

PLACE: Dobbs Building, Raleigh, North Carolina
DATE: Friday, November 4, 2022
DOCKET NO.: W-354, Sub 398
TIME: 9:00 a.m. - 1:07 p.m.
BEFORE: Commissioner Jeffrey A. Hughes, Presiding
Chair Charlotte A. Mitchell
Commissioner ToNola D. Brown-Bland
Commissioner Daniel G. Clodfelter
Commissioner Kimberly W. Duffley
Commissioner Floyd B. McKissick, Jr.
Commissioner Karen M. Kemerait

IN THE MATTER OF:

Carolina Water Service, Inc. Of North Carolina,
5821 Fairview Road, Suite 401,
Charlotte, North Carolina 28209,
for Determination of Fair Value of Utility Assets
Pursuant to N.C. Gen. Stat. § 62-133.1A and
Establishing Rate Base for Acquisition of the
Carteret County Water System

Volume 3

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E X H I B I T S

IDENTIFIED/ADMITTED

PS Exhibit Attachment MGL-1 and MGL-2	74/119
Public Staff Lane Redirect Exhibit Number 1	116/-
Junis Exhibits 1 through 7	121/-
Public Staff Junis Redirect Exhibit Number 1	210/-
Public Staff Junis Redirect Exhibit Number 2	214/-

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P R O C E E D I N G S

COMMISSIONER HUGHES: Good morning, everybody, let's go back on the record. You will notice that we lost a few up here for Commissioners. Just to comment about that, we've had some things come up for Commissioners. One Commissioner is on the way and will be here momentarily, another Commissioner we hope to be here momentarily, has a little more complicated things that they're dealing with.

I did want to ask counsel now, just out of an abundance of caution, if one or both the Commissioners don't make it in a timely manner, do you have any objections to them reading into this case, given the circumstances?

MS. SANFORD: We have no objections.

MR. GRANTMYRE: The Public Staff has no objections.

MR. WHEATLY: The County has no objections.

COMMISSIONER HUGHES: Okay. All right. With that, Mr. Hartman, good to see you again.

THE WITNESS: Good to see you.

Whereupon,

1 GERALD C. HARTMAN,
2 having first previously been duly sworn, was examined
3 and testified as follows:

4 COMMISSIONER HUGHES: Okay. I think we
5 have a few more Commissioner questions that we'll
6 go through with you, and then see how it goes. So
7 I think Commissioner Clodfelter, I think.

8 THE WITNESS: If I may, I want to
9 correct one number. I said 263 customers, or
10 potential customers, that were paying the minimums
11 that would have waived impact fees relative. It is
12 237. I went back and checked and talked to the
13 County, and there -- some of them changed, so the
14 number changed. It's 237.

15 COMMISSIONER HUGHES: Okay. Thank you
16 for that clarification. It will reflect that in
17 the transcript.

18 THE WITNESS: Thank you.

19 COMMISSIONER HUGHES: All right.
20 Commissioner Clodfelter?

21 EXAMINATION BY COMMISSIONER CLODFELTER:

22 Q. Good morning, Mr. Hartman. I have just a
23 couple of fill-in-the-gaps questions. I'm not gonna
24 cover material that's already been covered in other

1 questions.

2 You have access to your appraisal, either
3 electronically or in hard copy?

4 A. Yes, sir.

5 Q. All right. I'm looking at the income
6 approach section, and I'm looking at page 4-5 -- as
7 you've numbered it, 4-5 -- and I'm understanding
8 reading what you're saying there, but you have that --
9 I'm sorry, I should have let you --

10 A. Go ahead, I'm fine.

11 Q. I should wait.

12 A. Go ahead.

13 Q. You reference the County's June 30, 2021,
14 financial statements, and then you say -- after
15 reviewing that, you say another County representation
16 reflected something.

17 What was the other County representation you
18 were referring to there? Because I couldn't connect it
19 to anything in the materials.

20 A. I believe that's the audit.

21 Q. The County -- the County's 2021 audit,
22 financial audit?

23 A. Yes.

24 Q. Is that included in your -- is any of the

1 supporting materials in your appraisal? If so, I
2 overlooked it.

3 A. No, it's not.

4 Q. Okay.

5 COMMISSIONER CLODFELTER: Ms. Sanford
6 and Mr. Drooz, that's referenced in several other
7 documents. Is that in the record anywhere, the
8 County's 20 -- I should say, Mr. Wheatly, you're
9 probably the more appropriate person. Do you know
10 if the County's 2021 audit is in the record
11 anywhere? If so, I've overlooked it.

12 MR. WHEATLY: I do not, sir, but if it's
13 not, we certainly can make arrangements and have it
14 sent to you.

15 COMMISSIONER CLODFELTER: If it's there,
16 at the appropriate time when the case is with you,
17 if you can just, at that point, just sort of direct
18 me where in the materials it already exists; and if
19 it's not, I'll ask you to file it as a late
20 exhibit, because it is referenced in several of the
21 appraisals.

22 MR. WHEATLY: We could do that, sir.

23 THE WITNESS: That's the -- those are
24 the two documents I was looking at. I should have

1 put note of that. I apologize.

2 Q. That's fine. We've cleared it up, and that's
3 all I want to do.

4 A. That's the document.

5 Q. As I say, I'm just filling in a couple of
6 gaps here.

7 Back on page 4-1, as I recall, your
8 appraisal, the effective date of your appraisal is
9 February 14, 2022?

10 A. That's correct.

11 Q. And on page 4-1, you're using data as of
12 June 30, 2021. You made a reference to this in your
13 answers to Commissioner McKissick's questions
14 yesterday, but I want to just clean it up and close it
15 up.

16 You didn't, at least on the written
17 materials, consider the revenue impact, or the
18 potential revenue impact, of the rate increase enacted
19 by the Board of County Commissioners in 2021.

20 A. Correct.

21 Q. And I -- we all know what the facts were, and
22 they were initially 95 percent rate increase and then
23 20 percent reduction and then the elimination of the
24 water --

1 A. You're correct.

2 Q. My question really is, why didn't you
3 consider that? Why didn't you consider that material?

4 A. I didn't consider it because I didn't have
5 the impact of it on the system. I didn't have any
6 actual data, historical data with that -- with that
7 change. There is something called price elasticity,
8 and sometimes people don't use as much water when the
9 rates go up so much and go down. And because of all
10 that, it was uncertain.

11 Q. At the point you did it, in February 2022,
12 you didn't have part-year data or any reliable data, as
13 far as you were concerned?

14 A. Not enough under my practice. My practice
15 looks back at least one year, plus we go back five
16 total to get the trend. And with such a massive --
17 with such a change, it would -- to understand the
18 impact was not within the practice I do.

19 Q. Okay. Thank you, sir. I think Commissioner
20 McKissick covered everything else I had, so that's all
21 I have. Thank you, sir.

22 A. Thank you.

23 COMMISSIONER HUGHES: Please,

24 Commissioner McKissick.

1 EXAMINATION BY COMMISSIONER MCKISSICK:

2 Q. Thank you, Mr. Hartman. Just one or two
3 questions for clarification purposes.

4 You indicated in the record this morning that
5 the number of households that had paid in, I guess,
6 impact fee was 237; is that correct?

7 A. They paid a minimum charge.

8 Q. Paid a minimum charge.

9 A. And therefore the impact fee was going to be
10 waived. It's like a sign-up-and-save program.

11 Q. Okay. And do you know how long that program
12 had been established?

13 A. The duration of it, I don't recall.

14 Q. You don't recall. All right. And in terms
15 of what they had paid, do you know what the totality is
16 that they paid in over whatever what period of time it
17 was?

18 A. I did not do that analysis.

19 Q. Okay. But these are people who have paid in
20 a certain sum, but they are not connected to the system
21 at this time?

22 A. That is correct.

23 Q. All right. Thank you, sir.

24 A. Thank you, sir.

1 COMMISSIONER HUGHES: Commissioner
2 Kemerait?

3 EXAMINATION BY COMMISSIONER KEMERAIT:

4 Q. Mr. Hartman, thank you for your testimony. I
5 just have one follow-up question from -- a question
6 from -- that you just heard. You talked about that you
7 didn't provide an analysis about the impact of the rate
8 increase on the system because you didn't have the data
9 that you needed.

10 And just for clarification, what data would
11 you have needed in order to have performed that
12 analysis?

13 A. For what I do for value, to have a credible
14 result, other than a projection, I look at historical
15 data for at least a year. At least a full year. And
16 then I like to go back five years also.

17 Q. Okay. Thank you very much.

18 COMMISSIONER HUGHES: Okay. Any further
19 questions?

20 (No response.)

21 COMMISSIONER HUGHES: Okay. I know you
22 did not have prefiled testimony. I believe your
23 appraisal is already in the record, but just
24 confirming that. Okay. Now we have questions on

1 Commissioner questions.

2 MR. CREECH: No questions for the Public
3 Staff. But we defer to the County first, yes. We
4 would like to have the ability to cross last, so
5 defer to the County first. Go ahead.

6 COMMISSIONER HUGHES: In general, our
7 order was going to be Public Staff, County, and the
8 Company, but --

9 MR. CREECH: And I just know --
10 Commissioner Hughes, again, William Creech with the
11 Public Staff. I think, traditionally, and that may
12 not always be the case, that the Public Staff has
13 had the ability to cross last. But that may not --

14 COMMISSIONER HUGHES: This isn't cross.
15 This is just -- clarification.

16 MR. CREECH: But no additional questions
17 on Commissioner questions.

18 COMMISSIONER HUGHES: And this is the
19 Company's witness, so, traditionally, the Company
20 would go last. And sorry about that.

21 County, any questions on -- this is a
22 question on Commissioner question period, anything
23 you want clarified.

24 EXAMINATION BY MR. WHEATLY:

1 Q. Yes, sir. Based on the Commissioners'
2 questions, this appraisal was done on Valentine's Day
3 of this year. And I'd like to ask Mr. Hartman if he
4 would bring in that appraisal up to date to today, with
5 the inflation that has been occurred and the increased
6 cost in piping, steel, and those sort of things affect
7 his appraisal, and if so, how much.

8 COMMISSIONER HUGHES: Generally, we want
9 to have just a question that's referred to
10 Commissioner question, and I see a loose connection
11 there, so I'll allow the question.

12 THE WITNESS: Thank you. I ask for
13 indulgence that this is off the top of my head, and
14 so it may -- it's not gonna be exact or anything
15 like that. But in the February to October time
16 period, based on the engineering news record, cost
17 indices, and those types of things, as well as
18 cross-check back to Handy Whitman and others, it's
19 been -- it's gonna be the highest inflation year
20 this year for construction in the last, you know,
21 45 years of that record.

22 And in that period of time, truncating
23 February and truncating October, it would be
24 5 percent. And -- about. And then that would be

1 5 percent of \$10 million is about -- \$11 million,
2 so about \$550,000. I'm doing the calculation as I
3 talk. And depreciation would be in the order of a
4 couple percent, so it would be, say, \$200,000. So
5 there would be an increase of at least \$350,000.
6 Probable. I mean, that's just probable.

7 COMMISSIONER HUGHES: Okay. Thank you
8 for that.

9 MR. WHEATLY: No further.

10 COMMISSIONER HUGHES: Okay.

11 Commissioner Duffley has a question that she forgot
12 to ask, so we're gonna break order a little bit.

13 COMMISSIONER DUFFLEY: Many apologies.
14 The overnight made me forget I had one more
15 question.

16 EXAMINATION BY COMMISSIONER DUFFLEY:

17 Q. So yesterday you testified that you had only
18 looked at one of the appraisals and not the other
19 appraisal. I guess, the appraisal for the County you
20 stated you did not look at, but you looked at the
21 appraisal performed for the Public Staff.

22 And my question is just why did you only look
23 at one appraisal and not both appraisals before
24 testifying today and yesterday?

1 A. I just didn't get them. I did not have them
2 in my data file, and so that's why. If I had them, I
3 probably would have looked at them in detail. But I
4 was not asked, so I did not, you know, go into it. My
5 appraisal is my opinion of value, and I stand by it.
6 And so what other people say in appraisal is what other
7 appraisers say, you know. I'm not going to be impacted
8 by any other appraisal by another outfit.

9 Q. Okay. Thank you for that.

10 A. Both of the other two outfits are good. I
11 know Michael Lane and I know, you know, Harold Spurm
12 (phonetic spelling), and they're both excellent firms.
13 I'm not trying to say anything bad about them.

14 COMMISSIONER HUGHES: Okay. I think
15 that brings us to the Company.

16 MR. DROOZ: Thank you. Just a few
17 questions here.

18 EXAMINATION BY MR. DROOZ:

19 Q. You were asked early on about how many cases
20 you had represented consumer interest, and so I wanted
21 to ask if -- is it the normal practice in your business
22 to either represent a buyer or a seller?

23 A. Typically it is, unless -- like CMUD and
24 others, both sides -- because they know me and they do

1 a lot of acquisitions, both sides hire me, and then I
2 render my opinion, and that's the purchase price. In
3 fact, I think I did one where Utilities, Inc. was
4 involved, and I've done others where others were
5 involved, Landon and other systems with CMUD.

6 So many Greensboro/Spartanburg does the same
7 thing. So sometimes they split your fee, both pay
8 50/50, both waive any conflict and we go ahead and I
9 render my opinion of value. And typically that's the
10 purchase price. So that's -- but most of the time it's
11 one side or the other.

12 COMMISSIONER CLODFELTER: Mr. Drooz,
13 pardon me for interrupting. CMUD is Charlotte
14 Mecklenburg Utilities Department?

15 THE WITNESS: Yes, correct.

16 COMMISSIONER CLODFELTER: Now Charlotte
17 Water?

18 THE WITNESS: Yes. I'm sorry, I'm
19 used --

20 COMMISSIONER CLODFELTER: Everybody in
21 the room may not know who you're referring to.

22 THE WITNESS: I've got some gray hair on
23 me. I'm used to CMUD.

24 Q. It's a memorable acronym.

1 So do you have a rough idea of, among your
2 clients, the balance between municipalities and
3 utilities?

4 A. Yes. I've served governmental entities,
5 not-for-profits, authorities, districts, things like
6 that about 40 percent of the time. So in my practice,
7 about 280 times. And then relative to investor-owned
8 utilities, I've served 8 of the top 11 in the United
9 States, and that's the remainder.

10 Q. So you were asked a series of questions about
11 the engineering cost valuation coming from Draper Aden
12 and why that's different from appraisal values.

13 Can you explain the role of the engineering
14 valuation versus the appraisal valuation?

15 A. Yes. Typically, the engineer's evaluation is
16 a costing exercise, or -- and a condition -- a
17 condition costing future cap improvements, or CapEx,
18 what we call that, and regulatory compliance, as well
19 as operational issues and -- which are all covered by
20 the DA report. And why it's -- why you go to a local
21 engineer for the costing aspects, because they have
22 done the most projects in that area for construction
23 costs, so they typically do the cost.

24 Now, past cost to the appraisal is a totally

1 different thing. You have land value that the engineer
2 doesn't do, and so I deleted that out of there where
3 you get an MAI for a land appraiser and not an
4 engineer.

5 Q. And could you explain what MAI is, please.

6 A. Made as instructed. No, that's a joke. I'm
7 sorry. It's a real estate appraiser. I apologize.
8 The CMUD thing is in my brain.

9 Q. That's all right. We can all get a little
10 punchy here.

11 A. It was a long night --

12 Q. In -- in your appraisal, what is MAI?

13 A. That's a real estate appraiser, you know. I
14 forgot what -- I'm drawing a blank.

15 Q. Okay. Is it attached to your appraisal
16 report?

17 A. Oh, oh, no, yeah, Chris did -- the Mashburn
18 Group, excellent group here in North Carolina,
19 understands utility real estate appraisals. And he's
20 done several throughout the state, and he's who I used,
21 and he's signed and sealed a report, pending the value
22 for the real estate at \$425,250.

23 Q. So getting back to this engineering versus
24 appraisal valuation, does the engineering look at the

1 book value of the utility system assets?

2 A. Well, that is one aspect, but -- one
3 consideration. But, actually, the engineer is supposed
4 to be looking at that and also the costs, the local
5 costs in the area. And that's why you want to do that.
6 And they come up with their costing. It's not their
7 appraisal, it's their costing. I take that, modify
8 that to -- first you test it, you talk to them about
9 it, which I did, and then you either accept it or
10 reject it.

11 I accepted it with modifications. And I
12 talked about the modifications I made. And then you
13 convert it into a value -- opinion of value for that
14 one approach, which is the cost approach.

15 Q. And the -- so that process that you just
16 described, is that the standard practice for
17 professional appraisals?

18 A. For utilities.

19 Q. Not the engineering side, but what you do
20 with the engineering --

21 A. What I do, yes, as a standard, it follows
22 USPAP --

23 Q. Okay.

24 A. -- Uniform Standards of Professional

1 Appraisal Practice, which I'm accredited in.

2 Q. Okay. And when the engineering cost is done,
3 are they looking at both the historical cost and the
4 replacement cost?

5 A. They can.

6 Q. Okay.

7 A. Uh-huh.

8 Q. And how does that differ from the fair value
9 that an appraiser is estimating?

10 A. With all the -- it doesn't have all the
11 adjustments. It doesn't have -- it has physical or age
12 life depreciation, but that does not have functional
13 and external obsolescence. In my report you saw almost
14 \$724,000 in functional obsolescence that you take away
15 from the cost estimate as a deduction.

16 And so that's what the appraisers do, the
17 other types of -- all three types of depreciation,
18 et cetera.

19 Q. Thank you. There was also a question about
20 use of the -- I guess a special taxing district funds
21 and including them show a -- at least under one
22 calculation, a small profit.

23 And I wanted to ask, for appraisal purposes,
24 are tax revenues counted as part of the revenues that

1 would support a utility enterprise, if you know?

2 A. That is a Board of County Commissioners,
3 typically, decision relative to the utility facilities.
4 Your word "typically," no, it's not. And the only way
5 that you could include it is if there was an agreement
6 by the County that they would transfer such funds in
7 the future for some term to support the utility. And I
8 found none.

9 Q. And if the utility were sold to a private
10 company, would that source of funds be available as
11 supporting the operation?

12 A. Not -- not just generically, but if there's
13 an agreement between the County and the investor-owned
14 utility to supplement rate revenues through taxation
15 for some long period of time -- and taxes typically are
16 year to year, so it's very difficult to get something
17 like that.

18 Q. Okay. Thank you. Last couple of questions
19 here. In your market sales comparison approach, I
20 believe you came up with a list of comparable
21 companies.

22 And how many utility sales were in your final
23 list of comparables?

24 A. Fourteen.

1 Q. Do you know, of those 14, did you do
2 appraisals on any of them?

3 A. Eight. I knew them well. I had been out
4 there to see them.

5 Q. Eight of the fourteen you did appraisals on?

6 A. That's correct.

7 Q. Okay. Thank you. That's all my questions.

8 COMMISSIONER HUGHES: Okay. I think
9 we've already dealt with your appraisal report,
10 it's Exhibit 1C in the application, which is
11 already in record. So I think, with that, no
12 further questions. No, I spoke too soon.

13 COMMISSIONER CLODFELTER: Mr. Drooz, you
14 prompted one question just so that I have it.

15 And if I may, Commissioner Hughes?

16 COMMISSIONER HUGHES: Please.

17 EXAMINATION BY COMMISSIONER CLODFELTER:

18 Q. Mr. Hartman, looking at page 5-18 of your
19 appraisal, which is the 14 companies, can you just --
20 so I can put checkmarks beside them, tell me which of
21 the eight you did appraisals on?

22 A. Oh, surely.

23 (Witness peruses document.)

24 You're talking about Table 5?

1 Q. Table 5-2, yeah. Which are those were the
2 eight that you appraised?

3 A. Hardin; Mt. Pulaski; Park Water; the Waverly
4 System, you know, I testified in that one; I was one of
5 the appraisers on the Commons; and I had done
6 Andalusia, Hillview, and Skyline.

7 Q. Hillview, you mean Hallsville?

8 A. No.

9 Q. Oh, Hillview, I'm sorry. All right. And
10 Skyline?

11 A. And Skyline.

12 Q. Thank you, sir.

13 A. The breakout is seven -- I did four of the
14 seven that dropped, and I did four of the seven that
15 were kept for the deal.

16 Q. Tell me what you mean by that.

17 A. I participated in four of the seven that I
18 found not to be -- not to be used, the bottom half, if
19 you will. And then I participated in four of the seven
20 in the top half that were used.

21 Q. Okay. Well, again, I just -- apologies,
22 Mr. Drooz, but I just -- I want to get the accurate
23 information here. So of the ones that you --

24 A. There's eight. I gave you eight.

1 Q. Eight total.

2 A. And some of those I did not --

3 Q. And which are the -- which of those eight are
4 the four that you used and which are the four that you
5 dropped?

6 A. Hardin, Mt. Polaski, Waverly, Andalusia.

7 Q. And that means you did not use the other
8 four: Park Water, Commons, Hillview, and Skyline,
9 right?

10 A. No. I used Park Water, I used Commons, I
11 used Diversified, Hillview -- excuse me. The ones --
12 the seven that I used. Bellflower, Georgetown, and
13 Skyline.

14 Q. Okay. Thank you. Of the ones that you
15 appraised, of the eight that you appraised, how many of
16 those transactions went to closing; do you know?

17 A. Hardin did; Mt. Polaski; Park Water; Waverly;
18 the Commons; Diversified, I believe, is in the process;
19 Hillview, I believe, is done also; Andalusia; and
20 Skyline.

21 Q. Those actually --

22 A. Almost all of them that I appraised closed.

23 Q. Went to closing?

24 A. Yes.

1 Q. Okay. Thank you.

2 COMMISSIONER HUGHES: Okay. With that,
3 you may step down. Thank you very much for your
4 testimony.

5 THE WITNESS: Thank you very much.

6 COMMISSIONER HUGHES: Mr. Wheatly, the
7 Commission has requested to have Mr. Walker testify
8 at this time to answer Commission questions about
9 his valuation opinion, so we'll follow the same
10 process that we did with Mr. Hartman. So we'd ask
11 that he take the stand, please.

12 MR. WHEATLY: County will call
13 Mr. Walker to come to the stand, please.

14 MR. CREECH: Chair Hughes, if I could
15 just for one moment ask, in terms of clarifying
16 here, with respect to the County witness, when --
17 in terms of questioning, could the Public Staff go
18 after the Company in the questioning if we have
19 questions?

20 MR. DROOZ: We're comfortable with that.
21 It may increase the number of Public Staff
22 questions, but we're happy to work with them on
23 this.

24 COMMISSIONER HUGHES: Okay. I'll allow

1 it.

2 MR. CREECH: Thank you.

3 MR. WHEATLY: May I proceed, sir?

4 COMMISSIONER HUGHES: Good morning,
5 Mr. Walker.

6 THE WITNESS: Good morning.

7 Whereupon,

8 HAROLD WALKER, III,
9 having first been duly sworn, was examined
10 and testified as follows:

11 MR. WHEATLY: May I proceed, sir?

12 COMMISSIONER HUGHES: Okay.

13 DIRECT EXAMINATION BY MR. WHEATLY:

14 Q. State your name, please.

15 A. Harold Walker, III.

16 Q. What is your address, Mr. Walker?

17 A. My address is 1010 Adams Avenue, Audubon,
18 Pennsylvania.

19 Q. And what is your occupation?

20 A. I am a manager of financial studies employed
21 by Gannett Flemming Valuation & Rate Consultants.

22 Q. And what do you do in the course of that
23 business?

24 A. Provide -- well, as it pertains to this

1 assignment, I provide appraisals of utility property.

2 Q. How long have you been doing that, sir?

3 A. Appraisals for probably 30 years -- 25 to
4 30 years. I've been working in the financial
5 utility -- financial consulting industry for -- in the
6 utility industry for over 35 years. So I've been
7 involved in all aspects of rate cases, cost of capital,
8 lead lag, depreciation, touching on all different
9 aspects of the utility industry regulation.

10 Q. Did you make an appraisal of the Carteret
11 County water system, sir?

12 A. Yes, sir, I did.

13 Q. Did you prepare a report?

14 A. I -- yes.

15 Q. And to the best of your knowledge, is that
16 report before the Commission now?

17 A. That is my understanding, yes.

18 Q. If you would, please answer the
19 Commissioners' questions with regard to that report.

20 A. Yes, sir.

21 COMMISSIONER HUGHES: Okay. I believe
22 we'll start with Commissioner McKissick.

23 EXAMINATION BY COMMISSIONER MCKISSICK:

24 Q. Thank you for being here, Mr. Walker.

1 A. Good morning.

2 Q. How are you this morning, doing pretty good?

3 A. Good.

4 Q. Excellent. Excellent.

5 A. Thank you.

6 Q. We're gonna be asking you a few questions
7 related to your report.

8 Were you here yesterday when the prior
9 appraiser was testifying?

10 A. Yes, sir.

11 Q. All right. So you're familiar with his
12 testimony?

13 A. Yes and no. It was a long afternoon. I
14 might have daydreamed here and there, so. But,
15 generally, I think I can answer. But I'll be honest,
16 if I was daydreaming, I'll tell you I have no idea what
17 you're talking about.

18 Q. Well, that's completely understandable since
19 we started at 1:00. You would not be alone. All
20 right.

21 Now, in applying to be on the list of
22 approved utility evaluation experts, this Commission
23 maintains you attested that a utility valuation expert
24 holds a fiduciary duty to provide a thorough,

1 objective, and fair valuation.

2 What does that mean to you?

3 A. It means -- thorough, in the sense of looking
4 at all aspects of information that is available, not
5 being swayed by outside influence, and making sure that
6 the appraisal is consistent with USPAP as well as
7 financial theory.

8 Q. Now, if you had to make a judgment call, and
9 it was kind of a close call, I mean, how would that
10 affect your fiduciary duty, in terms of making a
11 decision?

12 A. That's a good question. The judgment call
13 will be swayed by as much outside evidence as I can
14 find. When I say "outside evidence," I mean published
15 evidence, as opposed to my personal opinion or the
16 firm's personal opinion. If it is -- there's more
17 evidence in the sense of personal opinion, then it gets
18 swayed in that direction. I can give you an example.

19 Within the income approach, there were
20 questions yesterday about growth of customers served.
21 And with the income approach, we typically look at
22 growth from state agencies that provide projections.
23 And that's what we defer to, regardless of what our
24 opinion is.

1 In -- as of the appraisal date, there were
2 not local projections available for the local
3 communities. The most micro projection available was
4 for the county. So we used that county population
5 growth as a -- as an estimate for the customer growth.
6 And that worked out to -- my recollection is
7 0.29 percent per year, which is about three, three and
8 a half customers per year are added.

9 Looking at the system the way it's designed,
10 my personal opinion is there's a lot more pocket for
11 growth there. That because the lines are -- the mains
12 are located as they are, there's a lot of incentive for
13 developers to come along. Because, typically,
14 developers have to contribute property if they're
15 developing systems far outside existing systems. But
16 the way the configuration of the system, to me,
17 personally, invites it.

18 But I -- as I said, I defer to the projection
19 put out by the State on the county's projection --
20 population growth. So when I say tipping, in terms of
21 personal opinion, that's what I'm trying to describe.

22 Q. I understand. So you relied upon the
23 projected rate of growth for being about 3.5 customers
24 per year for the system?

1 A. Yes.

2 Q. All right. However, you think it has greater
3 potential, but there wasn't data to substantiate that;
4 is that what I'm understanding?

