aden testified in this proceeding.

in the System. Application Ex. 2. CWSNC has no plans for significant infrastructure improvements above routine operations and maintenance. *Id.* Based on his own inspection of the System, Public Staff witness Junis testified that the System assets were overall in good condition and had been well maintained. Tr. vol. 3, 135-36.

In addition to the Engineering Assessment, CWSNC included in Exhibit 5 to its Application the DAA 2019 Report and the DAA 2021 Report. Application Ex. 5B, 5C. The DAA 2019 Report and the DAA 2021 Report are not signed, other than by three individuals who provided third party reviews. It does not appear that Dr. Gandy prepared those reports, as he had only been at Draper Aden for one year at the time he prepared the Engineering Assessment. Application Ex. 5A, Engineering Assessment (see Gandy resumé). Dr. Gandy attached and explicitly referenced the information he relied on in preparing the Engineering Assessment, e.g., his resumé and the DEQ approvals for each supply well; in contrast, Dr. Gandy does not reference the DAA 2019 Report or the DAA 2021 Report in the Engineering Assessment. Accordingly, the record does not reflect the professional credentials or experience of the individual or individuals who prepared the DAA 2019 and DAA 2021 Reports, and in particular, the present value assessments that two of the three utility valuation experts relied on, at least in part, in preparing their appraisals.

The DAA 2019 Report included a section entitled “Estimated Value of the County’s Water Systems” that stated that the “net worth of the water system assets owned by the County was calculated to be approximately \$12,335,392.” The DAA 2019 Report stated that Draper Aden estimated the value of the System by taking the historical cost, subtracting accumulated depreciation, and adding current depreciation. Application Ex. 5B at 9. Where historical cost data was available, Draper Aden followed that formula. *Id.* at 10-11. Using the formula described, the assets detailed on Table 7, entitled “Estimated Book Value of Carteret County Water System,” are listed with date of acquisition, useful life, accumulated depreciation, current depreciation, and present book value. The total shown for the estimated book value of assets on Table 7 is \$2,094,250. Where historical cost data was not available, “the County provided financial data that detailed the present book value of the assets as listed in Table 8.” *Id.* at 12. Table 8 simply lists assets and their present book value, which in many cases is estimated, and the values total \$10,241,142.

The DAA 2021 Report concludes that the System assets have a value of approximately \$12.7 million. Application Ex. 5C at 2 (DAA 2021 Report). Public Staff witness Junis testified that the present book value estimates in Table 2 of the DAA 2021 Report — constituting \$10,719,713 of the total value — do not include original cost, discount rate, or depreciation. Tr. vol. 3, 133. In fact, a number of the values on that table were increased by 5% in comparison to the DAA 2019 Report. Witness Junis further testified that the County has extensive accounting records that would enable appraisers to establish the original cost less depreciation. *Id.*

Draper Aden is not on the Commission’s list of qualified Utility Valuation Experts maintained pursuant to N.C.G.S. 62-133.1A(b)(1).

CWSNC witness Denton, the Senior Vice President, East Operations for Corix, testified in response to questions from the Commission that the County initially retained Draper Aden to prepare an engineering report in 2019, and then in 2021 the County and CWSNC jointly decided to reengage Draper Aden to save expense. Tr. vol. 2, 107, 133. He further stated that the Company did not prepare the scope of work or otherwise direct the work. Tr. vol. 2, 107. Witness Denton acknowledged that a valuation analysis by an engineer, such as that provided in the DAA 2021 Report, is not required by N.C.G.S. § 62-133.1A. *Id.* at 137.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 17-22

The evidence supporting these findings of fact is found in the Application, the Commission's list of qualified Utility Valuation Experts maintained pursuant to N.C.G.S. § 62-133.1A(b)(1), Late-Filed Exhibit 1, the testimony of Company witness Denton, the testimony of CWSNC appraiser witness Hartman, the testimony of County appraiser witness Walker, the testimony of Public Staff appraiser witness Lane, and the testimony of Public Staff witness Junis.

Hartman Consultants, Gerald C. Hartman

CWSNC retained Hartman Consultants as its appraiser, and its appraisal report was signed by Gerald C. Hartman, who also appeared as a witness in the hearing. Witness Hartman has been valuing utilities for 46 years. Tr. vol. 2, 155.

Witness Hartman's opinion of value of the System is \$10,900,000. Application Ex. 1C (hereafter, Hartman Report).

Cost approach. Witness Hartman arrived at an Original Cost New, Less Depreciation (OCNLD) of \$12.3 million. Hartman Report at 3-6. In arriving at an opinion on OCNLD, he did not review the System's books and records, but relied on the DAA 2021 Report, tr. vol. 2, 158, in which Draper Aden performed a "present book value of assessment" analysis that considered an estimated book value for some assets and a present book value for others. Hartman Report at 3-1 (see Draper Aden Tbls. 1, 2). Witness Hartman did not perform an independent assessment of the System assets, and testified that as a North Carolina Professional Engineer, he is allowed to accept the report of another Professional Engineer, and that he felt obligated by the Fair Value Statute to utilize the DAA 2021 Report. *Id.* He testified that in many states, having an independent engineer perform an engineering cost is the preferred approach. Tr. vol. 2, 161, 164. He understands the value of the System assets in the Draper Aden Reports to represent the OCNLD. *Id.* at 163-64. He also accepted Draper Aden's decision to increase the values of some assets by 5% due to inflation. *Id.* at 165-66.

Thus, witness Hartman did not perform an original cost study, although he did make some adjustments to the value of the System assets in the Draper Aden reports. He used an appraisal report from a licensed real estate appraiser for the land values, according to industry standards. *Id.* at 159. He also added a going concern value of

\$247,000, which he stated he based on going concern values for similar systems that were not profitable based on a percentage of the value of the assets. Hartman Report at 3-5; tr. vol. 2, 167-68. Finally, he subtracted \$740,000 for functional obsolescence, reflecting the meters installed for 533 customers that have not yet chosen to connect to the System. Hartman Report at 3-5, tr. vol. 2, 170.

Market approach. In applying the market approach to valuation, witness Hartman drew from a large database of water system sales created and maintained by Hartman Consultants, tr. vol. 2, 175, and chose transactions that closed between 2018 and 2022 in jurisdictions with fair value statutes, and where the systems had between 700 and 2,000 connections. Hartman Report at 5-1, Tbl. 5-1. From that list, Table 5-2 in the Hartman Report, he used only the top-half average of the water system sales. He dropped the bottom-half average of the sales based on his own assessment that the System is in the top half of the selected list of sales in terms of the condition of the assets. Hartman Report at 5-17; tr. vol. 2, 177. Witness Hartman's selection of the top-half average of water system sales yielded a sales price per connection of \$6,598, which he adjusted upward to \$7,000 based on his conclusion that Carteret County's growth opportunities are "equal to or superior to" those in the regions represented by the seven water system sales that he selected. Hartman Report at 5-19; tr. vol. 2, 177. Witness Hartman testified that he did not think that his assessment – that the County's growth opportunities are "equal to or superior to" the water system sales that he selected – was inconsistent with his conclusion that the income approach (discussed below) was too speculative because of an unknown growth rate. Tr. vol. 2, 185. Witness Hartman reconciles his market opinion with his income opinion by testifying that in his experience, if systems build infrastructure, the systems will have "good growth." *Id.* By multiplying the upwardly adjusted amount of \$7,000 per connection with the number of connections in the System (1,246 connections), he arrived at a market valuation of \$8,750,000.

Income approach. Witness Hartman did not employ the income method of valuation because he does not believe that that approach could be relied upon. Hartman Report at 4-1. Witness Hartman found the System to be operating at a loss of \$161,342, and therefore, determined that a nonprofitable water utility does not provide credible results for the income approach. *Id.* He testified that he did not consider it appropriate to consider tax revenues as income, because an investor-owned utility does not have taxing authority. Tr. vol. 2, 174; tr. vol. 3, 23.

In his responses to questions from the Commission, witness Hartman testified as to additional reasons he did not use the income approach. First, he explained that he could not determine an appropriate growth rate for a system with a growth of 25 customers a year over a 2.5-to-3-year period. Tr. vol. 2, 169. He noted that 237 customers – that had paid minimum charges that allowed their impact fees to be waived, but that had not yet established active connections – represented potential growth, but

that such growth is “quite speculative.”² Tr. vol. 2, 171, tr. vol. 3, 12. He also stated that because the Commission has made no decision as to the amount of rate base upon which rates will be set to create income, assuming a rate base is “highly speculative.” Tr. vol. 2, 171. He further testified that the two rate changes (the 95% rate increase in July of 2021 and the 25% decrease in rates in September of 2021) that the County imposed shortly before he performed his appraisal resulted in “highly variable” rates that did not provide sufficient “rate stability” data to analyze. Tr. vol. 2, 183; tr. vol. 3, 11.

