

**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	)
Company, Inc., 3212 6 <sup>th</sup> Avenue South,	)
Suite 200, Birmingham, Alabama 35222,	)
for Authority to Adjust and Increase Rates	)
for Water Utility Service in All Its Service	)
Areas in North Carolina	)

**PUBLIC STAFF REPORT  
ON ONSWC’S COMPLIANCE  
WITH LAWS AND  
RECAPITALIZATION PLAN**

NOW COMES THE PUBLIC STAFF – North Carolina Utilities Commission (Public Staff), by and through its Executive Director, Christopher J. Ayers, and files this report in compliance with Ordering Paragraph No. 12 of its Order Approving Settlement Agreement and Stipulation, Granting Partial Rate Increase, and Requiring Customer Notice issued in this docket on June 13, 2022.

**I. Legal Compliance**

1. In Ordering Paragraph 12, the Commission directed the Public Staff to review the items listed below and determine 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.”

- (a) various sources of funding utilized by ONSWC for its capital and operational needs;
- (b) funds disbursed by ONSWC to Chatham North Holdings, Inc.; and
- (c) relationships, operating agreements, and contracts between and among ONSWC, Integra, the Integra affiliates, and Chatham North Holdings, Inc.

**A. Relationships between and among ONSWC; Integra Water, LLC; the Integra affiliates; and Chatham North Holdings, Inc.**

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

3. 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%.

4. Two Rivers Holdings, LLC, is owned by Michael Myers.

5. John McDonald is the sole owner of ONSWC.

6. ONSWC is not an affiliate of Integra, the Integra Affiliates, CHN, or ONSWC-CN because (a) ONSWC does not have an ownership interest in any of those entities and (b) none of those entities have an ownership interest in ONSWC.<sup>1</sup>

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<sup>1</sup> This determination is based upon the definition of a public utility set forth in N.C.G.S. § 62-3(23)c., which reads as follows:

The term "public utility" shall include all persons affiliated through stock ownership with a public utility doing business in this State as parent corporation or subsidiary corporation to such an extent that the Commission shall find that such affiliation has an effect on the rates or service of such public utility.

## **B. Sources of Funding for ONSWC**

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

## **C. Funds Disbursed by ONSWC to Chatham North Holdings, Inc.**

8. ONSWC loaned CNH \$5,000,000 in December 2020. The loan was memorialized in an Intercompany Loan and Security Agreement (CNH Loan Agreement), which is attached as CONFIDENTIAL Exhibit No. 1.

9. The CNH Loan Agreement has two exhibits: an Intercompany Promissory Note and a Guaranty Agreement.

10. Paragraph 4 of the CNH Loan Agreement grants ONSWC a security interest in “all assets of [CNH], including without limitation all personal or real property, all accounts, chattel paper, inventory, equipment, instruments, including promissory notes, investment property, documents, deposit accounts, letters of credit rights, general intangibles, supporting obligations, farm products, wherever located, whether now owned or hereafter acquired, and all proceeds and products of the foregoing, whether owned by [CNH] directly or through a subsidiary of [CNH].”

11. Data on the CNH Loan Agreement is shown in the table below.

Effective Date	December 4, 2020
Executed by	John McDonald for CNH and ONSWC
Principal	\$5,000,000
Maturity Date	December 3, 2024
Interest	“a rate per annum equal to the Mid-term Applicable Federal Rate then in effect for the applicable month as published by the United States Internal Revenue Service, adjusted monthly, until the Maturity Date” (see Paragraph 2 of the Intercompany Promissory Note of the CNH Loan Agreement)

12. Pursuant to Paragraph 1 of the Guaranty Agreement of the CNH Loan Agreement, ONSWC-CH is “irrevocably and unconditionally” guaranteeing ONSWC “full, complete, and punctual performance by [CNH] of all terms, covenants, obligations and condition contained in the [Promissory Note] including, without limitation, payment of the [debt]” and “payment of all sums at any time owed by [CNH] under the [Promissory Note] as and when the [Promissory Note] shall become due and payable” if CNH defaults on the Promissory Note.

13. CNH has not repaid any portion of the loan.

14. There are no repayment or amortization schedules associated with the loan.

15. Financial statements provided for CNH and ONSWC-CN (attached as CONFIDENTIAL Exhibit No. 2) raise concerns about CNH’s and ONSWC-CN’s ability to repay the loan.

16. Neither CNH nor ONSWC-CN is a public utility; therefore, neither entity has violated N.C.G.S. §§ 62-153, 62-160, nor § 62-161 by taking part in the transaction.