5 A. That is correct.

6 Q. Okay. Very good. Now, have you provided
7 opinions in other utility fair market proceedings?

8 A. Yes, I have.

9 Q. Okay. Have you ever been retained by a
10 consumer advocate to give a valuation opinion in a
11 utility matter such as this one?

12 A. No. But I don't believe I've ever had the
13 opportunity as well.

14 Q. Okay. Now, has a utility commission ever
15 declined to consider your opinion in making its
16 ultimate determination of fair value?

17 A. No.

18 Q. All right. Now, has a commission ever
19 applied adjustments to your valuation opinions, to the
20 best of your knowledge?

21 A. There may have been one adjustment, but it
22 ended up being rounding at the end. They did not
23 adjust my appraised value. So it might have rounded
24 out.

1 Q. So can you explain the context that was done
2 within?

3 A. I'm -- my recollection is in a Limerick
4 Township proceeding, it was in Pennsylvania, and there
5 was some adjustment done to a market multiples
6 approach. However, in the -- in the weighting and the
7 ultimate appraised value, it did not impact the number,
8 because it was -- it rounded out to thousands as
9 opposed to tens of millions.

10 The appraised value, I'm gonna -- I'm
11 guessing was \$75 million. So this little adjustment
12 maybe was a couple hundred thousand. So it rounded out
13 at the end when you went through. So when you look at
14 the -- if you look at the Commission's order, their
15 final decision regarding my appraised value is
16 unchanged from what was actually filed.

17 Q. Thank you for providing that information.

18 A. Sure.

19 Q. Now, as a part of your analysis, you
20 developed a comparable group of water utilities shown
21 in Table 2 of your report; is that correct?

22 A. Yes.

23 Q. All right. Now, how did you use the
24 comparable group in your analysis?

1 A. The comparable group of utilities was used,
2 one, to gauge the financial and risk characteristics of
3 the system in question; and two, it was used to develop
4 the weighted cost of capital for discounting purposes;
5 and three, it was used in a market multiple method in
6 which the multiples from that group were adjusted
7 downward by 70 -- or excuse me, by 30 percent to
8 account for what we concluded was the risk difference
9 between the system in question versus the comparable
10 group.

11 So if the -- for example, when I say downward
12 by 30 percent, if the comparable group's multiple were
13 10 times, we would say, after a 30 percent adjustment,
14 that the same multiple applicable to the system was
15 seven times. So that's a 30 percent adjustment in the
16 multiple. And, I'm sorry, I'm trying to recall what
17 you asked.

18 Q. That's fine.

19 A. I believe that covers everything.

20 Q. Sure.

21 A. Yes.

22 Q. Now, were you aware of the statutory
23 requirement in North Carolina that, in the process of
24 doing your fair market assessment -- appraisal, I

1 should say, that you were required to use three
2 valuation methods, both the cost, the income, and the
3 market approach?

4 A. Yes, sir.

5 Q. Okay. And did you comply with that
6 requirement in doing your appraisal?

7 A. Yes, sir.

8 Q. All right. Now, can you explain how you
9 developed the list of comparables that you used?
10 Because every single company on your list has larger
11 revenues, greater number of customers, and serves a
12 much larger population. For instance, the smallest
13 company by revenues is York Water Company, which has
14 revenues of over \$55 million, which is 43 times the
15 revenue of the County system. And the York Water
16 system also has the smallest number of customers in
17 your comparable list. I think it's 73,144, which is 58
18 times the number of customers that the Carteret County
19 system has.

20 So how did you develop this list, and how did
21 you go about using it for comparability, considering
22 the vast difference between the list that you have
23 assembled and the stark contrast between those
24 comparables and what we're dealing with in Carteret

1 County?

2 A. Okay. The criteria for their selection is
3 listed on page 13 of the appraisal, where there were
4 seven separate criteria for their selection. Within --
5 and the purpose of the group is to look at a
6 market-based group. In other words, companies whose
7 stock is publicly traded. So that's, sort of, the
8 initial step.

9 When you look at water utility stocks,
10 publicly traded, there are very few. In fact, there
11 are about nine. So this group is seven of those nine.
12 So two -- two companies, I believe, didn't make the --
13 the screening process. I can't tell you offhand why,
14 but they didn't. So the universe that is available is
15 limited. So that was -- that was the basis for why we
16 used these companies.

17 Now, these companies that are used here are
18 the same exact companies that I believe are used by any
19 witness who testifies in a water or wastewater case
20 before this Commission regarding cost of capital. So
21 they're the same exact companies. So they're the same
22 companies that any Commission around the country uses,
23 and they're the same companies that anybody on Wall
24 Street who does the same type of analysis used, because

1 simply put, they are the universe. There is nothing
2 else to choose from.

3 In a perfect world, I believe what your
4 question is getting to is would you want a more
5 comparable group in terms of size. And absolutely, but
6 they don't exist.

7 Q. I think I understand your testimony.

8 So are you aware of sources of data for
9 smaller water system transactions?

10 A. Oh, for transactions, in terms of actual
11 sales?

12 Q. Yes.

13 A. Yes. And we did that separately.

14 Q. Okay.

15 A. So we did two -- within the market approach,
16 there are two -- there are two methodologies. There is
17 the market multiple methods, which is where you look
18 at -- at the multiples in the stock market, which is
19 what this comparable group was done -- is used for.
20 And then there is a second method called the -- we term
21 the selected transaction method where we look at asset
22 sales.

23 And those groups are more comparable to the
24 system here than -- in terms of size. And we did look

1 at them. We looked at 18 of those transactions.

2 Q. All right. Now, have you ever valued a
3 system in the past with fewer than 2,000 customers?

4 A. Yes.

5 Q. You have?

6 A. Yes.

7 Q. On -- how often? Would you have any idea
8 what the frequency might be?

9 A. I couldn't -- dozens of times. I don't
10 really -- I don't have a --

11 Q. You can't recall a number? That's fine.

12 A. If the question were under 500, I'd probably
13 say very few. But once you get to 1,000, 1,000 tends
14 to be the number that people are looking for
15 appraisals. Once you get into -- you know, once you
16 get up over 1,000, that's when appraisals are more
17 often needed than not.

18 Q. So you have done quite a few appraisals of
19 systems with 2,000 customers or less?

20 A. I would think so.

21 Q. Okay.

22 A. I mean, I'm just guessing off the top of my
23 head, I don't --

24 Q. That's fair. You don't have to speculate. I

1 was just --

2 A. Yeah. I mean, in terms of the -- the systems
3 that are purchased under fair market value rules, most
4 of those systems probably are in excess of 2,000
5 customers by far. Because it's just not -- it's cost
6 prohibitive for, you know, a small -- a really small
7 system. But I'd say 1,000 is the cutoff there. But
8 that's just my, you know, instinct, in terms of when a
9 suitor is looking to perhaps move in that direction.

10 Q. All right. Now, why did you use a different
11 set of companies in Exhibit 18 of your report when
12 performing your selected transactions market approach?
13 Would that set of companies have been appropriate to
14 use as comparables for the other portion of your
15 analysis?

16 A. Well, the -- no, because the same type of
17 information wasn't available. The one -- the one on
18 17 -- on Exhibit 17, that's the comparable group,
19 they're the publicly traded stocks. So we can look at
20 that and see what a stock price is and compare that
21 stock price to the plant and compare that stock price
22 to earnings, and we can see that it's fast, it's rapid,
23 it changes on the second, in terms of valuation of
24 assets. We can see that. So that's one method.

1 And then you referred to Exhibit 18, and
2 they're transactions, they're slow-moving transactions.
3 Maybe it takes two years for the entire process to, you
4 know, wind down.

5 So we looked at two different groups for, you
6 know, basically two different purposes.

7 Q. Got it. Now, could you please describe your
8 cost approach methodology? Just the methodology right
9 now.

10 A. Uh-huh. Sure. The cost approach, we utilize
11 the engineer assessment as the beginning point for
12 inventory. For certain items that we did not have an
13 installation date, we then relied on the same source of
14 information that the engineer relied on, and that was
15 the depreciation schedule. The County's depreciation
16 schedule. So we made those adjustments for date and we
17 developed an original cost of the system.

18 We then trended that for cost changes to
19 bring it up to current value. And then we reflected
20 the loss in value due to depreciation.

21 Q. Okay. Now, on page 21 of your testimony, you
22 stated the original cost method begins with determining
23 the original costs new, and you take and measure that
24 original cost new and look at the cost of assets when

1 it was first constructed to just, kind of, verify that.
2 But original cost new is based upon a review and
3 summary of the utility's accounting records,
4 contractors' invoices and bid tabulation to determine
5 the most appropriate data.

6 Did you at any point in time go back and
7 check and verify that or obtain that type of
8 information? Where did the data come from that you
9 used to determine the original cost new of the Carteret
10 County water system?

11 A. It primarily came from the engineering
12 assessment because --

13 Q. The engineering assessment?

14 A. Yeah. That was their task in this
15 proceeding.

16 Q. All right. Now, on page 6 of your testimony,
17 you state that, for the year ending June 30, 2021, that
18 Carteret County water fund showed \$5.7 million -- I
19 think the exact number was \$5.759 million -- in net
20 utility plant.

21 Did you use that information in your cost
22 approach? And if not, why?

23 A. The number you just referred to is from their
24 audited statements, and their audited statements

1 reflect shorter-than-applicable service lives for the
2 assets. For example, if you take the depreciation
3 expense and you relate it to the gross plant and any
4 one of the four-year period that we looked at on
5 Exhibit 1, the effective depreciation rate is
6 3 percent, which means plant life has, on average, 33
7 lot -- 33 years.

8 The largest accounts, in terms of plan
9 accounts for this system, would be mains and water
10 treatment. Well, clearly both of those accounts have
11 asset lives far in excess of 33 years. Our analysis
12 determined an effective depreciation rate of
13 1.75 percent versus the 3 percent used by the County on
14 the audited statements. So that's why we did not use
15 that.

16 Secondly, in around the year -- well,
17 22 years ago, I think, GASB 34 came out. GASB 34 is
18 Government Accounting Standards Board, in which the
19 financial statements of government were going to no
20 longer be reported on a cash basis but be reported on
21 accrual basis. Accrual accounting is what is typically
22 used by public utilities regulated by public utility
23 commissions.

24 Beginning at that time, this is 22 years ago,

1 I ran -- I assisted or oversaw our firm's effort --
2 there's 2,500 people in our firm -- in helping
3 municipal clients convert their cash basis systems to
4 complete inventory, including roads, bridges, streets,
5 water systems, wastewater systems. So I'm quite
6 familiar with the limitations, if you will, of
7 municipal audited statements.

8 It's been my experience that, typically, they
9 undercapitalize. In other words, there is more assets
10 there than typically reported. Secondly, they
11 overdepreciate. And as a result of overdepreciating,
12 once an asset is fully depreciated, for accounting
13 purposes, it is removed from the gross plant
14 outstanding. So, in theory, that plant no longer
15 exists. In other words, there might be pipe out there
16 that, hey, no longer exists.

17 Well, I can walk out there and look at that
18 pipe and know it still provides service. In terms of
19 value, that pipe still exists, and that pipe still has
20 value. And that's why we did not rely on the audited
21 financial statements, in terms of net plant.

22 Q. And when you refer to audited financial
23 statements, do you want to be more specific, in terms
24 of saying how those statements were provided and who

1 those statements were provided by?

2 A. It's not a -- it's not a question of who
3 provided, it's just the generalization. What I'm
4 saying is true with regards to just about any municipal
5 system. I'm not saying those -- those financial
6 statements are wrong, they're just prepared for a
7 different purpose.

8 Q. I understand.

9 A. They're prepared for a different purpose than
10 what we're using them for, for appraisal purposes.

11 Q. So these were Carteret County?

12 A. Yes, sir, they were Carteret County. And
13 that actually --

14 Q. That's what I was trying to get into the
15 record.

16 A. Yes, sir. Yes, sir. And, actually, there
17 was a question earlier about audited financial
18 statements in the record. My recollection is on -- if
19 you just want the -- without the footnotes, if you just
20 want the financials, they're in Exhibit 21 of my -- of
21 my appraisal. And I believe it's on page -- they begin
22 at page 102, I believe.

23 Q. Thank you. That's what I was trying to get
24 into the record.

1 A. Sure.

2 Q. Just in terms of that reference.

3 Now, can you please explain the source of
4 information in Exhibit 7 of your report, and how did
5 Draper Arden update to present value water system in
6 its updated report dated December 2021?

7 A. I'm sorry, I don't understand the question.

8 Q. Okay. Could you go to Exhibit 7? Your
9 Exhibit 7.

10 A. Yes.

11 Q. All right. Where did that source of
12 information come from?

13 A. Exhibit 7, if you -- if you turn to page 4 of
14 Exhibit 7 --

15 Q. Okay.

16 A. -- there's a comparison between the numbers
17 that we relied on ultimately versus the engineering
18 assessment. We primarily relied upon engineering
19 assessment. But because we were recalculating service
20 lives, we needed installation dates. So in certain
21 instances, we had to go back and look at accounting
22 depreciation records just merely for installation
23 dates.

24 If the dollar figures were different than

1 what the engineer used because we were using the date,
2 we also used the dollar figure from the depreciation
3 schedule. This is the same schedule that was provided
4 to the engineer.

5 There is also five different asset groups
6 that were not included in the engineer's assessment.
7 However, in the clarification letter that -- I believe
8 the staff asked questions of the engineer, and he
9 provided certain clarification statements. And those
10 clarification statements clarified that, in fact, he
11 had not included the items which we show on Exhibit 7,
12 page 4 as not listed, which we ultimately included in
13 the inventory because, number one, they add value;
14 number two, they are being -- they are part of the
15 transaction.

16 Q. Okay. So in terms of the use of the
17 December 21st report by Draper Aden, you basically went
18 back, used it, relied upon it for the purposes that you
19 just explained?

20 A. Yes.

21 Q. All right. And when you talked about
22 providing -- getting -- obtaining additional
23 information from the engineer and you talked about
24 certain clarifications, did you communicate with Draper

1 Aden directly to get those clarifications? Or how did
2 you go about contacting the engineer who did the
3 assessment or people with Draper Aden to obtain
4 information that you might require?

5 A. The -- the engineer was asked clarifying
6 questions by, I believe it was the staff, but please
7 correct me, but that's my recollection. There is a
8 letter in which the engineer replies to those
9 clarifying questions in which he lays out various
10 items.

11 For example, he clarifies that services or
12 meters are not part of his inventory. And so we
13 included those as part of the inventory because they're
14 part of the transaction and there is value related to
15 those assets.

16 So this was, in our view, a public document.
17 It's not a -- it wasn't a secret conversation with the
18 engineer, it was a letter. And I know it's in the
19 appraisal. There's a date on the letter. We cite to
20 the date of the letter to the staff. If need be, I can
21 find it in the appraisal.

22 Q. Okay. Now, let me ask you this. Is it your
23 understanding that the figures found in the Draper Aden
24 summary tables represent the original cost new?

1 A. Yes.

2 Q. Okay. And did you rely upon those tables?

3 A. Yes. With the -- with the understanding of
4 what I explained previously.

5 Q. Sure.

6 A. Yes.

7 Q. Now, you might notice in the report that --
8 now, we're talking about the Draper Aden report, that
9 Table 1 is titled "Estimated Book Value, Carteret
10 County Water System," and Table 2 is titled "Present
11 Book Value of Carteret County Water System."

12 Do you know why one is identified as being
13 the estimated book value and the other states it is the
14 present book value?

15 A. No, I can't answer that question. I --

16 Q. Okay. Now, on Table 2 there is also an
17 asterisk next to several entries, and a note at the
18 bottom of the page that states that the value has been
19 increased by approximately 5 percent from the 2019
20 study -- feasibility study. Can.

21 You explain why Draper Aden increased the
22 values on this table, and if they are meant to
23 representative the original cost new?

24 A. I can't explain why they were changed. We

1 removed that escalation. It's footnoted on page 4 of
2 Exhibit 7. We excluded the 5 percent.

3 Q. Excluded the 5 percent?

4 A. Yes.

5 Q. Okay. Very good. Now, on page 25 of your
6 testimony -- I'll wait for a minute for you to get
7 there. Okay.

8 You state that the original cost new of the
9 water system is not less than \$14.9 million, rounding
10 that off; is that correct?

11 A. That is correct.

12 Q. All right. And is that consistent with what
13 you believe that original cost new was?

14 A. Yes.

15 Q. All right. And then the Carteret County
16 water system assets selected audit financial
17 information, as attached to your report as Exhibit 1,
18 shows gross property plant and equipment of \$12,195,043
19 in 2021.

20 Can you explain the discrepancy between those
21 numbers and the assessments that it's not less than
22 \$14.9 million?

23 A. Well, I can give you my rationale for why
24 they're different. I don't know that this is factual.

1 But as I mentioned previously, the depreciation rate
2 used in the County financials is 3 percent. So that's
3 33 years. So once an asset is fully depreciated, it is
4 removed. So that \$12 million on the financials -- you
5 reference, Exhibit 1 -- that \$12 million is after the
6 removal of assets that, according to the accountants,
7 had been fully depreciated.

8 If they were -- if those assets are still
9 providing services, they would be included in the
10 \$14.9 million that we included in our analysis. So
11 you're talking about 2 to \$3 million, which I believe
12 can just simply be explained by the difference between
13 a 1.75 percent depreciation rate, which is what we
14 believe is appropriate for this system, versus the
15 3 percent used by the County. I believe, if you went
16 back in time, mathematically, you'd get pretty close to
17 that difference in the number.

18 Q. Now, the Draper Aden report --

19 A. Yes.

20 Q. -- which is essentially the engineering
21 assessment, also provided financial valuations.

22 Did you use or rely about the financial
23 valuations that it contained in preparing your
24 appraisal?

1 A. I don't -- I believe the answer is no, but I
2 don't know exactly what you're referring to. So -- but
3 I -- we treated their report -- we looked at the report
4 mainly for two things. One, condition of the system;
5 and two, an original cost inventory. That's what we
6 were looking for because we believe that's what the law
7 requires.

8 Now, obviously, we read the entire report,
9 but I don't know what you're referring to when you say
10 valuations. So -- but I don't believe -- we wouldn't
11 have used those other than what I just indicated,
12 condition and inventory.

13 Q. Were you aware that the original Draper Aden
14 report that was done was done in connection with the
15 proposed merger of the County's water system with the
16 Town of Beaufort?

17 A. Yes, I believe that -- 2019?

18 Q. Yes.

19 A. Yes. 2019, yes.

20 Q. And that it was done at that point in time as
21 a tool that could be used to evaluate whether the
22 merger was in the best interest of both --

23 A. Yes.

24 Q. -- the Town of Beaufort and the County?

1 A. Yes, that is my understanding. And I did
2 review that report as well.

3 Q. All right. And at that time, it was proposed
4 that the system would be transferred to the Town of
5 Beaufort for \$1; is that correct?

6 A. That's my recollection, yes, but I did not
7 follow the logic.

8 Q. Okay. Thank you. I don't have any further
9 questions at this time.

10 A. Sure.

11 COMMISSIONER HUGHES: All right. I'm
12 just gonna take over on the next approach, the
13 income approach.

14 THE WITNESS: Yes.

15 EXAMINATION BY COMMISSIONER HUGHES:

16 Q. At a very high level, can you just explain
17 how you utilize the income approach in this particular
18 appraisal?

19 A. We're assessing the income or cash-producing
20 capabilities of the assets in question. So, basically,
21 we look at revenues less expenses and adjust for
22 depreciation, capital expenditures. And that value, in
23 any given year, is a net of debt cash flow, which is
24 discounted over an extended period of time. And we

1 take the present value of that discounted cash flow to
2 develop a value for the system.

3 Q. Okay. So following up on that, you mentioned
4 discount -- discount value discount factor.

5 A. Yes.

6 Q. It appears you used several different ones
7 and you, kind of, made justifications for different
8 ones.

9 Just, in general, is it mathematically, or
10 from a finance analyst standpoint, the lower the
11 discount rate, the higher the valuation, all things
12 else equal; is that correct?

13 A. All things else equal, that is correct. In
14 the analysis, different -- all things were not equal
15 between the municipal ownership versus the
16 investor-owned ownership. So I just want to clarify
17 that.

18 Q. Well, and speaking of those two sets of
19 ownership, do you think the income approach valuation
20 for a fair value proceeding, so for this type of
21 proceeding, should focus on establishing the income
22 that the buyer will receive after purchasing the
23 system, or on the income that the seller would receive
24 if they did not sell? Does that make sense, those two

1 approaches? Because as you said, they're not apples
2 and oranges.

3 A. Yes, I believe I understand what you're
4 saying. In fair market value, we're looking at
5 hypothetical buyers and sellers. They're not -- it's
6 not Carolina and it's not the County. It's somebody
7 very similar to them. It's sort of a composite, if you
8 will. So the buyer is a composite out there.
9 Potential buyers.

10 If we used Carolina Water as the buyer, that
11 would be known as investment value. Now, there's a
12 difference between investment value and fair market
13 value, and they fall under what's known as the standard
14 of value. When you appraise something, you state the
15 standard of value. What is the purpose? Why am I
16 valuing something? And depending on that standard, you
17 make different assumptions.

18 So, by law, we're required to appraise these
19 systems under a fair market standard, fair market-value
20 standard. So Carolina, under that standard, Carolina
21 Water is not the buyer, it's a hypothetical buyer, so
22 it's a composite.

23 Q. Okay. Thank you for that. So it is actually
24 a composite of both investor and a potential other

1 county?

2 A. Yes. Yes.

3 Q. Okay. That helps, because for our purposes,
4 we are looking at Carolina Water.

5 A. Absolutely, I -- yes.

6 Q. Okay.

7 A. Right. So it's sort of like a house, right?
8 When a house sells, somebody appraises it, it's worth
9 \$100 or whatever it's worth, people go out and bid and
10 there's bid prices all around. Those bid prices are
11 not necessarily the same as the appraised value. The
12 appraised value is just a fair market value for that
13 house. Anybody is gonna bid something different than
14 that, so.

15 Q. Okay. Thank you for that. Do you know, are
16 there any jurisdictions that would, you know, I guess,
17 overrule the standards and say that, for their income
18 approach, since it is dealing with an IOU that is going
19 to be buying the system and investor-owned utility,
20 that they would require the income approach to be done
21 with just that? I mean, I understand you did a good
22 job saying the standards, but what if the law under a
23 particular fair valuation said that we are dealing with
24 investment value, so we want you to use that? Are you

1 aware of any of those?

2 A. Personally, I am not. I assume it could --
3 well, under law, anything could be done. So I
4 shouldn't say anything could be done. But I believe it
5 could be done. I'm not aware of what you're describing
6 actually existing elsewhere.

7 Q. Okay. So on page 36 of your report, you
8 state that your capitalization of earnings method
9 suggested a value of \$10.8 million based on pro forma
10 2012 results. Should that have read 2021? Was that
11 just a typo?

12 A. That is a typo, sir. That should be 2021.

13 Q. Okay. Looking at your summary chart,
14 Exhibit 19, it appears that you disregarded your
15 capitalization earnings analysis and only used the DCF,
16 the discounted cash flow; is that correct?

17 A. That is correct.

18 Q. Can you explain why you made that?

19 A. The capitalization approach was calculated
20 based strictly on current owner and current operator.
21 And we did not -- we don't believe the current owner
22 and current operator is representative of a
23 hypothetical buyer.

24 Q. Okay. Makes sense. So -- okay. Jumping to

1 the market approach now, thank you for the -- can you
2 just explain your market approach assessment and value?
3 Same thing, just at a high level.

4 A. Yes. In the market approach, there are two
5 methodologies. There's the market multiple in which we
6 use the comparable publicly traded stocks. You know,
7 what is that multiple of their stock price? And then
8 there's the selected transaction method in which we
9 look at actual sales of utility assets.

10 Q. Okay.

11 A. So the selected transaction would be similar,
12 or I should say went through a process similar to what
13 we're going through today. They're also the result of
14 fair market value legislation and other regulatory
15 jurisdiction.

16 Q. Okay. Thank you for that. I'm gonna pass it
17 over to any other of my colleagues that have questions.

18 COMMISSIONER HUGHES: Chair Mitchell?

19 EXAMINATION BY CHAIR MITCHELL:

20 Q. Just a quick one. On your -- for the income
21 valuation --

22 A. Yes.

23 Q. -- am I correct that you-all assumed a
24 scenario of no growth and then a scenario of minimal

1 growth?

2 A. Yes.

3 Q. Okay. The minimal growth -- help me, sort
4 of, quantify what the minimal growth rate was.

5 A. 0.1 percent.

6 Q. So what is that? 0.1 percent of what?

7 A. Of cash flow. So cash is growing in the
8 future at 0.1.

9 Q. Okay. So you're -- so -- okay. Got it.

10 Can you help me understand more your
11 assumptions about earnings? Where is the starting
12 place for earnings for this -- for these two systems?

13 A. The starting place for earnings is the cost
14 of capital calculated for the comparison group.

15 Q. Okay. And so in that instance, we're looking
16 at the -- it's a muni cost of capital; is that right,
17 as opposed to an IOU cost of capital?

18 A. Well, there's two. We did both muni and
19 investor-owned. So for the muni, we use muni cost of
20 capital, and for investor-owned, we use investor-owned
21 cost of capital.

22 Q. Okay. Did you hear Mr. Hartman's testimony
23 about income approach in this context? The income
24 valuation approach in this context?

1 A. I guess I -- yes, I -- yes, I was -- yes.

2 Q. Okay. Well, can you tell me what you heard
3 him say?

4 A. He was explaining why he didn't do it. You
5 know, he was troubled by not knowing the growth of
6 customers. He also -- and I don't mean to put words
7 in --

8 Q. I'm not asking --

9 A. This is my recollection.

10 Q. Understood. Just tell me what you heard.

11 A. And he also looked at the financial
12 statements through -- I believe it was 2020, because he
13 was looking at actual financials. And he saw they were
14 losing money, and he did not think it was a meaningful
15 calculation.

16 Q. Okay. So what we have, the folks up here who
17 have to make a decision in this case, is we've got one
18 appraiser who says the income valuation approach is of
19 no use here for these reasons. And that's Mr. --
20 that's what I understand Mr. Hartman's position to be.
21 Your appraisal includes an income valuation.

22 So defend -- in light of the testimony we've
23 heard from Mr. Hartman, defend your decision to use the
24 income valuation and why we should give it weight. Why

1 should we give it weight?

2 A. Well, part of the difference is we included
3 budget 2021. So budget 2021 includes the change in the
4 structure of rates as opposed to terribly low rates
5 subsidized by taxes to eliminating the taxes and
6 pushing basically those dollars up in the rates.

7 So the revenue stream increased by roughly
8 95 percent. By -- and that was our beginning point in
9 the valuation. So that, I know, is a difference from
10 Mr. Hartman and what we did. And I only know that from
11 sitting here today.

12 Q. Okay.

13 A. I did not review his appraisal.

14 Q. So then for the non --

15 A. Yes.

16 Q. I'm just a lawyer --

17 A. Yes.

18 Q. -- and I'm trying to understand this
19 technical information that you-all are putting in front
20 of us, so bear with my questions because they're gonna
21 be remedial. Why does that matter? Why does it matter
22 that you-all use the most recently in effect rate
23 structure or rate design?

24 A. Well, one, it eliminates, sort of, that

1 problem of a money losing system by -- without the
2 taxes. The system has been subsidized for, I don't
3 know, close to ten years because of taxes, basically
4 \$400,000 a year. I believe that's the figure, between
5 4- and \$500,000 a year, and taxes were basically moved
6 over into the water fund, which acted as a
7 subsidization of the rates.