In arriving at his final conclusion of a \$10,900,000 value of the System, witness Hartman weights the cost approach 1.5 times the market approach. Hartman Report at 6-1. In response to questions from the Commission, he explained that his weighting is based on his “judgment call” that the cost approach is specific to this System. Tr. vol. 2, 178.

Gannet Fleming Valuation and Rate Consultants, Harold Walker III

The County retained Gannet Fleming to conduct an appraisal of the System. Harold Walker III, Manager of Financial Studies, signed the appraisal report and testified in support of the report. Witness Walker stated that he has been in the business of financial consulting for the utility industry for over 35 years and has been providing appraisals of utility property for 25 to 30 years. Tr. vol. 3, 29.

Gannet Fleming’s opinion of value of the System is \$14,575,000. Application Ex. 1A at 1 (hereafter, Gannet Fleming Report).

For his analysis, witness Walker developed a list of eight comparable companies. Gannett Fleming Report at 13-14. His criteria were water and wastewater companies in the S&P Capital IQ database with a market value of greater than \$200 million and an enterprise value of greater than \$450 million. All of the comparable companies are larger than the System by one to three orders of magnitude in terms of revenues, number of customers, and population served. *Id.*; tr. vol. 3, 36-38. Witness Walker utilized this comparable group in all three valuation approaches.

Cost approach. Like witness Hartman, witness Walker used the DAA 2021 Report as the starting point for his cost analysis. Gannett Fleming Report at 24. Witness Walker made adjustments to the figures provided in the DAA 2021 Report. First, he used installation dates and original cost information from the County’s depreciation schedules where that information was missing from or in conflict with the Draper Aden reports. *Id.* at

² County witness Foxworth testified that the County retained an engineering firm to manage the design of the System expansion in the early 2000s. Tr. vol. 4, 111. That firm had expected a greater percentage of potential customers to connect to the System than ever came to fruition. *Id.* As an incentive to connect to the System, customers were given an opportunity to pay a flat fee for the right to connect. There are 237 households that currently have paid for the right to connect to the System without further connection fees but have never chosen to do so. *Id.* These customers are served by private wells. *Id.* Although there are 3,875 parcels in the Water District, only 2,167 are improved with structures. Tr. vol. 4, 119. Witness Foxworth testified that that area of the County is growing, but not very quickly. *Id.*

24-25. He also subtracted the 5% inflation adjustment Draper Aden applied in the DAA 2021 Report. Tr. vol. 3, 49-50. In response to a question from the Commission, witness Walker explained that he did not use the book values shown on the County's audited financial statements because the County had used accelerated depreciation. *Id.* at 43-44. Using this methodology, witness Walker determined the OCNLD to be \$11,257,855. Gannett Fleming Report at 25.

Witness Walker used the OCNLD to perform a replacement cost study. His opinion of the depreciated replacement cost (RCNLD) is \$18,135,328. *Id.* at 27. By reference to his list of comparable companies, he determined that the System has functional and economic obsolescence requiring a downward adjustment, and he arrived at a final RCNLD of \$16 million (rounded), which is his valuation using the cost approach. *Id.* at 30.

Income approach. Witness Walker explained that the County utilized a Water Fund to account for System operations, and that the Water Fund was not self-sufficient, and had to rely on revenues from the Water Taxing District Special Revenue Fund as a subsidization of the rates. Gannett Fleming Report at 6; tr. vol. 3, 62. Witness Walker treated these transfers as revenue for the purpose of his analysis. Responding to questions from the Commission, Witness Walker testified that considering the 2021 budgeted tax revenues allowed him to perform the income approach to valuation (whereas CWSNC witness Hartman did not perform the income approach). Tr. vol. 3, 62. Witness Walker testified that there have been appraisals where Gannett Fleming did not utilize the income approach due to a lack of income. *Id.*

Witness Walker considered two common methods of the income approach to valuation, the discounted cash flow method (DCF), and the capitalization of earnings or cash flow method. Gannett Fleming Report at 31. He finds both methods to be problematic when valuing a system that is owned by a government entity and being purchased by an investor-owned utility, because the new ownership makes it difficult to estimate future earnings. *Id.* at 33.

Witness Walker considers an appropriate discount rate for a government-owned system to be the municipal bond yield (which was 2.85% on December 31, 2021), whereas, an appropriate discount rate for an investor-owned utility would be the weighted average cost of capital net of tax, between 6.59% and 8.5%. *Id.* at 32-33. He chose to use the municipal bond rate for an overall discount rate of 2.75%. *Id.* A lower discount rate would yield a higher valuation. Tr. vol. 3, 54. For the System, he chose a growth rate of 0.1%, in light of the County's projected growth and the recent rate increase implemented by the County. Gannett Fleming Report at 36.

Witness Walker arrived at a value of \$10.8 million for the capitalization of earnings. However, he ultimately did not rely on that method because it was based on the current owner, and he does not believe the current government owner is representative of the hypothetical buyer. Tr. vol. 3, 57. Instead, he employed the DCF method, exploring various combinations of discount rates and market multiples drawn from his comparable

group. Gannett Fleming Report at 36-39. He arrived at valuations between \$10.4 million and \$16.8 million and settled on \$15.1 million. *Id.* at 39.

Market approach. Witness Walker employed both the market multiples and selected transaction methods. For the market multiples analysis, he used his comparable group, making various downward adjustments to account for the differences between the companies in the comparable group and the System, arriving at a range of \$9.9 to \$15.4 million, and selecting \$12.6 million as the valuation using that method. *Id.* at 42. Witness Walker did not give any weight to the selected transaction method (which resulted in a range of values between \$9.5 and \$22.0 million), because he could not be assured that the market involved (Pennsylvania) was similar to North Carolina. *Id.* at 45-46.

Witness Walker gave equal weight to the values he arrived at for each method – \$16,024,799 under his cost approach, \$15,061,795 under his income approach, and \$12,638,497 under his market approach – and concluded that the fair market value of the System was \$14,575,000. *Id.* at 46-47.

NewGen Strategies & Solutions, Michael G. Lane

The Public Staff retained NewGen to appraise the system, and its report, Application Exhibit 1B (hereafter, NewGen Report), was sponsored by Michael G. Lane. NewGen's opinion of fair market value for the System is \$7,332,000. NewGen Report, Executive Summary.

Cost approach. Witness Lane arrived at an OCNLD (without accelerated depreciation) of \$5,904,000, and he used the County's depreciation records to determine OCNLD. NewGen Report at 4-1; tr. vol. 3, 85. Witness Lane determined that the RCNLD, without adjusting for economic obsolescence, was \$13,032,000. NewGen Report at 4-3.

Market approach. Witness Lane evaluated the market approach, specifically the sales comparison method, and found a range of values between \$7,527,000 (considering the ratio of sales price to OCNLD) and \$2,506,000 (considering the ratio of sales price per customer). *Id.* at 4-3 to 4-4. However, he did not ultimately rely on the market approach, because of the difficulty of comparing transactions in different regions of the country and assessing the condition of each system. Instead, "NewGen generally uses the comparable sales method as a test of the reasonableness of the values produced by the cost and income approaches." *Id.* at 4-3.

Income approach. For estimating the value of regulated utility property, NewGen's opinion is that "the capitalized income value for regulated utility property is generally equivalent to its rate base value with an adjustment for expected future growth." *Id.* at 4-5. NewGen considers the rate base to generally be close to the OCNLD. *Id.* NewGen operates from the premise that the hypothetical purchaser should be the most likely purchaser, i.e., a regulated investor-owned utility. Tr. vol. 3, 84. Witness Lane arrived at his risk premium by averaging the CRSP and Kroll risk premia approaches. He used a capitalization rate of 5.7% (average utility weighted average cost of capital of

7.80% less long-term earnings growth rate of 2.10%). Using the income approach, he arrived at a valuation of \$7,332,000.

When asked whether NewGen's income approach were circular, given that it used a presumptive rate base drawn from the County's records in order to arrive at a valuation for the Commission to use as the rate base for the System if the Company purchases it, Witness Lane responded that an entity making a purchase would look at invested capital since that is what a utility can earn a return on. *Id.* at 86.