17. Pursuant to N.C.G.S. § 62-161(a), ONSWC, as a public utility, must apply for and secure Commission approval before issuing any security. Notes fall within the definition of a security set forth in N.C.G.S. § 62-3(26). N.C.G.S. § 62-167 provides a safe harbor from N.C.G.S. § 62-160 *et seq.*, for notes that are issued “for a proper purpose and not in violation of law, payable at a period of not more than two years from the date thereof.”

18. Given the term of the note, N.C.G.S. § 62-167 does not apply; as such, ONSWC should have secured Commission approval before issuing the note to CNH.

#### **D. Loans Integra and the Integra Affiliates Made to ONSWC**

19. As shown in CONFIDENTIAL Exhibit No. 3, ONSWC owes Integra and the Integra Affiliates approximately \$13,882,387.<sup>2</sup> The debt is composed of two notes payable, four lines of credit,<sup>3</sup> and nine vehicle notes.<sup>4</sup>

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<sup>2</sup> CONFIDENTIAL Exhibit 3 (Updated Balances Excel file) was received from ONSWC in discovery.

<sup>3</sup> To avoid confusion, the debts are referenced using the categories (note payable, line of credit, or vehicle) ONSWC used in its discovery response. The lines of credit are long-term notes memorialized in Intercompany Loan and Security Agreements.

<sup>4</sup> ONSWC is not purchasing the vehicles associated with the nine vehicle notes included in its long-term debt. It is leasing them from Integra. To avoid confusion and maintain consistency, “vehicle note or vehicle notes” are used throughout the filing even though the arrangement is, in fact, a lease. ONSWC’s erroneous representation and related accounting treatment impacts the accuracy of ONSWC’s Balance Sheet and Income Statement.

20. According to ONSWC, it is making monthly payments on one of the notes<sup>5</sup> and all nine vehicle notes. The monthly payments are approximately \$11,002.69.<sup>6</sup>

21. All of the debt is classified as long-term debt on ONSWC's Balance Sheet.

22. The clause below is an excerpt from Paragraph 4 of the Intercompany Loan and Security Agreement of all five loans:<sup>7</sup>

The obligations of [ONSWC] to pay Lender the principal of and interest on the Loan and other amounts due hereunder are being secured by all assets of [ONSWC], including without limitation all personal or real property, all accounts, chattel paper, inventory, equipment, instruments, including promissory notes, investment property, documents, deposit accounts, letters of credit rights, general intangibles, supporting obligations, farm products, wherever located, whether now owned or hereafter acquired, and all proceeds and products of the foregoing . . . [ONSWC] hereby grants, conveys, and pledges to Lender a security interest in and security title to all of its rights, title, and interest in and to the Collateral as security for the full and punctual payment and performance of the obligations to pay to Lender the principal of and interest on the [loan and other amounts due under the Intercompany Loan and Security Agreement] . . .

23. N.C.G.S. § 62-160 requires Commission approval of certain utility pledges of the utility's "faith, credit, moneys or property for the benefit of any holder of its preferred or common stocks or bonds, nor for any other business interest with which it may be affiliated."

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<sup>5</sup> ONSWC is making payments on the note to Integra for \$217,250 issued in early 2014. There are no signed loan documents related to this note.

<sup>6</sup> The amount paid out related to the vehicle leases is \$8,359.34.


<sup>7</sup> All five Intercompany Loan and Security Agreements are attached as CONFIDENTIAL Exhibit 4.

24. The pledge embodied in the excerpt above, considered in isolation, does not appear to fall within the parameters of N.C.G.S. § 62-160.

25. Pursuant to N.C.G.S. § 62-161(a), a public utility must apply for and secure Commission approval before issuing any security. Notes fall within the definition of a security set forth in N.C.G.S. § 62-3(26). N.C.G.S. § 62-167 provides a safe harbor from N.C.G.S. § 62-160 *et seq.*, for notes that are issued “for a proper purpose and not in violation of law, payable at a period of not more than two years from the date thereof.”

26. The terms of the notes and lines of credit between ONSWC and Integra or the Integra Affiliates exceed two years; therefore, N.C.G.S. § 62-167 does not apply and, as such, ONSWC should have secured Commission approval before it entered into the underlying transactions.

## **II. Recapitalization Plan**

27. ONSWC’s capital structure as of September 30, 2022, is comprised of **[BEGIN CONFIDENTIAL]**  **[END CONFIDENTIAL]**.

28. The Public Staff and ONSWC discussed different ways ONSWC could modify its capital structure to reduce long-term debt and increase equity but were unable to reach consensus on a recapitalization plan.

29. Recapitalization options include (1) Integra acquiring ONSWC; (2) Integra and the Integra Affiliates forgiving a portion of ONSWC's outstanding debt; or (3) an equity infusion from Mr. McDonald.