8 And had the budget not reflected the tax, the
9 elimination of the tax dollars and the perceived
10 correction in the rate, our perceived correction in the
11 rate, I don't -- I can't say that we would have been
12 able to do an income approach. That was a big starting
13 point, to be able to have revenues to at least have
14 some profitability in the system.

15 Without that, it's difficult -- I have
16 done -- we have done appraisals before where we've said
17 we can't do an income approach because of there's no
18 money there.

19 Q. Okay.

20 A. There's no -- so the approach makes no sense.

21 Q. Okay. Thank you. You've answered my
22 questions. Thank you. I appreciate your responses.

23 A. Sure.

24 COMMISSIONER HUGHES: Commissioner

1 Clodfelter?

2 EXAMINATION BY COMMISSIONER CLODFELTER:

3 Q. Mr. Walker, I've got a couple of detailed
4 questions for you and then one general education
5 question. The detailed question follows on what
6 Chair Mitchell was just asking you about.

7 On page 6 of your appraisal report, you
8 discuss your approach to the income evaluation, and you
9 indicate that you -- the date of your appraisal is --
10 effective date of your appraisal is December 1, 2021,
11 correct? That's the effective date of the appraisal as
12 of 12/1/21, right?

13 A. 31. December 31, 2021.

14 Q. I'm sorry. Did I write it down wrong?
15 December 31st is the effective --

16 A. I'm not looking at the page, but I just know
17 offhand that it's -- you were saying -- it should be,
18 if it's not.

19 Q. In either case, it's in December of 2021?

20 A. Yes, it's December 2021.

21 Q. And so for your income approach, you sort of
22 base that off of the water rates that were approved in
23 July of 2021?

24 A. Correct.

1 Q. Did you make an adjustment or did you do a
2 revision for the subsequent reduction of those rates in
3 September 2021?

4 A. No, we did not.

5 Q. Tell me why.

6 A. Because we relied on a budget. Had they
7 revised the budget, we would have done so.

8 Q. You didn't do it because you were relying on
9 the adopted -- official adopted budget?

10 A. Correct.

11 Q. There wasn't a subsequent budget amendment
12 when they reduced the rate?

13 A. As far as we know, there was not. There
14 could have been, but --

15 Q. Thank you. As I said, my questions are
16 detailed, so apologies for being in the weeds.
17 Commissioner McKissick asked you some questions about
18 this. I just want to go back and be sure I'm really
19 clear on what you gave us. Exhibit 7 to your appraisal
20 report.

21 A. Yes.

22 Q. Page 4.

23 A. Yes.

24 Q. Do you actually have that open in front of

1 you?

2 A. (Witness peruses document.)

3 Yes.

4 Q. Okay. Am I correct that the pages following
5 that page are the depreciation schedules that you
6 obtained from the County?

7 A. No, sir. They are --

8 Q. What are the pages that follow that page?

9 A. That is our determination of the estimated
10 accrued depreciation at December 31, 2021.

11 Q. That is your depreciation?

12 A. Yes.

13 Q. That's not the County's schedule 6.1?

14 A. I don't know what -- it's not the County's, I
15 do know that.

16 Q. Okay. Well, that helps me, and thank you for
17 that. I guess the question really I have about page 4
18 is, in any case where, from the County's schedule, you
19 had an original cost figure and an installation date,
20 did you always use the County's figure and the County's
21 installation date when you had it?

22 A. Yes.

23 Q. Thank you. That's the detailed question, I
24 just wanted to confirm. Now, the question just for

1 general education purposes, has nothing to do with this
2 case, all right? So I'm familiar with why for-profit
3 companies use accelerated depreciation, but you and
4 Mr. Hartman both have alluded to the fact that local
5 governments sometimes use what I would call accelerated
6 depreciation.

7 What's the benefit to a local government of
8 using accelerated depreciation? Just general
9 education.

10 A. General education.

11 Q. Why would a local government find it
12 beneficial to depreciate an asset more rapidly than its
13 actual useful life?

14 A. Because -- primarily because debt is paid
15 with cash, and depreciation is a source of cash.

16 Q. Ah.

17 A. So it helps with that service coverage,
18 regardless of the type of -- that's my -- as a
19 financial analyst, that's my rationale for it. I've
20 never worked in that field, so -- in terms of I've
21 never, you know, been an accounting officer for
22 government. So I don't know that that's a fact. But
23 as an outsider looking at it, that's what I believe to
24 be the reason.

1 Q. Okay. Thank you. As I say, it's not
2 material to this case, but both of you referred to it,
3 and I just needed to understand.

4 A. Yes.

5 Q. Thank you. That's all I have.

6 A. Sure.

7 COMMISSIONER HUGHES: Okay.

8 Commissioner Kemerait?

9 EXAMINATION BY COMMISSIONER KEMERAIT:

10 Q. Just one follow-up question to make sure that
11 I understand your testimony about the income approach,
12 and it relates to Chair Mitchell and Commissioner
13 Clodfelter's question about why you believed you could
14 provide a value based upon the income approach. And
15 you testified that you used the 95 percent increase in
16 rates.

17 But explain to me why that -- that value or
18 that reliance remained valid after the rates were
19 decreased. In other words, after the County decreased
20 the rates again, why would it still be appropriate to
21 use that 95 percent increase in rates?

22 A. Well, we relied on the budget, and the budget
23 not only reflected the 95 percent rate increase in the
24 revenues, it also reflected what expenses had to be

1 covered by those revenues. In other words, the need
2 for that increase. I would assume that, if they
3 reduced that rate by 25 percent, they better have found
4 25 percent savings in expenses. We didn't know, you
5 know, what those numbers were.

6 But -- and the reason we don't know is we
7 don't know that there's a revised budget at least
8 published. There might be an internal revised budget.
9 But if rates were reduced by 25 percent subsequent to
10 the adopted budget, then I would assume they'd have to
11 have similarly reduced expenses by 25 percent, because
12 the two have to, sort of, mirror one another.

13 Q. Okay. Thank you.

14 A. Sure.

15 COMMISSIONER HUGHES: Any further
16 Commissioner questions?

17 (No response.)

18 COMMISSIONER HUGHES: Okay. We're gonna
19 have questions on Commissioner questions. And the
20 order that we agreed on, I believe, is that we are
21 gonna start with the Company, go to Public Staff,
22 and then go to the County.

23 EXAMINATION BY MR. DROOZ:

24 Q. One brief question to clarify the last

1 question you got from the Commission regarding an
2 income approach and using the rates the County had that
3 covered approximately 95 percent of their cost.

4 Is it appropriate to reflect an income that
5 would cover the cost of the utility enterprise without
6 tax subsidies when doing a fair value appraisal?

7 A. I'm not sure that I understand your question.
8 I think you're asking would we had include the tax
9 subsidies. We would -- we would not include tax
10 subsidies in our appraisal, if they existed, but it was
11 eliminated as a result of the budget that was adopted.

12 Q. Okay. And maybe I can reword. I think we're
13 on the same page here.

14 But would the income approach that you use
15 properly rely on rates that covered the cost?

16 A. Yes, with the 95 percent increase, yes.

17 Q. Thank you. That's all.

18 COMMISSIONER HUGHES: Mr. Creech?

19 EXAMINATION BY MR. CREECH:

20 Q. Just one question. And this is also kind of
21 an educational. You talked a lot about depreciation,
22 and I believe that you mentioned full depreciation.

23 Was it was after 33 years coming off the
24 book?

1 A. Yeah, that was just in round numbers, using
2 the 3 percent. You know, obviously, that's a composite
3 number. It's gonna vary by account, by type of asset
4 that's in that account. So if there's a 5-year asset
5 or a 10-year asset, you know, they retire when they do.

6 Q. Do you know which portions of the Carteret
7 County system are older than 33 years?

8 A. Thirty-three years. I think the wells are,
9 offhand, but, you know, other than that -- and again,
10 that's a composite number.

11 Q. Understood. Thank you.

12 A. Sure.

13 COMMISSIONER HUGHES: Any questions from
14 you, Mr. Wheatly?

15 EXAMINATION BY MR. WHEATLY:

16 Q. Mr. Walker, going back to the question asked
17 Mr. Hartman. Mr. Clodfelter pointed out your
18 appraisal's effective as of 12/31/21?

19 A. Correct.

20 Q. And to bring it current today, do you have an
21 estimate on how much the appraisal should be increased
22 or decreased over the intervening 10 or 11 months?

23 A. Roughly speaking, construction costs for
24 water utility plant -- I'm thinking of Handy Whitman

1 indices -- they've increased about 10 percent in the
2 past 12 months. From that 10 percent, you'd have to
3 subtract out depreciation, which, you know, ballpark
4 is -- we use 1.75, but if we just round it to
5 2 percent. There's probably be an 8 percent increase
6 in the appraised value, based on the change in cost
7 indices.

8 MR. WHEATLY: Thank you, sir. I have no
9 other questions.

10 COMMISSIONER HUGHES: Okay. Thank you.
11 Any? Okay. Well, I think, again, we have your
12 appraisal already in the record, and thank you very
13 much for your time. You may step down.

14 MR. WHEATLY: Mr. Chairman, could we
15 excuse Mr. Walker to leave, sir?

16 COMMISSIONER HUGHES: Yes. Yeah, I
17 don't believe there's any rebuttal questions for
18 him. Yes, you are excused. Thank you.

19 MR. WHEATLY: To stop his meter to us.
20 The real reason, sir.

21 COMMISSIONER HUGHES: Glad I could help.

22 MR. WHEATLY: Thank you, Mr. Walker.

23 COMMISSIONER HUGHES: Okay. Mr. Creech?

24 MR. CREECH: Yes. William Creech again

1 with the Public Staff, and we would like to
2 introduce Mr. Lane, our appraiser.

3 COMMISSIONER HUGHES: Okay. Welcome,
4 Mr. Lane.

5 THE WITNESS: Thank you.

6 Whereupon,

7 MICHAEL G. LANE,
8 having first been duly sworn, was examined
9 and testified as follows:

10 DIRECT EXAMINATION BY MR. CREECH:

11 Q. Mr. Lane, will you please state your name,
12 business address, and position for the record?

13 A. My name is Michael Lane. My business address
14 is 49 Music Square West in Nashville, Tennessee.
15 Position is partner and chairman of the board at NewGen
16 Strategies and Solutions.

17 Q. Thank you, Mr. Lane.

18 Mr. Lane, on October 14, 2022, did you
19 prepare and cause to be filed in this docket, testimony
20 consisting of four pages, and two exhibits marked MGL-1
21 and MGL-2?

22 A. I did.

23 Q. And do you have any changes or corrections or
24 supplements to your testimony?

1 A. To my testimony?

2 Q. Yes.

3 A. No.

4 Q. What about to the exhibits thereto?

5 A. We have one clarification. As I was sitting
6 in the hearing room yesterday, I noticed there was a
7 print range error on one of the tables. And so there
8 were footnotes that were referenced on the page but not
9 included at the bottom of the page. So I had the print
10 range error corrected last night. We have a revised
11 table that includes all the footnotes.

12 Q. Mr. Lane, do you have the actual page number
13 on that?

14 A. It is exhibit -- I believe it's Exhibit 1,
15 Table 2.

16 Q. Exhibit 1, Table 2. And so --

17 A. Let me just verify that. Yes, it's
18 Exhibit 1, Table 2 of my appraisal report.

19 Q. Just a moment. I will hand out these
20 corrections.

21 A. It's not substantive, but I wanted to make
22 sure it was complete.

23 MR. WHEATLY: Do I get one too?

24 MR. CREECH: Yes. Yes.

1 MS. SANFORD: Coming your way.

2 Q. And other than that supplement or correction
3 to the print-range error, Mr. Lane, if you were asked
4 those same questions today that were posed to you in
5 your testimony, would your answers be the same?

6 A. They would be.

7 Q. Okay.

8 MR. CREECH: Chair Hughes, I move that
9 Mr. Lane's direct testimony be copied into the
10 record as if given orally from the stand, and that
11 Mr. Lane's Exhibits MG-1 and 2 as corrected for the
12 print-range error today be identified as premarked
13 when filed.

14 COMMISSIONER HUGHES: Okay. Just so I
15 understand, for the -- we have -- we have the
16 existing appraisal already in the record, but with
17 this correction, in an abundance of caution, is
18 your motion to just put in the entire appraisal
19 with the correction?

20 MR. CREECH: Yes.

21 COMMISSIONER HUGHES: Okay. So moved.

22 (PS Exhibit Attachment MGL-1 and MGL-2
23 were identified as they were marked when
24 prefiled.)

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(Whereupon, the prefiled direct testimony of Michael G. Lane was copied into the record as if given orally from the stand.)

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. W-354, SUB 398

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

**TESTIMONY OF
MICHAEL G. LANE
ON BEHALF OF
PUBLIC STAFF –
NORTH CAROLINA
UTILITIES COMMISSION**

OCTOBER 14, 2022

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND PRESENT POSITION.

A. My name is Michael G. Lane. My business address is 49 Music Square West, Suite 505, Nashville, Tennessee 37203. I am a Partner for NewGen Strategies and Solutions, LLC.

Q. BRIEFLY STATE YOUR QUALIFICATIONS AND DUTIES.

A. I received an Associate Degree in Applied Science and Nuclear Engineering Technology from Thomas Edison State College in Trenton, New Jersey in 1994. In 1999, I earned a Bachelor of Business Administration Degree from Belmont University in Nashville, Tennessee, and in 2003 I earned a Master of Business Administration Degree (Finance) from the Jack Massey Graduate School of Business at Belmont University in Nashville, Tennessee. Also, in 2003, I earned the designation of Accredited Senior Appraiser (Utility Specialization) from the American Society of Appraisers. Accredited Senior Appraisers with a Utility Specialization are required to pass appraisal education classes, to have a minimum of five years full time experience appraising and valuing utility property, and to pass an eight-hour, comprehensive public utility appraisal exam administered by the American Society of Appraisers. I have participated in the preparation of appraisals of electric, water, wastewater, and gas facilities throughout the United States. Attached as Attachment MGL-1 is a list of independent utility appraisals that I have performed.

From 1985 to 1994, I was with the United States Navy as a submarine-based nuclear power plant operator. From 1994 until 1998 I was employed by Hartford Steam Boiler Inspection and Insurance Company as a boiler inspector. I joined R. W. Beck in 1998. R. W. Beck changed its name to SAIC Energy Environment and Infrastructure (SEE&I) in 2010. I was employed by SEE&I as a Senior Consultant and Accredited Senior Appraiser until December 2012. I joined NewGen in January 2013.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to sponsor the appraisal performed by NewGen of the Carteret County Water System (the System). In undertaking the study and analyses required to provide an opinion with respect to the FV of the System, NewGen relied on generally accepted valuation methods and procedures. This appraisal report was prepared in conformance with the 2020-2021 Edition of the Uniform Standards of Professional Appraisal Practice (USPAP) as promulgated by the Appraisal Standards Board of the Appraisal Foundation (extended through December 31, 2022). The Appraisal is attached to my testimony as Attachment MGL-2.

Q. WHAT WERE THE FINDINGS OF NEWGEN'S APPRAISAL?

A. Based on our analyses, NewGen is of the opinion that the Fair Value estimate of the Carteret County Water system as of January 1, 2022, is approximately \$7,332,000. A summary of the indicators of value is provided in the table below.

Summary of Value Indicators

	Value Indicators
Cost Approach	
OCLD	\$ 5,750,000
RCNLD *	\$ 13,032,000
Sales Comparison Approach	Not relied upon
Income Approach	
DCF	\$ 7,332,000
Fair Market Value	\$ 7,332,000

* Excludes adjustment for economic obsolescence

Note: Table values may not equal exhibit values due to rounding to the nearest \$1,000

NewGen relied on the income approach to value because a buyer, evaluating the System on a purely financial basis, should not be willing to pay more than the income value unless external factors specific to the buyer's situation are influencing the purchase, which would be at odds with the definition of Fair Value. NewGen did not rely upon the Sales Comparison Approach due to difficulties in comparing transaction data. Difficulties are due to the fact that no two utilities are exactly alike - the technologies employed differ; the customer composition, use, and growth all differ; and the regulatory environments sometimes differ.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

1 MR. CREECH: Mr. Lane is available for
2 cross examination and any questions from the
3 Commission.

4 COMMISSIONER HUGHES: Okay.

5 EXAMINATION BY COMMISSIONER HUGHES:

6 Q. Mr. Lane, we took away some of the surprises
7 here by being third, but we may be able to make it a
8 little quicker if we can start by just understanding
9 something fairly basic. It appears -- the bottom line
10 of your appraisal is -- you focus on the income
11 approach and using the income approach to come up with
12 your bottom-line number.

13 A. We considered all three approaches. We rely
14 primarily on the income approach, yes.

15 Q. Okay. Primarily meaning the number that is
16 at the -- that you put forward, that is the number
17 that's coming directly from your income approach?

18 A. It's our opinion that that's the most
19 reliable indicator value in this case.

20 Q. Okay. Very high level, so we maybe can avoid
21 going through all the details of the approaches you
22 didn't use, but could you just briefly say why you
23 didn't use the other ones again.

24 A. I want to be clear. We did use them. All

1 three approaches inform our opinion of value. We
2 considered all three approaches. All three approaches,
3 we like to say, hung together, told us a complete
4 story, and affirmed our opinion that the income
5 approach was the most likely indicator of value.

6 We don't typically rely on the market
7 approach to value because there are so many differences
8 between utilities: customer density, regulatory
9 environment, political environment, general economic
10 area, that it makes it a very difficult exercise to
11 make adjustments to get them to be apples-to-apples.

12 In addition, and probably more importantly,
13 the transactions that we get the data for that are
14 publicly available, they don't tell the whole story.
15 We don't know what strategic synergies there were, what
16 strategic incentive there was for a particular purchase
17 price. We know of instances where utilities
18 intentionally overpaid and, you know, had to write down
19 the overpayment simply to keep a competitor out of
20 their backyard.

21 Those don't show up in the data, in the
22 newspaper, right? So we don't know what their
23 incentives were, what their motives were. We can't
24 account for that. And so we don't typically use that

1 approach as a primary indicator of value. We use it as
2 a check.

3 The cost approach, we use to set the lower
4 and upper bounds of value. We know that no prudent
5 seller would sell for less than original cost
6 depreciated. And no prudent buyer would buy for more
7 than replacement cost depreciated. All right? So
8 those set the lower and upper bounds. It tells us that
9 if we do an income approach and the number is beyond
10 replacement cost less depreciation, we've done
11 something wrong, we need to go back and look at it. If
12 the market approach comes in at a different number
13 that's outside those bounds, we've done something
14 wrong, we need to go back and look.

15 All three approaches should tell you a
16 similar story, and in this case they did for us.

17 Q. Okay. That's helpful. I did just have to
18 comment or get a follow-up question on one of the
19 things that you just said, that no willing seller would
20 sell below the original cost --

21 A. Outside of some other motivation.

22 Q. Okay. Okay. That last part. Okay. Because
23 we do have some evidence that the County --

24 A. Outside of some other noneconomic motivation,

1 yes.

2 Q. Okay. Because we do have evidence in the
3 record --

4 A. Sure.

5 Q. -- that the County --

6 A. Sure.

7 Q. -- did make a potential sales offer to --

8 A. Right.

9 Q. -- or merger offer to Beaufort. Okay. So
10 let's focus on the income just because you primarily
11 relied on that.

12 A. Sure.

13 Q. Okay. So I'm gonna jump right into some of
14 your calculations.

15 A. Okay.

16 Q. So on page 4 to 6 of your report, you state
17 that you developed a regulated retail revenue
18 requirement for the system and performed a discounted
19 cash flow analysis to identify the income value for the
20 system.

21 A. Yes.

22 Q. So I take that to mean that -- and correct me
23 if I'm wrong -- that regulated retail would actually be
24 what I think the previous speaker referred to as an

1 investment value. Or it is a value for somebody that
2 is underneath our regulation as opposed to, say, a
3 municipal government.

4 A. So no, it's not the same. Let me just
5 clarify. Agree completely with Mr. Walker's
6 characterizations of investment value versus fair
7 market value. Two different standards, the standard
8 here is fair market value. We differ slightly. That
9 might surprise you that two appraisers differ.
10 Slightly that the most -- the hypothetical purchaser
11 should be the most likely or the most likely purchaser.
12 In our opinion, the most likely purchaser of a utility
13 such as this is a regulated investor-owned utility,
14 right?

15 And so we looked at a basket of market
16 comparable investor-owned utilities to develop a return
17 on equity and a weighted average cost of capital, which
18 gives us a discount rate, which also gives us a return
19 on rate base that we could apply to the rate base which
20 we based on the County's accounting records to develop
21 revenues. And then we used benchmarks to develop
22 expenses for that hypothetical third party.

23 So we have revenue that's derived from rate
24 base and return on rate base, expenses based on a

1 benchmark of other utilities to develop a cash flow
2 that is then discounted back to present value.

3 Q. It makes sense. But if I'm looking -- if I'm
4 looking puzzled, it was to your remark that you -- that
5 you based the rate base on the accounting records of
6 the County. Could you just say a little bit --

7 A. Sure. We worked with the County, they gave
8 us their audited financials. We have the original cost
9 less depreciation that was in their records. We looked
10 at the differences in depreciation. Our calculation
11 showed that there should probably be 53 percent
12 depreciated, it was actually more like 50 percent
13 depreciated. So it was close. We didn't feel like we
14 were so far apart that we should substitute our
15 opinion. And so we used their accounting records.

16 And I think -- let me just -- that number
17 would be \$5,750,000 on Table 4-1.

18 Q. Okay. So that makes sense. Are you aware
19 that, under our fair value regulatory regime, what the
20 application today, or that's in front of us today and
21 yesterday, what it's actually trying to do, and it's in
22 the title of the application, is to establish the rate
23 base?

24 A. Yes, I am.

1 Q. Okay. So -- so my challenge with
2 understanding the income approach is, you're using the
3 income approach to establish the rate base for fair
4 value purposes under our requirements, yet you are
5 taking the rate base from accounting records from a
6 county government and plugging it into your
7 calculations.

8 Isn't there some circularity in this approach
9 and logic?

10 A. I wouldn't call it circularity. What I would
11 say is that, if an entity is going to make a purchase
12 of an asset, this is the approach they would use. They
13 would look at the -- what they consider to be
14 appropriate rate base, what they could earn a return
15 on, which is invested capital. And they would apply
16 their ability to earn a return and an appropriate
17 discount rate, and they would come up with a value or a
18 range of values based on that income approach.

19 Q. Okay. So following up on that, it was
20 difficult, there's a lot of tables. I'm an engineer, I
21 like tables, I like Excel. To the best that I could
22 tell, your final number that is put forth is using a
23 rate base, and correct me if I'm wrong, of \$5,904,123.
24 There's a -- there's a line in, I think it's Table 6

1 where it says that the -- it's one of your tables and
2 the calculations. Carteret water system income
3 approach revenue requirement water system Table 6 of
4 your calculations.

5 A. (Witness peruses document.)

6 Q. And this is some of your detailed
7 calculations where you are determining what the
8 revenues would be for this system. So I think, in your
9 description, that would be what the revenues the
10 applicant would hope to be getting.

11 A. Yes.

12 Q. Do you have that table?

13 A. I'm not finding the number that you're --
14 when I look at Table 6, it does not --

15 Q. It's line number 9 of Table 6.

16 A. Oh, in the report. In the report or in the
17 exhibit?

18 Q. Exhibits, I'm sorry.

19 A. Exhibit 1?

20 Q. It's Exhibit 1B.

21 MR. CREECH: May I approach?

22 Q. And I apologize, sometimes we have three
23 labels on this because --

24 CHAIR MITCHELL: It's Exhibit 1B in the

1 application. It's Table 6 in your appraisal
2 report.

3 THE WITNESS: In the body of the report
4 or in the exhibits?

5 COMMISSIONER McKISSICK: Exhibit 1B.

6 MR. CREECH: May I approach?

7 CHAIR MITCHELL: Somebody get the table
8 in front of him.

9 COMMISSIONER McKISSICK: It's in
10 Exhibit 1B.

11 COMMISSIONER HUGHES: And again,
12 apologies, there's some multiple labeling here
13 going on, we're not --

14 COMMISSIONER McKISSICK: Table 6, 1B.

15 MR. CREECH: It is page 32.

16 THE WITNESS: Oh, line number 9, rate
17 base, \$5,904,000. Yes, sir, I have that. I was
18 looking at it all along.

19 Q. No, and I apologize, I have an excerpt of the
20 table, and just in this little excerpt I have three
21 references, so I apologize for that.

22 A. If you can see -- just for clarification.
23 You can see on row 3, we had the net utility plant,
24 \$5,749,000, which came from their -- the County's

1 records. And then we have -- we add working capital,
2 took out some accumulated deferred income tax, and that
3 gives us the \$5,904,000 number. So that's what our
4 assumed rate base was.

5 Q. I appreciate that clarification. So you
6 didn't pull a number directly from the County's --

7 A. It was the basis of our calculation, but we
8 did further analysis to it, yes.

9 Q. Okay. So again, this spreadsheet and this
10 model is designed to produce a value that we are to
11 consider as the rate base for --

12 A. Yes.

13 Q. -- the applicant?

14 A. Yes.

15 Q. Imbedded in this model -- and it's a little
16 buried, but it's pretty clear, you even call it rate
17 base -- is a number of 5 point -- roughly \$5.9 million.
18 And then you put that in and that produces the fair
19 value from your income approach.

20 A. Yes.

21 Q. Circular or not, if it turned out to be that
22 the fair value hypothetically was \$9.5 million as
23 the -- as the applicant has put forth, and you
24 replaced, in your calculations, the rate base number of

1 \$9.5 million -- I mean, you replaced the \$5.9 million
2 with \$9.5 million and ran it again -- you don't have to
3 run it now, but would the -- would the income number
4 that came out the end, would it be, in your opinion,
5 significantly higher or higher than what your math
6 produced by putting in \$5.9 million?

7 A. It would be higher than what's in there now,
8 yes.

9 Q. Okay.

10 A. It would be in excess of the 9.5.

11 Q. Okay. So if you put in here, then your
12 income approach would have produced a higher -- higher
13 value that you put forward?

14 A. It would, yes.

15 Q. So the value that you put forth is dependent
16 on -- mathematically, not in theory, but is
17 dependently -- is dependent on you establishing a rate
18 base in your formula of \$5.9 million?

19 A. It is. It's also dependent on, you know, the
20 discount rate and the return on rate base and all of
21 the assumptions that go into the calculation.

22 Q. No, I understand. And your discount rate, I
23 think, is -- you probably heard us talking about
24 discount rates in some of the previous ones. I do

1 think that you use the discount rate as if -- which is
2 pretty comparable to what Carolina Water's weighted
3 average capital cost --

4 A. Yeah, and we actually did an analysis using
5 their numbers for illustration purposes. Didn't rely
6 on it, but it's in the report.

7 Q. Okay. Did you do it -- you didn't do an
8 analysis using their 9.5?

9 A. No.

10 Q. Okay. Okay. In other states that you've
11 done this with, just gone through a similar exercise,
12 is this generally the process that you would -- for the
13 income approach?

14 A. It's a very similar process. The whole
15 process is very similar to other states, yes.

16 Q. Okay. I think that's it for my questions
17 related to --

18 COMMISSIONER HUGHES: Do other
19 Commissioners have any other questions?

20 (No response.)

21 COMMISSIONER HUGHES: Okay. We will now
22 go to questions on questions. We didn't get the
23 order, but I'm gonna assume Public Staff, you, in
24 this case, want to go last.