NewGen considered all three valuation approaches, but ultimately relied on the income approach to value because a buyer evaluating the System on a financial basis should not be willing to pay more than the income value of the property. *Id.* at 79-80.

Witness Lane testified that the process NewGen followed in valuing the System is similar to what it would do in other valuations. *Id.* at 91. NewGen used the other two valuation methods as a check on its income approach. NewGen used the cost approach to set the upper and lower boundaries on price, reasoning that no prudent seller would sell for less than the depreciated original cost, and no prudent buyer would pay more than replacement cost depreciated. *Id.* at 82. NewGen typically does not rely on the market approach for two reasons. First, because there are so many differences among utilities that make it a difficult exercise to make the necessary adjustments to cause the comparison to be apples-to-apples. *Id.* at 81. Second, while closing prices may be publicly available, there is not information about strategic motivations for transactions that may cause a buyer to overpay for a system compared to a purely financially motivated transaction. *Id.* However, NewGen does look for the market approach to yield a number between OCNLD and RCNLD. *Id.* at 82. NewGen looks for all three approaches to "tell a similar story, and in this case they did for us." *Id.*

Public Staff Approach

Public Staff witness Junis presented the Public Staff's view that the Application should be dismissed, as discussed below. He further testified that if the Commission does make a finding of fair value in this proceeding, the Public Staff recommends that it adjust the fair value, as detailed below. Witness Junis did not recommend that the Commission accept any of the appraisals, including the one from the Public Staff's valuation expert. Instead, the Public Staff prepared a proposed adjusted fair value that was not – and was not intended to be – an appraisal, as described below.

Witness Junis noted that in 2019, Draper Aden had recommended that the County transfer the System to the Town of Beaufort on terms that were very favorable to the Town, but that the Town was not interested in pursuing a merger at that time. Tr. vol. 3, 132.

Witness Junis criticized the DAA 2019 Report for using an estimated present book value of \$10,241,142 for the System's land, well houses, water treatment plant, and piping with no original cost, discount rate, or depreciation, despite the existence of County accounting records. *Id.* at 133. This estimated present book value of selected assets was

a large portion of the overall valuation Draper Aden placed on the System assets in 2019 of \$12,335,392. In Witness Junis' opinion, use of this undepreciated book value inappropriately influenced the bids in the subsequent County sale process. *Id.* at 191.

Witness Junis offered some critiques of the appraisals by Hartman Consultants and Gannett Fleming. He observed that both appraisals relied heavily on the Draper Aden report for the original cost new (OCN) and OCNLD values instead of County financial records. *Id.* at 145. He noted that Hartman Consultants' valuation did not consider the income approach, but rather focused on the market approach, which witness Junis described as highly selective and reliant on the top-half average of select water system sales with significant upward rounding. *Id.* He asserted that Gannett Fleming's methods included a theoretical accumulated depreciation (24% of OCN) that is significantly lower than the County's records (over 50%), thus inflating the OCN and OCNLD. *Id.* He added that the market approach used by Gannett Fleming relied on a comparable group of select investor-owned utilities that were not comparable to the System in size of customer base and revenues. For instance, the revenues, customer base, and population of the System is less than 2% of the smallest company included in the comparable group. *Id.*

Accordingly, Witness Junis does not believe that the average of the three appraisals is a reasonable fair value. Nor does he believe that a rate base value of \$9,675,000 (contract price plus then-estimated transaction costs and fees) is in the public interest. He testified that Carteret County's unaudited financial records, as of June 30, 2022, indicate total capital assets less depreciation in the amount of \$5,402,027. Tr. vol. 3,149. This figure includes contributions in aid of construction and cost-free capital. *Id.* at 150.

Public Staff witness Feasel calculated the weighted average rate base per customer for the last five water rate divisions as approved in Aqua and CWSNC's last rate cases as \$2,090. *Id.* at 152. Witness Junis testified that if the contract price plus reasonable transaction fees is utilized as rate base, then the per customer cost of the acquisition will be \$7,576, which he characterized as "extraordinarily high." *Id.* Witness Junis opined that, absent the application of the Fair Value Statute, this result would violate the Commission's general policy of the inclusion of acquisition adjustments in rate base. *Id.* at 152-56.

Although the Public Staff's primary position is that the Commission should simply deny the Application, if it does not do so, witness Junis recommends that the Commission exercise its authority under N.C.G.S. § 62-133.1A(e) to adjust the fair value to a reasonable amount consistent with the public interest. Witness Junis arrived at his recommended adjusted fair value as follows:

1. Based on an average of the rate base per customer for the five water rate divisions as approved in Aqua and CWSNC's last rate cases (\$2,090), the rate base for the Carteret County Water System would be \$2,668,930; and
2. Based on the June 30, 2022 unaudited financial records for Carteret County showing total capital assets less depreciation of \$5,402,027

reduced by contributed capital from grants and developer contributions, the original cost less depreciation and amortization equals \$2,332,055.

Tr. vol 3, 157-59.

Witness Junis weighted the second method twice that of the first, because the figures were drawn from the System's actual costs, and thus recommends that the Commission adjust the fair value to \$2,444,347. Tr. vol. 4, 11. When asked whether this method was justified in light of the statutory language stating that the source of funds for the assets being acquired is not relevant to the evaluation of fair value, witness Junis stated that his method was indifferent to the source of the funds, whether they were grants or developer contributions, but rather the ratemaking consideration of those funds. *Id.* at 12. Stated differently, he does not view the statutory prohibition on considering the source of funds in arriving at fair value through the appraisal process to be a limitation on the Commission's discretion in adjusting fair value under N.C.G.S. § 62-133.1A(b)(1)(e). Tr. vol. 4, 13.

In his rebuttal testimony, Company witness Denton asserted that the competitive bid process is the best evidence of fair market value because it results in the actual price agreed upon by a willing buyer and a willing seller. *Id.* at 141. He further noted that the Public Staff's position was at odds with its own appraisal expert. *Id.* He contended that the Commission's discretion to adjust the fair value pursuant to N.C.G.S. § 62-133.1A(b)(1)(e) is "bounded" by the statutory definition of fair value as the average of the three appraisals. Tr. vol. 4, 143. He argued that the Public Staff's methodology for arriving at an adjusted fair value is misguided because it relies on traditional ratemaking principles to which the Fair Value Statute is intended to be an alternative. *Id.*

Testifying on cross-examination, witness Denton explained that CWSNC initially bid \$4.9 million for the System expecting that it would be outbid by Aqua. Tr. vol. 2, 59-60. He acknowledged that CWSNC was aware of the initial valuation by Draper Aden at the time it was bidding on the System. *Id.* at 60.

On cross-examination, witness Denton acknowledged that other than the depreciation of the System until it is brought into rates, granting the Application would mean that over time, customers would be paying the acquisition price through rates. Tr. vol. 4, 150.

Public Interest

CWSNC witness Denton testified that absent the ability to establish a realistic value for government-owned water systems, there was an obstacle to purchases of such systems by regulated utilities. Tr. vol. 2, 24. He asserted that if limited to recognition of the original cost basis for ratemaking purposes, CWSNC could not justify as reasonable a purchase price that would reflect a fair, reasonable, or realistic value for the asset. *Id.*

Witness Denton testified that the System's customers will benefit from CWSNC's operational service expertise. *Id.* at 27. He noted that CWSNC already has a qualified work force in the Carteret County area. *Id.* at 28. Further, the Company has agreed to

keep rates at existing levels for System customers for four years. *Id.* at 75. That means that for a customer with monthly use of 4,000 gallons, the monthly rate for 2023 – 2026 (subject to Commission approval) would be \$70.55. Application Ex. 3. In 2027, CWSNC estimates that the average bill will be \$98.24. *Id.* In response to questions from the Commission, witness Denton explained that the rate in the fifth year after the transfer is calculated on the assumption that the System would become part of the Company's uniform rate division and that the Company's then-pending application for a multiyear rate plan would be granted. Tr. vol. 2, 125, 127.

With respect to benefits to CWSNC's other customers, witness Denton pointed to the economies of scale gained by spreading fixed costs over a larger customer base, as well as the benefits of being part of a larger system, such as smoother rate adjustments and access to capital. *Id.* at 28-29. On cross-examination, witness Denton acknowledged that CWSNC did not quantify the economies of scale that it expects to realize with the transaction. *Id.* at 66-67. Responding to a question from the Commission, witness Denton agreed with the principle that there could be a fair value so high that the economies of scale from the acquisition would not provide a benefit to CWSNC's existing customers but stated that he does not know what that threshold would be. *Id.* at 100. He testified that CWSNC would like to make additional acquisitions utilizing N.C.G.S. § 62-133.1A but reiterated that the Company has not performed calculations as to the point at which the increase in rate base would exceed the benefits to existing customers. Tr. vol. 2, 103.

