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November 13, 2023

Ms. Shonta Dunston
Chief Clerk
North Carolina Utilities Commission
430 N. Salisbury Street
Raleigh, North Carolina

**Re: Application by Red Bird Utility Operating Company, LLC and Etowah Sewer Company, Inc. for Transfer of Public Utility Franchise and for Approval of Rates
Docket No. W-933, Sub 12
Docket No. W-1328, Sub 0**

Dear Ms. Dunston:

Enclosed on behalf of Red Bird Utility Operating Company, LLC, please find the Rebuttal Testimony of:

Josiah Cox, with two exhibits
Brent Thies, with one exhibit
James Beckemeier

Please contact me if you or the Commission have any questions regarding this filing.

Best regards,

/s/ Mindy McGrath
Mindy McGrath

Enclosure

c: Parties of Record w/Encl.

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Nov 13 2023

**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. W-933, SUB 12
DOCKET NO. W-1328, SUB 0

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of)
Application by Red Bird Utility Operating)
Company, LLC, and Etowah Sewer)
Company, Inc., for Transfer of Public)
Utility Franchise and for Approval of Rates)

**REBUTTAL TESTIMONY OF JOSIAH COX
ON BEHALF OF RED BIRD UTILITY OPERATING COMPANY, LLC**

I. INTRODUCTION

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

2 A. My name is Josiah Cox. My business address is 1630 Des Peres Road, Suite 140,
3 St. Louis, Missouri, 63131.

4 **Q. ARE YOU THE SAME JOSIAH COX WHO PREVIOUSLY FILED**
5 **DIRECT TESTIMONY IN THESE DOCKETS?**

6 A. Yes.

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

8 A. My rebuttal testimony responds to the pre-filed direct testimony of Public Staff
9 witnesses Franklin, Feasel, and Hinton. Specifically, I address the Public Staff's
10 testimony regarding:

- 11 • Etowah Sewer Company, Inc.'s ("Etowah") status as a distressed or
12 troubled utility;
- 13 • the Public Staff's contention that the Commission should disallow an
14 acquisition adjustment in connection with the proposed acquisition;

- 1 • the Public Staff’s argument that Red Bird Utility Operating Company’s
2 (“Red Bird” or the “Company”) due diligence costs are excessive and
3 should be capped at \$10,000; and
- 4 • the Public Staff’s testimony pertaining to the effect the approval of the
5 proposed acquisition would have on customer rates.

6 I also reiterate how Red Bird’s proposed acquisition of Etowah would bring many
7 benefits to Etowah’s current customers—both immediately and in the long term. I
8 also briefly address the concerns raised in the testimony of Public Staff witness
9 Hinton regarding CSWR, LLC’s (“CSWR”) ability to provide the capital necessary
10 to acquire, make required upgrades and improvements, and operate the Etowah
11 system post-closing.

12 **Q. ARE ANY OTHER WITNESSES PRE-FILING REBUTTAL TESTIMONY**
13 **ON BEHALF OF THE COMPANY?**

14 A. Yes. Two other witnesses are filing rebuttal testimony on behalf of Red Bird. The
15 rebuttal testimony of Red Bird witness Brent Thies addresses the accounting issues
16 raised in the testimony of Public Staff witnesses Lynn Feasel and Michael Franklin
17 and the rebuttal testimony of Red Bird witness James Beckemeier responds to the
18 Public Staff’s concerns regarding due diligence costs.

19 **Q. DO YOU HAVE ANY EXHIBITS TO YOUR REBUTTAL TESTIMONY?**

20 A. Yes. My rebuttal testimony includes two exhibits: **Cox Rebuttal Exhibit 1** is an
21 Order from the Arizona Corporation Commission examining water utility viability
22 and articulating guiding factors and indica for such determinations. **Cox Rebuttal**

1 **Exhibit 2** provides a map showing the location of systems our affiliates own and
2 operate in the United States.

3 **Q. WERE THESE EXHIBITS PREPARED OR PROVIDED BY YOU OR**
4 **UNDER YOUR DIRECTION AND SUPERVISION?**

5 A. Yes.

6 **II. THE PUBLIC STAFF’S EVALUATION OF THE CONDITION OF**
7 **ETOWAH’S WASTEWATER SYSTEM**

8 **Q. WHAT IS THE PUBLIC STAFF’S ASSESSMENT OF THE OVERALL**
9 **CONDITION OF THE ETOWAH WASTEWATER SYSTEM AND**
10 **RELATED FACILITIES?**

11 A. Public Staff witness Franklin testified that the Etowah wastewater system “appears
12 to be in fair condition”¹ and that he does not consider the system to be distressed or
13 troubled.

14 **Q. WHAT IS THE BASIS OF MR. FRANKLIN’S ASSESSMENT?**

15 A. Mr. Franklin’s assessment of the Etowah wastewater system is based on a visual
16 inspection of the facilities on October 12, 2023, and “the recent performance of the
17 wastewater system, including the lack of customer complaints, the routine
18 maintenance performed, and recent improvements made by Etowah”²

19 **Q. DO YOU CONCUR WITH MR. FRANKLIN’S ASSESSMENT?**

20 A. No, I do not. I base my disagreement on at least two factors. First, based on
21 information provided in responses to data requests in a previous case, it is my
22 understanding that Mr. Franklin has never designed, constructed, or operated a

¹ See Direct Testimony of Michael D. Franklin, Docket Nos. W-933, Sub 12; W-1328, Sub 0, at 4.

² *Id.* at 11.

1 water or wastewater system. In addition, although he has utility industry
2 experience, that experience was with a large electric utility whose operations differ
3 materially from those of a small wastewater utility. Given Mr. Franklin’s lack of
4 experience with wastewater utilities, I question whether he is qualified to accurately
5 (or adequately) assess the current condition of Etowah’s facilities, their
6 functionality, or the upgrades or improvements the wastewater system will require
7 in the future.

8 Second, as I explained in my direct testimony, and as I further explain in
9 my rebuttal testimony, the poor condition of Etowah’s facilities combined with its
10 substandard operations history qualify the system as “distressed.” My assessment
11 is corroborated by the eleven Notices of Violations (“NOVs”) that Etowah received
12 from September 1, 2020 through October 1, 2023, which are detailed in witness
13 Franklin’s testimony.

14 I also believe Etowah’s facilities qualify as “non-viable” under *North*
15 *Carolina’s Statewide Water and Wastewater Infrastructure Master Plan – The*
16 *Road to Viability*, which defines a “viable system” as “a [utility] system that
17 functions as a long-term, self-sufficient business enterprise, establishes
18 organizational excellence, and provides appropriate levels of infrastructure
19 maintenance, operation, and reinvestment that allow the utility to provide reliable
20 water services now and in the future.”³ Although that definition expressly applies

³ N. C. Dep’t of Env’t Quality, *North Carolina’s Statewide Water and Wastewater Infrastructure Master Plan – The Road to Viability* 1 (2017), https://files.nc.gov/ncdeq/WI/Authority/Statewide_Water_and_Wastewater_Infrastructure_Master_Plan_2017.pdf.

1 to water systems, I believe it also describes the characteristics of a “viable”
2 wastewater system and, conversely, a “non-viable” system as well.

3 **Q. WHAT INFORMATION DOES RED BIRD HAVE TO SUPPORT ITS**
4 **CONTENTION THAT ETOWAH’S WASTEWATER SYSTEM IS**
5 **DISTRESSED AND TROUBLED?**

6 A. Red Bird commissioned a preliminary survey and analysis of the Etowah system
7 by third-party engineering firm McGill Associates, P.A. (“McGill”), which
8 identified required repairs, improvements, and upgrades. McGill also reviewed the
9 documented occasions of past non-compliance collected over the last three or more
10 years, all of which support Red Bird’s assessment that Etowah is distressed or
11 troubled.