1 MR. CREECH: Yes, Chair.

2 COMMISSIONER HUGHES: Okay. Okay. And
3 you're closer, Mr. Drooz, I'm gonna go with you.

4 MR. DROOZ: I'm good with that. And
5 these are cross questions as well as any questions
6 on Commission questions, if that's okay. Because I
7 think this is the only time he's up here.

8 COMMISSIONER HUGHES: Yes.

9 MR. DROOZ: Thank you.

10 CROSS EXAMINATION BY MR. DROOZ:

11 Q. Okay. Just to sort out page numbering up
12 front, what I have in front of me is a copy of your
13 filed testimony with an MGL-2 attached to it; do you
14 have that?

15 A. Yes.

16 Q. And at the top of your MGL-2, you have
17 pages 1 through 97; is that correct? I just want to
18 make sure we're all using -- the two of us are using
19 the same page numbering convention.

20 MR. CREECH: (Indicating.)

21 THE WITNESS: Oh, for the report.

22 MR. CREECH: Looking at exhibit to your
23 testimony, yes.

24 THE WITNESS: Okay. Yes. Okay.

1 Q. And where possible, I may also reference the
2 page number down at the bottom which was the way it was
3 filed, the Application, just to help others. Okay.

4 So I understand, as you stated in your
5 report, that the purpose of your appraisal is to assist
6 in determining the fair value of the Carteret County
7 water system in accord with applicable laws and
8 statutes and the uniform standards for professional
9 appraisal practices; is that correct?

10 A. Yes.

11 Q. Okay. And the applicable law and statutes
12 would, in this case, be General Statute §62-133.1A, the
13 fair value statute; is that right?

14 A. That's correct.

15 Q. Okay. And I believe you defined fair value
16 as the price at which a willing seller and a willing
17 buyer with -- both having knowledge of the relevant
18 facts and not being under any compulsion, would agree
19 to a price of the sale of the system; is that fair?

20 A. That's fair.

21 Q. Is that essentially a fair market value?

22 A. Essentially.

23 Q. So you -- if I'm correct, and please let me
24 know if I'm not, as sort of a starting point for at

1 least your cost approach, and also as help for your
2 income approach, you used the Draper Aden report on the
3 original cost value of the Carteret system?

4 A. We used the Draper Aden report for the
5 condition assessment, and we also for the inventory and
6 the -- and we utilized the replacement cost as an
7 allocation methodology to allocate the plant's
8 account- -- the County's planned accounting records to
9 asset accounts.

10 Their records weren't separated by asset
11 account. And so in order to get appropriate
12 depreciation rates, we wanted to get it into separate
13 asset accounts. And so we used Draper Aden's
14 replacement cost calculations as that allocator.

15 Q. And in doing that, did you look at the cost
16 of assets that were contributed as well as those paid
17 for by the County?

18 A. The contributed assets are included in the
19 number, yes.

20 Q. And the reason for doing that is a buyer
21 would be obtaining the value of those assets, whether
22 they are contributed or funded some other way?

23 A. Well, we did it because the way that the
24 statute is written requires it to be done. That

1 distinction about including contributed assets or not
2 including contributed assets is handled differently in
3 different jurisdictions. And so it's really a policy
4 question, and I had no -- you know, I had no leeway
5 there.

6 Q. Right. So have you read Mr. Junis'
7 testimony?

8 A. Yes, I have.

9 Q. And you're aware that he recommends a value
10 that deducts the value of the contributed assets?

11 A. I'm aware of that.

12 Q. Okay. That's not how a professional
13 appraisal would do it, is it? Under the USPAP.

14 A. Well, I mean, no, but I don't think Mr. Junis
15 was doing an appraisal, so.

16 Q. Right. And the purpose of the appraisal was
17 to recommend a fair value?

18 A. That's correct.

19 Q. Okay. So on page 13, you begin talking about
20 the cost approach, and you've got an OCLD, original
21 cost less depreciation, and the other one is the
22 replacement cost less depreciation.

23 I think you described one as the lower bound
24 and the other as the upper bound; is that right?

1 A. That's right.

2 Q. Okay. So for the land value of the Carteret
3 County system, I believe you have a number of \$98,126;
4 is that correct? Table 1 of MGL. Or that's on your --
5 I think that's your page 23 of your MGL-2.

6 A. (Witness peruses document.)
7 \$98,126; is it that what you said?

8 Q. Yes.

9 A. That's correct.

10 Q. And that's in the column that you have
11 labeled as original cost, right?

12 A. It is.

13 Q. Okay. So you're using the original cost of
14 the land and not the present value of the land; is that
15 correct?

16 A. For original cost, yes.

17 Q. Yes. Okay. In terms of coming up with an
18 appraisal value, would it be more appropriate to use
19 the current value of the land?

20 A. I'm -- I think, if you're appraising land,
21 then you use the current value of the land. That's not
22 what this -- this was analysis as a part of an
23 appraisal, it's not the complete appraisal.

24 Q. But the land for the County's water system is

1 part of what is being purchased?

2 A. Sure.

3 Q. Okay. I think Mr. Hughes stole some of my
4 questions. You -- but I'm gonna ask a little bit along
5 these lines.

6 Looking again at your Table 1, which is in
7 your MGL-2, it's on page 23, it looks to me like the
8 bottom line, 33, you've got for the Carteret County
9 water system, a replacement cost of \$25-some-million,
10 and an original cost of roughly \$12.3 million; is that
11 correct?

12 A. Yes, roughly.

13 Q. And then you take -- in column R, you take
14 accumulated depreciation of \$6-and-a-half million, and
15 you subtract that from the original cost to get your
16 \$5,749,000 figure; is that correct?

17 A. That's correct.

18 Q. Okay. Also included in your MGL-2 at page
19 67 --

20 A. (Witness peruses document.)

21 Q. -- this is the Draper Aden report.

22 A. I'm there.

23 Q. Okay. And this is, frankly, just because I'm
24 not sure how all this is done, but it has -- this is

1 Draper Aden describing what they did, the theory of
2 asset valuation.

3 And I see a line that says they're trying to
4 estimate the present worth of an asset as the
5 historical cost minus accumulated depreciation plus
6 current depreciation; is that correct?

7 A. I see that.

8 Q. And is that how they arrived at their -- at
9 the \$12.3 million original cost that you show on your
10 Table 1?

11 A. Did you say original cost?

12 Q. That's what your label says on Table 1.

13 A. Yes.

14 Q. And it says --

15 A. That would not be how they arrived at
16 original cost, that would be how they would arrive at
17 their original cost less depreciation, I believe.

18 Q. Okay. So that's their original cost less
19 depreciation.

20 And do you understand they updated that in
21 March of '22 to, I think, roughly \$12.7 million?

22 A. That's my understanding, yes.

23 Q. Okay. So if the -- let's just work with
24 what's in your table, the \$12.3 million in round

1 numbers.

2 If that is Draper Aden's original cost minus
3 depreciation -- accumulated depreciation -- why, in
4 column R, do you do a subtraction for accumulated
5 depreciation again?

6 A. I said this -- so if you go back to the 67,
7 that calculation they did there is how they get to --
8 so we're not understanding each other. I did not -- I
9 did not use their original cost less depreciation. I
10 only used their replacement cost less depreciation to
11 allocate the original cost of the assets on the
12 County's books to asset classes.

13 Q. So how do you get to that \$5.7 million? Is
14 it not subtracting depreciation from the 12.3? I
15 haven't even done that math, but, you know, if you can
16 walk me through that.

17 A. Let me get back there.

18 (Witness peruses document.)

19 Okay. So --

20 (Witness peruses document.)

21 So we have a replacement cost estimate in
22 column -- it's not even labeled, but it says engineer
23 replacement cost estimate, \$25 million. The original
24 cost -- it says in footnote 4:

1 "Original cost from Carteret County audit
2 fiscal year '21, costs are allocated based
3 off of the Draper Aden Associates engineering
4 report dated March of 2022."

5 The \$12.3 million comes from original cost
6 from the County. Not their net but their original.
7 That number is allocated to these asset classes based
8 on the replacement cost estimate in the Draper Aden
9 report.

10 Q. Okay. So the \$12.3 million from the County
11 audit, is that net of accumulated --

12 A. That is not net --

13 Q. -- depreciation?

14 A. That is not net, that is gross.

15 Q. Okay. Thank you. That helps.

16 You have calculated a replacement cost, and
17 what is your number on that? Replacement cost less
18 depreciation?

19 A. (Witness peruses document.)

20 Replacement cost less depreciation, you see
21 it on Table 2, which is on page 24, on row 33, of
22 \$13,032,241.

23 (Reporter interruption for
24 clarification.)

1 THE WITNESS: \$13,032,241. Are you not
2 hearing me well?

3 MR. CREECH: Not as well.

4 Q. So what weight did you give this replacement
5 cost less depreciation in your reconciliation?

6 A. So we don't reconcile approaches in our
7 opinion of value, because, in our opinion as a firm, it
8 is too subjective to weight approaches. We utilize --
9 as you can see, we utilize the cost approach and our
10 income approach. We use -- we utilize market-based
11 approaches to arrive at a cost of capital and a return
12 on rate base in our income approach as well.

13 And so the income approach includes aspects
14 of both the cost approach and the market approach. So
15 it's a much more holistic view of value that encaptures
16 all of the economic and functional obsolescence
17 associated with the assets. And so, in this case --
18 not in all cases, but in this case, it was our opinion
19 that the income approach was the most reliable
20 indicator of value.

21 Q. And the income approach looks at a stream of
22 payments over time discounted to present value; is that
23 right?

24 A. It is.

1 Q. And the stream of payments is, essentially,
2 based on what you believe the revenues are to cover
3 operating expenses plus revenues that are the rate of
4 return times the rate base?

5 A. That's correct, yes.

6 Q. Okay. And for that rate base figure in
7 there, what did you use?

8 A. We used the 5 million -- bear with me one
9 second, I want to get the exact right number. It's
10 roughly \$6 million, but I want to get the exact right
11 number. \$5,904,123.

12 Q. Okay. You did not use a rate base number
13 derived from replacement value, did you?

14 A. We did not.

15 Q. Okay. This is more derived from the original
16 cost value; is that right?

17 A. That's correct.

18 Q. Okay. So you use the lower bound but not the
19 upper bound for your income approach?

20 A. Yes, because I don't know of a utility that's
21 allowed to earn a return on its replacement cost.

22 Q. Well, that's an interesting question here.
23 But the -- in terms of a new statute.

24 But did you consider, since you had an upper

1 bound and lower bound, doing the calculation based on
2 the average of the two?

3 A. I also don't know any utility that's allowed
4 to earn a return on an average of the two.

5 Q. Is it typical for a utility return to be
6 granted on a rate base that looks at original cost less
7 depreciation?

8 A. That is a component, typically, of
9 determining what rate base is, yes.

10 Q. And fair market value may well be higher than
11 that; is that correct?

12 A. Fair market value typically is some small
13 multiple of that rate base, yes.

14 Q. So you're looking, in your income approach,
15 at using a rate base amount based on original cost less
16 depreciation with whatever appropriate adjustments --

17 A. Yes.

18 Q. -- under a traditional regulatory framework,
19 to produce a rate base amount under a fair value?

20 A. That's correct.

21 Q. Okay. And again, you don't see a circularity
22 in there?

23 A. There's -- to the extent that there's
24 circularity in ratemaking, there is some circularity in

1 this -- in the income approach, but it's -- it's an
2 accepted methodology.

3 MR. DROOZ: Couple minutes here.

4 COMMISSIONER HUGHES: And excuse me, I
5 think we're gonna take a break for the court
6 reporter. But I do apologize, you did request
7 cross. I jumped the gun with my questions. So
8 just to make sure everyone is straight, we're gonna
9 take a break until 11:15, come back, finish your
10 cross. We will allow Public Staff to do any
11 redirect on the cross. I don't think anyone else
12 has any cross. You do have cross? Okay.

13 MR. WHEATLY: Just a few.

14 COMMISSIONER HUGHES: Okay. So we will
15 come back at 11:15, we'll finish the cross, you
16 will do your redirect. That very well might have
17 led to some more Commissioners' questions. So
18 again, I apologize for going a little out of order,
19 but that's the way we'll proceed.

20 MR. DROOZ: Thank you.

21 MR. CREECH: Thank you.

22 (At this time, a recess was taken from
23 11:06 a.m. to 11:17 a.m.)

24 COMMISSIONER HUGHES: Okay. Mr. Drooz,

1 I believe we are with you with your last few cross
2 questions.

3 MR. DROOZ: Thank you.

4 Q. Your discount factor used in your income
5 approach, you were looking at an overall weighted
6 average cost of capital, and as part of that overall
7 weighted average cost of capital, you assumed a return
8 on equity of 12 percent?

9 A. We estimated cost of equity of approximately
10 12 percent using the capital asset pricing model.

11 Q. If the -- and I believe you've reflected this
12 in your testimony.

13 If the actual cost of capital for Carolina
14 Water was lower than the number you used in doing your
15 income approach, then basically that's gonna reduce the
16 discount factor and increase the number for the --
17 produced by the income approach; is that correct?

18 A. The lower the discount rate, the higher the
19 value.

20 Q. Thanks. You did look at the sales -- the
21 market sales comparison approach as well?

22 A. I considered it, yes.

23 Q. Yeah, yeah.

24 A. And did the analysis.

1 Q. I think that's in your Table 4.2, but as I
2 read that, it says you looked at a median sales price
3 per original cost less depreciation and a median sales
4 price per customer; is that correct?

5 A. That's correct.

6 Q. Okay. Do you know, have you done an analysis
7 to determine if the Carteret County system is
8 comparable to the median in those sales?

9 A. I'm not sure I understand what you're asking.
10 Can you clarify that?

11 Q. Well, your sales approach has numbers for
12 medians.

13 A. Oh, we applied those to Carteret County to
14 arrive at an estimated value using that cost -- that
15 market approach.

16 Q. Right.

17 A. And you can see that in Table 4.2, the
18 indicator of value applies their metric, the County's
19 metric to those.

20 Q. And my question really is, do you know if the
21 Carteret system is comparable to a median?

22 A. As I testified earlier, it's very difficult
23 to know whether Carteret County is comparable to any of
24 those utilities in that transaction. The transactions

1 are typically not, you know, well publicized, they
2 don't publish in the paper what their strategy was or
3 why they made the purchase offer that they made. It's
4 very difficult. So no, I don't know whether they're --
5 I would not know how to characterize their
6 comparability beyond the numbers.

7 Q. Thank you. Do you know if the USPAP --
8 USPAP, professional appraisal practices, requires a
9 reconciliation among the three approaches if you
10 consider all three approaches?

11 A. It requires you to consider all three
12 approaches. It requires you to use your judgment as to
13 the reconciliation and which approach is the most
14 likely indicator of value.

15 Q. And in your judgment, only the income
16 approach was appropriate here?

17 A. I don't think that's a fair characterization
18 to say only the income approach was appropriate. I
19 think that the income approach was the most likely and
20 appropriate indicator of value. They're all
21 appropriate.

22 Q. The other appropriate approaches didn't move
23 your number off of the income approach, did they?

24 A. No, because -- for several reasons that we've

1 already talked about, but also because the numbers
2 didn't differ appreciably from the income approach.

3 Q. Almost done here. If you will, turn back to
4 page 23 of MGL-2, which is your Table 1.

5 A. Okay.

6 Q. And for the lines 14 through, I guess, 22,
7 you've got distribution system. And in column D, you
8 show an in-service date or install date of 1988 for all
9 the distribution system; is that correct?

10 A. That's correct.

11 Q. Are you aware that the vast majority, if not
12 all, of that distribution system was installed after
13 1988?

14 A. We didn't have that data, so if I had that
15 data, I would have put different dates.

16 Q. And if the dates were much more recent, there
17 would be less of an accumulated depreciation deduction
18 from the value of those assets; is that right?

19 A. Possibly, yes.

20 Q. Okay.

21 A. Okay. Thanks. That's all my questions.

22 COMMISSIONER HUGHES: Okay. Redirect.

23 MR. GRANTMYRE: I believe the County had
24 some cross.

1 COMMISSIONER HUGHES: I apologize again.

2 Mr. Wheatly, it's with you for cross.

3 MR. WHEATLY: Thank you, sir, just a few
4 questions.

5 CROSS EXAMINATION BY MR. WHEATLY:

6 Q. Mr. Lane, what is the total figure that you
7 contend the fair market value of this property is, of
8 what date?

9 A. As of January 1, 2022, our fair market value
10 opinion is -- I want to get the exact number for you.

11 (Witness peruses document.)

12 Well, sorry. These are out of order.
13 \$7,332,000.

14 Q. Which, basically, is a little more than half
15 of the cost approach less depreciation, the
16 \$13 million, something like that?

17 A. Essentially, yes.

18 Q. Now, in your process of doing --

19 A. I'm sorry, I'm sorry, can you -- which -- I
20 may have misheard you.

21 Q. The cost approach, the paper that was handed
22 out today --

23 COMMISSIONER HUGHES: Excuse me, could
24 both of you speak to your mic.

1 THE WITNESS: Sorry.

2 Q. Is \$13,032,241 figure that you just read a
3 few minutes ago.

4 A. That is, I believe, the original cost.
5 That's the replacement cost new less depreciation.

6 Q. Yes, sir.

7 A. Yes.

8 Q. Now, when you do your appraisal work, you go
9 back and look at what has happened from when you're
10 doing your appraisal backward to see what has happened
11 in the market, right?

12 A. Yes.

13 Q. And yet Carolina Water Service and Aqua
14 Service, they're basically working in the future,
15 right? I mean, they're making plans for the future.
16 You can tell them what it was in the past, but they
17 know what it's worth in the future, don't they?

18 A. Well, the income approach inherently looks at
19 future revenues, so -- and capital expenditures and
20 expenses. So it's looking in the future as well. I'm
21 not sure I'm understanding your question.

22 Q. And yet you know they're two reputable
23 companies who made offers to purchase our company in
24 excess of your appraised value. Two companies in

1 North Carolina, right?

2 A. Yes, sir.

3 Q. Why, if they -- why would they do that?

4 A. Why would they make offers in excess of my
5 opinion of fair market value?

6 Q. Yes, sir.

7 A. There is any number of strategic reasons they
8 might do that. I don't know their internal reasoning.

9 Q. There is some value that they know about as
10 water companies that you don't, isn't there?

11 A. There may be -- I don't know the answer to
12 that, sir. I don't know what they're thinking. I
13 can't possibly insert my opinion into their
14 calculations.

15 Q. So if this deal goes through, then we've got
16 market data information now showing what a system of
17 this size is worth, don't we?

18 A. You have market data that shows what a
19 particular investor was willing to pay for that
20 particular system.

21 Q. And the fact there were five upset bids was
22 competitive, and have all that transparency, that
23 should be a benefit to an appraiser looking to value a
24 small system, wouldn't it?

1 A. Again, I'm not understanding your question.

2 Q. Let me ask you another question.

3 What do you contend the percent of inflation
4 has been on this system? And if so, would that change
5 the evaluation date effective from your date?

6 A. Over what period, in the last year?

7 Q. Yeah.

8 A. 10 percent or more has been what the
9 inflation is, and it changes the number. I can't,
10 without running the numbers and doing the calculations,
11 tell you how much.

12 Q. Well, you know, we've heard -- we've heard
13 the figure 5, plus a depreciation, bringing it to 3.
14 We've heard a number of 10, depreciation of 2, bringing
15 the number to 8 -- 8 percent.

16 So you're at 10; do you also agree on the
17 depreciation at 2?

18 A. Roughly.

19 Q. So you're contending that your report should
20 be increased by 8 percent to be fair?

21 A. Sir, I don't think it's appropriate to do
22 that kind of calculation on the stand without doing the
23 due diligence and running the math. Does it change the
24 value? Yes, it changes the value. I cannot tell you

1 how much it changes the value.

2 Q. Well, you do this appraisal work all day long
3 every day, don't you?

4 A. Not all day every day, but.

5 Q. Pretty much?

6 A. Quite a bit.

7 Q. And you're aware of the depreciation issues,
8 and you're also aware of the inflation that's happening
9 with regard to components used in water companies, are
10 you not?

11 A. I am.

12 Q. And I think you said that it was generally
13 10 percent increase based upon the last year?

14 A. Yes.

15 Q. And the fact that you don't have the time to
16 do those absolute calculations, the best value we got
17 today of you sitting on that stand would be an
18 8 percent increase, would it not?

19 A. I can't put a number on that, sir. If you
20 would like for me to run the calculations again, I
21 could do that. But I don't think it's appropriate for
22 me to sit here and pretend that I can run those
23 calculations in that spreadsheet in my head. That's
24 not appropriate.

1 MR. WHEATLY: I have no further
2 questions, sir.

3 COMMISSIONER HUGHES: Okay. Thank you.
4 Mr. Creech?

5 REDIRECT EXAMINATION BY MR. CREECH:

6 Q. Mr. Lane, we talked, I think, a little bit at
7 the outset relating to the statute, and I think
8 Mr. Drooz had a question on that.

9 You're not -- you're not a lawyer, are you?

10 A. I am not.

11 Q. And -- but you -- you've taken a look at the
12 statute there, have you not?

13 A. I have.

14 Q. And how would -- you know, on the top of the
15 statute there -- again, we're looking at the fair value
16 statute -- does the word "public interest" -- is that
17 anywhere in the appraisal aspect in there?

18 A. I don't believe so, no.

19 Q. All right.

20 MR. CREECH: I also have -- I'd like
21 to -- I need to approach opposing counsel first
22 momentarily. I have one exhibit I'd like to
23 introduce, if I could. And this is Public Staff
24 data request number 8. It had originally -- it

1 does not have the attachment which was a
2 confidential attachment. This is entitled "Corix
3 Acquisition." So this is just the substance of the
4 Word document but not the attachment of that
5 document.

6 So I've been -- I've been apprised by
7 counsel for the Company that this is no longer a
8 confidential document, at least this Word document.
9 And I will approach counsel and confirm that.

10 COMMISSIONER HUGHES: Please do.

11 (Pause.)

12 MR. WHEATLY: Zeke, can I have one, too?

13 MR. CREECH: Yes, sir.

14 (Pause.)

15 MR. CREECH: All right. Mr. Junis, if
16 you'll give a copy to Mr. Lane, then we'll go ahead
17 and get started.

18 Q. Mr. Lane, if you will turn to the second --
19 well, this is, again, Public Staff Data Request 8, and
20 it's a two-page Word document front and back that you
21 have there. Can you turn to the back page there and
22 read -- just you can read the -- starting at the second
23 sentence there -- excuse me, the third sentence, you
24 can read the response, please.

1 A. Starting with "that is"?

2 Q. Yes.

3 A. "That is, none were subject to the
4 North Carolina statute at hand in the current
5 proceeding, nor has any other CWSNC affiliate
6 purchase been subject to the North Carolina
7 fair value statute. In addition, purchases
8 of existing systems inherently include a
9 variety of considerations, such as seller
10 type, asset age and condition, compliance
11 issues, capital investment required,
12 contiguity with buyer's service territories,
13 et cetera."

14 Q. Thank you.

15 MR. CREECH: And, Chair Hughes, my
16 apologies, we'd like to mark this as Public Staff
17 Lane Redirect Exhibit Number 1.

18 COMMISSIONER HUGHES: So marked. And
19 note for the record that -- because it's labeled as
20 confidential still, that the parties consulted and
21 it's no longer confidential.

22 MR. CREECH: Yes, sir, thank you.

23 (Public Staff Lane Redirect Exhibit
24 Number 1 was marked for identification.)

1 Q. And with respect to that language, what --
2 how does that comport with your discussion earlier on
3 marked comparables?

4 A. I agree with it and, and these are all of the
5 issues that I have with using the market approach as a
6 primary indicator of value.

7 Q. Thank you, Mr. Lane, no more questions.

8 COMMISSIONER HUGHES: Okay. So we will
9 go to back to Commissioners' questions, if there is
10 any further ones. All right. Go ahead,
11 Commissioner Duffley, please.

12 EXAMINATION BY COMMISSIONER DUFFLEY:

13 Q. So good morning.

14 A. Good morning.

15 Q. Did you hear the testimony of Mr. Walker
16 today?

17 A. I did.

18 Q. And did you hear the Commission questions
19 relating to the income approach and his testimony that
20 he used the rates, that, when the County increased the
21 rates by 95 percent for that two to three months, and
22 then he didn't revise the --

23 A. I heard that, yes.

24 Q. -- appraisal?

1 Did you use those rates as well?

2 A. No, ma'am. We used a hypothetical
3 third-party purchaser method -- methodology. And so we
4 used a return on rate base to develop the revenue
5 associated with our income approach. So we didn't use
6 the actual rates of the County. That's not how that
7 third-party purchaser would, you know, do ratemaking.
8 They would do ratemaking in front of the Commission
9 determining rate base and a return on rate base.

10 Q. Thank you. And I think you testified to that
11 already, but hearing it again, it sunk in this time.
12 Thank you.

13 COMMISSIONER HUGHES: Okay. So just
14 questions on Commissioner questions, and both feel
15 free on my original questions or Commissioner
16 Duffley's questions.

17 MR. DROOZ: None from the Company.
18 Thank you.

19 MR. WHEATLY: None from the County, sir.

20 MR. CREECH: No questions.

21 COMMISSIONER HUGHES: Okay. With that,
22 looks like your service here is complete. Thank
23 you very much for your testimony, Mr. Walker, and
24 for your time. And you're not on rebuttal, so you

1 are excused.

2 MR. CREECH: Chair Hughes, if I could, I
3 would like to move the admission of Mr. Lane's
4 exhibits -- two exhibits.

5 COMMISSIONER HUGHES: Yes, that shall be
6 done.

7 MR. CREECH: Excuse me, his prefiled
8 testimony consisting of four pages and two exhibits
9 marked MGL-1 and 2 as supplemented today.

10 COMMISSIONER HUGHES: So those -- so
11 moved and marked.

12 (Public Staff Exhibit Attachment MGL-1
13 and MGL-2 were admitted into evidence.)

14 MR. CREECH: Public Staff would like to
15 call Charles Junis.

16 COMMISSIONER HUGHES: Just let me know
17 when you're settled. All right. You know the
18 drill. Good morning. Mr. Junis.

19 Whereupon,

20 CHARLES JUNIS,
21 having first been duly sworn, was examined
22 and testified as follows:

23 COMMISSIONER HUGHES: Proceed.

24 DIRECT EXAMINATION BY MR. CREECH:

1 Q. Mr. Junis, will you please state your name,
2 position, and business address for the record.

3 A. Yes. My name is Charles Junis. I'm the
4 director of the water, sewer, and telephone division of
5 the Public Staff. My business address is 4030 North
6 Salisbury Street, Dobbs Building, in Raleigh,
7 North Carolina.

8 Q. And, Mr. Junis, on October 14, 2022, did you
9 prepare and cause to be filed in this docket, testimony
10 consisting of 37 pages, an Appendix A, and seven
11 exhibits marked Public Staff Junis Exhibits 1 to 7?

12 A. Yes, sir.

13 Q. And do you have any changes or corrections to
14 your testimony?

15 A. No, sir.

16 Q. If I were to ask you those same questions
17 today, would your answers be the same as in your
18 prefiled testimony?

19 A. Yes, sir.

20 MR. CREECH: Chair Hughes, I move that
21 Mr. Junis' direct testimony be copied into the
22 record as if given orally from the stand, and that
23 Mr. Junis' Appendix and Exhibits 1 to 7 be
24 identified as marked when filed.