Witness Denton testified that the business strategy of CWSNC is expansion, which has included serving as an emergency operator for distressed systems. *Id.* at 93. In response to questions from the Commission, witness Denton testified that the Company sees the potential for growth in the System, in light of the fact that there are a number of potential customers who could tap into the System, but who currently have their own wells. *Id.* at 117. He noted that CWSNC tests its water for PFOS contamination, which could be an inducement for customers to switch from private wells to receiving water from the System. *Id.* When asked if the Company agreed with the growth assumptions of NewGen of 1.13% annually, witness Denton testified that he does not have sufficient information to challenge that number, but his "gut instinct" is that it is a little low. *Id.* at 119. Likewise, he does not have the information about how many of the parcels of land that could interconnect to the System are developed. *Id.* at 119-20.

CWSNC believes that it can operate the System at a lower cost than the County can. *Id.* at 79.

On cross-examination, witness Denton acknowledged that there were features of the System that would increase operation costs, such as dead-end lines rather than loop flows, which increase the costs of taking samples to check for contaminants, and a neighborhood with relatively few customers located twenty miles from the remainder of the System. *Id.* at 45-59.

Witness Denton acknowledged that Carteret County's cost of debt is substantially lower than CWSNC's. *Id.* at 64, 69-70, Public Staff Denton Cross-Examination Ex. 3.

During the expert witness hearing, the Commission requested that CWSNC provide an analysis of CWSNC's projected rates in the year 2027 with the same assumption that the System would be included in the Uniform Water Rate Division, but projecting the rates necessary for CWSNC to recover the revenue requirement for the System beginning with CWSNC's presently approved rates (established in Docket No. W-354, Sub 384) rather than the rates CWSNC is seeking in its pending Application for General Rate Increase and Approval of Multi-Year Rate Plan, Docket No. W-354, Sub 400. On November 21, 2022, CWSNC filed its Late-Filed Exhibit No. 1 in response to the Commission's request. Late-Filed Exhibit No. 1 shows that, starting with CWSNC's present rates and projecting only the rate increase necessary to recover the annual revenue requirement in 2027 for the System, the average water bill for a customer in the Uniform Water Rate Division using 4,000 gallons per month is projected to increase from its present amount of \$71.37 to \$72.61 in the year 2027, a 1.74% increase.

On further questioning from the Commission, witness Denton stated that CWSNC would not include the System in its rate base until its next rate case, in approximately four years, and that in the meantime the value of the asset would be depreciated at approximately 2% per year, such that the remaining rate base at that time would be \$8.7 million. *Tr. vol. 2, 110-12.* He stated that the shareholders would absorb the loss and that the Company does not plan to seek any type of special deferral accounting treatment. *Id.* at 112.

County witness Foxworth testified that local elected officials know better than anyone else what serves the public interest in their community. *Tr. vol. 4, 81.* He noted that the System customers represent a very small percentage of the County's total population of seventy thousand, as well as comprising less than one-half of the parcels in the Water District. *Id.* At the time the County was making the decision to sell the System to CWSNC, witness Foxworth had not been aware that the Commission could order system-specific rates. *Id.* at 114.

From both an operational standpoint and a financial standpoint, the Public Staff does not find that the transaction serves the public interest. Public Staff witness Junis testified that DEQ – Public Water Supply Section records indicate that the System has had no violations or enforcement actions over the last six years. *Tr. vol. 3, 138.* To his knowledge, the County provides safe, reliable, and compliant service to customers of the System. *Id.* As noted above, Witness Junis personally conducted a visual inspection of the System's operational assets and found them to be in good condition. *Id.* at 135-36.

Turning to the System's financial outlook under County ownership, witness Junis testified that before transfers from other funds, the County has operated the water fund at a loss annually from 2003 through 2021; however, in fiscal year 2022 after rates were increased, the water fund had a profit of \$39,605. *Id.* at 139. After transfers from other funds and capital contributions from developers, witness Junis stated that the audited profit total over the life of the System from 2003-2022 is \$3,535,341, and the ending equity through 2022 is \$5,805,173. *Id.* Witness Junis stated that while operating losses were concerning, the County has increased rates to cover expenses and intends to accumulate a reserve in the future. *Id.* He added that the County has effectively sought and been

awarded “cost free” capital grants and below market interest rate loans to fund significant capital needs. *Id.* He noted that because the System is owned by a local government unit and has been designated as distressed by the State Water Infrastructure Authority (SWIA),³ it has access to public grant funds that are not available to investor-owned utilities. *Id.* at 141-42. Witness Junis opined that the County management is capable and has shown the ability to improve the financial outlook of the water fund. *Id.* at 139. Further, he testified that the County had sufficient access to capital, as shown by its ability to significantly expand the System in the 2000s. *Id.* at 140.

Witness Junis also testified as to the rate impacts of granting the Application. Initially, as noted above, CWSNC proposes to transfer the System’s customers at the existing rates charged by the County, which is \$70.55 for a customer using 4,000 gallons per month. Tr. vol. 3, 146-47, Application Ex. 3. In the fifth year following the transaction, CWSNC proposes to include the System customers in its uniform water rates, which it estimated at the time of the Application would result in an increase of 28.19% for the average customer, and which it told the Public Staff in response to data requests it had revised upward to a 31.92% increase. Tr. vol. 3, 147-48.

Using the calculations of rate base per customer from previous Aqua and CWSNC rate cases prepared by Public Staff witness Feasel, witness Junis stated that the weighted average rate base per customer of the five water rate divisions in Aqua and CWSNC’s last rate cases is \$2,090, and the rate base per customer approved for the CWSNC Uniform Water rate division is \$2,337. *Id.* at 152. Witness Junis testified that the acquisition cost would be \$7,576 per customer which is extraordinarily high and would negatively impact both System customers and CWSNC’s existing Uniform Water customers if rate base for the System were established as requested in the Application. *Id.*

Witness Junis compared the sale of the System to a loan that will need to be repaid by ratepayers, either by System customers alone if the Commission ultimately orders system-specific rates or by all Company ratepayers. *Id.* at 150-51. He stated that the revenue requirement to be recovered in rates would function as payment by ratepayers of the purchase price including the cost of capital. *Id.* Referencing an Aqua bill summary of the then-pending legislation, witness Junis contended that the intent of the Fair Value Statute is to facilitate the sale of troubled systems. Tr. vol. 3, 143-44.\

Utilizing the contract price of \$9.5 million, plus estimated closing costs of \$175,000, as rate base and applying per customer expenses allowed in the Company’s most recently completed rate case, Docket No. W-354, Sub 384, witnesses Junis and Feasel conclude that if the Commission ordered system specific rates for the System, the average customer bill would be \$113.71. Tr. vol. 3, 147-48. Using the same assumptions as to the rate base

³ Witness Junis explained that the designation of “distressed” is not the same as the term “troubled,” used by the Commission. SWIA’s distressed designation is based on metrics such as population, debt service coverage ratio, monthly water bill, revenue deficits, depreciation, and operating margin, and witness Junis asserts that small rural systems with low rates and insufficient revenues generally score highly in SWIA’s assessment for categorization as distressed. Tr. vol. 3, 142-43.

for the System, witnesses Junis and Feasel estimate that if the System were put into uniform rates, the rate impact for the average residential customer would be a 4.5% increase in the customer's bill, from \$71.37 per month to \$74.59 per month. *Id.* at 148-49. On cross-examination, witness Junis clarified that those calculations assumed that the System assets came into rate base at \$9,675,000 without accumulated depreciation. *Id.* at 173. Witness Junis testified that application of the Fair Value Statute, without adjustment of the fair value, would increase CWSNC's rate base by over 14%, while only adding 4.4% more customers to share costs. *Id.* at 157. Responding to a question from the Commission, witness Junis testified that rates of a little over \$70 per month for an average customer would constitute sustainable rates for the System. Tr. vol. 3, 10.

