

**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. W-1300, SUB 60

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of		
Application by Old North State Water)	ORDER REQUIRING FURTHER
Company, Inc., 3212 6 th Avenue South,)	REPORTING AND DIRECTING
Suite 200, Birmingham, Alabama 35222,)	OLD NORTH STATE WATER
for Authority to Adjust and Increase)	COMPANY, INC. TO REFRAIN
Rates for Water Utility Service in All Its)	FROM CERTAIN ACTIONS
Service Areas in North Carolina)	

BY THE PRESIDING COMMISSIONER: On June 29, 2021, Old North State Water Company, Inc. (ONSWC or Company),¹ filed an Application for Rate Increase in Docket No. W-1300, Sub 60 (Sub 60 Rate Case).

The evidence received during the rate case indicated that John McDonald was co-owner of the Company, with a 95% ownership stake. In Late-Filed Exhibit 4 filed March 31, 2022, the Company stated that Mr. McDonald had taken steps to acquire the interest of the minority owner. In addition, Mr. McDonald testified that he is the sole owner and manager of Integra Water, LLC (Integra). He testified that all of the Company's financing was provided by Integra, which he controls. On March 8, 2022, the Company and the Public Staff filed a Joint Settlement Agreement Stipulation (Stipulation), which provides in part as follows:

As the authorized representative of Integra Water, LLC, John McDonald commits Integra Water, LLC, to continue financing the capital needs of ONSWC and inject any necessary funding to allow ONSWC to continue meeting its capital and operational needs in an amount sufficient to permit ONSWC to meet its reasonable capital expenditure needs as well as its normal day-to-day operational expenses necessary to provide good quality, reliable, water service to the customers of ONSWC consistent with environmental and regulatory requirements.

Stipulation § IV.A. As a result of this provision of the Stipulation, the Public Staff withdrew its recommendation for an infusion of equity to the Company to achieve an actual capital

¹ On July 12, 2022, Old North State Water Company, Inc., made an undocketed filing notifying the Commission of the Company's conversion from a limited liability company (LLC) to a C Corporation. Included with the filing were the Articles of Incorporation Including Articles of Conversion that were filed with the North Carolina Department of the Secretary of State, indicating that effective July 11, 2022, the Company's name is Old North State Water Company, Inc.

structure of 50% debt and 50% equity and its recommendation for the Company to file audited financial statements for the next three years. Stipulation § IV.B.

On June 13, 2022, the Commission issued its Order Approving Settlement Agreement and Stipulation, Granting Partial Rate Increase, and Requiring Customer Notice (Rate Case Order). Despite the provisions of the Stipulation, the Commission directed the Public Staff to conduct an investigation and directed the parties to work together to create a plan to improve the capitalization of the Company:

That pursuant to N.C.G.S. § 62-34, the Public Staff shall thoroughly review the various sources of funding utilized by ONSWC for its capital and operational needs, the funds disbursed by ONSWC to Chatham North Holdings, Inc., and the relationships, operating agreements, and contracts between and among the Company, Integra, the Integra affiliates, and Chatham North Holdings, Inc.; including whether they are reasonable, appropriate, and in conformity with North Carolina law and Commission Rules, including but not limited to N.C.G.S. §§ 62-153, 62-160, and 62-167. Within six months of the date of this Order, the Public Staff shall make a report to this Commission regarding the Company's compliance with applicable North Carolina law. ONSWC shall have the opportunity to respond to the Public Staff's report within 30 days of the filing of such report. Additionally, the parties shall work together to create a plan to improve the capitalization of the Company, and the parties shall make a report to the Commission within six months of the date of this Order regarding the recapitalization plan[.]

Rate Case Order at 32.

On December 12, 2023, the Public Staff filed its Report on ONSWC's Compliance with Laws and Recapitalization Plan (Public Staff Report). The Public Staff stated that the parties had been unable to agree on a recapitalization plan. The Public Staff Report contained the following factual assertions and legal conclusions:

Integra Water, LLC (Integra) is the parent company for the following entities: Integra Water Madison County, LLC, Integra Water Creola, LLC, and Integra Water Vinemont, LLC, (collectively, the Integra Affiliates). John McDonald is the sole owner of Integra.

Chatham North Holdings, Inc. (CNH) is the sole owner of ONSWC-Chatham North, LLC (ONSWC-CN). Integra owns 95% of CNH and Two Rivers Holdings, LLC owns the remaining 5%. Two Rivers Holdings, LLC, is owned by Michael Myers.

John McDonald is the sole owner of ONSWC.