12 In contrast, witness Franklin testified that he “visually inspected” the
13 Etowah facilities on one day. An accurate assessment of the condition of
14 wastewater systems typically requires not just a visual inspection, but a *physical*
15 inspection, which can uncover structural issues and those that may be cosmetically
16 hidden. Moreover, a one-time visit provides only a “snapshot” of what was
17 observed on a particular day and may not – especially in the face of contrary
18 historical evidence – provide an accurate picture of the true condition of Etowah’s
19 system or its operations over time.

20 While witness Franklin also notes the eleven NOVs issued by the North
21 Carolina Department of Environmental Quality (“NCDEQ”) to Etowah, eight of
22 which were directed at the wastewater treatment plant and three to the wastewater

1 collection system, he simply dismisses them as having no consequence.⁴ Witness
2 Franklin’s testimony acknowledges that “two NOV’s remain open as a result of the
3 January 9, 2023, SSO [sanitary system overflow] event” However, I think the
4 Public Staff and Commission should be concerned and should not disregard the
5 potential for these types of violations to reoccur in the future if the acquisition is
6 not approved.

7 As part of this acquisition proceeding, a review of the available compliance
8 data for the Etowah system was conducted. Etowah has received NOV’s every year
9 since 2017, certainly demonstrating a history of noncompliance. Regarding the
10 wastewater treatment plant, in 2018, Etowah received several NOV’s related to a
11 March 2018 violation resulting from the exceedance of daily maximum limits for
12 biochemical oxygen demand “BOD”⁵ and fecal coliform.⁶ Again, in November
13 2021, Etowah received an NOV for exceeding the daily maximum limit for fecal
14 coliform in September 2021. NCDEQ advised Etowah that if the violations
15 continue, it may require remedial actions. Most recently, in April of 2023, Etowah
16 received another NOV for exceeding the daily fecal coliform limits in February
17 2023. These violations are significant because they represent human health
18 hazards that could cause illness – or, in extreme cases, even death to people in and

⁴ Witness Franklin’s testimony details NOV’s issued from September 1, 2020, through October 1, 2023. My direct testimony shows that Etowah also received NOV’s in 2017, 2018, and 2019.

⁵ BOD measures the amount of dissolved oxygen in water. *See, e.g.,* Raleigh, North Carolina Code of Ordinances Sec. 8-2112.

⁶ The presence of fecal coliform bacteria indicates that the water has been exposed to fecal material from humans or other warm-blooded animals. *See* N.C. Dep’t of Health & Human Servs., *Total Coliform Bacteria, E. coli & PRIVATE WELLS*, (Sept. 2019), <https://epi.dph.ncdhhs.gov/oe/docs/TotalColiformBacteriaEcoliAndPrivateWells.pdf>.

1 around Etowah’s service area. Given Etowah’s track record for these types of
2 violations, unless something is done it is likely that they will recur in the future.

3 In addition to the events described above, which raise significant public
4 health concerns, the Etowah wastewater collection system, which operates under a
5 separate permit from the wastewater treatment plant, received a NOV in January
6 2023 related to a sanitary system overflow incident. In that event, approximately
7 600 gallons of sewage were released. The NCDEQ inspection summary for the
8 sanitary system overflow event stated that the complainant “had seen the . . . pump
9 station overflowing for two weeks” and that the “pump station sign does not have
10 phone numbers for the current emergency personnel.”⁷

11 Red Bird considers these violations to be very serious and views them as
12 significant public health risks. It is even more concerning that some situations were
13 permitted to continue for weeks without Etowah personnel taking corrective action.
14 While I have not detailed all of Etowah’s NOV’s from the last five years, this sample
15 of violations demonstrates the risks noncompliance poses to human and
16 environmental health. The repeated exceedance of fecal coliform limits as well as
17 a sanitary system overflow event results in the release of improperly treated waste
18 into the surrounding environment and poses risks to adults and children alike.

19 In addition, as I stated in my direct testimony, McGill’s preliminary
20 assessment of Etowah’s wastewater system identified serious deficiencies and
21 needed improvements that would require an additional capital investment of almost

⁷ NCDEQ Inspection Summary (January 10, 2023), available at:
<https://edocs.deq.nc.gov/WaterResources/PDF10/981a7a29-2fa0-4736-bfda-d1d6f6e4fccb/2781022>.

1 half a million dollars. Note, however, that McGill’s assessment was completed in
2 February 2020, over three years ago. Therefore, the capital cost estimates included
3 in McGill’s report do not reflect the current or future costs of those improvements.
4 Moreover, if certain routine maintenance has not been undertaken during the
5 pendency of this application, it is likely that additional work will be necessary to
6 address operational and compliance issues with Etowah’s wastewater system.

7 **Q. WHAT CRITERIA OR FACTORS DOES RED BIRD CONSIDER WHEN**
8 **DETERMINING WHETHER A UTILITY SYSTEM IS DISTRESSED OR**
9 **TROUBLED?**

10 A. In many states where our affiliate group operates, regulatory commissions have
11 identified criteria that qualify a water or wastewater utility as “distressed” or
12 “troubled.” Red Bird’s Arizona affiliate, Cactus State Utility Operating Company,
13 is regulated by the Arizona Corporation Commission (the “ACC”) which has
14 extensively studied the issue and has articulated criteria and indicia for what the
15 ACC deems “viable” or “non-viable” water or wastewater utilities. A copy of the
16 ACC’s Order articulating these factors and examining water utility viability is
17 included with my testimony as **Cox Rebuttal Exhibit 1**. While, of course, the
18 Commission is not bound by the decisions of regulatory commissions in other
19 jurisdictions, these criteria may be helpful or instructive to this Commission as it
20 seeks to evaluate troubled or distressed systems in North Carolina proceedings.⁸

21 The ACC defines a non-viable water or wastewater utility as one that:

⁸ See Order, Arizona Corporation Commission Investigation into Potential Improvements to its Water Policies, Docket No. W-00000C-0151 (September 19, 2016) at 15.

- 1 1. Lacks and is unable to acquire the managerial, technical
2 and/or financial capabilities to safely and adequately
3 operate; or
- 4 2. Is currently not in compliance or is unable to achieve
5 compliance with Arizona Department of Environmental
6 Quality, Arizona Department of Water Resources,
7 and/or Arizona Corporate Commission rules or orders or
8 is unable to achieve such compliance without
9 managerial, technical, or financial assistance; or
- 10
- 11 3. Will not be able to meet other requisite regulatory
12 requirements on a short- or long-term basis.

13 In addition to these general characteristics, the ACC developed a non-
14 exhaustive list of factors or indicia that may be present when a water or wastewater
15 utility is non-viable, any one or any combination of which the ACC considers
16 sufficient to show non-viability. These factors include:

- 17 • The utility lacks and is unable to acquire the managerial, technical,
18 and/or financial capabilities to:
- 19 ○ Perform necessary operations and maintenance to assure an
20 adequate, safe, and permanent water supply and/or adequate and
21 safe treatment of wastewater, including:
- 22 ▪ Maintaining and improving essential equipment.
- 23 ▪ Properly addressing growth in excess of current utility
24 capacity.
- 25 ▪ Failing to properly address any needs for significant
26 capital improvements and the inability to attract
27 investment or obtain financing for needed improvement.
- 28 ▪ Contaminants in excess of drinking water or wastewater
29 standards.
- 30 ▪ Failure to consistently or correctly perform required
31 testing.
- 32 ▪ Failure to ensure compliance with new drinking water or
33 wastewater standards in effect or going into effect.