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COMMISSIONER HUGHES: So granted.
(Junis Exhibits 1 through 7 were identified as they were marked when prefiled.)
(Whereupon, the prefiled direct testimony of Charles Junis was copied into the record as if given orally from the stand.)

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. W-354, SUB 398

OCTOBER 14, 2022

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

**TESTIMONY OF
 CHARLES JUNIS
 ON BEHALF OF
 THE PUBLIC STAFF –
 NORTH CAROLINA
 UTILITIES COMMISSION**

OFFICIAL COPY

Nov 24 2022

1 **Q. Please state your name, business address, and present**
2 **position.**

3 A. My name is Charles Junis. My business address is 430 North
4 Salisbury Street, Dobbs Building, Raleigh, North Carolina. I am the
5 Director of the Water, Sewer, and Telephone Division of the Public
6 Staff – North Carolina Utilities Commission.

7 **Q. Briefly state your qualifications and duties.**

8 A. My qualifications and duties are included in Appendix A.

9 **Q. What is the purpose of your testimony?**

10 A. The purpose of my testimony is to present to the Commission the
11 Public Staff's review and recommendations regarding the application
12 filed on July 26, 2022, and revised on August 11, 2022, by Carolina
13 Water Service, Inc. of North Carolina (CWSNC) requesting
14 determination of fair value of utility assets pursuant to N.C. Gen. Stat.
15 § 62-133.1A and establishment of rate base for acquisition of the
16 Carteret County Water System (Application).

17 The following table of contents serves as a convenient reference to
18 the areas of my investigation presented in detail with my findings and
19 accompanying recommendations:

1 Table 1

Topic	Beginning Page No.
N.C.G.S. § 62-133.1A Commission Rules R7-41 and R10-28	Page 4
Application and Engineering Assessment	Page 7
Site and Visit Plant Conditions and Operations	Page 14
Appraisals	Page 23
Rate Impact	Page 25
Fair Value	Page 29
Recommendations	Page 35

2 **Q. Please briefly summarize your investigation and**
3 **recommendations.**

4 A. I have reviewed the application and exhibits filed in the subject
5 docket and accompanying filings in Docket No. W-354, Sub 399. I
6 have conducted discovery of CWSNC, Hartman Consultants, LLC
7 (Hartman), Carteret County (County), and Gannett Fleming
8 Valuation and Rate Consultants, LLC (Gannett Fleming). I have
9 worked with Public Staff Financial Manager Lynn Feasel to evaluate
10 the fair value, purchase price, and rate impacts.

11 The average of the three appraisals is \$10,935,667 and exceeds the
12 purchase price of \$9,500,000. CWSNC estimates that the fees and
13 closing costs will be a total of \$175,000, but could be higher.

1 The monthly metered residential bill for a Carteret County customer
 2 using 4,000 gallons under present rates and after establishing the
 3 Carteret County water customers as a system specific rate division
 4 of CWSNC, and treating the associated \$9.5 million purchase price
 5 and \$0.175 million estimated fees and closing costs as rate base,
 6 are shown in the table below.

7 Table 2

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

8 The rate impact of the purchase price and associated costs as shown
 9 in the table above is not reasonable. The Carteret County Water
 10 System is not troubled. CWSNC has failed to show material benefits
 11 will be provided to the acquired customers without harm to them or
 12 its existing customers. Based on these considerations, which are
 13 further detailed in my testimony, the fair value is not reasonable and
 14 the public interest is not served, therefore, I recommend that the
 15 Commission deny the fair value application.

16 **Q. What is fair value of utility assets pursuant to N.C.G.S. § 62-**
 17 **133.1A?**

18 A. The procedure for a fair value determination of an existing water or
 19 wastewater system owned by a municipality or county or an authority
 20 or district established under Chapter 162A of the General Statutes

1 was enacted by Session Law 2018-51 (House Bill 351), N.C.G.S. 62-
2 133.1A (Fair Value Statute), which became effective June 25, 2018.
3 Although there are similar statutes in other states, the appraisal
4 process for potentially determining rate base is new to North
5 Carolina. Fair value, for rate-making purposes under N.C.G.S. § 62-
6 133, shall be the average of the three appraisals (buyer, seller, and
7 Public Staff). N.C.G.S. § 62-113.1A(b)(1)(c). Alternatively, if the
8 Commission finds that the average of the three appraisals will not
9 result in a reasonable fair value, the Commission may adjust the fair
10 value as it deems appropriate and in the public interest. N.C.G.S. §
11 62-113.1A(e). The rate base value of the acquired system, which
12 shall be reflected in the acquiring public utility's next general rate
13 case for rate-making purposes, shall be the lesser of the purchase
14 price negotiated between the parties to the sale or the fair value plus
15 the reasonable fees and costs. N.C.G.S. § 62-113.1A(b)(4).

16 **Q. Has the Commission adopted rules to implement the Fair Value**
17 **Statute pursuant to N.C.G.S. § 62-133.1A(f)?**

18 A. Yes, on December 31, 2019, in Docket No. W-100, Sub 60, Aqua
19 North Carolina, Inc. (Aqua), and CWSNC (together, Companies) filed
20 a petition requesting that the Commission establish a rulemaking
21 proceeding in this docket for the purpose of considering and adopting
22 rules to implement N.C.G.S. § 62-133.1A. After receiving comments
23 from the Public Staff and reply comments from the Companies and

1 North Carolina Attorney General's Office (AGO), the Commission
 2 issued its Order Adopting Commission Rule R7-41 and Commission
 3 Rule R10-28 on December 30, 2020. Noteworthy from the discussion
 4 and conclusions of the order, the Commission agreed with the parties
 5 that the burden of proof is appropriately on the acquiring utility in all
 6 respects in the proceeding on the utility's application and for
 7 demonstrating that the acquisition of the Local Government Utility is
 8 in the public interest. The Commission therefore incorporated
 9 paragraph (h) into R7-41 and Rule R10-28.¹

10 **Q. What safeguards are included in the statutory provisions of**
 11 **N.C.G.S. § 62-113.1A?**

12 A. The AGO succinctly highlighted key statutory provisions on page 4
 13 of its reply comments filed on June 1, 2020, in Docket No. W-100,
 14 Sub 60, as follows:

15 The Commission has been provided three significant
 16 tools in the new statute in order to protect North
 17 Carolina consumers from unreasonable rate increases.
 18 First, the Commission is authorized to adjust the fair
 19 value determined by the three appraisals if it finds that
 20 the average will not result in a reasonable fair value
 21 that is appropriate and in the public interest. N.C. Gen.
 22 Stat. § 62-113.1A(e). Second, it may classify the
 23 acquired system as a separate entity for ratemaking
 24 purposes. Id. Treating the acquired system as a
 25 separate rate class for ratemaking purposes serves to
 26 protect the public utility's existing customers from

¹ (h) Burden of Proof.—The utility shall have the burden of proof regarding all aspects of the proceeding on an application filed pursuant to G.S. 62-133.1A and this Rule, and for demonstrating that the acquisition of the Local Government Utility is in the public interest.

1 upward pressure on their rates due to the acquisition,
2 but could result in very high rates for the customers in
3 the acquired system, depending on the particular
4 circumstances. Id. Third, the Commission may deny
5 the application. N.C. Gen. Stat. § 62- 133.1A(d).

6 **Q. Please briefly summarize the Application.**

7 A. The Application pleading on page one states, “CWSNC requests
8 Commission approval of the “fair value” determination contained
9 herein, and of the subsequent calculation of rate base value of these
10 assets that is derived by use of the “fair value” mechanism,
11 authorized under N.C.G.S. § 62-133.1A.” The Company describes
12 the statutory authorization and rules, the parties and contract to
13 purchase, determination of fair value, determination of rate base, and
14 the required elements of the application. On Form Application Exhibit
15 4, CWSNC lists the results of the three appraiser’s valuations and
16 the average as \$10,935,667.

17 **Q. Please briefly summarize the direct testimony of Donald H.
18 Denton.**

19 A. Donald H. Denton, Senior Vice President, East Operations for Corix,
20 and President of CWSNC and Blue Granite Water Company, filed
21 testimony in support of the Application and verified the contents as
22 true and accurate as required by the Commission form. CWSNC
23 witness Denton contends that purchase of a governmental system by
24 a Commission-regulated utility could not happen without fair value.

1 He further testifies to the benefits of consolidation, including capital
2 investment, cost efficiencies, and rate stability, which the Company
3 contends serves the public interest of both Carteret County and
4 CWSNC customers.

5 **Q. Do you have concerns about the testimony of CWSNC witness**
6 **Denton?**

7 A. Yes. Regarding the benefits to customers, witness Denton neither
8 quantifies the cost impact of the purchase price if established as rate
9 base or cost savings to be passed to customers, nor substantiates
10 the need for additional capital investment in the Carteret County
11 Water System, in either his testimony or in response to discovery,
12 shown in **Junis Exhibits 1 and 2.**²

13 **Q. Do you agree with any of the testimony of CWSNC witness**
14 **Denton?**

15 A. Yes. Witness Denton testifies to specific protections for customers of
16 the combined systems as follows³:

17 CWSNC emphasizes, in support of this filing, that the
18 “Fair Value” statute is replete with tools whereby the
19 Commission can protect ratepayers and maintain the
20 public interest. The NCUC retains the authority to set
21 rates for the acquired system in future rate cases, has
22 the discretion to classify the acquired system as a
23 separate rate entity in future rate cases, and has the

² Data request responses to Public Staff Data Requests 3 and 4, respectively.

³ Page 5, line 21, through page 6, line 5, Direct Testimony of Company witness Donald H. Denton filed in Docket No. W-354, Sub 398, on July 26, 2022.

1 authority to adjust the “fair value” as the Commission
2 deems appropriate and in the public interest.

3 These tools generally mirror those recognized by the AGO in its
4 rulemaking reply comments with the exception that the Commission
5 can approve, deny, or adjust the fair value as it deems appropriate
6 and in the public interest.

7 **Q. Please briefly summarize the engineering assessment.**

8 A. The Fair Value Statute requires that, “[t]he acquiring public utility and
9 selling utility shall jointly retain a licensed engineer to conduct an
10 assessment of the tangible assets of the system to be acquired, and
11 the assessment shall be used by the three appraisers in determining
12 fair value.”⁴ In this case, the starting point for the engineering
13 assessment is a document prepared by Draper Aden Associates
14 (Draper Aden) entitled “Feasibility Study for Water System Merger”
15 dated December 2019.⁵ For the use of the appraisers, CWSNC and
16 Carteret County retained Draper Aden “to conduct an assessment of
17 the tangible assets of the system to be acquired” and Draper Aden
18 produced “Update to Present Value of Water System” dated
19 December 2021.⁶

⁴ N.C.G.S. § 62-133.1A(b)(2).

⁵ Form Application Exhibit 5B.

⁶ Form Application Exhibit 5C.

1 **Q. What was the purpose of the Feasibility Study for Water System**
2 **Merger?**

3 A. In response to Public Staff Data Request 6, Question 5, shown in
4 **Junis Exhibit 3**, Carteret County states that it “applied and received
5 a Water System Merger Grant from the State of North Carolina in
6 2019.” The Executive Summary⁷ states as follows:

7 Carteret County (the County) retained Draper Aden
8 Associates (DAA) to evaluate the feasibility of a
9 “merger” of the County’s water systems with Town of
10 Beaufort’s (the Town) water system. The proposed
11 “merger” would entail the Town of Beaufort taking over
12 the ownership and operation of the County’s water
13 systems.

14 **Q. What was the recommendation?**

15 A. Draper Aden recommended that the County transfer the water
16 systems to the Town of Beaufort for one dollar (\$1). It was further
17 recommended that with the continued collection of special water tax
18 district revenues, the County would pay off its water fund debts in the
19 amount of approximately \$2,066,128 (principal only) and contribute
20 to the Town’s upgrades and expansions to the system over the next
21 11 years. Draper Aden also recommended modified water rates that
22 would have lowered the average monthly bill for 5,000 gallons

⁷ Form Application Exhibit 5B, at E1.

1 charged to Carteret County water system customers from \$55.10 to
2 \$46.09.⁸

3 **Q. Did Carteret County meet with the Town of Beaufort and discuss**
4 **the Town acquiring the water system?**

5 A. Yes. Carteret County states it met and discussed assuming the water
6 system assets and debt with the Town of Beaufort and even offered
7 the system to the Town in early 2020. However, the Town responded
8 that it did not wish to pursue merger at the time.⁹

9 **Q. Is there anything else in the Feasibility Study for Water System**
10 **Merger that is relevant to this proceeding?**

11 A. Yes. Regarding the County's capital improvement plan, Draper Aden
12 states¹⁰:

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

20

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

⁸ *Id.* at E2.

⁹ Junis Exhibit 3, Response to Question 5.

¹⁰ Form Application Exhibit 5B, at 6.

1 A significant portion of the document describes Draper Aden's
2 assumptions, calculations, and development of its estimate of the
3 water system assets' net worth of \$12,335,392. Of this amount,
4 \$10,241,142 is an estimate of present book value of existing land,
5 wellhouses, water treatment plant, and piping with no original cost,
6 discount rate, or depreciation. It is unclear why this was done at all
7 as it is not plainly required to receive the grant. Eligible projects for
8 Merger/Regionalization Feasibility Grants are described on the North
9 Carolina Department of Environmental Quality (DEQ), Division of
10 Infrastructure (DWI), website as "[s]tudies to evaluate the potential
11 consolidation or two or more systems into one system into one
12 system and the potential physical interconnection with another
13 system for regional wastewater treatment or regional water
14 supply."¹¹

15 The County has extensive accounting records to establish the
16 original cost less depreciation. Furthermore, the County has
17 maintained records detailing contributions in aid of construction and
18 funding sources. For example, part of Form Application Exhibit 5A,
19 pages 55 through 61 appears to be a document or partial email chain
20 from approximately 2009 that describes the development of the
21 water systems and finances, including the use of \$2.08 million from

¹¹ Available at <https://deq.nc.gov/about/divisions/water-infrastructure/i-need-funding/mergerregionalization-feasibility-grants> (last visited on October 12, 2022).

1 the Community Development Block Grant (CDBG) Program, \$3
2 million in state grants, \$0.1 million in sales tax refunds, and \$2.8
3 million in debt. In addition, Carteret County provided an Excel
4 spreadsheet detailing infrastructure by funding sources, which
5 shows a breakdown as follows: Grants (\$6,491,452 / 54.27%), Loan
6 (\$4,435,608 / 37.08%), Developer Paid (\$305,944 / 2.56%), Other
7 (\$727,732 / 6.08%), and Total (\$11,960,736 / 100.00%). This clearly
8 shows over half the capital investment was contributions. Shown in
9 **Junis Exhibit 4.**

10 **Q. How was the purchase price negotiated between the buyer and**
11 **seller?**

12 A. According to Carteret County Board of Commissioners meeting
13 minutes, CWSNC submitted an offer of \$4.9 million.¹² Based on
14 Board of Commissioners meetings, meeting minutes, and local news
15 articles, around that same time, Aqua submitted a bid of \$7 million.
16 At the February 15, 2021 meeting of the Board of Commissioners,
17 the high offer was accepted and the upset bid process began. My
18 understanding of the bids are summarized in the table below:

¹² Minutes from the February 15, 2021, Board of Commissioners' meeting.
<https://www.carteretcountync.gov/AgendaCenter/ViewFile/Minutes/02152021-1179> (last
visited on October 8, 2022).

1 Table 3

Date	Company	Bid Amount
January 13, 2021	CWSNC	\$4.9 million
February 2021	Aqua	\$7.0 million
March 1, 2021	CWSNC	\$7.5 million
March 23, 2021	CWSNC	\$8.5 million
April 18, 2021	Aqua	\$8.925 million
April 27, 2021	CWSNC	\$9.5 million

2 After the upset bid period expired and the County voted to accept the
3 \$9.5 million bid on September 20, 2021, and approve the contract on
4 October 18, 2021, as a result the County and CWSNC entered into
5 the Utility Asset Purchase Agreement dated October 18, 2021.

6 **Q. Have you visited the Carteret County Water System?**

7 A. Yes. On April 29, 2022, I, along with Public Staff Public Utilities
8 Engineer Mike Franklin and Attorney Zeke Creech and NewGen
9 Strategies and Solutions Consultant Mike Lane traveled to Beaufort
10 to meet with Carteret County staff, including Eugene Foxworth, Tony
11 Cahoon, and Arrington Moore, and visually inspected the North
12 River/Mill Creek (PWSID NC0416197) and Merrimon (PWSID
13 NC0416198) water systems.

- 1 **Q. Please briefly summarize your observations from the site visit.**
- 2 A. The wellhouses were well maintained and clean. The elevated
3 storage tanks were in various states of acceptable to good condition
4 based on staggered recoating schedules and are regularly
5 inspected, maintained, and recoated pursuant to a water tank
6 management agreement with Southern Corrosion Incorporated. The
7 water treatment plant, including greensand filters, water softeners,
8 ortho-polyphosphate feed system, chloramines disinfection, and
9 onsite backup generator, was in good condition. The North River/Mill
10 Creek distribution system is sprawling, including over 55 miles of
11 water lines, nearly 600 valves, 175 hydrants, and interconnections
12 with the Town of Beaufort and Craven County, to serve 1,200 plus
13 customers as of June 2022. The Merrimon system is approximately
14 18 miles away and serves about 20 customers.
- 15 **Q. What is your expert opinion of the condition of the utility**
16 **assets?**
- 17 A. Overall, it is my professional opinion that the utility assets are in good
18 condition and have been well maintained.
- 19 **Q. Were any deficiencies identified in the engineering**
20 **assessment?**
- 21 A. Form Application Exhibit 2 summarizes, “[n]o deficiencies noted.”

- 1 **Q. Did CWSNC include in its application a five-year plan for**
2 **prudent and necessary infrastructure improvements as**
3 **required by Commission Form FV1?**
- 4 A. No. Form Application Exhibit 2 states in pertinent part, “CWSNC
5 plans no significant improvement above routine O&M, such as tank
6 coatings which are covered in the current maintenance contract and
7 chlorine conversion from gas to liquid due to safety concerns.”
- 8 **Q. Does CWSNC anticipate the need for any major**
9 **improvements/additions in the next five to ten years?**
- 10 A. No. On page 8 of its Application for a Certificate of Public
11 Convenience & Necessity and for Approval of Rates filed in Docket
12 No. W-354, Sub 399, CWSNC states, “[n]o major improvements /
13 additions planned.”
- 14 **Q. Does CWSNC anticipate the need for any major replacements in**
15 **the next five to ten years?**
- 16 A. No. On page 8 of its Application for a Certificate of Public
17 Convenience & Necessity and for Approval of Rates filed in Docket
18 No. W-354, Sub 399, CWSNC states, “[n]o major replacements
19 planned.”
- 20 **Q. How would you describe the technical operations of Carteret**
21 **County?**

1 A. According to Public Water Supply Section records available on
2 Drinking Water Watch system, neither of the water systems have had
3 any violations issued or enforcement actions taken for over the last
4 six years. To my knowledge, the County provides safe, reliable, and
5 compliant service to the North River/Mill Creek and Merrimon water
6 systems.

7 The public hearing witness hearing on both the Fair Value
8 Application and the CPCN Application is scheduled at 7:00 pm on
9 Tuesday, October 18, 2022. CWSNC is required to file a report
10 addressing all customer service and service quality complaints
11 expressed at the public hearing within 14 days after the public
12 witness hearing. A Public Staff Utilities Engineer will attend the public
13 hearing and be available to answer questions before and afterwards.
14 A Public Staff Attorney will participate in the public hearing by
15 sponsoring customers who attend and choose to testify. Depending
16 on the content of customers' testimony at the public hearing and the
17 Company's report, the Public Staff may further investigate quality of
18 service and request the Commission's approval for an opportunity to
19 submit supplemental testimony.

20 It should be noted that CWSNC and the County entered into an
21 operation and maintenance oversight agreement dated January 24,
22 2022. Under the agreement, CWSNC provides a certified operator to

1 serve as Operator in Responsible Charge (ORC) and provides
2 consultation services to County staff for a maximum of one hour per
3 day pursuant to the terms and conditions.

4 **Q. How would you describe the management of the utility?**

5 A. According to Attachment 2B of Junis Exhibit 3, Carteret County has
6 operated the water fund, before transfers from other funds, at a loss
7 annually from 2003 through 2021. However, according to the
8 unaudited fiscal year 2022 data, the water fund had a profit of
9 \$39,605, or 3.7%. After transfer from other funds and capital
10 contributions from developers, the audited profit total over the life of
11 the system (2003-2022) is \$3,535,341. The ending equity through
12 2022, is \$5,805,173. While the operating losses were concerning,
13 the County has increased rates to cover its expenses, including debt,
14 and intends to accumulate a reserve in the future. The County has
15 also effectively sought and been awarded “cost free” capital grants
16 and below market interest rate loans to fund a significant portion of
17 capital needs. According to the FY23 Budget, the water fund is 0.7%
18 of the revenue in FY23. The County management is capable and has
19 shown the ability to improve its water fund financial outlook while also
20 managing a County-wide budget of over \$163 million.

21 **Q. Are Carteret County’s present rates sufficient to cover its**
22 **costs?**

1 A. Not quite. On June 21, 2021, the Carteret County Board of
 2 Commissioners voted to increase the water rates by 95% and
 3 reduced the water tax district rate from 5.5 cents to 0 cents per one
 4 hundred dollars valuation of property effective July 1, 2021. On
 5 September 20, 2021, the Carteret County Board of Commissioners
 6 voted to decrease the water rates by 25%. On June 20, 2022, the
 7 Carteret County Board of Commissioners voted to adopt the county
 8 budget ordinance and the water rates were maintained at a basic
 9 charge of \$40.25 per month, including the first 1,000 gallons, and a
 10 volume charge of \$10.10 per 1,000 gallons after the first 1,000
 11 gallons.¹³ The FY2023 Adopted Budget includes Water Fund
 12 operating revenues of \$1,085,000 and expenditures of \$1,160,000,
 13 therefore a budgeted deficit of \$75,000 is netted against the water
 14 fund balance resulting in a water fund balance of \$5,783,118.¹⁴

15 **Q. Does Carteret County have sufficient access to capital?**

16 A. Yes. Carteret County significantly expanded the water system in the
 17 2000s. Please also see the discussion of capital investment and
 18 funding on page 12 above.

¹³ Water Service FY 23 Fee Schedule. Available at
<https://www.carteretcountync.gov/DocumentCenter/View/10202/Water-Service-Fee-Schedule-FY2022-2023> (last visited on October 13, 2022).

¹⁴ 2023 Carteret County Budget. Available at
<https://www.carteretcountync.gov/ArchiveCenter/ViewFile/Item/1409> (last visited on October 13, 2022).

1 **Q. Is the Carteret County Water System designated as distressed?**

2 A. Yes. As of September 27, 2022, Carteret County has been
3 designated as distressed by the State Water Infrastructure Authority
4 and the Local Government Commission.¹⁵ A distressed unit is a
5 public water system or wastewater system operated by a local
6 government unit exhibiting signs of failure to identify or address those
7 financial or operating needs necessary to enable that system to
8 become or to remain a local government unit generating sufficient
9 revenues to adequately fund management and operations,
10 personnel, appropriate levels of maintenance, and reinvestment that
11 facilitate the provision of reliable water or wastewater services.¹⁶
12 Carteret County has received assessment scores of eight based on
13 2019 data and nine based on 2021 data. A unit providing only one
14 service, either drinking water or wastewater, is identified as
15 distressed if the total assessment criteria score is equal to or greater
16 than eight.

17 **Q. Does being designated a distressed unit have benefits?**

18 A. Yes. As a distressed unit, in addition to the Drinking Water State
19 Revolving Fund and Drinking Water Reserve Program, Carteret
20 County is eligible to apply for funds from the Viable Utility Reserve

¹⁵ Local Government Units Assessment Scores. Available at <https://deq.nc.gov/water-infrastructure/vur-assessment-unit-list-sept-2022/download?attachment> (last visited on October 8, 2022).

¹⁶ N.C.G.S. § 159G-20.(4a).

1 and additional construction grants¹⁷ funded by allocation from the
2 American Rescue Plan Act (ARPA).

3 **Q. After closing, would CWSNC have access to the benefits**
4 **available to a distressed unit?**

5 A. No. The distressed unit designation is limited to public water or
6 wastewater systems operated by a local government unit, as defined
7 in N.C.G.S. § 159G-20(4a) and (13). CWSNC will not have access
8 to millions of dollars of grants and below market interest rate loans.

9 **Q. Is it your understanding that distressed means something**
10 **different from the term troubled that is used commonly before**
11 **the Commission?**

12 A. Yes. The assessment criteria summary for the 2022 assessment and
13 assessment criteria scorecard specific to the Carteret County Water
14 System based on 2021 Audit data are provided as **Junis Exhibit 5**.
15 Carteret Count scored points for the following criteria:

- 16
- Population served of less than 10,000 people;
 - 17 • Debt service coverage ratio of less than 1.1;
 - 18 • Transfers of money from other sources into the water fund to
19 cover expenditures in at least 2 or more of the last 5 years;

¹⁷ Division of Water Infrastructure American Rescue Plan Act (ARPA) Administration Plan-Feb.2022. Available at <https://deq.nc.gov/water-infrastructure/dwi-arpa-administration-plan-feb-2022/download?attachment> (last visited on October 8, 2022).

- 1 • Service population of less than 100 people per mile of water
- 2 lines;
- 3 • Monthly water bill for 5,000 gallons in excess of \$50;
- 4 • Revenue deficit after expenses and debt service;
- 5 • Depreciation of utility assets exceeds 50%; and
- 6 • Operating margin less than 0.

7 A relatively small rural system with low rates, especially if revenues
8 are insufficient to cover expenses or supplemented by other sources,
9 will score highly in the assessment. However, Carteret County being
10 designated distressed for these criteria is correctable but has some
11 benefits as described above. Carteret County does not need
12 CWSNC to acquire the system at a cost premium to correct these
13 issues. The Carteret County Water System is not troubled in the
14 sense that the utility assets are beyond their useful life, there are
15 serious or widespread environmental compliance issues, lack of
16 capital funding, or is devoid of technical, managerial, and/or financial
17 expertise and capabilities.

18 **Q. Is it your understanding that the purpose of the Fair Value**
19 **Statute was intended to facilitate the sale and consolidation of**
20 **troubled systems?**

21 A. Yes. In support of the legislation, Aqua provided a summary
22 document on February 26, 2017, that states, in pertinent part, the
23 following:

1 North Carolina's water and wastewater industry is both
2 fragmented and in need of infrastructure infusion. This
3 fragmentation and lack of adequate funding sources
4 often result in systems that may lack operational
5 expertise and access to capital necessary to fund
6 investments that will keep their systems safe, reliable
7 and in compliance with environmental standards.

8 Shown on **Junis Exhibit 6**. The Carteret County Water System does
9 not lack access to capital and already provides service that is safe,
10 reliable, and in compliance with environmental standards. Aqua also
11 contends that the proposed legislation "[p]rotects customers of both
12 the governmental system and of the currently regulated system."

13 **Q. Please summarize the three appraisals.**

14 **A.** N.C.G.S. § 62-133.1A(b)(1) subsections a. and b. state as follows:

15 a. One appraiser shall represent the public utility
16 acquiring the system, another appraiser shall represent
17 the utility selling the system, and another appraiser
18 shall represent the Public Staff of the Commission.

19 b. Each appraiser shall determine fair value in
20 compliance with the uniform standards of professional
21 appraisal practice, employing cost, market, and income
22 approaches to assessment of value.