Pursuant to the definition of “public utility” set out in N.C.G.S. § 62-3(23)c, ONSWC is not an affiliate of Integra, of the Integra Affiliates, nor of CNH, because it does not own any of those entities, nor is it owned by them.

ONSWC funds its capital and operational needs using operating revenues and long-term debt issued by Integra or an Integra Affiliate.

ONSWC loaned CNH \$5,000,000 in December of 2020 with a maturity date of December of 2024. In connection with that loan, CNH granted ONSWC a security interest in all of its assets and signed a promissory note. ONSWC-CH provided an unconditional guarantee. Mr. McDonald executed the loan agreement on behalf of both ONSWC and CNH. CNH has not repaid any portion of the loan. Based on confidential financial statements it has reviewed, the Public Staff has concerns about CNH’s and ONSWC’s ability to repay the loan.

The Public Staff states that public utilities must get Commission approval before issuing any security pursuant to N.C.G.S. § 62-161(a)², and that notes are securities under N.C.G.S. § 62-3(26). The Public Staff’s opinion is that pursuant to N.C.G.S. § 62-161(a), Old North State should have sought Commission approval for the loan to CNH.

As of the date of the Public Staff Report, ONSWC owed Integra and the Integra Affiliates approximately \$13,882,387. The debt is composed of two notes payable, four long-term notes, and nine vehicle “notes,” which the Public Staff states are in fact vehicle leases.

Because the notes payable and the long-term notes have terms that exceed two years, ONSWC should have received Commission approval prior to issuing them, pursuant to N.C.G.S. § 62-161(a).

ONSWC is making monthly payments of approximately \$11,000 on the vehicle “loans” and a note that ONSWC issued to Integra in 2014. There are no signed loan documents relating to this note. Implicitly, although the Public Staff Report does not specify, ONSWC is not making regular payments on the other five notes.

The other five notes that ONSWC gave to Integra and the Integra Affiliates are governed by Intercompany Loan and Security Agreements in which ONSWC grants a security interest in all of its assets to the lender. A utility must have Commission permission prior pledging its assets to an affiliate, under N.C.G.S. § 62-160. The Public Staff states that since ONSWC is not an affiliate of Integra or the Integra Affiliates, the pledge in the Intercompany Loan and Security

² There is an exception for notes issued “for a proper purpose” with a maturity date of not more than two years. N.C.G.S. § 62-167. All of the promissory notes at issue here had four year terms, and so the exception does not apply.

Agreement “considered in isolation does not appear to fall within the parameters of N.C.G.S. § 62-60.”

With respect to a recapitalization plan, the Public Staff suggested three options, none of which was acceptable to ONSWC: (1) Integra acquiring ONSWC; (2) Integra and the Integra Affiliates forgiving a portion of ONSWC’s debt; or (3) an equity infusion from Mr. McDonald. As a fourth option, the Public Staff states that the Commission could declare Mr. McDonald a *de facto* public utility, pursuant to N.C.G.S. § 62-3(23)(c), as the sole shareholder of ONSWC. The Public Staff contends this would give the Commission the power to “regulate and control his conduct related to ownership and operation of ONSWC.”

Additionally, the Public Staff Report states that it experienced “significant difficulty” obtaining financial statements from ONSWC in a timely fashion. Furthermore, the Public Staff identified multiple instances where ONSWC provided inconsistent financial statements for the same reporting periods in filings in the Commission’s dockets. The Public Staff stated that these issues were concerning and undermine its confidence in the accuracy of financial information ONSWC has provided to the Commission and the Public Staff, as well as Integra’s and ONSWC’s accounting and financial reporting functions, personnel, and systems.

The Public Staff makes the following recommendations:

1. That the Commission schedule an evidentiary hearing;
2. That the Commission consider declaring Mr. McDonald a *de facto* public utility;
3. That the Commission order a management audit pursuant to N.C.G.S. § 62-37(b);
4. That the Commission order a full forensic audit of ONS’s books and records; and
5. That the Commission order a full forensic audit of the financial statements of Integra and the Integra Affiliates.

On January 11, 2023, ONSWC filed a Response to Public Staff Report (Response).

ONSWC accepts responsibility for its “failure to seek advance approval for the promissory note to CNH,” which it characterizes as an “unintentional oversight.” It stated that it is in the process of acquiring ownership of the assets of ONSWC-CN in satisfaction of the note and that it will inform the Commission when the transaction is complete. ONSWC further states that it now understands that the definition of security under Chapter 62 is broader than publicly traded securities regulated by the United States

Securities and Exchange Commission and that it will seek approval to issue securities in the future.