- 1 ○ Lack of adequate staffing and/or certified operators due to the
2 utility’s inability to attract, hire, and retain engineers, attorneys,
3 accountants, etc. to properly operate the utility.
- 4 ○ Failure to file for regular rate increases and/or the inability to
5 hire experts that may be needed to assist in processing rate cases
6 that contribute to rates that fail to cover expenses and liabilities.
- 7 ○ Is unable or unwilling to ensure adequate supply or treatment
8 capabilities as demonstrated by:
- 9 ▪ Insufficient storage leading to water outages or repeated
10 shortages.
- 11 ▪ Frequent triggering of curtailment tariffs.
- 12 ▪ Utility relying on hauling or otherwise purchasing water
13 on an emergency basis to meet demand.
- 14 ▪ Implementation of a moratorium on new service
15 connections or the inability to add new service
16 connections due to low supplies or pressure.
- 17 ○ Issues related to billing such as a failure to bill, sporadic billing,
18 or inaccurate billing.
- 19 ○ The utility is in bankruptcy or is considering bankruptcy.
- 20 ○ The owner/operator of the utility has walked away.
- 21 ○ There isn’t a clear succession plan in place in the event the
22 owner/operator passes away or becomes incapacitated.
- 23 ○ The utility is unable or unwilling to respond to service
24 complaints.
- 25 • The utility is not in compliance with [applicable] rules or order such as:
- 26 ○ Outstanding violations, a history of violations, and/or the
27 inability to correct violations.
- 28 ○ Inability to meet existing mandates for significant capital
29 improvements.
- 30 ○ Failure to obtain required approval to construct, discharge
31 authorizations, or other required permits.
- 32 ○ The utility isn’t current on sales and/or property taxes.

- 1 • The utility will not be able to meet other requisite regulatory agency
2 requirements on a short- or long-term basis, such as:
- 3 ○ The utility's CCN has been revoked.
- 4 ○ Accounting systems are not kept in accordance with required
5 standards.
- 6 ○ Failure to properly complete and/or file annual reports.
- 7 ○ Appointment of an interim manager.
- 8 ○ The utility has applied for interim or emergency rates.
- 9 ○ The setting of adequate rates would be unduly burdensome with
10 the existing customer base.⁹

11 **Q. DO ANY OF THE ABOVE FACTORS SUPPORT A DETERMINATION BY**
12 **THIS COMMISSION THAT THE ETOWAH SYSTEM IS DISTRESSED**
13 **OR NON-VIABLE?**

14 A. Yes, there are several factors listed above that support our assertion that the Etowah
15 system is distressed or non-viable. In its 2022 Annual Report filed with the
16 Commission in Docket No. M-2 Sub 2023W, Etowah reported a negative net
17 income of approximately (\$32,000). With the exception of 2021, where Etowah
18 reported positive net annual income of approximately \$2,000, Etowah has reported
19 negative net income since 2018. Moreover, these self-reported financials would not
20 enable Etowah to borrow from a commercial lender, which in turn means that it
21 lacks the financial ability to make the necessary capital improvements identified in
22 McGill's preliminary engineering assessment. That most likely explains why from
23 2018 to 2022, Etowah reported no change in utility plant in service. This is telling

⁹ *Id.* at 15-17.

1 as it demonstrates that Etowah has not made any capital investments in its systems
2 during the past five years.

3 Also, as I detailed above, Etowah has an outstanding NOV as well as a
4 history of violations and noncompliance. Each of these facts – operating loss, lack
5 of access to capital, no investment in plant, outstanding violations, and a history of
6 noncompliance – are indicia of a “non-viable” utility under the ACC’s criteria and
7 support our position that the Etowah system is distressed.

8 **Q. WHAT EVIDENCE HAS RED BIRD IDENTIFIED THROUGH THE DUE**
9 **DILIGENCE PROCESS THAT DEMONSTRATES THAT COMPLIANCE**
10 **WILL BE DIFFICULT FOR ETOWAH TO ACHIEVE AND MAINTAIN?**

11 A. As discussed above, Etowah’s recent annual reports demonstrate that it will be
12 difficult for Etowah to achieve and maintain compliance. Since at least 2018, there
13 have been no investments in plant made for the Etowah system and the annual
14 reports further demonstrate that Etowah does not have the capital, or the ability to
15 access capital, to maintain and improve its system. During that same time frame,
16 Etowah has continued to receive NOVs, and, according to the United States
17 Environmental Protection Agency’s enforcement and compliance history online
18 database, Etowah has been in a state of noncompliance for eleven of the last twelve
19 quarters. All the while the necessary investments identified by McGill’s
20 preliminary engineering assessment, which includes required investments and
21 upgrades of almost half a million dollars, have not been completed. Without a
22 significant change in circumstances, it is hard to imagine a scenario in which
23 Etowah is able to achieve and maintain continued compliance.

1 **III. ACQUISITION ADJUSTMENT**

2 **Q. PLEASE RESPOND TO THE PUBLIC’S STAFF RECOMMENDATION**
3 **THAT RED BIRD SHOULD NOT RECEIVE AN ACQUISITION**
4 **ADJUSTMENT IN THIS PROCEEDING.**

5 A. While the Public Staff testifies that Red Bird should not receive an acquisition
6 adjustment, it is the Company’s position that the Commission need not decide that
7 issue in this proceeding. Instead, Red Bird requests that Commission defer this
8 decision to an initial rate case proceeding involving the Etowah system, which
9 provides the best forum for such a determination.

10 **Q. PLEASE EXPLAIN WHY RED BIRD BELIEVES THAT THE**
11 **ACQUISITION ADJUSTMENT IS BETTER DETERMINED IN**
12 **ETOWAH’S FIRST RATE CASE PROCEEDING.**

13 A. There are three reasons why Red Bird’s acquisition adjustment should be deferred
14 to Etowah’s first rate case proceeding.

15 First, the amount of the proposed acquisition adjustment is not currently
16 known. Because the transaction is not finalized, all of the requisite information for
17 such a determination is not available.

18 Second, deferring a decision on an acquisition adjustment is consistent with
19 what I believe is the intent of recent changes to the statute governing the transfer of
20 water and wastewater utilities which narrowed the scope of the Commission’s
21 inquiry in such cases to public interest in the context of the rates proposed by the
22 acquiring utility and the technical, managerial, and financial qualifications of a
23 potential acquiror. Specifically, based on recently enacted N.C. Gen. Stat. § 62-

1 111, the Commission's focus in acquisition proceedings is limited to determining:
2 (1) whether the party seeking to acquire a system possesses the technical,
3 managerial, and financial capabilities necessary to provide public utility services,
4 and (2) whether the transaction is in the public interest.

5 Regarding the Commission's public interest determination, that
6 determination is to be made in the context of the rates proposed to be in effect
7 immediately after the system is transferred. Because an acquisition adjustment is
8 not relevant to either of the factors to be considered in an acquisition proceeding
9 under N.C. G. S. §62-111,¹⁰ it is neither necessary nor appropriate to decide this
10 issue in the context of an acquisition proceeding.

11 Third, after closing, Red Bird plans to adopt and continue to charge
12 customers Etowah's currently approved rates. Red Bird is not proposing a change
13 in rates; rather, Red Bird proposes to adopt Etowah's currently approved rates.
14 Consequently, the Public Staff's projections regarding future rate impacts of the
15 proposed acquisition are purely speculative and are therefore unreliable. By
16 deferring the determination on the acquisition adjustment to a future rate case
17 proceeding, deficiencies in the current record regarding both the reasonableness of
18 the purchase price and the effect of the proposed acquisition on customers can be
19 cured. Thus, any decision regarding whether an acquisition adjustment should be

¹⁰ The Commission has articulated, and the Public Staff cites, the factors provided in the Commission's *Order Approving Transfer and Denying Acquisition Adjustment*, Petition of Utilities, Inc. for Transfer of the Certificate of Public Convenience and Necessity for Providing Sewer Utility Service on North Topsail Island and Adjacent Mainland Areas in Onslow County from North Topsail Water and Sewer, Inc. and for Temporary Operating Authority, Docket No. W-1000, Sub 5 (January 6, 2000).

1 authorized can be deferred to the initial rate case involving the Etowah system when
2 that issue and its impact on rates can be fully considered.

3 Considering the reasons articulated above, I believe it is appropriate for the
4 Commission to defer a decision regarding an acquisition adjustment to Red Bird's
5 initial rate case proceeding.