Witness Junis challenged the public interest benefits asserted by the Company. With respect to providing customers of the System with access to capital, Witness Junis noted that there were no capital investment needs for the System projected over the next five years. Tr. vol. 3, 129, 132, 137. He further stated that the Company had not quantified either the cost impact of the purchase price if established as rate base or the cost savings to be passed on to customers. *Id.*

Witness Junis stressed that the water and sewer industry is already facing immense upward rate pressure from increased expenses and needed infrastructure improvements and replacements. Tr. vol. 3, 156. He stated that providing incentives for acquisitions at a significant cost premium that lack material benefits does not serve the public interest. *Id.*

Witness Junis concluded that because of the rate impact of the proposed acquisition, the fact that the System is not troubled, and his belief that CWSNC has failed to show that material benefits will be provided to the acquiring customers without harm to existing customers, the fair value indicated by the statute is not reasonable and the public interest is not served. *Id.* at 125. Accordingly, he recommends that the Commission deny the Application. *Id.*

On cross-examination from the County, witness Junis stated that his testimony on the public interest was focused on the existing CWSNC ratepayers as well as the 1,250 System customers, not the interest of the County or its residents. Tr. vol. 3, 194. Responding to a question from the Commission, he testified that even if the Commission imposed system-specific rates, he would recommend denial of the Application, because he does not believe the projected system-specific rates would be reasonable or affordable. Tr. vol. 4, 50.

Responding to further questions from the Commission, witness Junis clarified that it is not his position that the Fair Value Statute can only be applied to acquisition of troubled systems; rather, for systems that are not troubled, the fair value should be closer to book value to be in the public interest. See, e.g., Tr. vol. 4, 28. Witness Junis is concerned about affordability if a pattern is set in which public utilities pay five times the book value for water and wastewater systems. *Id.* at 26.

Granting or Denying the Petition

The Fair Value Statute requires that the Commission enter an order within six months of a public utility filing a complete application, either approving or denying the application. The statute offers no limiting principle on the Commission's discretion to deny the application. In its proposed order, the Company takes the position that if the decision to approve or deny the application were purely discretionary, it would render meaningless the statutory language that a public utility may elect fair value rate base treatment and would undermine the statutory purpose of facilitating sales of government-owned water and wastewater systems. CWSNC Proposed Order at 15 (citing N.C.G.S. § 62-133.1A(a)). Therefore, the Company reasons, denial of an application is warranted only when the public utility fails to meet its burden of proof to provide sufficient evidence from which a reasonable fair value can be determined.

The Public Staff contends in its proposed order that the Commission should consider the public interest in considering whether to deny the Application. The Public Staff is not persuaded by the quality and quantum of evidence presented by CWSNC on the issue of whether the proposed transaction benefits existing customers. With respect to the interest of the System customers, the Public Staff contends that the County has the ability to provide adequate and compliant service and to fund any necessary operational and capital needs of the System. The Public Staff argues that the costs of the transaction will burden customers without corresponding benefits. Accordingly, the Public Staff believes that CWSNC's purchase of the System is not the type of transaction the General Assembly intended to promote by enacting the Fair Value Statute.

The Public Staff asks the Commission to infer a narrow statutory purpose of the Fair Value Statute that is not present in the statutory language. The Commission declines to do so. There is nothing in the statute suggesting that the General Assembly intended to limit application of the statute to situations where the local government unit is less capable of operating the water or wastewater system than the public utility.

In this proceeding, it is not necessary for the Commission to determine the exact contours of its discretion to deny an application under the Fair Value Statute. Given that the statute allows the Commission to deny an application even when it includes all of the information required by the statute, the Commission is inclined to find the Company's interpretation of the Commission's discretion excessively narrow. The Commission is called upon to exercise and exercises its authority under the Fair Value Statute in a manner that is consistent with all provisions of Chapter 62, to achieve the fair regulation of public utilities in the interest of the public. N.C.G.S. §§ 62-3, 62-30.

To assess whether granting or denying an application is in the public interest, the Commission considers both the costs and the benefits to customers of the acquiring utility as well as the system to be acquired. While rate impacts to customers are included in that consideration, as supported by N.C.G.S. § 62-131.1A(c)(3), rate impacts are not the sole factor to be considered. The Company, in the present case, offered generalized opinions regarding the benefits of consolidation and growth. However, the Company did not

quantify the benefits to customers of spreading costs over a larger customer base or demonstrate that the value of those benefits would exceed the costs to customers. The Company failed to adequately respond to the Public Staff's questions about whether the operating costs of the System will be higher than necessary because of inefficient design of the System. The Company did not articulate any business plan for growth of the System or integration of the System into the Company's other systems that would suggest that acquisition of the System was part of a considered strategy for organic growth or improved operational efficiencies. This type of evidence would have aided the Commission in its decision-making. It does, however, appear that the System assets will not require capital improvements in the next five years, and as such that the System would join the CWSNC system on a better footing than many past acquisitions.

On the other hand, the Commission notes that the System has not been financially self-sufficient and has been subsidized for years. Additionally, the County has been searching unsuccessfully for an exit from providing water services to the System's customers, and the Fair Value Statute provides a means for the System's customers to receive appropriate service from a public utility. Although the record reflects that there are many System customers who would like to continue to be served by the County and that there was a robust public process with ample opportunity for input from affected County citizens, the County still voted to accept CWS's bid. While it may be the case that rates will rise in the future for the customers of the System once sold, the agreement of CWSNC to freeze rates for System customers for four years provides those customers with a meaningful benefit. Further, as described below, the Commission is exercising its discretion to reduce the fair value of the System in the public interest, which will moderate potential rate impacts of the transaction.

The Commission observes that the evidence of a benefit to System customers is decidedly mixed. The County Commission has no present plans to use any of the sales proceeds to directly benefit System customers specifically, for instance by creating a hardship fund for System customers who have difficulty affording the rates under private ownership.

Even with the deficiencies in the evidence noted above by the Commission, the Commission determines that under the totality of the facts, denial of the Application is not warranted.

Establishing an Appropriate Fair Value in the Public Interest

The Average of the Three Appraisals Does Not Result in a Reasonable Fair Value

As previously noted, the Fair Value Statute provides the Commission with the authority to adjust the fair value if finds that the average of the appraisals will not result in a reasonable fair value. On the evidentiary record in this proceeding, the Commission finds that the average of the appraisals will not result in a reasonable fair value.

Determining the fair value of the System is the central factual question to be determined in this proceeding. The three appraisals varied greatly. The difference between the highest appraised value, \$14,575,000 by the County's chosen appraiser, and the lowest, \$7,332,000 by the Public Staff's chosen appraiser, is nearly 100% and yet the parties did not engage in significant cross-examination of the expert witnesses, nor did they put on testimony by their own experts challenging the approaches or assumptions of the others.

For example, the Public Staff engaged in cross-examination of CWSNC witness Denton that suggested that the System had excess capacity and was poorly designed in a way that may increase operating costs. The Commission notes that the valuation experts looked at functional and economic obsolescence to some extent. However, there is insufficient evidence in the record for the Commission to adjust the fair value on that basis.⁴ Similarly, the Company cross-examined Public Staff witness Lane on the accuracy of some of the in-service dates he used in arriving at his determination of the original cost less depreciation of the system assets, tr. vol. 3, 108, but did not introduce contrary evidence, for instance by asking the County witnesses. The Commission finds it particularly perplexing that the three experts produced three very different values for original cost new less depreciation, a figure that should have been a relatively objective and straightforward one to develop from the available records of the System.

Nevertheless, as the North Carolina appellate courts have recognized, the members of this Commission have "expertise in ratemaking that makes them uniquely qualified to decide the issues that are presented for their consideration," including the weight and credibility of any expert opinion testimony. *State ex rel. Utils. Comm'n v. Stein*, 375 N.C. 870, 900, 851 S.E.2d 237, 256 (2020) (citing *State ex rel. Utils Comm'n v. Edmisten*, 291 N.C. 575, 584, 232 S.E.2d 177, 182 (1977) and *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 48, 103 S. Ct. 2856, 2869, 77 L. Ed. 2d 443, 461 (1983)). The Commission has carefully reviewed the three appraisal reports and questioned the valuation experts on their opinions during the expert witness hearing.

The Commission finds that each of the three appraisers who testified in this matter is qualified as a Utility Valuation Expert. Each has previously been included on the list of Utility Valuation Experts maintained pursuant to N.C.G.S. § 62-133.1A(b)(1), of which the Commission takes judicial notice in this proceeding. The Commission recognizes that appraising a public water system requires quite a bit of professional judgment and that reasonable experts can and do disagree on those matters.