30. The Commission can also declare Mr. McDonald a *de facto* public utility under the definition of a public utility set forth in N.C.G.S. § 62-3(23)(a) based on his status as ONSWC's sole shareholder. Declaring Mr. McDonald a public utility would give the Commission the authority to regulate and control his conduct related to ownership and operation of ONSWC. See N.C.G.S. § 62-30, which gives the Commission "general power and authority to supervise and control the public utilities of the State as may be necessary to carry out the laws providing for their regulation, and all such other powers and duties as may be necessary or incident to the proper discharge of its duties."

### **III. Other Issues Identified by the Public Staff**

31. The Public Staff has had significant difficulty obtaining financial statements for ONSWC in a timely manner. The Public Staff requested financial statements for ONSWC and Integra for the reporting periods ending on December 31, 2021; March 31, 2022; June 30, 2022; and September 30, 2022, multiple times and was advised those statements were not available.

32. Full financial statements for ONSWC for the reporting periods ending on December 31, 2021; March 30, 2022; June 30, 2022; and September 30, 2022, were finally received on September 23, 2022; October 31, 2022; and November



20, 2022, respectively.<sup>8</sup> Full financial statements for Integra for the reporting period ending on March 30, 2022, were received on October 13, 2022. Full financial statements for the reporting periods ending June 30, 2022, and September 30, 2022, were received on November 22, 2022.<sup>9</sup> Financial statements for the reporting period ending on December 31, 2021, have not been provided.

33. The financial statements for the reporting periods ending on June 30, 2022, and September 30, 2022, were labeled “Preliminary Draft.” ONSWC did not indicate when final statements for those reporting periods would be available.

34. The Public Staff compared information ONSWC provided at different times and in different dockets and identified multiple instances where ONSWC provided inconsistent financial statements for the same reporting period. CONFIDENTIAL Exhibit 7 is a side-by-side comparison of different versions of ONSWC’s Balance Sheets and Income Statements for the reporting periods ending on December 31, 2021, and March 30, 2022.

35. The issues enumerated above are concerning and significantly undermine the Public Staff’s confidence in (1) the accuracy of the financial information ONSWC has provided the Public Staff and the Commission and (2) ONSWC’s (and by extension, Integra’s) accounting and financial reporting functions, personnel, and systems.

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<sup>8</sup> CONFIDENTIAL Exhibit 5 includes the listed financial statements for ONSWC.

<sup>9</sup> CONFIDENTIAL Exhibit 6 includes the listed financial statements for Integra.

36. The Public Staff also finds ONSWC's failure to seek Commission approval of debt issuances totaling over \$13,000,000 alarming. The Public Staff's concern is amplified by the fact that those debts are held by entities that are owned and controlled by the, now, sole owner of ONSWC.<sup>10</sup>

#### **IV. Public Staff Recommendations**

38. The Public Staff recommends the following:
- a. That the Commission schedule a hearing to receive evidence and testimony from ONSWC, providing its plan for recapitalization and explaining the reasons why the Public Staff's recapitalization options are unacceptable;
  - b. That the Commission consider declaring Mr. McDonald a *de facto* public utility based on his ownership interest in ONSWC;
  - c. That the Commission order a management audit pursuant to N.C.G.S. § 62-37(b);
  - d. That the Commission order a full forensic audit of ONSWC's books and records; and
  - e. That the Commission order a full forensic audit of Integra and the Integra Affiliates' financial statements.

WHEREFORE, the Public Staff requests that the Commission accept this filing in compliance with Ordering Paragraph No. 12 of its Order Approving

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<sup>10</sup> McDonald was the 95% owner of ONSWC when all five of the Intercompany Loan and Guaranty Agreements between ONSWC and Integra or an Integra Affiliates were executed. McDonald is now the sole owner of ONSWC (see the letter filed in the Company folder on March 25, 2022).

Settlement Agreement and Stipulation, Granting Partial Rate Increase, and Requiring Customer Notice issued in this docket on June 13, 2022.

This the 12th day of December, 2022.

PUBLIC STAFF  
Christopher J. Ayers  
Executive Director

Lucy E. Edmondson  
Chief Counsel

Electronically submitted  
/s/ Reita D. Coxton  
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## CERTIFICATE OF SERVICE

I certify that I have served a copy of the foregoing Report on all parties of record in accordance with Commission Rule R1-39, by United States mail, postage prepaid, first class; by hand delivery; or by means of facsimile or electronic delivery upon agreement of the receiving party.

This the 12th day of December, 2022.

Electronically submitted  
/s/ Reita D. Coxton