6 **IV. DUE DILIGENCE COSTS**

7 **Q. WHAT DOES THE PUBLIC STAFF RECOMMEND REGARDING RED**
8 **BIRD'S RECOVERY OF DUE DILIGENCE COSTS?**

9 A. Public Staff witness Franklin recommends that the Commission apply a \$10,000
10 cap on Red Bird's due diligence costs incurred in connection with the proposed
11 Etowah transaction.

12 **Q. HOW DO YOU RESPOND?**

13 A. I disagree with the Public Staff's recommendation for two main reasons:

14 First, and consistent with the reasons articulated in support of a deferral of
15 the acquisition adjustment determination, the amount of due diligence costs will
16 have no effect on the rates Red Bird will charge immediately after closing if the
17 transfer is approved, nor do due diligence costs have a bearing on Red Bird's
18 technical, managerial, or financial capabilities to own and operate the Etowah
19 system. As I previously explained, the changes to N.C.G.S. § 62-111 limit the issues
20 the Commission is to consider in water and wastewater acquisition cases to these
21 two factors—the appropriate amount of due diligence costs to be recovered by an
22 acquiring entity is not one of the factors the Commission is required to consider.
23 Therefore, the question regarding the amount of due diligence costs that should be

1 included in rate base can and should be deferred to Red Bird's initial rate case
2 involving the Etowah system.

3 Second, Red Bird has not proposed any change in rates for the Etowah
4 system. So, again, deferring this issue will not harm or disadvantage any customer
5 or party to this proceeding. Instead, a deferral of this issue will allow the
6 Commission to make its decision when the transaction-related costs are known and
7 measurable, and all parties will have the opportunity to present evidence regarding
8 the prudence of those costs and whether they should be included in the rate base.

9 **Q. IF THE COMMISSION DETERMINES THAT IT IS NECESSARY TO**
10 **DETERMINE THE AMOUNT OF DUE DILIGENCE COSTS TO BE**
11 **INCLUDED IN RATE BASE AS PART OF THIS PROCEEDING, DO YOU**
12 **AGREE WITH WITNESS FRANKLIN'S RECOMMENDATION THAT**
13 **RED BIRD ONLY BE PERMITTED TO INCLUDE \$10,000?**

14 A. No. As explained in more detail in the rebuttal testimony of Red Bird witness James
15 Beckemeier, all the due diligence costs that Red Bird incurred are a necessary part
16 of the transaction. Red Bird's estimated due diligence costs, which were provided
17 as Exhibit 4 to my direct testimony, include costs associated with engineering,
18 valuation and legal assessments conducted in pursuit of the underlying acquisition.
19 Final due diligence costs will not be known until after closing. Moreover, contrary
20 to witness Franklin's testimony, these costs represent a necessary component of the
21 acquisition process. I address this issue from a high-level perspective, but the
22 rebuttal testimony of Mr. Beckemeier provides more detailed information about the

1 due diligence process and the underlying rationale for undertaking due diligence
2 work, particularly in the context of acquiring utility systems.

3 For example, Questions 1 and 2 of the Commission's *Application for*
4 *Transfer of Public Utility Franchise and for Approval of Rates* require applicants,
5 like Red Bird, to provide the following information:

6 1. Are there any major improvements/additions
7 required in the next five years and the next ten years?
8 Indicate the estimated cost of each improvement/addition,
9 the year it will be made, and how it will be financed (long-
10 term debt, short-term debt, common stock, retained earnings,
11 and other (please explain)).

12 2. Are there any major replacements required in the
13 next five years and the next ten years? Indicate the estimated
14 cost of each replacement, the year it will be made, and how
15 it will be financed (long-term debt, short-term debt, common
16 stock, retained earnings, and other (please explain)).

17 Only after undertaking a fairly detailed engineering due diligence review would an
18 applicant be able to accurately respond to these application requirements. And
19 without this information Red Bird's applications almost certainly would be deemed
20 "deficient."

21 Additionally, the Public Staff will not recognize that a Joint Application is
22 complete until the parties to the application establish that the seller owns or
23 otherwise controls and is able to convey to the purchaser all real property and
24 easements, etc., required for operation of the utility system. Both of these
25 requirements mean that Red Bird, in order to file a Joint Application that will be
26 deemed "complete," must engage in extensive, pre-filing due diligence to obtain
27 necessary engineering studies and ownership information.

1 As part of the engineering portion of the due diligence costs, Red Bird's
2 affiliate group routinely engages a third-party engineering firm to assess the
3 condition of assets we propose to purchase and to project necessary capital
4 improvements during the first few years we own and operate those assets. For
5 Etowah, McGill performed that assessment. Although the results of its efforts are
6 preliminary—as we have found that the true condition and needs of acquired
7 systems can only be determined after we own and operate those systems—those
8 assessments and estimates are nonetheless invaluable for many reasons, including
9 the need to respond to discovery questions and questions raised by regulators in
10 acquisition cases regarding future capital plans.

11 Red Bird's affiliate group also engaged Valbridge Property Advisors to
12 provide an appraisal for the utility assets being purchased. An appraisal is required
13 to determine the value of the assets being acquired in order to determine the fair
14 value of the assets.

15 21 Design Group, the remaining entity whose costs are included in the
16 engineering due diligence total, was engaged to perform tasks such as surveying
17 and mapping the service area, including the location of Etowah's utility facilities
18 Red Bird proposes to acquire. Some of this work is required to complete the
19 Commission's application process; however, even if it was not, the work is critical
20 to the successful operation of the system after closing.

21 Regarding the legal portion of our due diligence costs, Red Bird engaged
22 The Beckemeier Law Firm, which in turn engaged Law Firm Carolinas, to handle
23 matters and issues related to ensuring Red Bird would obtain clear title at closing

1 to all utility assets it contracted to acquire from Etowah—a requirement of the Joint
2 Application.

3 The remaining firm whose costs are included in the due diligence total is
4 Burns, Day & Presnell who performed legal work required to secure Commission
5 approval of the proposed acquisition.¹¹ Mr. Beckemeier describes the due diligence
6 work each of these law firms performed and why it was essential to the
7 consummation of the proposed transaction.

8 **V. EFFECT OF PROPOSED ACQUISITION ON CUSTOMER RATES**

9 **Q. WHAT IS THE EFFECT OF THE PROPOSED ACQUISITION ON**
10 **CUSTOMER RATES?**

11 A. As I reiterated above, Red Bird proposes to adopt the rates currently in effect for
12 Etowah customers should the Commission approve this acquisition. These rates
13 will continue until the Commission authorizes a change in rates in a future rate case.
14 Therefore, this application will have no impact whatsoever on customer rates
15 immediately after closing.

16 **Q. WHAT DOES THE PUBLIC STAFF CONTEND REGARDING RED**
17 **BIRD'S FUTURE RATES?**

18 A. Public Staff witnesses Franklin and Feasel include estimated rates using projections
19 for various components of Red Bird's operating costs of the Etowah system. The

¹¹ Witness Franklin testifies that Red Bird included legal costs from “five law firms.” While the invoices provided on Cox Direct Exhibit 4 appear to be from five different law firms, in actuality there are three. Beckemeier LeMoine Law and The Beckemeier Law Firm are one and the same; the firm's name changed during the pendency of this Joint Application. The same is true for Black, Slaughter & Black and Law Firm Carolinas.

1 Public Staff also appears to have calculated rate increases as related to an
2 acquisition adjustment, capital improvements, and due diligence costs.

3 **Q. HOW DOES RED BIRD RESPOND?**

4 A. My response to the Public Staff’s projections regarding the proposed acquisition of
5 Etowah’s system on future rates is twofold. First, because the changes to N.C.G.S.
6 § 62-111, the only rates the Commission should consider in determining whether
7 an acquisition is in the “public interest” are those that will be in effect immediately
8 after closing. Future rates—i.e., those that would be set by the Commission in a
9 future rate case—are irrelevant to the determination of whether an acquisition
10 application should be granted. Because approval of the Joint Application will have
11 no impact on customer rates, the Commission should disregard the Public Staff’s
12 rate impact estimates as irrelevant to the three issues currently before the
13 Commission: 1) whether Red Bird is technically, managerially, 2) whether Red
14 Bird is financially qualified to own and operate the Etowah system as a regulated
15 public utility; and 3) whether the proposed transaction is in the public interest.