⁴ The parties have not sought any deduction in the fair value of the System for property that is not used and useful. The Fair Value Statute allows a utility to establish rate base using fair value instead of original cost, N.C.G.S. § 62-133.1A(a), and it does not alter the Commission's authority to set rates under Chapter 62. N.C.G.S. § 62-133.1A(e). The determination about whether utility property is used and useful is made at the time of a rate case, in relation to the applicable test period. N.C.G.S. § 62-133(b)(1). Therefore, the Commission can exclude property for which a fair value was determined in accordance with the Fair Value Statute but at the time of the rate case is found not to be used and useful.

The record demonstrates that there were several factors that caused the average of the three appraisals to be unreasonably upwardly biased.

First, each appraiser was required to employ the cost, market, and income approaches to valuation. N.C.G.S. § 62-133.1A(b)(1)(b). However, Witness Hartman did not utilize the income method at all, because he found the System to be operating at a loss. During the hearing, he elaborated further and testified that he did not know what growth rate to apply to the System, given that it had only had a net growth of 25 customers in two and a half years. The Commission concludes this opinion is at odds with witness Hartman's conclusions about growth opportunities when he employed the market approach.

Second, in witness Hartman's market approach, he initially found a sales price per connection of \$6,598, but rounded this number up to \$7,000 per connection, due to his opinion that the County's growth opportunities are equal or superior to the other water systems he considered. The Commission is unable to resolve this position with witness Hartman's position that he found the System's potential for growth to be speculative.

Third, in employing the income method of valuation, two of the appraisers utilized the DAA 2021 Report valuation. The Commission finds this to be inappropriate.

CWSNC witness Hartman placed heavy reliance on the DAA 2021 Report for his conclusion that the OCNLD of the System is \$12.3 million. On the face of the DAA 2021 Report it appears that the bulk of the assets listed – \$10,719,713 of total assets valued \$12.7 million – are shown at book value in 2019 with a 5% inflation escalation but with no depreciation. Witness Hartman did not adequately explain how the DAA 2021 Report constituted an OCNLD assessment. Witness Hartman testified that he felt he was obligated by the Fair Value Statute to utilize the DAA 2021 Report. Similarly, County witness Walker relied heavily on the DAA 2021 Report and developed a much lower theoretical accumulated depreciation than the County's records show.

The Commission finds that the DAA 2021 Report is not part of the statutorily required "assessment of the tangible assets of the system to be acquired" that the County and CWSNC were required to jointly obtain from a licensed engineer. N.C.G.S. § 62-133.1A(b)(2). It is not an assessment of the tangible assets, but of their value. The Draper Aden 2019 Report, from which the 2021 report was updated, was created in order to promote to the Town of Beaufort the benefits of acquiring the system. From CWSNC witness Denton's testimony, the Commission finds that the DAA 2021 Report was not part of the joint retention of the Draper Aden firm. Further, given that the DAA 2021 Report is not referenced in the Form FV1(a) prepared by Dr. Gandy, the Commission is unclear what relevance, if any, Dr. Gandy placed on the report. As noted, Draper Aden is not on the Commission's list of approved Utility Valuation Experts.

The Commission finds the reliance of witnesses Hartman and Walker on the DAA 2021 Report to be inappropriate and contrary to the spirit of the Fair Value Statute, which contemplates that each appraiser will independently evaluate and assess the available information and not rely on a separate valuation made by a third party, especially a third

party not approved by the Commission. There is not sufficient evidence in the record to determine who prepared the DAA 2021 Report, the qualification of the person or persons preparing the report, or the process by which the report was prepared.

Fourth, the market multiples approach County witness Walker utilized in applying the market approach to valuation relied on a group of companies that are by no means comparable to the System.

Fifth, in employing the income method of valuation, County witness Walker used a municipal bond rate as the discount rate for some of his calculations, which leads to a higher valuation than a corporate earnings rate would and is simply not applicable for the valuation of a system to be owned by an investor-owned utility and included in the rate base of that regulated utility. The Commission finds that under these circumstances a government entity is not likely to engage in a market-based transaction to purchase a water or wastewater system from another unit of government. The Commission takes note of the fact that the Pennsylvania Public Utility Commission Additional Guidelines for Utility Valuation Experts⁵ consider the acquiring company's cost of equity and cost of debt to be the default inputs for determining a discount factor under the income approach. Witness Walker's income approach also utilized the group of companies that the Commission finds to be inappropriate as comparables, given that they are several orders of magnitude larger than the System in revenues, customers, and population served.

The Commission further finds that facts external to the appraisals themselves suggest that the valuations of Hartman Consultants and Gannett Fleming are excessive.

First, the County was unable to entice the Town of Beaufort to take ownership of the System, even after agreeing to retire its debts and assume future capital improvement costs for eleven years. The County acknowledges that a shortcoming of the System is that it has approximately 1,250 customers along 54 miles of water line. Given that hundreds of customers could connect to the System at a minimal cost, but have not elected to do so heretofore, the Commission is not sanguine as to its growth prospects if rates rise in four years, as both CWSNC and the Public Staff expect.

Second, even under the "race to the top" bidding war between Aqua and CWSNC, caused by the County's use of the upset bid process, the contract price of \$9.5 million is less than the average of the three appraisals, as well as being lower than both the Hartman Consultants and the Gannett Fleming appraisals.

Accordingly, the Commission gives less weight to the Gannett Fleming and Hartman Consultant opinions of value. The Commission gives greater weight to the opinion of NewGen, which does not suffer from the concerning approaches discussed above.

⁵ The guidelines are available at www.puc.pa.gov/filing-resources/issues-laws-regulations/section-1329-applications/

To guard against these issues with the appraisals recurring in future proceedings, the Commission intends to, by subsequent order, propose revisions to Commission Rules R7-41 and R10-28 to provide additional guidance on the contents and development of the appraisals and will invite comments.

Adjusting Fair Value in the Public Interest

Having found that the average of the three appraisals is not a reasonable fair value, it is the task of this Commission to adjust the fair value as it deems appropriate and in the public interest. N.C.G.S. § 62-133.1A. The Commission first addresses contentions and arguments of the parties.

The Contract Price Is Not a Fair Value

Company witness Denton asserted that the contract price of \$9.5 million represents fair market value – and therefore presumably also a fair value – because it is a price agreed to by a willing buyer and a willing seller in a transparent public bidding process.⁶ The Commission disagrees. If a local government entity's use of lawful procedures for the disposition of public property pursuant to Article 12 of Chapter 160A of the North Carolina General Statutes were expected to result in a fair value of a water or wastewater system, there would be no reason for the detailed valuation procedures in N.C.G.S. § 62-133.1A.

The undisputed evidence in the record establishes that the County would have accepted a lower price for the System. In fact, the County initiated negotiations with the Town of Beaufort in which it offered to pay the System's debt and fund its future capital needs for eleven years in order to extricate itself from the responsibility of operating the System. On the other side of the transaction, as a regulated public utility, CWSNC is largely (although not entirely) funding the transaction through its regulated rates collected from its captive customers, as Company witness Denton acknowledged.

In addition, the Commission is troubled by the potential impact of the DAA 2019 Report on the upset bid process. To be clear, there is nothing in the record that suggests any improper conduct by the County, Draper Aden, Aqua, or CWSNC. Nevertheless, it does seem likely that the valuation Draper Aden placed on the System created an atmosphere in which Aqua and CWSNC felt comfortable driving the bidding to nearly twice the depreciated book value of the System assets. As discussed elsewhere in this Order, there is nothing in the record to suggest that the System presents unusual growth opportunities or is an intrinsically attractive acquisition target.

For these reasons, the Commission does not find the contract price of \$9.5 million to constitute a reasonable fair value for the System as suggested by Company witness

⁶ The Commission notes that the task of N.C.G.S. § 62-133.1A is to establish the *fair value* of the system being acquired, not the *fair market value*, which is a different concept.

Denton. However, for the reasons Company witness Denton gave, the Commission finds it to be a relevant data point for what an investor-owned utility would pay for the System.

Public Staff Proposal for Adjusting Fair Value

The Commission concludes that the Public Staff's proposal for the Commission to adjust the fair value to \$2,444,347 is not permitted under the Fair Value Statute. Witness Junis does not represent that its position of the fair value of the System is an appraisal. Rather, witness Junis arrived at this figure by blending an average rate base per customer based on recent Aqua and CWSNC rate cases and the System's book value of capital assets, less depreciation, amortization, and contributed capital. The Public Staff objects to setting the fair value of the System at the contract price or any of the appraised values on the grounds that ratepayers will be paying more than under the cost-based rate base but will not actually receive better service.