23 Hartman Consultants, LLC on behalf of CWSNC, Gannett Fleming
24 Valuation and Rate Consultants, LLC on behalf of Carteret County,
25 and NewGen Strategies and Solutions, LLC on behalf of the Public
26 Staff, each assessed the value of the Carteret County Water System.
27 The appraiser's valuations are as follows: Hartman – \$10,900,000,
28 Gannett Fleming – \$14,575,000, and NewGen – \$7,332,000, which
29 totals to \$32,807,000 and averages to \$10,935,667.

1 **Q. Do you have concerns about the appraisal performed by**
2 **Hartman?**

3 A. Yes. The valuation of \$10,900,000 is equal to \$8,536 per customer.
4 The cost approach heavily relied on the engineering assessment for
5 the original cost new less depreciation instead of County financial
6 records. The income approach was not exhaustively considered and
7 not relied upon. The market approach was highly selective and relied
8 on the top half average of the selected water system sales with
9 significant and unsubstantiated, upward rounding.

10 **Q. Do you have concerns about the appraisal performed by**
11 **Gannett Fleming?**

12 A. Yes. The valuation of \$14,575,000 is equal to \$11,413 per customer.
13 The cost approach heavily relied on the engineering assessment for
14 the original cost new (OCN) instead of County financial records and
15 calculated a theoretical accumulated depreciation (24% of OCN),
16 which is significantly lower than the County's records (over 50%).
17 These methods inflate the OCN and original cost new less
18 accumulated depreciation (OCNLD) that are the starting points for
19 the replacement cost method. The market approach relied on a
20 "Comparable Group." In comparison, the Carteret County Water
21 System is a government-owned utility with revenues, customer base,
22 and population of less than 2% of the smallest company of the
23 selected Comparable Group of IOUs.

1 **Q. As part of its application, did CWSNC include a statement about**
2 **the public utility’s future plans for integrating the acquired**
3 **system into an existing rate division?**

4 A. Yes, CWSNC proposes to transfer the customers at existing
5 rates as charged by Carteret County and then integrate them into its
6 uniform water rate division as part of its next general rate case.
7 CWSNC projects the present rates to be charged for the next four
8 years and then an increase of 28.19% in the average residential bill
9 in 2027. Form Application Exhibit 3. The Utility Asset Purchase
10 Agreement¹⁸ states as follows:

11 CWSNC would retain your current rates at the time of
12 APA execution until our next approved rate case, at
13 which time Carteret customers would move into our
14 then current rate structure. We anticipate the next rate
15 case filing would occur in July 2022 with new uniform
16 rates becoming effective 12-18 months after filing.

17 In response to Public Staff Data Request 2, Question 1, shown in
18 **Junis Exhibit 7**, CWSNC provided the following response:

19 The original Form Application Exhibit 3 rates were
20 based on estimates of the expected rate case filing in
21 the Sub 400 Docket. It was unknown at the time the
22 specific rate increases that would be requested by rate
23 group. Subsequent to the Sub 400 rate filing, CWSNC
24 has more information available as to its rates in 2027
25 with the subsequent rate case filing that would be
26 applicable to Carteret customers. The 2027 rates are
27 still an estimate at an approximate 5% increase in the
28 filing after the current WSIP period ending. Please see
29 attached DR#2 – Exhibit 3 Update.xlsx, table included
30 below.

¹⁸ Exhibit O to Form Application Exhibit 6B.

Docket	CWSNC Uniform Water					Carteret Avg. Residential Bill	
	Avg. Us	BFC	Usage/1,	Avg Bil.	Increase	Water	Increase
Sub 384	4000	24.53	11.71	\$ 71.37		\$ 70.55	
Sub 400 WSIP Yr 1	4000	28.78	13.57	\$ 83.06	16.38%	\$ 70.55	0.00%
Sub 400 WSIP Yr 2	4000	29.76	14.03	\$ 85.88	3.40%	\$ 70.55	0.00%
Sub 400 WSIP Yr 3	4000	30.72	14.48	\$ 88.64	3.21%	\$ 70.55	0.00%
New Filing	4000	32.26	15.20	\$ 93.07	5.00%	\$ 93.07	31.92%

1

2 **Q. What would be the rate impact to customers of the purchase**
3 **price and estimated fees and closing costs?**

4 A. Based on the lesser of the purchase price (\$9.5 million) negotiated
5 between the parties to the sale or the fair value (~\$10.9 million) plus
6 the proposed reasonable fees and costs, which is \$9.5 million plus
7 estimated fees and closing costs of approximately \$0.175 million,
8 Public Staff Financial Manager Lynn Feasel calculated the annual
9 revenue requirement to be \$1,181,882. Assuming system specific
10 rates for 1,277 customers¹⁹ in Carteret County, the average monthly
11 rate impact of the purchase price and estimated fees and closing
12 costs is \$77.13 per customer.

13 **Q. What would be the estimated rate impact to customers of**
14 **CWSNC's operations and maintenance expenses?**

15 A. Utilizing the O&M expense levels for CWSNC Uniform Water in the
16 Sub 384 rate case, Ms. Feasel calculated an annual O&M expense
17 per customer of \$439, which is equal to an average monthly rate
18 impact of \$36.58 per customer. This is an appropriate method of

¹⁹ Junis Exhibit 3, Attachment 3A, FY 2022 Billing Information.

1 high-level estimation because the Carteret County Water System is
 2 comprised of two water systems physically separated from each
 3 other and the rest of CWSNC's systems.

4 **Q. How did the Public Staff calculate the estimated rate impact to**
 5 **customers?**

6 A. The estimate of the Carteret County system specific average monthly
 7 residential bill is calculated as the sum of the revenue requirement
 8 of the purchase price and estimated fees and closing costs and the
 9 CWSNC Uniform Water O&M expense per customer from the Sub
 10 384 rate case. The County's present rates were approved by the
 11 Board of Commissioners on September 20, 2021, effective
 12 September 21, 2021. The monthly metered residential bill for a
 13 Carteret County customer using 4,000 gallons under present rates
 14 and after establishing the Carteret County water customers as a
 15 system specific rate division of CWSNC, and the associated \$9.5
 16 million purchase price and \$0.175 million estimated fees and closing
 17 costs as rate base, are shown in the table below.

18 Table 2 (from above)

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

19 CWSNC's present rates were approved on April 8, 2022, in Docket
 20 No. W-354, Sub 384. The monthly metered residential bill for a

1 CWSNC Uniform Water customer using 4,000 gallons under present
 2 rates and after incorporating the Carteret County water customers,
 3 and the associated \$9.5 million purchase price and \$0.175 million
 4 estimated fees and closing costs, are shown in the table below.

5 Table 4

Sub 384 – Uniform Water	Consolidated
\$71.37	\$74.59

6 As shown in Table 2 above, the rate impact of the purchase price far
 7 exceeds any conceivable benefits and is prohibitively large. While
 8 the rate impact of \$3.22 per month per customer, or 4.5%, on a
 9 consolidated basis harms both the acquired and existing customers
 10 at a magnitude comparable to the maximum allowable rate increases
 11 in Rate Year 2 and Rate Year 3 of the WSIP, pursuant to N.C.G.S. §
 12 62-133.1B.

13 **Q. Is the average of the three appraisals a reasonable fair value?**

14 A. No.

15 **Q. What is the original cost less depreciation of the Carteret
 16 County Water System?**

17 A. As of June 30, 2022, Carteret County's unaudited financial records
 18 indicate total capital assets less depreciation in the amount of
 19 \$5,402,027.

1 **Q. Is the original cost less depreciation net of contributions in aid**
2 **of construction or “cost free” capital?**

3 A. No.

4 **Q. What is the significance of contributions in aid of construction**
5 **or “cost free” capital on ratemaking?**

6 A. The significance is contributions in aid of construction (CIAC) offset
7 associated plant in service, thereby, reducing the return on rate base
8 and depreciation expense for ratemaking purposes. Customers are
9 not charged for plant by the utility that customers, builders,
10 developers, or someone else has already paid for. CIAC includes
11 grants, connection or tap fees, capacity fees, meter installation fees,
12 cash contributions from developers, utility plant installed or paid for
13 by the contributor and conveyed to the utility, and land conveyed by
14 the contributor to the utility.

15 **Q. In simple and concise terms, what would result from the**
16 **proposed sale at the current purchase price of \$9.5 million?**

17 A. The situation is analogous to a loan. Carteret County would collect
18 proceeds from the sale in the form of the purchase price that far
19 exceed its remaining liabilities (i.e., debt) and could use those net
20 proceeds to the benefit of the county government and its residents.

1 However, loans typically must be paid back.²⁰ Once the purchase
2 price is placed into rate base, the ratepayers would owe the balance
3 “of said loan,” \$9,500,000 plus reasonable fees, and interest to
4 CWSNC. Similar to a loan, the revenue requirement for annual
5 depreciation would function as payment of principal and the cost of
6 capital in the form of a return on the undepreciated balance and
7 interest on debt would function as the interest amount on the unpaid
8 balance.

9 **Q. Is rate base value established as \$9,675,000, which is the lesser**
10 **of the purchase price negotiated between the parties to the sale**
11 **and the fair value plus fees, in the public interest?**

12 A. No. There are a few considerations that should materially inform the
13 Commission’s decision when determining whether the purchase
14 price is in the public interest. Those include the rate base per
15 customer of the acquiring utility, and in this case the other bidder in
16 an upset bid process, the rate impact of the proposed acquisition, the
17 potential benefits to the acquired and existing customers and how
18 effectively and likely those benefits are to be realized, and the
19 Commission’s tried and effective acquisition adjustment criteria. The
20 rate base per customer amounts calculated by Public Staff Financial
21 Manager Lynn Feasel from the Commission’s orders in the most

²⁰ A relevant exception is funding offered by the State Revolving Fund, which may be eligible for principal forgiveness, and State Reserve Program Grants.

1 recently completed rate cases for CWSNC (W-354, Sub 384) and
 2 Aqua (W-218, Sub 526) are as follows in the table below.

3 Table 5

Rate Division	Rate Base	Customer Count	Rate Base Per Customer
Aqua Uniform Water	\$135,909,810	62,534	\$2,173
Aqua Uniform Sewer	\$60,371,609	16,515	\$3,656
Brookwood Water	\$27,073,706	13,821	\$1,959
Fairways Water	\$3,345,093	4,775	\$701
Fairways Sewer	\$10,435,206	3,042	\$3,430
CWSNC Uniform Water	\$68,514,633	29,317	\$2,337
CWSNC Uniform Sewer	\$62,678,740	17,209	\$3,642
BF/FH Water	\$3,321,564	3,533	\$940
BH/FH Sewer	\$9,141,959	3,613	\$2,530

4 The weighted average rate base per customer of the five water rate
 5 divisions listed in the table above is \$2,090, which is 10.6% less than
 6 the CWSNC Uniform Water rate base per customer of \$2,337. Given
 7 that 1) the acquisition cost of approximately \$7,576 per customer²¹
 8 is extraordinarily high and if established as rate base would
 9 negatively impact both the Carteret County customers to be acquired
 10 and CWSNC's existing Uniform Water customers, 2) the Company
 11 failed to quantify, let alone guarantee, cost efficiencies that result in

²¹ Based on the purchase price and estimated fees and closing costs, the proposed rate base per customer is \$9.675 million divided by 1,277 customers (as of June 2022 billing), which equals \$7,576.35.

1 cost savings to customers, and 3) the Company failed to show the
2 acquisition would provide material benefits to the acquired
3 customers, the public interest is not served by establishment of rate
4 base under N.C.G.S. § 62-133.1A.

5 It is a worthwhile exercise to consider for context the acquisition
6 adjustment criteria that would be used to evaluate the purchase price
7 prior to the Fair Value Statute, or if the system was not owned by a
8 governmental entity. As a general proposition, when a public utility
9 buys assets that have previously been dedicated to public service as
10 utility property, the acquiring utility is entitled to include in rate base
11 the lesser of the purchase price or the net original cost of the
12 acquired facilities owned by the seller at the time of the transfer. See
13 Order Approving Transfer and Denying Acquisition Adjustment
14 issued on January 6, 2000, in Docket No. W-1000, Sub 5; see *also*
15 *In re Carolina Water Service, Inc., of North Carolina*, Docket Nos. W-
16 354, Subs 74, 79, 81. The Commission has indicated "a strong
17 general policy against the inclusion of acquisition adjustments in rate
18 base subject to exceptions in appropriate cases." See Order
19 Approving Transfer and Denying Acquisition Adjustment issued on
20 January 6, 2000, in Docket No. W-1000, Sub 5. If not for the Fair
21 Value Statute, under which the acquiring utility has the discretion to
22 proceed, the potential acquisition of the Carteret County Water
23 System is not an exceptional situation that warrants an exception to

1 the general policy against including acquisition adjustments in rate
2 base. CWSNC has not demonstrated that an acquisition adjustment
3 will provide substantial benefits to all customers, and those benefits
4 outweigh the cost of including the acquisition premium in rate base.

5 In the Commission's Order Approving Transfer, Acquisition
6 Adjustment, and Maintaining Current Rates issued on April 30, 1997
7 for Heater Utilities, Inc.'s acquisition of the Hardscrabble Plantation
8 water utility system in Docket No. W-274, Sub 12, the Commission
9 found and concluded that the test for determining whether an
10 acquisition adjustment should be allowed in rate base is the following
11 three-prong test: (1) the benefit to ratepayers should outweigh the
12 cost of inclusion in rate base of the excess purchase price; (2)
13 system deficiencies would go unaddressed if not for the acquisition
14 of the acquiring company; and (3) the acquisition is the result of arm's
15 length bargaining. The Commission also noted that it is the
16 Commission's policy to encourage the orderly transfer of water and
17 wastewater systems from developers and small owners to reputable
18 water and wastewater utilities.

19 In the Commission's Order Approving Transfer and Denying
20 Acquisition Adjustment issued on January 6, 2000 for the transfer of
21 North Topsail Water and Sewer, Inc. 's wastewater system to
22 Utilities, Inc., the Commission discussed the circumstances when the

1 rate base treatment of acquisition adjustments should be deemed
2 proper. On page 27, the Commission stated the following:

3 As should be apparent from an analysis of the
4 Commission's previous Orders concerning this subject,
5 a wide range of factors have been considered relevant
6 in attempting to resolve this question, including the
7 prudence of the purchase price paid by the acquiring
8 utility; the extent to which the size of the acquisition
9 adjustment resulted from an arm's length transaction;
10 the extent to which the selling utility is financially or
11 operationally "troubled;" the extent to which the
12 purchase will facilitate system improvements; the size
13 of the acquisition adjustment; the impact of including
14 the acquisition adjustment in rate base on the rates
15 paid by customers of the acquired and acquiring
16 utilities; the desirability of transferring small systems to
17 professional operators; and a wide range of other
18 factors, none of which have been deemed universally
19 dispositive. Although the number of relevant
20 considerations seems virtually unlimited, all of them
21 apparently relate to the question of whether the
22 acquiring utility paid too much for the acquired utility
23 and whether the customers of both the acquired and
24 acquiring utilities are better off after the transfer than
25 they were before that time. This method of analysis is
26 consistent with sound regulatory policy since it focuses
27 on the two truly relevant questions which ought to be
28 considered in any analysis of acquisition adjustment
29 issues. It is also consistent with the construction of G.S.
30 62-111 (a) adopted in State ex rel. Utilities Commission
31 v. Village of Pinehurst. 99 N.C App. 224,393 S.E.2d
32 111 (1990), affd 331 N.C. 278,415 S.E.2d 199 (1992),
33 which seems to indicate that all relevant factors must
34 be considered in analyzing the appropriateness of
35 utility transfer applications. As a result, . . . the
36 Commission should refrain from allowing rate base
37 treatment of an acquisition adjustment unless the
38 purchasing utility establishes, by the greater weight of
39 the evidence, that the price the purchaser agreed to
40 pay for the acquired utility was prudent and that both
41 the existing customers of the acquiring utility and the
42 customers of the acquired utility would be better off [or
43 at least no worse off] with the proposed transfer,

1 including rate base treatment of any acquisition
2 adjustment, than would otherwise be the case.

3 **Q. Do you recommend approval of the Fair Value Application?**

4 A. No. I recommend that the Commission deny CWSNC's request for
5 determination of fair value of utility assets pursuant to N.C.G.S. § 62-
6 133.1A and establishment of rate base for acquisition of the Carteret
7 County Water System. For the reasons described above the
8 acquisition of the Carteret County Water System at the purchase
9 price does not serve the public interest. The average of the three
10 appraisals of \$10,935,667 is not reasonable, because it exceeds the
11 purchase price and would exacerbate the negative impacts. The
12 water and sewer utility industry is already facing immense upward
13 rate pressure from increasing expenses, needed infrastructure
14 improvements and replacements, contributions in aid of construction
15 reaching full amortization, and emerging contaminants. Incentivizing
16 acquisitions at this magnitude of cost premium while also lacking
17 material benefits does not serve the public interest.

18 **Q. Do you have an alternative recommendation if the Commission**
19 **does not deny the application?**

20 A. Yes. If the Commission does not deny the application, I recommend
21 the Commission exercise its authority under N.C.G.S. § 62-
22 133.1A(e) to adjust the fair value to a reasonable amount consistent
23 with the public interest.

1 **Q. Under this alternative recommendation, what do you**
2 **recommend is a reasonable fair value consistent with the public**
3 **interest?**

4 A. For context, the average of the three appraisals of \$10,935,667 plus
5 estimated fees and closing costs of \$175,000 is equal to a rate base
6 per customer of \$8,701. As stated above, the purchase price and
7 estimated fees and closing costs totaling approximately \$9.675
8 million is equal to \$7,576 per customer and if the Carteret County
9 Water System is incorporated into CWSNC's Uniform Water rate
10 division, the CWSNC Uniform Water rate base would increase by
11 over 14% but only add 4.4% more customers to spread costs across.
12 Therefore, the fair value must be adjusted to a reasonable amount in
13 the public interest.

14 The weighted average rate base per customer of the five water rate
15 divisions listed in the table above is \$2,090. This amount is below the
16 rate base per customer of the CWSNC Uniform Water rate division.
17 If the per customer amount of \$2,090 is assumed to be reasonable
18 fair value, the rate base of the Carteret County Water System would
19 equal to \$2,668,930.

20 As of June 30, 2022, Carteret County's unaudited financial records
21 indicate total capital assets less depreciation in the amount of
22 \$5,402,027. As shown on Junis Exhibit 4, 56.83% of the capital

1 funding was CIAC (either in the form of grants or developer
2 contributions). Therefore, the original cost less depreciation and
3 amortization of CIAC would be equal to \$2,332,055.²²

4 After weighting the second method twice that of the first, I
5 recommend that the Commission, pursuant to its authority granted in
6 N.C.G.S. § 62-133.1A(e)²³ and in the public interest, adjust the fair
7 value to \$2,444,347.²⁴

8 **Q. Does this conclude your testimony?**

9 **A.** Yes, it does.

²² Calculated as \$5,402,027 multiplied by 43.17%.

²³ (e) Commission's Authority. – The Commission shall retain its authority under Chapter 62 of the General Statutes to set rates for the acquired system in future rate cases, and shall have the discretion to classify the acquired system as a separate entity for rate-making purposes, consistent with the public interest. If the Commission finds that the average of the appraisals will not result in a reasonable fair value, the Commission may adjust the fair value as it deems appropriate and in the public interest.

²⁴ \$2,668,930 plus two times \$2,332,055, and divided by three.

QUALIFICATIONS AND EXPERIENCE

CHARLES JUNIS

I graduated from North Carolina State University, earning a Bachelor of Science Degree in Civil Engineering in May 2011. I am a licensed Professional Engineer in North Carolina since December 2015. I have over eleven years of water and wastewater engineering experience, and since joining the Public Staff in April 2013, have worked on general rate cases, new franchise and transfer applications, emergency operations proceedings, customer complaints, rulemakings, and other aspects of utility regulation. More specifically, I have assisted in the investigation and drafting of petitions and/or testified in the Webb Creek (Docket No. W-864, Sub 11), Riverbend Estates (Docket No. W-390, Sub 13), Mountain Air (Docket No. 1148, Sub 20), and Kinnakeet Shores (Docket No. W-1148, Sub 20) emergency operator proceedings. I also contributed to the Public Staff's Initial Comments and Recommended Rules filed in Docket No. W-100, Sub 60. Prior to joining the Public Staff, I worked for Farnsworth Group, an engineering and architectural consulting firm. Through this education and experience, I have gained considerable knowledge of relevant engineering and construction principles and utility operations, maintenance, and capital planning.

1 MR. CREECH: Mr. Junis is available for
2 cross examination and questions from the
3 Commission.

4 COMMISSIONER HUGHES: Okay. And I
5 believe we have two parties signed up for cross,
6 so.

7 CROSS EXAMINATION BY MR. DROOZ:

8 Q. Good morning.

9 A. Good morning, David.

10 Q. So I'm gonna, kind of, walk through your
11 testimony in sequence here just because that's how I --

12 A. In order makes it a lot easier for
13 references, so I think it's a good idea.

14 Q. Yeah. Page 4.

15 A. I'm there.

16 Q. You've got a Table 2 shows County present
17 rates, and by that you mean the average bill, and then
18 a Carolina Water system-specific rate; is that correct?

19 A. Yes, sir.

20 Q. And just for clarification, Carolina Water
21 has not proposed system-specific rates in this case; is
22 that right?

23 A. That's correct.

24 Q. Okay. So what you show in that Table 2 is

1 not what's proposed?

2 A. That is correct.

3 Q. Okay. I'm next gonna flip up to about pages
4 9 and 12. You reference the Draper Aden report.

5 And you -- this is just, kind of,
6 ministerial, but you note it was dated December 2021,
7 and you're aware that it was updated March of 2022 with
8 the new value of roughly \$12.7 million; is that
9 correct?

10 A. Yes, sir.

11 Q. Okay. Page 18 of your testimony.

12 A. You skipped a lot here.

13 Q. Well, you know, lunch is approaching.

14 A. I am hungry.

15 Q. And around the middle of that page, I think
16 it's line 11, you indicate that -- I believe you got
17 this from some Carteret County records.

18 You said there is an audited profit total
19 over the life of this system of approximately
20 \$3-and-a-half million?

21 A. That's correct. And that's a reference to
22 Junis Exhibit 3.

23 Q. Okay. Does that number of
24 \$3-and-a-half million include monies received from tax

1 revenues in addition to the rates charged to the users?

2 A. Will you repeat that question?

3 Q. Does that \$3-and-a-half million include
4 revenues from taxes used to support the system in
5 addition to the user rates?

6 A. (Witness peruses document.)

7 Yes, sir.

8 Q. Okay. And does it also include revenues from
9 developer contributions, if you know?

10 A. Yes, sir.

11 Q. On page 19, towards the bottom, you indicate
12 that Carteret County does have sufficient access to
13 capital, and so a couple of quick questions on that.

14 Do you have expertise in municipal finance?

15 A. No.

16 Q. And do you -- are you aware whether general
17 fund for the County can be used for utility cost?

18 A. So they have made appropriations of general
19 funds to the water fund in the past, and then they also
20 have a water fund-specific reserve that I know has
21 certain restrictions.

22 Q. And what's the source of money in that
23 reserve, if you know?

24 A. You're talking about the water fund balance?

1 Q. Well, I'm talking about the reserve you just
2 mentioned.

3 A. Yes. So it's my understanding that there are
4 a number of sources, one of which includes income from
5 the water fund.

6 Q. And was there a special taxing district set
7 up to help provide some of those monies?

8 A. There was.

9 Q. Has the Carteret County water system been
10 designated as distressed?

11 A. Yes.

12 Q. And is it your opinion that Carteret County
13 should correct that distressed classification without
14 selling the system to Carolina Water?

15 A. I think it can be corrected. Now, what I --
16 if it was up to me, I would suggest that the Carteret
17 County utilize that designation to its advantage and to
18 the advantage of its residents and customers to gain
19 access to certain funds. And that's detailed in my
20 testimony starting on page 20.

21 Q. Wouldn't it be preferable for the County,
22 from a finance point of view, to not be distressed
23 rather than to take advantage of being distressed?

24 A. So you -- that seems to have an insidious

1 connotation, and taking advantage can also be a good
2 thing. This is a benefit. Low cost or potentially
3 no -- free working capital is a benefit to customers.
4 It offsets costs. So -- and it's my understanding that
5 they even applied for funds in the fall. So that is
6 something that they're trying to use and have clearly
7 used in the past.

8 Q. But really in the long term, isn't it
9 appropriate for the County to try to get out of the
10 distressed classification?

11 A. There are certain factors that are up to its
12 control that would be beneficial to correct. There are
13 other factors that are not necessarily in its control
14 that will naturally still lead to a point designation
15 on the scorecard.

16 For example, density of customers. That
17 requirement is 100 people per mile of main. Well,
18 they're currently at 51 people per mile of main. That
19 density issue is not completely up to their control.
20 That depends on further development. Clearly, the
21 County has suggested that the installation of this
22 system was an economic development project. And, you
23 know, they tried to subsidize connections, and those
24 connections have not come through.

1 And that's what Mr. Hartman spoke to. It's
2 in my exhibits. There's 237 people that can connect to
3 the system at basically no cost, and they are choosing
4 not to for whatever reason. Likely, they have a well
5 that they feel sufficiently provides service to them.

6 Q. And I don't think we have any argument on
7 that.

8 Really, where I'm going with this is, isn't
9 it up to the prerogative of County government to decide
10 how to address distressed system status and the best
11 approach for them to take?

12 A. It is absolutely up to their prerogative.
13 However, as an expert before this Commission in
14 ratemaking and evaluating the fair value transaction,
15 and really where rates are, I think it's appropriate
16 that they utilize that access to those low-cost or
17 no-cost funds.

18 Q. I believe you were here when there was
19 discussion by Mr. Denton about his testimony that,
20 under the traditional original cost approach, there was
21 an obstacle to private utilities buying municipal
22 systems; do you recall that?

23 A. Yes. I'm very familiar with Mr. Denton's
24 prefilled testimony and his testimony yesterday.

1 Q. Right. He struck the word "insurmountable"
2 but left the word "obstacle"?

3 A. That's correct.

4 Q. Yeah. Now, if the county utilizes an upset
5 bid process, as allowed by statute, and sells his
6 property for \$9-and-a-half million, but the utility
7 that's buying it is looking at only getting rate base
8 of \$2-and-a-half million, do you think that might be an
9 obstacle to this kind of transaction occurring?

10 A. So that really becomes a business decision of
11 the utility. I recognize that it is unlikely for a
12 utility to want to, essentially, eat a \$7 million net
13 on its purchase price. However, we are tasked with,
14 and this Commission is tasked with, is that a
15 reasonable fair value and is it in the public interest.
16 And that is the question that I am responding to.

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

1 Q. I'll go with that.

2 So the statute requires professional
3 appraisals to give their opinion, right?

4 A. That is one component, yes.

5 Q. Right. And if their standards for the
6 industry require looking at fair market value, that
7 kind of tells you where the statute's going with this,
8 doesn't it?

9 A. I think the language of the statute is far
10 more important. That's what's controlling here.

11 Q. And speaking of the language of the statute,
12 we look in subsection (e) and there are the words
13 "reasonable fair value," and if the Commission finds
14 the appraiser average is not reasonable, then they can
15 adjust for public interest, right?