16 Furthermore, the Commission should disregard the Public Staff’s rate
17 impact testimony because the underlying estimates are based on assumptions
18 regarding all elements of ratemaking – revenue, expenses, rate base, capital
19 structure, rate of return, rate design, etc. – that may or may not be valid. Red Bird
20 has made clear that it intends to request in its first North Carolina rate case approval
21 of consolidated, statewide rates for both water and wastewater services. Based on
22 the experience of our affiliate group in states outside North Carolina, where such
23 rates have been approved, consolidated rates are an effective mechanism to mitigate

1 “rate shock” that otherwise would result when small, undercapitalized, and
2 mismanaged systems are acquired by experienced and technically competent
3 owners that invest the capital required to address needed capital improvements in
4 those systems. Consolidated rates allow all customers within a state to share the
5 benefits of economies of scale our affiliated group can achieve. Consolidated rates
6 also help spread out the rate impact of required capital investments that have greater
7 impacts on some systems in the short term but that will affect all systems in the
8 long run. Despite Red Bird’s declared intent to seek consolidated rates, Public
9 Staff’s estimated rate impacts, in addition to being based on estimates and
10 assumptions, are incorrectly calculated as if rates for the Etowah system would
11 always be set on a stand-alone basis.

12 **Q. SHOULD THE COMMISSION CONSIDER FUTURE RATE IMPACTS IN**
13 **REACHING A DECISION IN THIS CASE?**

14 A. No. The impact on future rates of Red Bird’s acquisition of the Etowah system is
15 not known and measurable, so it would be inappropriate and unreasonable for the
16 Commission to consider that issue in the current proceeding. Moreover, as a
17 regulated utility, Red Bird is prohibited by law from changing rates until such a
18 change is authorized by the Commission, and no change in rates can be approved
19 by the Commission without a thorough consideration of a utility’s rate change
20 request, with full opportunity for interested parties – including the Public Staff – to
21 present evidence and arguments regarding that request. Therefore, it serves no
22 purpose for the Commission to consider hypothetical future rate impacts in this
23 case. Similar to the issue of an acquisition adjustment and inclusion of due diligence

1 costs in rates, the issue of rates should be deferred to a future rate case proceeding
2 where information is known and measurable and all parties can present evidence
3 relevant to ratemaking.

4 **VI. BOND**

5 **Q. WHAT IS THE PUBLIC STAFF’S RECOMMENDATION REGARDING**
6 **THE AMOUNT OF THE BOND RED BIRD IS REQUIRED TO POST TO**
7 **SATISFY N.C.G.S. § 62-110.3?**

8 A. Public Staff witness Franklin recommends that Red Bird post a \$200,000 bond.

9 **Q. DOES RED BIRD AGREE WITH THE PUBLIC STAFF’S BOND**
10 **RECOMMENDATION?**

11 A. No. Red Bird finds the Public Staff’s bond recommendation to be excessive. It
12 appears the Public Staff bases its recommendation on Red Bird’s lack of a history
13 of operations and management in North Carolina, the large customer size, the
14 system improvements planned by Red Bird, and the size of the wastewater
15 treatment plant and wastewater collection system.¹² However, in response to one of
16 Red Bird’s data requests Mr. Franklin admitted that “[b]ond recommendations are
17 not determined by a mathematical formula” and therefore, he was unable to supply
18 workpapers showing how the Public Staff considered and quantified each of the
19 previously mentioned factors in reaching its bond recommendation.¹³

20 Although witness Franklin is correct that Red Bird does not have a lengthy
21 history owning and operating water and wastewater systems in North Carolina, Red

¹² Direct Testimony of Michael D. Franklin, Docket Nos. W-933, Sub 12; W-1328, Sub 0, at 23-25.

¹³ See Public Staff’s Response to Red Bird’s First Set of Data Requests, Response 23.

1 Bird has significant operating and managerial experience with regard to ownership
2 and successful operation of water and wastewater systems across our affiliate
3 groups. Outside of North Carolina, our group owns and manages facilities in ten
4 other states: Arkansas, Arizona, Florida, Kentucky, Louisiana, Mississippi,
5 Missouri, South Carolina, Tennessee, and Texas. The group currently provides
6 wastewater service to more than 200,000 customers and water service to more than
7 130,000 customers. A map showing the location of systems our affiliates own and
8 operate is attached to my rebuttal testimony as **Cox Rebuttal Exhibit 2**.

9 In every state where we operate, our systems are successfully serviced and
10 maintained by third-party operations and maintenance contractors hired for that
11 purpose. We require those contractors to adhere to very specific performance
12 standards – which include periodic (sometimes daily) testing and inspections and a
13 requirement to respond to emergency service calls within two hours. We regularly
14 monitor our contractors’ performance—indeed, through entries contractors are
15 required to make in our operations and customer service data entry and recording
16 systems, we have access to real-time information regarding those contractors’
17 performance. The success of our affiliate group in keeping the commitments we
18 have made to provide first-rate customer service can be measured, in part, from the
19 fact that no state utility commission has ever found that we are unqualified to
20 operate water and wastewater systems. To the contrary, most of these commissions
21 have time and time again approved our affiliates’ acquisition applications. Such a
22 track record would not be possible if we did not possess the technical, managerial,
23 and financial qualifications required of a potential acquiror, or if we failed to

1 provide the level of customer service to which we commit in each and every
2 acquisition case.

3 Our North Carolina operations mirror those in the other states I just
4 mentioned. If Red Bird is authorized to acquire the Etowah system, it will be
5 operated in a similar fashion – i.e., using professional and experienced third-party
6 contractors whose adherence to our customer service requirements are carefully
7 monitored. And although our affiliate group has not had years of experience in
8 North Carolina, based on our track record elsewhere, there is no reason for the
9 Commission – or Public Staff – to believe Red Bird’s performance here will be of
10 lesser quality than its affiliates’ performance elsewhere.

11 **Q. DO YOU HAVE ANY OTHER EVIDENCE SUGGESTING THAT THE**
12 **PUBLIC STAFF’S RECOMMENDED BOND IS EXCESSIVE?**

13 A. Yes. According to Etowah’s 2022 Annual Report, the bond currently required for
14 the Etowah system is \$20,000. The Public Staff’s recommendation that Red Bird
15 post a bond in the amount of \$200,000 is *ten times* the current bond amount. I would
16 like to remind the Commission that the current bond amount applies to a small,
17 undercapitalized utility that has been subject to penalty actions and ongoing
18 violations as described earlier in my testimony. Despite those facts, the Public Staff
19 proposes a tenfold increase in the amount of the current bond if the Etowah system
20 is acquired by Red Bird, which is part of an affiliate group that is professionally
21 managed, well-capitalized, and successfully operates wastewater systems serving
22 more than 330,000 customers in eleven states. Therefore, even if an increase in Red

1 Bird's current bond is deemed necessary, the increase should not be anywhere near
2 Public Staff's recommendation.

3 **VII. PUBLIC STAFF'S RECOMMENDED ANNUAL REVIEW**

4 **Q. THE PUBLIC STAFF PROPOSES RED BIRD BE REQUIRED TO MEET**
5 **ANNUALLY WITH PUBLIC STAFF. HOW DO YOU RESPOND?**

6 A. In the Settlement Agreement and Stipulation filed between the Public Staff and Red
7 Bird in Docket Nos. W-1146, Sub 13 and W-1328, Sub 10 regarding the Total
8 Environmental Solutions Inc. ("TESI") transfer application, Red Bird agreed to
9 meet annually with Public Staff to discuss TESI's water and wastewater operations
10 and to review its financial condition. Although that agreement applied only to the
11 acquisition at issue in those two dockets, we plan to include in those annual
12 meetings information about all of Red Bird's North Carolina operations. Therefore,
13 if the Commission approves the proposed acquisition of Etowah's wastewater
14 system, information related to Etowah's system would be part of future annual
15 meetings with the Public Staff.