While the Fair Value Statute grants broad discretion to the Commission, that discretion is not unlimited. The statute allows the Commission to *adjust* the fair value; but the Public Staff advocates for the Commission remaking it entirely. In addition, the Fair Value Statute plainly states that "[t]he original source of funding for . . . the water or sewer assets being acquired is not relevant to an evaluation of fair value." N.C.G.S. § 62-133.1A. The Public Staff contends that this restriction applies only to the utility valuation experts' appraisals, and not to the Commission's discretion to adjust fair value. The Commission does not agree. Again, the Commission's discretion lies in adjusting the fair value as initially determined by an average of the three appraisals. The Commission concludes it would exceed its authority to adjust the fair value if it considered facts that the Fair Value Statute states are not relevant to fair value.

Appropriate Fair Value in the Public Interest

In determining a fair value that is appropriate and in the public interest, the Commission has considered the foregoing evidence and conclusions relating to the upward bias of the Hartman Consultants and Gannett Fleming appraisals. The upper end of the range of the appraisals exceeds any reasonable potential value to customers or the purchaser, and far exceeds the price at which the record reflects the County would have been willing to sell the System.

The Commission has also considered the evidence and conclusions set out above regarding the fact that the upset bid process is designed to extract the highest possible price, which is problematic when the bidders are largely funding the purchase, along with a future rate of return on capital, with ratepayer funds and was particularly troubling in this situation given the likelihood that the DAA 2019 Report set a benchmark for the value of the System.

In addition, the public interest requires the Commission to take into account the legitimate interests of the System customers in fair rates. Setting the fair value of the System under the Fair Value Statute is an element of ratemaking under N.C.G.S. § 62-133, which requires the Commission to fix rates that are fair both to the public utilities and

to the consumer. N.C.G.S. § 62-133(a). The public policy of this State is to promote “adequate, reliable and economical utility service.” N.C.G.S. § 62-2(a)(3). The evidence in this proceeding shows that in selling the System, the County was primarily acting in the interest of the County residents as a whole, not necessarily the System customers who are only a very small subset of the County’s population. The County witnesses were unaware until the expert witness hearing that the Commission had the discretion to set System-specific rates.

The Commission notes that CWSNC and the Public Staff have very different calculations of what uniform and system-specific rates would be in 2027, when CWSNC expects to file a rate case and seek to bring the System into its uniform rates. In part, this is because both calculations rely on various assumptions about future events. The Commission notes that the Public Staff’s calculations do not account for the fact that the System assets must be depreciated from the date of the transaction. However, with that caveat, the Commission agrees with the Public Staff’s conclusion that if the fair value of the System is not reduced, CWSNC’s customers face an unacceptable probability of increased rates without commensurate benefits. By setting the fair value at an appropriate level, it will avoid rate shock to System customers, in the event the Commission ultimately sets system-specific rates. If CWSNC is able to establish that it is appropriate to bring the System into uniform rates, then an appropriate fair value would not produce unfair rates to CWSNC customers.

By requiring an average of three appraisals from the three parties primarily interested in the transaction – the buyer, the seller, and the statutory consumer advocate – the General Assembly established a procedure that was designed to balance the tendency of the seller’s appraiser to utilize methods and assumptions that would be likely to yield a higher value and the tendency of the consumer advocate’s appraiser to lean towards methods and assumptions rendering a lower assessment of value. Given the flaws that affected both the Hartman Consultants and Gannet Fleming appraisals, biasing them upward, the Commission does not have confidence either in the range of the three appraised values or in their average to set an appropriate fair value.

However, if the Commission were to rely only on NewGen’s opinion of fair value, the balance afforded by averaging the three opinions of value would be lost. While the Commission finds that the NewGen opinion is entitled to more weight, the Commission does not find it to be appropriate on this record to allow any single opinion to set the fair value. The Commission finds that under the particular circumstances in which the contract price was determined, the contract price of \$9.5 million establishes an upper limit of what a purchaser would pay for the System. At the lower end of the range is the NewGen appraisal of \$7,332,000.

Based on all the foregoing and the evidentiary record as a whole, the Commission finds and concludes that an appropriate fair value in the public interest that balances the interests of customers and of CWSNC is the average of the contract price and the NewGen appraisal, \$8,416,000.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NO. 23

The evidence supporting these findings of fact is found in the CWSNC's Revised Form Application Exhibit 8, filed on August 11, 2022, as well as the Update to Revised Form Application Exhibit 8 filed on January 25, 2023.

In Revised Form Application Exhibit 8, CWSNC provided a list of the actual costs and fees incurred through August 9, 2022, and the estimated costs and fees through closing totaling \$174,439.74. The Update to Revised Form Application Exhibit 8 documents reasonable fees paid to the utility valuation experts in addition to reasonable transaction and estimated closing costs incurred by CWSNC in connection with the Application of \$312,039. The Commission finds that these figures do not include fees and costs relating to the CPCN Application.

The categories of fees and costs provided by CWSNC in the Revised Form Application Exhibit 8 and the Update to Revised Form Application Exhibit 8 are the types of fees and costs that are typically approved for inclusion in rate base in connection with the acquisition of utility property. The Public Staff has not contested the reasonableness of these fees and costs, and the Commission concludes that they are reasonable and appropriate for inclusion in the cost of the System and in rate base of the System pursuant to N.C.G.S. § 62-133.1A(b)(3) and (4).

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 24

The evidence supporting this finding of fact is found in the Application (including the revised exhibits), the testimony of Company witness Denton, and the testimony of County witness Foxworth.

The Fair Value Statute provides that "the selling utility's rates shall be the rates charged by the acquiring public utility until the acquiring public utility's next rate case, unless otherwise ordered by the Commission for good cause shown." N.C.G.S. § 62-133.1A(c)(8). CWSNC and the County have agreed that the County's current rates will remain applicable for the System. The Commission concludes this is appropriate and beneficial to the System customers and accepts Revised Form Application Exhibit 12 as the tariff to be filed, provided that the transaction closes and CWSNC is granted a certificate of public convenience and necessity to operate the System.

IT IS, THEREFORE, ORDERED as follows:

1. That the Application filed by CWSNC for determination of fair value of utility assets pursuant to N.C.G.S. § 62-133.1A and establishing rate base for acquisition of the Carteret County Water System is hereby approved as set out in the following paragraphs;
2. That the reasonable and appropriate fair value of the Carteret County Water System assets being acquired by CWSNC, as adjusted in the public interest, is \$8,416,000 as of the date of the acquisition;

3. That reasonable fees paid to the utility valuation experts, reasonable transaction and closing costs are \$312,039; and

4. That the rate base value of the Carteret County Water System assets being acquired by CWSNC is \$8,728,039 as of the date of the acquisition, and depreciation of shall begin to apply against the rate base value upon purchase of the system as required by N.C.G.S. § 62-133.1A(b)(5).

ISSUED BY ORDER OF THE COMMISSION.

This the 10th day of February, 2023.

NORTH CAROLINA UTILITIES COMMISSION

A handwritten signature in cursive script that reads "A. Shonta Dunston".

A. Shonta Dunston, Chief Clerk

Commissioner Floyd B. McKissick, Jr. dissents.

DOCKET NO. W-354, SUB 398

Commissioner Floyd B. McKissick, Jr., dissenting:

I have several serious concerns about the result the Commission reaches in this proceeding. I would deny the Application. Therefore, I dissent from the Commission's Order Establishing Rate Base of Water System Acquired from Carteret County.

First, I do not find that Carolina Water Service Inc. of North Carolina, (Carolina Water) has met its burden under Commission Rule R7-41(h) to demonstrate that the transaction is in the public interest, particularly with respect to the customers of the Carteret County Water System.

Carteret County has demonstrated the ability to operate the Carteret County Water System competently: the system has been well-maintained and has provided service in compliance with relevant environmental, health and safety laws and regulations. The record demonstrates that the County has the ability to make the system financially self-sufficient. Customers who testified at the public hearing stated that they wanted their water system to be operated by the County, and they understood that higher rates would be necessary. There are 533 additional households with water meters who are not currently receiving water service but who could be induced to become customers with appropriate incentives. This includes 237 households that have paid for the right to connect to the water system that have never done so. If these households became customers of the system it would likely result in lower long term rates for all of the system's customers particularly since surplus water capacity exists at this time.