16 A. Yes. They can adjust the fair value as it
17 deems appropriate and in the public interest.

18 Q. All right. And I'm looking at the statute,
19 right?

20 A. Yeah. I just read it verbatim.

21 Q. Okay. And grammar question.

22 Is "reasonable" in that phrase an adjective
23 that modifies "fair value"?

24 MR. CREECH: I think that's -- I imagine

1 Mr. Junis can give -- I have an objection to the
2 statutory interpretation. I mean, getting into
3 adjectives and -- of the statute here. But if
4 there is a way that Mr. Junis can answer the
5 question without getting into statutory
6 interpretation, I would be fine with that.

7 MR. DROOZ: Mr. Junis has opined a lot
8 on the meaning of this statute, so I think it's a
9 fair line of cross.

10 COMMISSIONER HUGHES: Opine away.

11 THE WITNESS: Would you mind repeating
12 the question?

13 Q. Yes. Is the word "reasonable" modifying the
14 words "fair value" in that statute?

15 A. Yes. So the specific clause we're talking
16 about states, quote, if the Commission finds that the
17 average of the appraisals will not result in a
18 reasonable fair value, the Commission may adjust the
19 fair value as it deems appropriate and in the public
20 interest, close quote.

21 Q. And so at the end of the day, whatever public
22 interest adjustments made under this statute, the goal
23 is still to arrive at fair value; is that right?

24 A. I mean, the ultimate determination is what is

1 rate base. So that's the question that is posed to the
2 Commission, and that's the question that I attempt to
3 answer with my testimony.

4 Q. Okay. Let's look at page 22 down at the
5 bottom. And the question is:

6 "Is it your understanding the purpose the
7 fair value statute was intended to facilitate
8 the sale and consolidation of troubled
9 systems," and you say yes.

10 The word "troubled" is not in the statute, is
11 it?

12 A. That's correct.

13 Q. In your opinion, does a system have to be
14 troubled for the fair value statute to come into play?

15 A. One second. It does not have to be troubled.
16 However, the way the justification here, and when you
17 look at Exhibit 6, it implied that there was going to
18 be a need here. So there was a need for capital
19 improvement, there was a lack of compliance. Those
20 things are not here to justify that.

21 So distressed or troubled, I think it depends
22 on the circumstances and what is the benefits to
23 customers. Carteret County has shown that they can
24 make capital investment, not only to construct this

1 sprawling system, but to maintain that system and make
2 replacements. I mean, they built two elevated storage
3 tanks in 2012, have a water treatment plant that
4 provides quality service, and they haven't had
5 compliance issues.

6 Q. So you referred to Junis Exhibit 6 as a basis
7 for your statutory interpretation. And as I read your
8 testimony, I flip back to that Exhibit 6, it looks like
9 you're quoting from a statement made by Aqua
10 North Carolina, and that's your guide for the statutory
11 intent?

12 A. So as was discussed, I think with Mr. Denton,
13 that there was an effort by both Aqua and Carolina
14 Water to lobby for this statute. And that document --
15 we were -- it was supplied, this summary, in support of
16 the statute and a draft statute, which was very similar
17 to the version that was initially introduced in the
18 House.

19 Q. Thank you. So if the Carteret system cost
20 were added to the consolidated system to the cost of
21 service that's used to derive uniform rates, there
22 would be both a rate base component and an O&M, or
23 operations and maintenance component; is that a fair
24 statement?

1 A. That's correct.

2 Q. Okay. You are aware that Carolina Water has
3 proposed to keep the current County rates for this
4 system in effect for four years if they acquire it?

5 A. That's correct. That's detailed starting on
6 page 25 and going onto page 26. I do think it's
7 important, you know, that bid of 9.5, if you go back in
8 my testimony to -- it's page 14. That bid occurred on
9 April 27th of 2021. And as we talked about, as the
10 parties negotiated, Carolina Water had offered to hold
11 rates steady for a period of time.

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

19 Then the County raises rates 95 percent. All
20 of a sudden there is some feedback that, okay, that's
21 too high, so they bump it down 25 percent. And then
22 the County goes ahead and accepts the
23 \$9-and-a-half million bid, and then they approve the
24 contract with the hold steady on the rates again.

1 So Mr. Denton testified that there was no
2 influence on the rate increase for the County
3 customers, but I would suggest that that string of
4 events does show there was influence. Even if it
5 wasn't directly said by Carolina Water, you need to
6 increase your rates for us to do the hold on the rates,
7 that's essentially what happened. So I think that's an
8 important note.

9 Q. Yeah. And I appreciate that's something
10 y'all wanted to get into the record, even though it
11 didn't really relate to where my question is coming
12 from. And I hope the Public Staff will ask the County
13 witness about that as well. That's an invitation.

14 So getting back to the rate base component of
15 including this system in uniform rates, and the
16 four-year freeze on the rates, does that mean that
17 there would be an additional four years of accumulated
18 depreciation before this cost went into the rates being
19 charged for Carolina Water customers?

20 A. So -- can you repeat the question? I want to
21 make sure that I understand.

22 Q. Right. So let's say there's a rate base
23 component to the purchase by Carolina Water today or
24 this year.

1 In terms of what is put into rate base and
2 charged to uniform customers, four years down the road
3 there will be additional depreciation that would reduce
4 that rate base value by four years of accumulated
5 depreciation, wouldn't there?

6 A. Yes.

7 Q. Thank you. Did you take that additional four
8 years of accumulated depreciation into account when you
9 came up with your numbers for the rate impact on
10 customers?

11 A. So again, we're looking at what the rate
12 impact would be today. There is a variation there. As
13 you accumulate depreciation, obviously, the return on
14 the unaccumulated -- or on the undepreciated balance
15 will decrease.

16 Q. Okay. Thanks. Okay. Let's turn to the O&M
17 component of the Carteret system costs going into
18 Carolina Water's uniform revenue requirement.

19 So as I understand looking at what you have
20 done with Ms. Feasel's affidavit information, the
21 Public Staff looked at an O&M component cost of \$439
22 per customer; is that correct?

23 A. That's correct.

24 Q. Times, I think it's 1,254 customers on this

1 system, the Carteret system?

2 A. So you don't need to multiply, because we
3 just take it from a per customer to a monthly rate. So
4 you don't need to multiply by the number of customers
5 unless you're trying to set an annual revenue
6 requirement.

7 Q. Okay. Thank you. The \$439 per customer is
8 based on the O&M cost that the Company had in Sub 384
9 rate case?

10 A. That's correct. Now, Ms. Feasel would be the
11 best witness, and I believe she was excused, to speak
12 to how that number was calculated. But it is my
13 understanding that she removed certain expenses, such
14 as depreciation.

15 Q. Okay. She did not remove expense categories
16 for rent, corporate overhead, rate case expense,
17 general office expense, capitalized labor, did she?

18 A. You say that definitively. She calculated
19 that number, and again, she was excused from this
20 proceeding.

21 Q. If she did not include those, then that would
22 have been a mistake and they should have been deducted;
23 would you agree with that?

24 A. Can you run back through the list? I

1 wasn't --

2 Q. Okay. Let's look at rent for the Charlotte
3 office; that's an O&M expense that's not gonna go up
4 when you add the 1,254 customers from Carteret County,
5 is it?

6 A. It's an expense that is allocated across
7 customers.

8 Q. Is that a yes or a no?

9 A. Will you repeat the question?

10 Q. Yes. There is the Charlotte office expense
11 for Carolina Water; that's not gonna increase as a
12 function of adding these 1,254 customers in Carteret
13 County, is it?

14 A. No.

15 Q. Okay. Thank you. Same for rate case
16 expense.

17 Is that gonna go up as a function of adding
18 these 1,254 customers?

19 A. Past rate case expense would not, but who
20 knows going forward.

21 Q. General office expense, would that go up?

22 A. The total would not go up, no.

23 Q. Okay. What about purchased water? Let me --

24 A. Well, let me preface on that, because,

1 depending on staffing level, it could change. So, I
2 mean, they're -- some of these expenses get pretty
3 complicated, in terms of how they're incurred and where
4 the expense stems from.

5 Q. You don't expect Carolina Water to add an FTE
6 in its general office staff as a result of adding the
7 Carteret system, do you?

8 A. So it was my understanding that they were
9 possibly adding two FTEs to operate the system.

10 Q. That would have been field staff down in
11 Carteret County; is that right?

12 A. That's right.

13 Q. That's not general office, is it?

14 A. No.

15 Q. Okay. Thank you. So, you know, I'm not
16 gonna go through the whole list, but I did want to ask
17 about purchased water.

18 Is that part of the O&M expense in Sub 384,
19 if you know?

20 A. So yes, it would be. But I don't know,
21 again, what Ms. Feasel's adjustments to this O&M
22 expense was, and those questions would be best suited
23 for her.

24 Q. There is no purchased water expense for

1 Carteret County, though, is there?

2 A. Well, there is the opportunity to purchase
3 water from -- there's shared services here with the
4 interconnects between Beaufort and Craven County.

5 Q. That would only be on an emergency back-up
6 basis, not a routine bulk service, would it?

7 A. It depends on how you operate the system.
8 You might purchase water to do flushing. Depends on
9 the circumstances.

10 Q. You don't know that that's happened, do you?

11 A. I vaguely recall, in our site visit,
12 discussion about a potential purchase, but I don't know
13 for sure.

14 Q. Even if they did purchase some water for
15 flushing, that amount of purchased water expense would
16 not be proportional to the amount used in the Sub 384
17 case, would it, per customer?

18 A. No.

19 Q. So for depreciation expense, the Public Staff
20 used a 4 percent rate?

21 A. That's correct.

22 Q. And that's an O&M cost, too, right, isn't it?
23 Well, actually, it's an expense that goes into the
24 revenue requirement, I should say; is that correct?

1 A. That's correct.

2 Q. Yeah. And have you heard most recently
3 Mr. Lane, and before him other witnesses, indicate that
4 the depreciation rate for the Carteret system would be
5 more appropriately about 2 percent?

6 A. So that would be if you were using the
7 original in-service date, you would continue to use a
8 life of potentially 50 years. And that's predominantly
9 what Draper Aden used in their study. However, you
10 wouldn't restart depreciation of the assets on that
11 long of a life going forward. I think that would be
12 irresponsible.

13 Because those assets are depreciated, they do
14 have use, and I would not expect a 50-year life for the
15 entirety of the assets going forward. It is also very
16 inconsistent with how the assets have been already
17 depreciated by the County.

18 Q. Yeah. And I'm really not asking about the
19 useful life, I'm asking about the depreciation rate.
20 Are you proposing that the depreciation rate be changed
21 from 2 percent to 4 percent?

22 A. So again, if you are starting over with an
23 undepreciated \$9-and-a-half million asset and
24 depreciating going forward, and that's representative

1 of the system, I do not think that that is accurate or
2 appropriate.

3 Q. And the \$9-and-a-half million would be
4 related, not to the cost of the assets, but to the fair
5 value transaction, wouldn't it?

6 A. Which the Company is applying to put into
7 rate base. And I see no representation that they were
8 going to accumulate depreciation consistent with the
9 County on that \$9-and-a-half million, otherwise we're
10 cutting that in half, essentially, for ratemaking
11 purposes.

12 Q. Page 30. Moving along here.

13 A. (Witness peruses document.)

14 Q. That's where you list your public interest
15 factors, and I counted four of them there in the bottom
16 half of the page; is that correct?

17 A. So I believe you're referring to rate base
18 per customer, rate impact of the proposed acquisition,
19 potential benefits, and then the acquisition adjustment
20 criteria as a consideration.

21 Q. Right. So to your knowledge, has the
22 Commission ever used, to establish rate base in a
23 transfer or a CPCN case, a comparison to the amount of
24 rate base per customer of other systems?

1 A. So I think that is a factor that the Public
2 Staff looks at for reasonableness of a purchase price.
3 So, you know, we're obviously looking typically at the
4 lesser of original cost less depreciation, NCIC and the
5 purchase price. When looking at acquisition
6 adjustments and the appropriateness, something that we
7 could look at is rate base per customer.

8 Q. Right. But when the Commission looks at
9 lower of original cost or purchase price, that is done
10 regardless of what the rate base per customer of other
11 systems is, isn't it?

12 A. Correct. Because you're taking the lesser of
13 the two. In this concept, the Company wants to take,
14 essentially, the higher of those two.

15 Q. And they're doing that under the statute as
16 they interpret it, right?

17 A. Correct.

18 Q. Okay. And this is a new statute, so it's a
19 little bit different from how rate base has been
20 established in the past; is that right?

21 A. It is different, and I think it's important
22 to recognize that, that we are at an important case. I
23 think Ms. Sanford said it and Mr. Denton said it that,
24 you know, this is a case of first impression. And to

1 Mr. Grantmyre's point on cross of Mr. Denton, there are
2 cases that get referenced for decades to come. This
3 case might be that in the water and sewer industry of
4 how rate base is decided on transfers, and they can
5 have lasting cost impacts to customers.

6 Q. You could become a historical figure here.
7 So let's look at your fourth public interest saying,
8 what you call the Commission's tried and effective
9 acquisition adjustment criteria. And I think you talk
10 about that a lot on pages 32 to 34.

11 And again, just to, kind of, establish a
12 baseline here, when a utility buys another system for a
13 purchase price greater than the original cost,
14 typically the Commission's policy and the Public
15 Staff's position is that you do not allow the
16 difference between original cost and the purchase price
17 to go into rate base; is that correct?

18 A. Right. Some might refer to that as an
19 acquisition premium, but, essentially, yes. If the
20 purchase price exceeds the original cost, that is not
21 allowed, typically.

22 Q. But there are exceptions where there is a
23 good reason to incentivize a transaction because it's a
24 troubled system and you want to encourage a buyer to

1 pick it up and, basically, for lack of better words,
2 fix it?

3 A. Yes, that's one consideration. We're still
4 mindful of rate impact to both the acquired customers
5 and the existing customers of that utility.

6 Q. So if this longstanding acquisition
7 adjustment policy of the Commission and the Public
8 Staff's recommendations under that was sufficient to
9 incentivize private utilities to buy municipal systems,
10 there wouldn't be a need for the fair value statute,
11 would there?

12 A. So to my knowledge, and that's spanning
13 almost 10 years, I haven't seen a company bring such a
14 transfer to this Commission to test out that procedure.
15 Instead, the route has been to lobby for fair value and
16 now attempt to elect fair value to pay, in my opinion,
17 a premium cost that harms both the acquired customers
18 and the existing customers.

19 Q. And would you agree that this fair value
20 statute is intended by the legislature to incentivize
21 private utilities to purchase municipal systems?

22 A. So I would argue that there has been no
23 substantiation that this is a problem that needed
24 solved. We've asked that question of the Company. We

1 did not get clear answers or any answer to the
2 question. So how do you have a problem and represent
3 that the system doesn't work if you never bring that to
4 the Commission to test?

5 If there were failed purchases of municipal
6 systems, then I think we would be looking at,
7 potentially, new solutions with these potential
8 benefits. This case does not have that string of
9 benefits that would justify a premium being paid and
10 rolled into rate base.

11 Q. And if there was a problem that needed to be
12 solved, that could be addressed under the exception to
13 the acquisition adjustment policy as has been done in
14 the past; would you agree with that?

15 A. So you're saying the problem with the lesser
16 of original cost and the purchase price is then
17 addressed with the potential acquisition criteria --
18 the acquisition adjustment criteria?

19 Q. Actually, what I'm saying, in terms of how I
20 understood the question problem, if there are troubled
21 systems or systems that need a new owner in order to
22 operate better, then the acquisition premium, as you
23 call it, could be granted under the existing Commission
24 policy to incentivize those transactions; is that

1 right?

2 A. With an acquisition adjustment. And again,
3 Carteret County's not a troubled system.

4 Q. Right. And the legislature decided that an
5 incentive beyond that was needed when they passed the
6 statute, or otherwise there would have been no point in
7 having the statute; is that a fair statement?

8 A. Will you repeat the question? I want to make
9 sure I caught the front-end part.

10 Q. Right. Is there any need for the fair value
11 statute if the only purpose is to incentivize purchases
12 of troubled systems, given that there's already a
13 Commission policy to address that?

14 A. We're not limiting it only to troubled
15 systems. That's a frame of reference and a
16 consideration in our valuation. We didn't say the only
17 way to use fair value is a troubled system.

18 Q. Okay. I think we beat that horse. Page 36,
19 at the bottom, you indicate Carteret County's unaudited
20 financial records indicate total assets less
21 depreciation in the amount of \$5.4 million; are you
22 there with me?

23 A. Yes, sir.

24 Q. Yeah. And you use that as the starting point

1 for the value that then you subtracted CIAC to get
2 \$2.4 million?

3 A. That's correct.

4 Q. Okay. Regarding that \$5.4 million in the
5 County's financial records for the asset value, do you
6 know if those financial records show a book value that
7 assigns zero value to assets that are fully depreciated
8 on the books but still being used?

9 A. Let me turn to, I believe it's my Exhibit 3.
10 (Witness peruses document.)

11 All right. And do you mind -- on that, so
12 I'm looking at like the top of the page, it says
13 there's "schedule of revenues and expenditures, budget
14 and actual," and then on the next page it's "note 5,
15 capital assets."

16 Q. I'm flipping through here, I don't have page
17 numbers, so --

18 A. It's approximately --

19 Q. I see note 5. I got you.

20 A. Yeah, like the tenth page, maybe, ballpark.
21 Okay. And your question was pertaining to this?

22 Q. There may well be capital assets not shown on
23 the books because they're fully depreciated, but
24 they're still out there being used; is that your

1 understanding?

2 A. Yes. However, when you look at Exhibit 4,
3 which looks at, sort of, the funding and capital
4 investment costs, a majority of this system was
5 installed after 2000. We even had the County go ahead
6 and mark on a map the different phases that, sort of,
7 tie to these investments. A majority of the system is
8 not older than 33 years and would not significantly
9 change, in terms of assets still providing service.

10 Q. Yes. Were you here when I asked Mr. Lane a
11 question about that and he had the depreciation start
12 date as 1988, and that was a bit earlier than would
13 realistically apply to those assets, wasn't it?

14 A. So it's my understanding of Mr. Lane's
15 exhibit where you pointed out the 1988, that that
16 actually doesn't change his calculation of the net
17 plan, because he used the County's records. So he
18 wasn't calculating the depreciation of those assets to
19 get to that \$5 million number, he took the County's
20 number. So just an editorial note there.

21 Q. Right. We may have different views, and I'm
22 not gonna ask you about his exhibits. So the book
23 value, the \$5.4 million, you are aware that's not the
24 number that an appraiser would use in an appraisal

1 opinion as their OCLD; is that correct?

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

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

7 A. That's up to the appraisers.

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

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

11 Q. Okay.

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

13 Q. So you speak to the public interest, in terms
14 of your recommendation to the Commission. And as I
15 look at it, you are focused on the public interest to
16 ratepayers, and that's the mission of Public Staff,
17 right?

18 A. So yes. And when you refer to ratepayers, in
19 this case it's both the acquired customers and the
20 existing customers of Carolina Water.

21 Q. And you heard Mr. Denton's testimony that,
22 actually, the existing customers would not be harmed;
23 there might even be a slight reduction of the uniform
24 rates as a result of this acquisition?

1 A. So nowhere are those numbers presented in
2 testimony, and never has the Public Staff had an
3 opportunity to vet those numbers, so that is clearly an
4 unsubstantiated representation.

5 Q. Well, it was his testimony, and we actually
6 offered to put the exhibit in, and I believe your
7 counsel opposed that. So -- but I shouldn't be arguing
8 here. Let me move on with the questions.

9 Does the Carteret County have a public
10 interest in receiving a net \$8 million to use for other
11 public necessities and benefits down there?

12 A. So let's talk about that \$8 million net. So
13 there is \$8 million that potentially is the net take
14 from the nine-and-a-half minus the basically
15 one-and-a-half or 1.6 in outstanding debt principal.
16 There is also the capital reserve fund that then they
17 would be able to potentially reappropriate. So there's
18 additional funds that are opened up for the County
19 also.

20 I think that's important to note. The focus
21 is on the purchase price, but there are additional
22 funds that all of a sudden can become available for a
23 different use for the County. We don't know what
24 those -- what that \$8 million is gonna be used for, but

1 what I do know is that, essentially, these acquired
2 customers, if on a standalone basis, would have to pay
3 back, and at a higher cost, that amount of \$8 million,
4 and really nine-and-a-half at the higher cost than the
5 existing one-and-a-half of debt, and potentially if it
6 is spread across uniform, but, I mean, the cost of
7 capital is way higher.

8 And then, obviously, the difference between
9 1.6 in debt at a lower cost rate and the
10 \$9-and-a-half million at a higher cost rate will have a
11 financial impact and harm to customers. It was talked
12 about that Carteret County, if added to the uniform
13 water, would be a 4 percent increase in customers. The
14 \$9-and-a-half million is a 14 percent increase in rate
15 base for uniform water.

16 So I'm not sure how that all of a sudden gets
17 smoothed out to where there's no impact to the inform
18 customers.

19 Q. Right. The parties have some different
20 calculations here. But my question really goes to
21 there's more than one public interest out here. You're
22 focused on the public interest of customers, and
23 regardless of whose number is, you know, more credible,
24 but the County has other interests, and those are

1 public interests, aren't they?

2 A. So you keep referring to numbers that aren't
3 in the record and weren't offered in direct testimony
4 or rebuttal, and I have a serious problem with that.
5 There's a procedure here for evidence to be entered,
6 the Company didn't use that opportunity to put that
7 evidence into record, and I think it would be unfair if
8 it were allowed to be introduced.

9 But then on the point of public interest, my
10 job for the Public Staff is to represent the using and
11 consuming public, and that public interest is specific
12 to the ratepayers. I do not know how you can suggest
13 that the interest of that \$8 million going to the
14 County outweighs the cost burden to customers to pay
15 this premium of \$9-and-a-half million at a cost of
16 capital.

17 Q. But you do recognize there is a public
18 purpose that those \$8 million be used for, and that is
19 a public interest the County has?

20 A. And I also understand that there are
21 alternate routes for Carteret County to find \$8 million
22 to make that investment and make that public interest.

23 Q. So is -- you would agree, I assume, that your
24 recommended rate base of around \$2-and-a-half million

1 is much lower than the market value that a
2 knowledgeable, willing buyer and seller would arrive at
3 as a purchase price; is that fair?

4 A. I don't necessarily agree to that's fair.
5 This deal could have possibly ended up at \$2.4 million,
6 but instead it ended up going through an upset bid
7 process that I think was influenced by the engineer's
8 valuation that was done as part of the feasibility
9 study, which did not factor in depreciation of
10 \$10 million of the assets that they valued.

11 I know Mr. Hartman called it, I think, a
12 facilities costing. So I think that inappropriately
13 set the table here of what would be a reasonable price
14 to pay, especially in light of the fair value statute
15 that, okay, that's gonna be our starting point.

16 So I think Aqua and Carolina Water had it in
17 their mind of, we can get pretty close to that, and an
18 appraisal will justify it, and that's how we'll go
19 about fair value. There could have been a sealed bid
20 process. There were other ways to dispose of this
21 property allowed by the General Statutes for the
22 County.

23 But this was a race to the top of how much
24 can we spend instead of trying to reach a reasonable

1 fair value. Because \$2.4 million still puts money in
2 the County's pocket. It still opens up that capital
3 reserve to be appropriated for other use. So there is
4 still a public benefit that would be allowed by
5 \$2.4 million. That's not where we ended up because of
6 the process.

7 Q. And I think, at the beginning of that --
8 trying to cast back -- at the beginning of that long
9 discussion I heard you say that this transaction could
10 have been done for \$2.4 million. I'm gonna leave it at
11 that. I'm gonna conclude my cross. Thank you.

12 A. Was that a question?

13 COMMISSIONER HUGHES: Was that a
14 question?

15 MR. DROOZ: Oh, no, I think it's already
16 in the record, thank you. I'm just concluding my
17 cross.

18 COMMISSIONER HUGHES: Okay. I believe
19 the County has some.

20 MR. WHEATLY: Yes, sir.

21 CROSS EXAMINATION BY MR. WHEATLY:

22 Q. Mr. Junis?

23 A. Good afternoon, Mr. Wheatly.

24 Q. I'm really upset with you on those last few

1 comments that you made. And I -- you're supposed to be
2 representing the public interest of this state. I
3 represent 70,000 people in Carteret County. We have
4 spent \$5.5 million on this system, as you've testified
5 to, and we now are in the position we can get out of
6 the water business by selling it to Mr. Don Denton's
7 company. And because we would negotiate with
8 Mr. Ruffin Poole with Aqua. And you sit there and act
9 like they don't know what they're doing. They don't
10 know what they're buying. They don't have the
11 expertise to know what they're gonna purchase.

12 And then isn't it true --

13 MR. CREECH: Chair, are we gonna get
14 to -- I mean, it's great to have a question here,
15 but I object. I just wonder here at some point in
16 time, will it be a question. That's my only
17 comment.

18 COMMISSIONER HUGHES: No, it's a valid
19 point. Is there a question here?

20 Q. So what's happened to Carteret County, isn't
21 it true, that now we -- you admit that this is a good
22 deal for Carteret County. If this deal goes through,
23 it's a good deal for Carteret County, is it not?

24 A. So I could argue that it's a good deal for

1 both the Company and Carteret County. The more they
2 pay and the more they get into rate base, the more
3 money Carteret County gets and the more money that ends
4 up going into the pockets of Carolina Water. Because a
5 higher rate base means higher returns.

6 But that's a cost to customers, and that
7 includes the 1,200 people that live in Carteret County,
8 and that's possibly the other 29,000 customers that are
9 outside of that system.

10 Q. I understand it's a matter of weight --

11 COMMISSIONER HUGHES: Could you please
12 just get closer to the mic? Thank you.

13 Q. So this is a matter of weight that is given
14 to the various consideration of the two parties. Now,
15 you're representing the customers, the 1,254 whose rate
16 the County can change anytime it wants to; is that
17 right? We don't have to come back up to the Utilities
18 Commission to change our rates.

19 A. Right. That's my understanding. The Board
20 of Commissioners can vote and change the rates to those
21 customers.

22 Q. And they did so. As you had mentioned, they
23 raised it 95 percent, and then came back and reduced it
24 25 percent; is that correct?

1 A. Yes, sir.

2 Q. And you contend and made -- or basically made
3 allegations that Carolina Water had something to do
4 with that, did you not?

5 A. So I certainly said -- and this was discussed
6 by the Board of Commissioners at their meetings,
7 because as soon as we heard about this potential
8 purchase, I was watching the meetings. If it wasn't
9 live, I was watching them the next morning, because
10 they are recorded. There is also minutes from those
11 meetings.

12 And it was detailed in those minutes that,
13 because of the rates, they were not going to adhere to
14 the hold. And then, ultimately, after that point, the
15 County did raise rates, and then Carolina Water agreed
16 to that rate hold at the current rates. That is a
17 string of events. I am just pointing out the facts of
18 those string of events.

19 Q. I understand. But in that string of events,
20 the County then reduced those rates?

21 A. Correct.

22 Q. And Carolina Water has agreed to keep those
23 rates in place for four years.

24 A. Yes. And that's a business decision that is

1 ultimately up to the Commission to approve the setting
2 of rates.

3 Q. Well, I understand, but we contractually
4 bound ourselves with them along those lines.

5 A. Well, my understanding from the testimony
6 yesterday of Mr. Denton, that that rate hold is not
7 actually in the contract. Now, there's some
8 conflicting details, Exhibit O does have a note in it,
9 but that was based on old facts and not completely up
10 to date in terms of rates and timing.