16 **Q. PUBLIC STAFF WITNESS HINTON EXPRESSES CONCERN**
17 **REGARDING LOSSES EXPERIENCED BY CSWR. HOW DOES RED**
18 **BIRD RESPOND?**

19 A. Public Staff witness Hinton testified that in view of the Company's business plan
20 and record of acquiring non-viable systems, raising additional equity capital, and
21 making necessary capital investments, he believes CSWR has sufficient capital
22 resources to be considered financially viable. He also testified that Red Bird will
23 have sufficient equity capital to acquire and improve Etowah's water and

1 wastewater systems, fund system upgrades, and support other capital
2 improvements.

3 Nevertheless, he notes that the Public Staff has some concerns related to
4 losses reported on CSWR's consolidated income statements. If you focus solely on
5 profit and loss from utility operations, it is true that CSWR has lost money each
6 year the Company has been in existence. However, these losses are not a cause for
7 concern because neither CSWR nor its utility affiliates fund day-to-day operations
8 exclusively from revenues derived from utility operations. Instead, those revenues
9 are substantially supplemented by working capital provided by investments from
10 U.S. Water Systems, LLC ("U.S. Water") – the affiliate group's ultimate corporate
11 parent.

12 As I explained in my direct testimony, U.S. Water invests equity in CSWR
13 sufficient to fund the purchase of systems like Etowah and the capital
14 improvements necessary to ensure those systems provide safe and reliable service
15 that complies with applicable law. U.S. Water also provides working capital
16 necessary to fund day-to-day operations until rates for the acquired systems can be
17 reviewed and adjusted by state regulators, as necessary. Like Etowah, most systems
18 our group acquires are losing money at the time of acquisition, and because we
19 routinely adopt rates in place at the time of acquisition, those losses continue after
20 closing. Indeed, we expect losses to increase because most systems we acquire were
21 not properly or professionally operated before our acquisition, and those systems
22 usually require significant capital investment to repair, replace, and upgrade
23 infrastructure that was neglected for many years. Therefore, losing money until

1 rates can be adjusted to compensatory levels is something our Company – and our
2 investors – plan for and expect. That is another reason why CSWR and its affiliates
3 have been so successful at turning around environmentally and financially
4 distressed utilities like Etowah. Consequently, the financial metrics that so concern
5 witness Hinton need not concern the Commission, especially since Etowah’s
6 current customers are being served by a utility that not only is losing money but is
7 failing to provide compliant service.

8 It is worth noting that since it began operations, CSWR has invested more
9 than \$450 million to acquire, improve, and operate water and wastewater systems.
10 Of that amount, approximately \$400 million was paid to sellers to acquire the utility
11 assets or has been invested to make capital improvements. The remaining \$50
12 million has provided working capital necessary to keep those operations going until
13 rates can be adjusted. Regulators in all other states where our affiliates operate
14 agree that this arrangement satisfies the requirement that a party seeking to acquire
15 utility assets demonstrate the financial wherewithal necessary to own and operate
16 those assets. This approach will work as well in North Carolina as it does elsewhere.

17 CSWR has access to the equity capital necessary to purchase, improve, and
18 operate the water and wastewater systems our affiliates acquire. Our commitment
19 to regulators has been to invest equity sufficient to fund purchases, make necessary
20 capital improvements, provide working capital and ensure safe and reliable utility
21 service. And because CSWR has continued to maintain those commitments, those
22 same regulators continue to approve our acquisitions. In fact, in a recent Red Bird
23 evidentiary hearing before the Commission, Public Staff witness Hinton testified

1 that “[his] research has indicated there’s no reason to think this company cannot do
2 as Mr. Cox testified to” and that he believes Red Bird to be “financially viable,”
3 abating his prior concerns.¹⁴

4 **VII. CONCLUSION**

5 **Q. DO YOU HAVE ANY CONCLUDING THOUGHTS FOR THE**
6 **COMMISSION’S CONSIDERATION REGARDING THE JOINT**
7 **APPLICATION FILED BY RED BIRD AND CSWR?**

8 A. Yes. I would like to reiterate that Red Bird’s proposed acquisition of the wastewater
9 system currently owned and operated by Etowah would be consistent with and
10 would promote the public interest. Transfer of these systems to a well-capitalized
11 enterprise that is a professional utility would be in the best interests of current and
12 future Etowah customers. Red Bird and CSWR are fully qualified, in all respects,
13 to own and operate this system and to otherwise provide safe and reliable service.
14 Accordingly, I respectfully ask the Commission to grant the authority sought in the
15 Joint Application and to adopt all other recommendations I included in my direct
16 and rebuttal testimony related to this application.

17 **Q. DOES THIS CONCLUDE YOUR PRE-FILED REBUTTAL TESTIMONY?**

18 A. Yes.

¹⁴ Transcript of Hearing Held in Raleigh, NC on Tuesday October 24, 2023, Volume 2 - Public, Docket
Nos. W-1146, Sub 13; W-1328, Sub 10, at 222-23.



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BEFORE THE ARIZONA CORPORATION COMMISSION

- DOUG LITTLE
Chairman
- BOB STUMP
Commissioner
- BOB BURNS
Commissioner
- TOM FORESE
Commissioner
- ANDY TOBIN
Commissioner

ARIZONA CORPORATION COMMISSION)
 INVESTIGATION INTO POTENTIAL)
 IMPROVEMENTS TO ITS WATER)
 POLICIES)

DOCKET NO. W-00000C-16-0151
 DECISION NO. 75743
ORDER

Arizona Corporation Commission
DOCKETED
 SEP 19 2016

Open Meeting
 September 7 and September 8, 2016
 Phoenix, Arizona

DOCKETED BY *KE*

BY THE COMMISSION:

* * * * *

FINDINGS OF FACT

BACKGROUND

1. On July 25, 2016, the Arizona Corporation Commission ("Commission") issued Decision No. 75626 that directed Commission Staff to work with industry representatives to develop and present information for Commission review.
2. Further, Staff was ordered to establish a Commission Ombudsman office for small water companies and to work with industry representatives to evaluate ways to reduce the regulatory burden on small water companies.
3. The Decision required that certain information related to several of the policies and components thereof be made available for Commission review by September 1, 2016. The report provides an update on the status of these items and provides various documents for Commission review as directed.

THE WATER POLICIES WORK GROUP

4. The Water Policies Work Group (“Work Group”) consists of members of Commission Staff in the Hearing and Utilities Divisions, Residential Utility Consumer Office (“RUCO”), the Water Utilities Association of Arizona (“WUAA”), the Rural Water Association of Arizona (“RWAA”), along with representatives from several water and wastewater companies including Arizona Water Company, EPCOR Water Arizona, Global Water, and Valley Utilities Water Company. The process was very open and collaborative. Input from all parties involved was incorporated into the end products that are being presented.

EMERGENCY SURCHARGES

5. The Work Group understands the desire of the Commission to lessen the regulatory obligations on smaller water companies while still protecting customers’ interests. One policy that addresses this desire is the direction to facilitate an emergency surcharge process.

6. Class C, D or E water or wastewater utilities that face a water supply emergency may request an emergency surcharge. Decision No. 75626, directed the Work Group to evaluate by September 1, 2016, the Commission’s current processing times for Emergency Surcharges, and to develop recommendations to allow a water or wastewater utility to receive a Commission vote on an emergency surcharge within 30 days and within 60 days after filing an initial surcharge application.

7. To meet this requirement the Work Group gathered input from the Hearing Division on a draft document of the Emergency Rate Case Application. This document was further refined by discussions of the Work Group. See Attachment A to the Status Update filed September 1, 2016 for the recommended processes that are the results of that group effort and the notice that would be required to be sent to customers at the time the applicant asks Staff to open a docket. Attachment A only specifically identifies the 30 day process; however, language was added to the attached document that, due to the unique circumstances of each case, and for good cause, any of the parties may request an extension of up to an additional 30 days.