Once the Carteret County System is purchased by Carolina Water, the customers of the system will still have to pay for the operation and maintenance of the system, but they will also have to pay Carolina Water's authorized rate of return. I found credible the Public Staff's evidence of a material rate impact on the order of a \$40.00 increase over current rates on an average customer's bill – from \$70.55 to \$114.86 – if the Commission orders system-specific rates. That is quite a bit higher than the County's estimate of self-sustaining rates, \$98.77. Moreover, the County has no present intent to use any of the proceeds of the sale to mitigate rate impacts on the Carteret County Water System customers. Although construction of the water system was funded in large part by public grants, loans, and general tax revenues, it was also funded in some measure through the rates customers paid. As Public Staff witness Charles Junis stated in his testimony, the sale is analogous to a loan in which the County obtains the loan proceeds. In this analogy, Carolina Water customers are the ones who will repay the "loan," with interest, through rates that will compensate Carolina Water for its depreciation expenses for the system, along with its cost of capital associated with the system's acquisition.

This proposed sale is very unpopular with the customers of the Carteret County Water System. They made their opposition known, through petitions, appearances at the meetings of the County Commission, and at this Commission's public hearing in Carteret

County. I listened carefully and attentively to their testimony. It appears that because they are a minority in the County – approximately 1,254 households in a County of roughly 70,000 residents – they did not have the political power to block the sale. Even so, the vote at the County Commission was divided, three to four. Under those circumstances, I think it is incumbent on the Commission to closely examine whether the Fair Value Statute serves the interests of the customers of the system being acquired. In the record before the Commission, I simply do not see evidence of clear benefits to the customers of the Carteret County Water System that are sufficient to justify application of N.C. Gen. Stat. § 62-131.1A, the Fair Value Statute.

Moreover, other than generic testimony stating that Carolina Water's customers will benefit from spreading costs over a larger number of customers, Carolina Water offered no evidence that this transaction with a requested rate base of \$9,812,039 will benefit its existing customers. The Public Staff demonstrated that granting Carolina Water's application and bringing the Carteret County Water System into Carolina Water's uniform rates would raise the average Carolina Water customer's monthly bill by around \$3.00. The reason for this increase is that the rate base per customer that Carolina Water is requesting for the Carteret County Water System is approximately \$7,576 per customer, compared to the average rate base per customer in Carolina Water's uniform rate division of \$2,337.

My second concern involves the public policy implications of this transaction with respect to public funding for water and wastewater systems. According to information Carteret County provided to the Public Staff, the Carteret County Water System received \$6,491,452 in federal and state grants to fund its infrastructure, along with \$4,435,608 in loans from federal and state agencies. At the time of the expert hearing, I asked a representative of the County who was testifying if the County would be repaying any of the grant funds they received for the purpose of constructing the water system they now sought to sell, and I was told that they would need to investigate whether any of the grants would need to be repaid from the sales proceeds. The County apparently had assumed they would receive all of the approximately \$8 million net proceeds of the sale. I do not believe that government agencies would have provided funding to construct a County water system if they had known the County would sell the system for a net projected windfall of approximately \$8 million in unrestricted funds. Unfortunately, the statute doesn't allow the Commission to consider the source of funding used to construct a water system.

Last, but not least, there was a lack of probative evidence on the central issue before the Commission, namely the fair value of the Carteret County Water System. Given the significant infirmities in the appraisals commissioned by Carolina Water and Carteret County, I would simply find that there was insufficient evidence for the Commission to determine the reasonable fair value for the Carteret County Water System in the public interest.

In particular, the impact of the two Draper Aden Associates (Draper Aden) valuation reports made it impossible, in my view, for the Commission to accurately assess

an appropriate rate base value of the Carteret County Water System. The County initially retained Draper Aden in 2019 in connection with a Merger/Regionalization Feasibility Grant that the County received from the North Carolina Department of Environmental Quality. As part of its report, entitled “Feasibility Study for Water System Merger” Draper Aden included a section entitled “Estimated Value of the County’s Water Systems” opining that the net worth of the water system assets was approximately \$12,335,392. In 2021, Carteret County and Carolina Water jointly retained Draper Aden to perform the assessment of the tangible assets to be acquired required by N.C.G.S. 62-133.1A(b)(2), and at that time Draper Aden updated its estimate of value to \$12,700,000.

Both of these Draper Aden valuations were superfluous to the tasks at hand. Public Staff witness Junis testified that a valuation was not required to receive the DEQ Merger/Reorganization Feasibility Grant. The valuation certainly was not required – nor desired – of the engineer assessing the water system’s physical assets. The required Engineer’s Assessment is for the purpose of determining the condition of the system from an engineering perspective not for the purpose of determining the system’s potential value. This is clear and unambiguous from reviewing the Engineer’s Assessment form. Reading the 2019 Draper Aden report, it appears that the value of the water system was dangled in front of the Town of Beaufort as an inducement for the Town to agree to the merger. In other words, the incentive was for the valuation to be as high as possible.

The Draper Aden valuations had a double impact in this proceeding because they affected both the contract price and the average of the three appraisals. The 2019 Draper Aden report valuing the system at \$12,335,392 was available to Carolina Water and Aqua North Carolina, Inc. before they began bidding. It is very likely that this high valuation, along with the upset bid process, drove the bid prices upward. The record is clear that Carteret County would have taken far less money for the water system. In 2019, it had offered the system to the Town of Beaufort, debt free and with an offer to pay for upgrades and expansions for eleven years.

Both the County’s appraisal expert and Carolina Water’s appraisal expert relied on the 2021 Draper Aden valuation of the system at \$12.7 million. Evidently, the two utility valuation experts thought it was acceptable or even required for them to consider the Draper Aden valuation simply because the same firm provided the required Engineer’s Assessment. However, their reliance on the Draper Aden valuation was inappropriate for many reasons. The person or persons who prepared that valuation did not testify before the Commission, and thus were not available to answer Commission questions about how the valuation was determined. That person or persons did not meet the other requirements imposed by the Fair Value Statute and this Commission’s implementing rules: to certify that they had a fiduciary duty to provide a thorough, objective, and fair valuation; to follow the uniform standards of professional appraisal practice; and to be approved to be on the Commission’s list of utility valuation experts. I expect the valuation experts in fair value proceedings to be exercising independent judgment and performing their own investigation of critical facts. In addition, there were not documents in the record to verify or substantiate that the value established was provided by a person or persons with appropriate professional credentials.

The Fair Value Statute provides for the rate base of a water system acquired from a local government entity to be the lesser of the contract price and the average of the three expert appraisals. Because the Draper Aden valuations improperly influenced both, I have no confidence that the statutory process as applied to the facts in this case could yield a reasonable value for the Carteret County Water System. The Commission's Order strives mightily to rescue the valuation process and arrive at a fair value. In my view, it is not our role to rescue such a deficient Application.

There were other serious issues with the appraisals. Carolina Water's appraiser, Gerald Hartman, simply did not utilize one of the three valuation methods required by the Fair Value Statute: "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." N.C.G.S. § 62-131.1A(b)(1)(b). Mr. Hartman stated that because the Carteret County Water System was losing money, the income approach to valuation would not produce creditable results. Accordingly, he performed no analysis of the value of the system under the income method of valuation. This violates the requirements of the Fair Value Statute. If one of the three chosen appraisers determines in his or her professional judgment that the facts and circumstances do not allow for all three methods of valuation to be employed, then the statutory requirements cannot be met. "Employ" is an active verb. To give the statute meaning, it must mean something more than including an explanation of why a particular method is not, in fact, being employed. This failure to comply with the clear requirements of the Fair Value Statute alone is a sufficient reason to deny the Application.

Carteret County's appraiser, Harold Walker, III, devised a group of so-called comparable publicly traded water and wastewater utilities. Mr. Walker used their financial metrics as benchmarks, making adjustments as he deemed appropriate, in all three of the valuation methods. Calling these large publicly traded companies "comparable" to the Carteret County Water System stretches the imagination. Their median revenues were \$536,270,000, compared to the Carteret County Water System's \$1.2 million. Their median number of customers served was 342,750, compared to the Carteret County Water System's 1,254. Neither of the other appraisers took this approach, and unsurprisingly Mr. Walker's appraisal opinion was the highest.

Large differences among the appraisal reports were not adequately explained in the record. For instance, for the cost approach to value, none of the appraisers took the same approach with respect to the cost of real property, leading to significant variations in that component of the cost approach. At the low end, the Public Staff's appraiser used the current assessed value of the land reported by the Carteret County property records, which was apparently \$98,126. The County's appraiser used the original cost of the land, \$369,722. At the high end, Carolina Water's appraiser commissioned an appraisal of the real estate as vacant land (with no deduction for demolition costs); that appraised value was \$425,000.

In short, I find Carolina Water's entire submission to be flawed, and accordingly, I would have denied the Application.