11 Q. You heard Mr. Denton, under oath, say that
12 the Company would honor that four-year freeze, did you
13 not?

14 A. That's correct. I was just pointing out the
15 facts, in terms of you said contractually.

16 Q. Well, that's a contract, isn't it?

17 A. I guess it's a verbal contract, but I'm not
18 an attorney.

19 Q. Now, the 1,254 customers you want to protect
20 because -- now, we have tried to protect them for four
21 years. On the fifth year, it's up to -- this
22 Commission protects them, right? They can protect
23 them?

24 A. You're referring to the rate hold and then

1 the --

2 Q. I'm talking about the fifth year, they've got
3 to get permission from this group of folks in order to
4 raise their rates?

5 A. Correct. It's up to the Commission to set
6 rates for the regulated utilities.

7 Q. So what it gets down to is the
8 \$9-and-a-half million purchase price that they have
9 agreed to pay us, and, of course, we've got to pay a
10 million and a half to that.

11 When you talk about your \$2 million price, is
12 that net the million and a half we have?

13 A. No. So that's a gross amount, the 2.4, in
14 terms of rate base. Again, I'm talking about rate
15 base. I don't dictate what Carolina Water is willing
16 to pay. If they want to, essentially, absorb the net
17 of those two, the rate base and the purchase price,
18 that is a business decision that they can make, and I
19 have seen happen before, in terms of a utility
20 absorbing some acquisition premium.

21 Q. I've only got a few more questions.

22 But basically, Carteret County is now in a
23 position that this \$9-and-a-half million, which is --
24 you've agreed is a good deal for us, you don't want to

1 be their basis for this rate base situation that you've
2 been arguing about; is that right?

3 A. So, you know, this \$9-and-a-half million --
4 and this is described in my testimony -- it's
5 essentially a loan put on Carolina Water's customers at
6 a much higher cost to borrow than for the County. You
7 can get \$9-and-a-half million elsewhere.

8 I've seen -- and, you know, this has been
9 discussed with our economist -- your bond ratings, your
10 borrowing power. Like, the County, this water system
11 is 0.7 percent of the County's budget and expenditures.
12 So this is not some big albatross on the County's
13 budget. The County's budget is \$163 million. This
14 system is \$1 million of that, essentially.

15 Q. When you keep talking about us getting this
16 money, sure, we could go out and borrow
17 \$9-and-a-half million, but for what purpose?

18 A. Well, I think that's the question for the
19 County. What purpose are you gonna use the
20 \$9-and-a-half million for? I think the County's
21 indicated that they would pay off their debt and net,
22 essentially, \$8 million, and there's been no clear
23 representation of what it would be used. I think you
24 testified at the public hearing, you know, I think

1 there was discussion of airports, jails --

2 Q. Schools?

3 A. -- schools. That will be up to the County
4 Board of Commissioners on how that would be
5 appropriated.

6 Q. Mr. Junis, let's go back to the question.

7 You're saying that we could go out and borrow
8 \$9-and-a-half million if we needed
9 \$9-and-a-half million, but we would have to pay that
10 back, would we not?

11 A. Right. And so instead, you're getting
12 \$9-and-a-half million and making your customers -- your
13 former customers in this situation -- and Carolina
14 Water's customers to pay for that at a cost of capital,
15 which is likely higher than your borrowing rate.

16 Q. So this is where I'll lose you. So you're
17 saying that -- well, first of all, the
18 \$9-and-a-half million, whatever is net of that -- we
19 pay off our loans and have no debt. Whatever is left,
20 if we have to repay grants, whatever, whatever is left
21 is money can be used by our Commissioners to fund
22 whatever projects they desire. They're the legislative
23 unit in our county, right?

24 A. Yes.

1 Q. Now, what I don't understand about us can
2 borrow \$9-and-a-half million and how this -- borrowing
3 this money is gonna put a load on the current 1,254
4 customers in Carteret County. It makes no sense to me.

5 Would you explain it to me?

6 A. Can you clarify the question? I was
7 referring to the \$9-and-a-half million purchase price
8 being treated as rate base, and then Carolina Water
9 customers and/or the existing 1,277 customers having to
10 pay that back. They would be responsible for that if
11 it is rate base.

12 Q. I don't know how they'd have to do that. But
13 let me go to another issue where I think is where we're
14 going. I think this is gonna be critical to municipal
15 and County governance. County municipal governance,
16 who own these water and sewer companies that are not
17 profitable, and if they're eligible to sell them to a
18 Carolina Water or to an Aqua, and they negotiate a
19 sales price and they're bound to the same rules of this
20 sale, they can do it one of three ways, what happens
21 when they're concerned that this Commission can reduce
22 the basis of their purchase?

23 A. Well, again, the Commission doesn't change
24 the purchase price. They potentially can change the

1 rate base for ratemaking purposes of the acquiring
2 utility if it's a regulated utility. I will also say
3 to the front end of your question, that government
4 entity decides what its rates are right now. You said
5 the County can set its rates on, basically, a whim, so
6 why is it not profitable? Because you're not setting
7 rates at an appropriate level.

8 The Commission sets rates to cover costs, and
9 if that's -- if you're not covering costs with your
10 municipal rates, they will cover costs under this
11 Commission, and it will result in a rate increase that
12 otherwise could have been implemented by the government
13 entity.

14 Q. Well, let's get down to the nitty-gritty.
15 The fair market value we contend is
16 \$9-and-a-half million; is that correct? The
17 \$9-and-a-half million purchase price for Carolina Water
18 is the fair mark value, and the way we have to sell
19 things in accordance with 160A-269, the General
20 Statutes; is that right?

21 A. So that is the -- you're referring to the
22 upset bid process?

23 Q. Yes, sir.

24 A. Yeah. So Article 12, sale and disposition of

1 property, that's G.S. 160A- , and then it's 265
2 through, essentially, 280 is my --

3 Q. 269 was the process that we followed, right?

4 A. Right. And that was the choice of the
5 County. There were five options. You couldn't use
6 one, is my understanding, because it exceeded the
7 threshold.

8 Q. Well, let's go back to the key issue. You
9 want this Commission to set a rate base much lower than
10 the purchase price that they're gonna have to pay to
11 the County?

12 A. Correct. And I think Mr. Denton addressed
13 this. You would have two options. If it is lower,
14 they could back out of the deal, or they could proceed
15 through the deal, and it would be our understanding
16 that the Company would absorb that acquisition premium.

17 Q. Now, in the event the amount rate base set is
18 such that they don't feel they can make any money and
19 walk away from the deal, that's a danger that you're
20 creating for my County, isn't it?

21 A. I wouldn't characterize it as a danger.
22 Obviously, the County has shown that they can operate
23 this system and provide safe and reliable service, and
24 they've shown an ability to raise rates that would

1 cover its cost.

2 Q. Well, basically you keep saying we can get
3 grants through -- to do our operating costs.

4 Have you ever heard of a grant covering
5 operating costs?

6 A. I didn't say you could get a grant to cover
7 operating costs. It's also interesting that there is
8 all this discussion about an operating cost is
9 expense -- depreciation expense. Because of the
10 accelerated -- what the appraisers have characterized
11 as accelerated depreciation, essentially a life of
12 33 years, that increases the depreciation expense,
13 which then offsets income and reduces the net income on
14 the County's books. So that's also a choice being made
15 by the county.

16 Q. Well, we -- you looked in our books and a
17 straight-line depreciation has been done, right?

18 A. Right. I don't have a problem with it. I
19 have a problem with people undoing depreciation or
20 trying to materially change depreciation or the value
21 of those assets.

22 Q. Well, that happens every time there's a sale,
23 doesn't it?

24 A. Not necessarily.

1 Q. Usually, with somebody buying something, the
2 assets are revalued, are they not?

3 A. Will you repeat the question for me?

4 Q. If I -- if I'm in a situation where I'm
5 buying from a willing seller and they have certain
6 assets and they have their own depreciation issues,
7 right, and I buy that asset --

8 A. Right.

9 Q. -- then I allocate my purchase price on those
10 assets the way I want to subject to the IRS rules?

11 A. Okay. Sure. Yeah. I'm not a tax
12 accountant, but I will accept that in concept. But I
13 think different -- this buyer is different in that, if
14 I'm buying a car or if I'm buying a house, I want to
15 pay the least amount that I can pay to buy that asset.
16 And that's not what happened in the sale of this
17 system.

18 Q. You think they could have bought it cheaper
19 than what they agreed to buy it for?

20 A. Potentially. I mean, it's interesting that
21 the appraisers relied on a report put together by
22 Draper Aden, that had this been transferred to the Town
23 of Beaufort, he was recommending that it be transferred
24 for a dollar and the County continue to pay its

1 \$2 million in debt costs and continue to have the
2 special tax district in place to pay for it for
3 11 years.

4 So that's essentially a negative \$2 million
5 transfer. That's what the engineer recommended in this
6 case. And then the County negotiated with Beaufort and
7 basically offered the system if Beaufort would take the
8 debt cost. So, essentially, pay off your debt, net
9 zero, and they didn't accept. That doesn't mean that
10 there weren't alternate routes.

11 There's potential regionalization funds from
12 DWI that could have been used for a potential
13 acquisition. That route was not pursued, to my
14 knowledge.

15 Q. Wasn't necessary, was it?

16 A. What wasn't necessary?

17 Q. It wasn't necessary to seek other monies.

18 They would give it to them for a dollar, why would they
19 want to seek additional funds?

20 A. Well, they could have sought DWI funds to
21 potentially pay something for the system. It really
22 just depends on how you wanted this to play out. I
23 don't think the other options were exhausted, to their
24 point.

1 Q. Every time I try to get to a point, you make
2 some assumption that we're gonna to have to go get some
3 grant or do something and we can do all these sort of
4 things that don't appear to have any business
5 necessity.

6 Do you understand what I'm saying?

7 A. I think appropriate due diligence is
8 appropriate.

9 Q. So basically, the only problem that you have
10 with our deal is that you want the Commission, for the
11 tax rate, to set it lower than the 9.5 purchase price?

12 A. For rate base purposes, for ratemaking and
13 setting rates for customers, my problem, yes, I want it
14 to be lower and have recommended that it be
15 \$2.4 million, approximately.

16 Q. So we were just lucky enough to come along at
17 a time when we were gonna be the test case and can't
18 get our money.

19 MR. WHEATLY: That's all the questions I
20 have, Your Honor.

21 COMMISSIONER HUGHES: Okay. Redirect?

22 MR. CREECH: Thank you.

23 REDIRECT EXAMINATION BY MR. CREECH:

24 Q. Mr. Junis, take a sip of water if you can.

1 Just to be clear on -- following up on the
2 numerous questions that we had, in terms of an opinion
3 as to a private water company and the local government
4 entering into a contract separate and apart from rate
5 base, do you have any real interest in that, at least
6 that aspect of the transaction?

7 A. In terms of the negotiations, it's really the
8 outcome that affects the customers that we represent
9 before this Commission.

10 Q. Now, talk about the statute. And there was
11 talk yesterday about the plain language of the statute.
12 And just to be clear, though, we covered earlier,
13 you're not a lawyer, though, right? But you have some
14 opinions on the statute. And can you talk about, with
15 respect to your testimony, how it was that you viewed
16 the top part of the statute and the bottom part of the
17 statute?

18 A. So when you're getting into the fair value,
19 there's obviously two options, that's the average of
20 the appraisals, the lesser of the purchase price or the
21 average of the three, and then there is that Commission
22 discretion, which is subsection (e).

23 Q. And that's what you referred to in your
24 testimony in reference to the Attorney General's

1 reference to consumer protection?

2 A. That's correct. So the Attorney General, in
3 the ratemaking proceeding, succinctly addressed this.
4 Mr. Denton addressed it as a safeguard, that the
5 Commission has this authority to set the -- to change
6 the fair value if it's deemed unreasonable.

7 Q. And you said "ratemaking" just then. I think
8 you meant "rulemaking"; is that right?

9 A. Correct. Sorry, rulemaking.

10 Q. And speaking of rules, are you aware of what
11 the Commission's rules, applicable rules say with
12 respect to the burden of proof?

13 A. Yes, the burden of proof is on the acquiring
14 utility.

15 Q. Now, we talked a moment ago, you talked a
16 moment ago about -- and there was a question about one
17 of the exhibits to your testimony. And it's exhibit --
18 it's Junis Exhibit 6. And that was -- it says Aqua at
19 the top, it says water and sewer utilities valuation.

20 A. Yes, sir. And I really should have ate a
21 Snickers before this.

22 Q. Are you okay?

23 A. Yeah, I'm fine.

24 Q. Okay. Can you read the proposed -- where it

1 says "proposed solution" on there, if you will, please,
2 Mr. Junis?

3 A. Yes.

4 "This legislation removes these impediments
5 by creating a beneficial optional and
6 voluntarily valuation appraisal process to
7 determine the asset value while providing
8 clarity to the valuation and ratemaking
9 process when a private regulated utility
10 acquires the water or wastewater assets of a
11 governmentally owned system."

12 Q. And then -- maybe I won't make you read so
13 much, given what you just said, but below in the key
14 points, will you accept that it says the legislation
15 would help address the needs and opportunities arising
16 from estimated \$26 billion in investment needs over the
17 next 20 years?

18 A. Yes, that's correct.

19 Q. And you also -- will you read the next bullet
20 point there, just the very first sentence.

21 A. "North Carolina's water and wastewater
22 industry is both fragmented and in need of
23 infrastructure infusion. This fragmentation
24 and lack of adequate funding sources often

1 result in systems that may lack operational
2 expertise and access to capital necessary to
3 fund investments that will keep their system
4 safe, reliable, and in compliance with
5 environmental standards." Close quote.

6 Q. All right. Now, I've got a -- you were asked
7 various statutory-related questions.

8 MR. CREECH: And so I do have a Junis
9 redirect exhibit I'd like to hand out, if I may.

10 COMMISSIONER HUGHES: Please.

11 MR. CREECH: This is entitled "House
12 Bill 351, Utilities Rate Base Fair Value
13 Determination," it's this bill analysis reflects
14 the contents of the bill as it was presented in
15 committee. It's dated June 12, 2018.

16 (Pause.)

17 COMMISSIONER HUGHES: Can you please go
18 ahead and mark it?

19 MR. CREECH: Yes, please, thank you so
20 much. I'd like to mark this Public Staff Junis
21 Redirect Exhibit 1.

22 COMMISSIONER HUGHES: Let it be marked.

23 MR. CREECH: Thank you.

24 (Public Staff Junis Redirect

1 Exhibit Number 1 was marked for
2 identification.)

3 Q. And, Mr. Junis, are you familiar with this?

4 A. Yes. I've reviewed this document before.

5 Q. And will you -- you see where it says "bill
6 analyses"?

7 A. Yes, sir.

8 Q. And would you -- would you start reading
9 where it says, "if the Commission finds." Excuse me,
10 "the system would receive."

11 A. Yes.

12 "The system would receive three different
13 appraisals, one of which must come from an
14 appraiser representing the Public Staff and
15 the Utilities Commission, and the averaging
16 of the appraisals would constitute fair
17 value. If the Commission finds, however,
18 that the average of the appraisals will not
19 result in a reasonable fair value, the
20 Commission may adjust the fair value as it
21 deems appropriate and in the public interest.
22 The rate base would be the lesser of the
23 purchase price negotiated between the parties
24 to the sale or the fair value plus fees and

1 costs authorized."

2 Q. And then we'll try to speed this up if we
3 can. In the next paragraph, read the second sentence
4 there, if you will.

5 A. The application would identify deficiencies
6 in the system, needed infrastructure
7 improvements for the next five years, and
8 projected rate impacts for the next five
9 years."

10 Q. All right. Now, let's look at that sentence
11 for a moment, if we can. There are three different
12 things mentioned there: deficiencies in the system,
13 needed infrastructure improvements for the next five
14 years, and projected rate impacts for the next five
15 years.

16 In this proceeding, in your view, which one
17 or which ones of these have been addressed by the
18 Company?

19 A. So the Company has identified no major
20 improvements or deficiencies necessary to address in
21 the system over the next 5 and 10 years. So the first
22 two there's, basically, not anything to identify. And
23 then the projected rate impacts we believe are
24 significant and unreasonable.

1 Q. Very good. Now, at -- the next questions I
2 have relate -- you had some questions related to cost
3 of funds, and Mr. Junis has a -- we have an exhibit
4 here entitled "Revenue Requirement By Year of 19.5
5 [Sic] Purchase Price Plus Estimated \$175,000 in Fees
6 and Closing Costs Depreciated Over 25 Years Using Sub
7 384 Cost of Capital."

8 (Pause.)

9 MS. SANFORD: Commissioner Hughes, might
10 I interpose a question for a clarification as to
11 the Exhibit 1? This is a committee analysis of the
12 proposed committee substitute; is that correct?

13 MR. CREECH: It is. It's -- it says
14 what it says. It's dated June 12, 2018.

15 MS. SANFORD: Right. But it's not an
16 analysis based on the final bill?

17 MR. CREECH: I can actually --

18 MS. SANFORD: Or is it the same?

19 MR. CREECH: We can refer to
20 Mr. Grantmyre's -- the history in Mr. Grantmyre's
21 first -- I believe first exhibit yesterday, and
22 this will tell you exactly where this is in that
23 process. But I'm pleased to cover that here at
24 some point in time. But it's a more final version

1 of the bill, yes.

2 MS. SANFORD: It's a -- the last --

3 MR. CREECH: It's dated June 12, 2018.

4 I can cover that here later.

5 MS. SANFORD: Okay. Thank you.

6 MR. CREECH: I mean, I will -- all
7 right. So I would like to mark this Public
8 Staff -- this exhibit starting revenue requirement
9 Public Staff Junis Redirect Exhibit 2, please.

10 COMMISSIONER HUGHES: So marked.

11 (Public Staff Junis Redirect
12 Exhibit Number 2 was marked for
13 identification.)

14 Q. Mr. Junis, can you -- you were asked about --
15 you were asked a lot of finance-related questions.

16 Can you explain this exhibit?

17 A. Yeah. So Ms. Feasel prepared this exhibit,
18 and it is the revenue requirement by year of the
19 \$9.5 million purchase price and the estimated fees of
20 \$175,000 if treated as rate base. So it's calculating
21 every year as if you are setting rates every year. The
22 total collected would be \$19.2 million on the
23 \$9.675 million.

24 Q. So just to write that down, to keep it

1 simple, you're saying that this is the revenue
2 requirement over those years?

3 A. Right. Assuming depreciation over 25 years.

4 Q. Anything else you want to offer, based upon
5 the questions you were asked before?

6 A. So, I mean, it was discussed, I think, with
7 Mr. Drooz about the first couple of years, if that
8 wasn't captured in rates, which there's a lot of
9 analysis of would it or wouldn't current rates cover at
10 least part of the revenue requirement, especially in
11 light of potentially changing the depreciation rate.

12 But even if you, sort of, move down to 2027
13 and then go, essentially, every five years, assuming
14 the rate case, that that would be the revenue
15 requirement incorporated into a rate case, you're
16 talking about -- so 2027, if you use that number, if
17 you use 2032, 2037, and 2042, if those were the revenue
18 requirements incorporated into rate cases every five
19 years, you're collecting north of \$15 million on the
20 \$9-and-a-half million.

21 This is purely to illustrate the full cost of
22 this \$9-and-a-half million plus the fees being rolled
23 into rate base. So when we're talking about benefits
24 and cost, there is a significant cost of this capital.

1 Q. And, Mr. Junis, you were also asked, and you
2 discussed County Commission meetings minutes in your --
3 in your -- in the cross just a moment ago. I'd like
4 to --

5 MR. CREECH: Chair Hughes, if I could,
6 I'd like to bring -- put forward Public Staff Junis
7 Redirect Exhibit Number 3, and these are County of
8 Carteret Board of Commissioner regular session
9 meeting minutes from February 15, 2021,
10 September 20, 2021, and October 18, 2021. We
11 thought we had all of them earlier, we have them
12 all now, and I will pass them out, if I may, in
13 that order. Again, February 15, 2021,
14 September 20, 2021, and October 18, 2021.

15 (Pause.)

16 MR. CREECH: And we do have the full
17 transcripts available for the court reporter.
18 These are excerpts.

19 COMMISSIONER HUGHES: So you mean to
20 have this entered in as one document?

21 MR. CREECH: Yes, sir.

22 COMMISSIONER HUGHES: Just to be clear,
23 read it in as one document now, if you don't mind.

24 MR. CREECH: Yes, sir. Thankfully, the

1 way the County Commission does it, their pages are
2 numbered, and so you will see a sequential aspect
3 of this at least in some regard.

4 So those were the February 2021 meeting
5 minutes, and these are the September 2021 meeting
6 minutes.

7 THE WITNESS: So just -- what I have has
8 excerpts from the February, September, and October,
9 the version I have.

10 MR. CREECH: Okay. My apologies, then.
11 I don't know that you need those. Gina, I don't
12 think we'll need that.

13 (Pause.)

14 MR. CREECH: Okay.

15 COMMISSIONER HUGHES: Mr. Creech, before
16 you actually clarify what the exhibit should be
17 labeled, just from a court reporter and from a
18 lunch standpoint, I think maybe Mr. Junis needs a
19 Snickers bar. How much longer do you think you
20 need to go on redirect?

21 MR. CREECH: Some time, I'd say
22 15 minutes. And we're pleased to take a break
23 depending on the -- but I could also try to hurry
24 it up.

1 COMMISSIONER HUGHES: Well, that's
2 always a good option. If you're offering that, I'm
3 gonna take you up on that. Okay. Let's hurry up
4 and let's try to get out of here in 10 minutes.

5 MR. CREECH: Yes, sir. Okay.

6 Q. So what you have in front of you, at the
7 start says February 15, 2021. This is Public Staff
8 Junis Redirect Exhibit 3. And at the top, it has pages
9 502. And you'll see it continues on sequentially, and
10 then it gets to -- then it gets to September 20, 2021,
11 board meeting minutes. And the top of the page there
12 is page 111, and then next, on page 219, it says
13 October 18, 2021, meeting minutes.

14 And, Mr. Junis, were these the meeting
15 minutes to which you were referring a moment ago?

16 A. Yes. This is a select group of those meeting
17 minutes. The County met month after month for an
18 extended period of time considering different bids and
19 the discussion of sale of the system.

20 Q. All right. Let's just in a general sense,
21 though, just let's -- I wanted to get those in, you
22 referenced them. I'm pleased to ask you some
23 additional questions about them. But I think the
24 purpose of it, and especially since we're gonna be

1 cutting this short, is to talk a bit about the
2 transaction history.

3 And in your testimony, you talk -- you have
4 attached to your testimony the Draper Aden report that
5 speaks to the County and the Town -- the Town of
6 Beaufort's possible transaction, do you not?

7 A. Correct.

8 Q. And you referenced earlier that, in that --
9 in that scenario, that the -- not only was the County
10 going to retain -- not only was the County offering, I
11 guess, for a dollar, they were actually gonna retain
12 approximately \$2 million of debt?

13 A. That's correct.

14 Q. And so one of the -- one of the questions --
15 one of the questions that's come up in the transaction
16 history here is that, that negative \$2 million
17 valuation was a starting point here, was it not?

18 A. Right. So that's where the engineers, sort
19 of, set an expectation of transfer municipally; but
20 however, they also did their valuation, which seemed to
21 set -- there's sort of a floor and a ceiling here
22 between negative \$2 million and the high of
23 \$12 million.

24 Q. Very good. And you talked a little bit about

1 the public upset bid process, and you characterized
2 that as a race to the top.

3 In terms of going from a negative \$2 million
4 valuation up to a \$9-and-a-half million purchase price,
5 what was -- what's your view of how this transaction is
6 played out, at least in that regard?

7 A. Right. So you had the upset bid process play
8 out between Carolina Water and Aqua, and in the matter
9 of, essentially, three and a half months, this thing --
10 this potential sale went from, you know, that floor to
11 now the \$9-and-a-half million.

12 Q. And in your view, is this -- taking all these
13 things into account -- you know, you've talked about
14 the statute, you've talked about the burden of proof on
15 the Company, you've talked about the explicit statutory
16 discretion of the Commission here, you've talked about
17 the appraisals -- appraisers in this process -- is this
18 the applicable -- is this the right test case for the
19 implementation of this statute?

20 A. So, I mean, to start with, where you began,
21 obviously, there was discussion of that process, in
22 terms of the discussions between Beaufort and the
23 County in the February meeting when they were talking
24 about the offers from Carolina Water and Aqua, and to

1 proceed with the upset bid process.

2 And then the September -- there's actually
3 consideration of, you know, should they keep the system
4 or not. And then accepting that bid. And then in the
5 October is when they actually approve. But in terms of
6 a test case, I mean, we talked about the statute and
7 the summary and the support for the statute. There is
8 not this material need for -- to address deficiencies
9 or capital investment for the County, and so that's
10 countered to the stated intent.

11 Q. And you had a conversation a moment ago with
12 counsel for the County relating to the -- not the
13 contract price but the implementation of this into
14 rates. And can you talk a moment more about the
15 concern that you have with respect to the impact on not
16 just the ratepayers in Carteret County, but the
17 ratepayers in the 37 other counties where Carolina
18 Water is located?

19 A. Right. So, I mean, if this system's
20 acquisition at \$9-and-a-half million is consolidated
21 into uniform rates, that will have an impact and create
22 a continued upward pressure in rates that the Company's
23 already facing with increased expenses, the full
24 amortization of CIAC for original plant, and continued

1 investment in its existing systems. And this will just
2 exasperate that.

3 Q. And I think this is the final question here.
4 You talked a moment about kind of precedent here. I
5 remember growing up, there was a commercial that was
6 kind of said, and so on and so on and so on.

7 Isn't -- is -- if this becomes the precedent
8 and the Company is able to socialize or share the cost
9 of the premium on other ratepayers across the state,
10 what is your fear about the impact that it will have on
11 rates and, kind of, like, a "rising tide sinks all
12 boats" scenario?

13 A. Right. It was interesting, Mr. Denton, in
14 response to, I believe, Commission questions about,
15 well, what is a fair value that is too high, or what
16 is -- how many acquisitions do you foresee. And I
17 apologize for being maybe a little crude, but he
18 basically said they hadn't figured out their puke
19 point. What was too high, what couldn't they handle.

20 And that creates legitimate concern of where
21 does this go if this full \$9-and-a-half million gets
22 put into rate base and that is then the precedent going
23 forward for acquisition says for a system that doesn't
24 have the issues that were intended to be addressed.

1 It is a safe, reliable, compliant system that
2 they're paying a significant premium for. That sets
3 the bar pretty lo to get a fair value and a premium
4 into rate base. And we all recognize that there is
5 already increased investment in infrastructure, and if
6 this pushes up rate base like it would, rates --
7 affordability of rates become an even bigger concern.

8 MR. CREECH: No more questions.

9 COMMISSIONER HUGHES: Okay. Thank you.
10 We are gonna break for the lunch. We will be back
11 here on the record at 2:00. If there is any
12 doubts, we will be finishing okay. Thank you very
13 much.

14 (The hearing was adjourned at 1:07 p.m.
15 and set to reconvene at 2:00 p.m. on
16 Friday, November 4, 2022.)
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CERTIFICATE OF REPORTER

STATE OF NORTH CAROLINA)
COUNTY OF WAKE)

I, Joann Bunze, RPR, the officer before whom the foregoing hearing was conducted, do hereby certify that any witnesses whose testimony may appear in the foregoing hearing were duly sworn; that the foregoing proceedings were taken by me to the best of my ability and thereafter reduced to typewritten format under my direction; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this hearing was taken, and further that I am not a relative or employee of any attorney or counsel employed by the parties thereto, nor financially or otherwise interested in the outcome of the action.

This the 17th day of November, 2022.

Joann Bunze



JOANN BUNZE, RPR

Notary Public #200707300112