8. The Work Group has recommended that the Commission adopt the Emergency Surcharges rate case process as detailed in Attachment A and discussed in the Status Update.

1 **SHORT FORM RATE APPLICATION**

2 9. Another policy facilitating the reduction of the regulatory burden on small water
3 companies involves making available to smaller companies, some adjustor mechanisms that some larger
4 utilities have been granted. These policies include making changes to the Short Form Rate Application
5 currently available to small water companies to assist with the rate case process. Specifically, Staff was
6 directed to update the Short Form Rate Application to include the schedules necessary for calculating
7 purchased power, purchased water, and system improvement surcharges, and to include a formulaic
8 method that will allow small utilities to calculate a Conservation Adjustment. Further, Staff was directed
9 to revise the questions in the current application to better reflect what is actually needed to process a
10 small company rate case.

11 10. The Work Group conducted an evaluation that included the information currently
12 requested, any missing information whose inclusion would make the process more efficient, how to
13 make the process easier in general, and how to incorporate the specific features ordered in the Decision.
14 Through the collaborative effort of the Work Group, a Short Form Rate Application has been
15 developed that includes all of the changes ordered in the Decision plus some additional changes that
16 are intended to streamline the process, as discussed in detail below.

17 11. In its current format, the Short Form Rate Application is available only as a Word/PDF
18 document. During the course of the evaluation, it was determined that in its current format, the
19 application can be somewhat cumbersome and overly burdensome. Specifically, it was difficult to add
20 columns where needed, some information between pages was duplicative, requesting all of the invoices
21 for each of the expense items in the application was unduly burdensome, and some of the instructions
22 were ambiguous, so much so that it wasn't always clear what was being requested.

23 12. The Work Group has recommended that the Commission make available an Excel
24 spreadsheet that can be downloaded and completed. This would be the first and biggest step to making
25 the process more efficient as discussed further throughout this summary. We believe that addressing
26 the required modifications in a Word or PDF document would likely make it more difficult for small
27 water companies to follow and/or use. Further, there are some efficiencies inherent in Excel that are
28 not available in Word or Adobe. We understand that some of the smaller water companies may not

1 have extensive experience in Excel so the Work Group has recommended that once the changes are in
2 place a version of this spreadsheet should be offered in a fillable PDF/Word format as an alternative.

3 13. In addition to the summary which explains all the changes that the Work Group has
4 recommended for the Short Form Rate Application, there is an accompanying Excel workbook available
5 for Commission review. Attachment B to the Status Update filed September 1, 2016 is the modified
6 version of the Word document for the Short Form Rate Application. Attachment C to the Status
7 Update filed September 1, 2016 contains the schedules for the recommended adjustor mechanisms.

8 14. The Work Group began this process by converting all of the tables included in the
9 existing Short Form Rate Application into schedules in an Excel workbook. The schedules include links
10 throughout which minimize the number of required and repeat inputs. There has also been some
11 additional functionality built-in as detailed below, but in general this includes features such as drop-
12 down menus and automatic formulas.

13 15. To make the process more efficient, the Work Group has recommended tying the Short
14 Form Rate Application to the Annual Report. Combining this information makes for a smoother
15 transition from the Annual Report to a rate case filing since the majority of the information required in
16 the Annual Report is also requested in the Short Form Rate Application¹. The Work Group has
17 recommended developing parameters in the annual report form that would alert the filing company that
18 it may want to consider filing a rate case².

19 16. While the Work Group has recommended the use of Excel, we have not recommended
20 that Excel be used exclusively. Some of the information in the application logically still belongs in the
21 current format, such as the general instructions, the checklist, background information, etc. See
22 Attachment B for the recommendation of the Work Group.

23 17. The Work Group also has recommended that the Commission review the Short Form
24 Rate Application as presented for review and provide further guidance for the Work Group on any
25 additional modifications that may be necessary.

26
27
28 ¹ The Work Group estimates that 70-80 percent of the information required in the Annual Report is also required in the Short Form Rate Application, as can be seen in the provided electronic version of the application.

² For example, a Company operating at a net loss. This functionality has yet to be built into the workbook.

1 *Detailed Changes to the Overall Short Form Rate Case Application:*

2 18. First, the number of copies required throughout the application process for smaller
3 companies has been reduced to two, as discussed in the June 14, 2016 Staff Meeting. Some of the
4 information being requested in the checklist has been clarified, including a recommended materiality
5 threshold of \$250 for the operating expense invoices being requested. This materiality threshold is
6 paramount for reducing the amount of time and resources spent by small utilities in preparing rate
7 applications, and is consistent with the Standard of Materiality discussed later. The definition of an
8 affiliated relationship has also been expanded, and the instructions have been updated to reflect all of
9 the recommended changes³. A simplified example illustrating how income taxes are calculated has also
10 been included.

11 *Specific Changes to the Short Form Rate Case Application by Schedule:*

12 19. The detailed changes as discussed in this section were made for efficiency purposes
13 coupled with addressing the requirements of the Decision.

14 20. **Title sheet** – This is a new sheet that contains inputs for the plant in service, the
15 accumulated depreciation and the fully depreciated plant balances that were approved in the last rate
16 case. This information is then linked throughout as necessary. Having these inputs on the title page
17 contributes to eliminating the need for any inputs on schedule 4 (Plant Summary) and schedule 5 (Utility
18 Plant in Service).

19 21. **Schedule 1: Balance Sheet** – This was formerly pages 24-25 (now page 3). Added
20 formulas and a way to flag for the Company’s attention if the balance sheet does not in fact balance.

21 22. **Schedule 2: Water Company Plant Description** – This was formerly pages 17-18
22 (now page 5). No other changes.

23 23. **Schedule 3: Plant Summary** – This was formerly page 15 (now page 7). No longer
24 requires any input, see the Title page comments.

25 24. **Schedule 4: Utility Plant in Service** – This was formerly page 16 (now page 8). No
26 longer requires any input, see the Title page comments.

27 _____

28 ³ For ease, instructions have also been imbedded on each schedule of the workbook that are applicable for that particular schedule.

1 25. **Schedule 5: Water Use Data Sheet** – This was formerly page 19 (now page 9). Added
2 some of the information requested on the Annual Report to be consistent.

3 26. **Schedule 6: Bill Count Summary** – This was formerly pages 30-34 (now page 10).
4 Removes the quarterly reporting requirement. Links to Schedule 7, and to the proof of revenue
5 calculations.

6 27. **Schedule 7: Current and Proposed Rates** – This was formerly page 9 (now page 11).
7 This schedule includes a drop-down box for the meter size and customer type that will allow the
8 Company to select from a list of options. These selections will then link to the commodity charges
9 section at the bottom of this schedule, the bill counts (Schedule 14), and the proof of revenue (hidden
10 but linked to the income statement Schedule 8). In the existing Short Form Rate Application, it isn't
11 clear that the rate information is required for all meter sizes and types, and is often missing when the
12 Company has more than one meter size/type that it serves. These changes correct for this.

13 28. **Schedule 8: Current and Proposed Service Charges** – This was formerly page 11
14 (now page 12). Included now are the service line and meter charges that Staff typically has
15 recommended. These are for illustrative purposes only and are not part of what will be printed as part
16 of the application for the filing.

17 29. **Schedule 9: Income Statement** – This was formerly page 20 (now page 13). Added
18 columns for the Company proposed adjustments. Also added a link to the proof of revenue which
19 follows Staff's typical methodology for calculating revenues using the bill counts. This is intended to
20 assist the Company with the accuracy of its filing and will hopefully speed up the sufficiency
21 determination, which will also speed up the resolution of rate cases and reduce the amount of time
22 between when the Company files the rate case and the date when rates become effective.