With respect to the notes that ONSWC issued to Integra and the Integra Affiliates, ONSWC asserts that “it does not appear there is any cure for the earlier noncompliance other than future compliance.” The Company states that the loans provided necessary financing that no other lender would have been willing to provide and have not materially impaired its operations. Further, it notes that the Public Staff did not express any concerns about this arrangement at the time it entered into the Stipulation.

ONSWC asks that the Commission deny the other recommendations of the Public Staff relating to accounting and management audits on the grounds that they will be an expense and distraction from the Company’s operations.

ONSWC does not agree with any of the Public Staff’s proposals for recapitalizing the Company. ONSWC continues to take the position that there is no functional distinction for the Company between debt and equity, given that Integra is ONSWC’s only source of funding. ONSWC states there is no reason to be alarmed by its debt, given that the debt is owned by companies that are also owned by Mr. McDonald, who has every incentive to support the financial success of ONSWC.

ONSWC rejects the proposal for Integra to forgive some of the Company’s debts as unreasonable. It states this could create taxable income for ONSWC. ONSWC questions whether the Commission has the necessary jurisdiction over Integra to enter such an order and whether it would constitute a taking of its property.

ONSWC continues to reject the proposal for John McDonald to invest additional capital as unnecessary and overreaching. It sees no practical benefit to Integra acquiring ONSWC, given that Mr. McDonald, who owns and controls Integra, has already promised to provide financial support to ONSWC. Further it finds it inappropriate to force Integra, as an unaffiliated company, to acquire ONSWC.

ONSWC argues against the Commission declaring Mr. McDonald to be a *de facto* or *de jure* public utility absent facts supporting a conclusion that ONSWC is not being maintained as a legally separate entity from Mr. McDonald.

ONSWC makes a proposal of its own, that some of the loans from the Integra and the Integra Affiliates could be converted into equity upon the expiration of their terms, thus creating a capital structure of approximately 45% equity at the end of 2024. The Public Staff has not taken a formal position on this proposal.

With respect to the timeliness and accuracy of its financial statements, ONSWC largely accepts the Public Staff’s critiques. It stated that the rapid growth of ONSWC and of Integra, which provides some administrative support to ONSWC, have caused the

companies to outgrow their accounting staff. ONSWC also lays blame at the feet of a prior owner of ONSWC and the owner's contractor, which was supposed to provide guidance on regulatory accounting and compliance with Commission rules.

ONSWC asserts that it is improving its accounting capabilities by adding internal and external resources. As of the first of this year, Integra has hired a new CFO and is recruiting an additional individual for its accounting staff. Mr. McDonald plans to hire an outside firm this spring to "thoroughly review the accounting needs and processes and to perform an accounting review of ONSWC and its financial statements." The Company states that it will provide a copy of this accounting review on request.

Prior to the Commission holding a hearing in order to consider whether it is appropriate to take action with respect to the matters discussed in the Public Staff Report, the Presiding Commissioner finds good cause to require ONSWC to report on the actions taken since its Response, to demonstrate that it has followed through with its plans to improve its accounting function, and to seek Commission approval before issuing any further securities.

IT IS, THEREFORE, ORDERED as follows:

1. That ONSWC shall promptly notify the Commission by a filing in this docket of any financial staff whom it has hired since the date of the Public Staff Report or who are employed by Integra to provide accounting services to ONSWC, such notification to include their professional qualifications;
2. That as soon as practicable, but at any rate no later than 30 days of the date of this Order, ONSWC shall provide the Commission with a copy of the report of the accounting review it has commissioned;
3. That within 30 days of the date of ONSWC filing the report ordered in paragraph 2, the Public Staff shall notify the Commission of any updates or modifications to the recommendations made in the Public Staff Report, specifically including its response to ONSWC's proposal for Integra to convert some of its secured debt to an equity interest in ONSWC;
4. That ONSWC shall not issue any securities or grant any security interest in its assets without prior approval from the Commission;
5. That ONSWC shall take no action with respect to the loan to CNH and the guarantee from ONSWC-CN without submitting such action to the Commission for review and approval;
6. That an evidentiary hearing before the full Commission on the issues raised and the relief sought in the Public Staff Report, as well as in ONSWC's Response and all subsequent reports made in this docket, shall be conducted on July 25, 2023 beginning

at 10:00 a.m. in Commission Hearing Room 2115, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina.

ISSUED BY ORDER OF THE COMMISSION.

This the 19th day of May, 2023.

NORTH CAROLINA UTILITIES COMMISSION

A handwritten signature in black ink that reads "Tamika D. Conyers". The signature is written in a cursive style with a large initial "T" and "C".

Tamika D. Conyers, Deputy Clerk