23 30. **Schedule 10: Calculation of Depreciation Expense** – This was formerly page 22
24 (now page 15). Reduced the number of required inputs by linking to other schedules and the Annual
25 Report. Also input the depreciation rates that Staff typically has recommended as a reference for the
26 Company. This schedule will now support the depreciation expense on a going forward basis that
27 reflects the test year plant balances.

28

1 31. **Schedule 11: Pro Forma Additions/Subtractions** – Added this schedule, which will
2 allow the Company to include pro forma adjustments along with explanations to the income statement
3 (linked to Schedule 9).

4 32. **Schedule 12: Pro Forma Property Tax** – Also added a pro forma schedule specific for
5 property taxes that will reflect the property taxes using the formula approach, under the Company
6 proposed revenues (linked to Schedule 9).

7 33. **Schedule 13: Customer Notice** – The existing version of the Short Form Rate
8 Application requires that the Company notice its customers on the same day that the application is filed.
9 The Work Group discussed this requirement and determined that it does not need to be done on the
10 same day and that it would likely be easier for small utilities if it weren't. Therefore, the Work Group
11 has recommended that the notice be sent out by the Company as soon as sufficiency is issued. This
12 requirement would be consistent with the process for larger utilities. The notice was, and still is the last
13 page in the document.

14 34. **Schedule 14: Free Cash Flow** – Added a schedule that links to the other schedules that
15 will show the free cash flow of the Company. This will assist the Company with setting the proposed
16 revenue requirement.

17 35. **Schedule 15: Water Conservation Adjustment** – Added a schedule that will calculate
18 a water conservation adjustment (utilizing a formulaic method) given the average usage per customer in
19 the test year as compared to a prior period(s) (Annual Reports or test year in the last rate case).

20 36. **Schedule 16: Purchased Water Adjustor Mechanism (“PWAM”)** – Added a PWAM
21 schedule. This is a more simplistic model for small water companies that is based on the more complex
22 models that have been approved by the Commission in rate cases for larger utilities.

23 37. **Schedule 17: Purchased Power Adjustor Mechanism (“PPAM”)** – Added a PPAM
24 schedule. This is a more simplistic model for small water companies that is based on the more complex
25 models that have been approved by the Commission in rate cases for larger utilities.

26 38. **Schedule 18: Systems Improvement Fund Surcharge (“SIFS”)** – Added a SIFS
27 Schedule. This is a version of the Systems Improvement Benefit (“SIB”) surcharge that has been
28 approved by the Commission in rate cases for larger utilities. This schedule is intended for Class D and

1 E companies with a large enough rate base for the revenue requirement to be set using a rate of return.
2 An option discussed in the Decision, for those companies with very little or negative rate base, is an
3 Emergency repair and replacement fund. The Work Group believes that the particulars of this surcharge
4 is in part a policy issue to be decided within a rate case, that could be coupled with another directive
5 before the Work Group, specifically that of the development of a standard minimum operating margin.

6 39. **Schedule 19: Checklist** – Added a copy of the expense items portion of the checklist
7 (mirroring the word/PDF version of the application) that requires copies of invoices. Also added a
8 template for each expense item that companies can use in putting together their applications.

9 40. **Work paper 1: Plant Additions and Retirements by Year** – This was formerly page
10 14. The Work Group has recommended that instead of this being a schedule that is included with the
11 filing this be included as a work paper that will be made available for Staff's audit. The number of pages
12 that would be required to print would vary depending on the number of years since the last rate case,
13 but to include this as a work paper instead would reduce the number of pages that are printed.

14 41. **Work paper 2: Plant Accumulated Depreciation** – This is a new addition that
15 requires no input by the Company but can be used to assist in the filing by calculating the accumulated
16 depreciation as a check figure. This work paper is linked to work paper 1.

17 42. **Work paper 3: Advances in Aid of Construction** – This was formerly page 27. In
18 addition to recommending that this now be a work paper instead, the Work Group has added an input
19 for the balance of AIAC that was approved in the last rate case. The Work Group also has
20 recommended splitting out the different categories of AIAC to make the process simpler by reducing
21 the need for future data requests for this information. This work paper is linked to work paper 1.

22 43. **Work paper 4: Gross Contributions in Aid of Construction** – This was formerly page
23 28. In addition to recommending that this now be a work paper instead, the Work Group has added
24 an input for the amortization of CIAC. This work paper is linked to work paper 1.

25 44. **Work paper 5: Supplemental Financial Information** – This was formerly page 26.
26 No changes other than to include as a work paper. This work paper is linked to the Annual Report.

27 45. The Work Group realizes that the Short Form Rate Application will evolve over time,
28 and that flexibility is key in developing a product that will be beneficial for all parties involved. In

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1 addition to the Work Group, the Excel version of the application being presented was also reviewed
2 by a representative of an ownership group that operates four small Class D and E water companies,
3 and his input was incorporated. The Work Group intends for the application to be reviewed by
4 additional small water companies and operators to solicit additional input. Another crucial step in the
5 evaluation process will be working with a small water company to file an actual rate application utilizing
6 the Excel version. The Work Group anticipates that these additional steps will occur at some as yet to
7 be determined point in the future.

8 46. The Work Group is also still working through the process of a Short Form Rate
9 Application for wastewater companies. The question was posed, "Should there be a short form
10 application for wastewater?" The Work Group's answer is that there should be a version created
11 specifically for wastewater utilities; however, because there are far more regulated water utilities the
12 focus has been on updating the water application. As such the Work Group has recommended that
13 the Commission be given the opportunity to review the recommended changes as presented for the
14 water application. Once further direction is given then the Work Group can develop a similar
15 wastewater application.

16 **ESTABLISH STANDARD OF MATERIALITY**

17 47. Another item detailed in the Small Water Company Rate Case Issues section addressed
18 materiality. This policy states that Staff's audits of small water companies should focus on issues likely
19 to materially impact rates. It also states that any accounting issues that have minimal impact on rates
20 need not be addressed in a small water utility rate case. As such, the Decision directs Staff to develop a
21 standard of materiality that takes into account rate impacts. The Work Group developed the following
22 materiality guidance for the Commission's review and consideration.

23 *Materiality Guidelines:*

24 48. As trained accountants and auditors, Staff members have an academic understanding of
25 "materiality." What is deemed to be material in one set of circumstances may be clearly immaterial in
26 another set of circumstances. When exercising regulatory auditor discretion, Staff needs to be mindful
27 of both the big picture and of any applicable policy statements or positions of the fact finder. The
28 overriding consideration should be whether a particular data request or adjustment will materially change

1 the revenue requirement. The "Materiality Levels by Class" chart below provides guidance on what sort
2 of data requests and adjustments are appropriate in different circumstances.

3 49. Staff is expected to think and utilize reason in applying these materiality guidelines and
4 in reaching recommendations. However, there are four general guidelines that should be specifically
5 applied and followed when assessing materiality and when developing recommendations. These four
6 general guidelines are discussed below. Likewise, an auditor's decision to pursue additional discovery
7 should be undertaken only after giving specific consideration to the materiality of the issue being
8 evaluated. That is, if the answer to a data request is not likely to materially affect the revenue
9 requirement, then the data request should not be sent unless there is some other clearly articulated
10 reason for needing the information.

11 *Four General Guidelines:*

- 12 a. Always consider the magnitude of the adjustment under consideration to the big picture.
13 Is the total underlying rate increase request only \$50,000? If so, then an adjustment of
14 \$2,000 is probably material whereas a possible adjustment of \$500 is probably not
15 material enough to recommend. The following table provides some specific guidance:

16 **Material Levels by Class**

	Revenue	Representative Expense		Rate Base			
		Revenue	Expenses	Data Request Threshold	Adjustment	Data Request Threshold	Adjustment
Class C	1 to 3 Million	\$2,000,000	\$1,700,000	\$400	\$2,000	\$1,000	\$5,000
Class D	.250 to 1 Million	625,000	562,500	250	1,000	500	3,000
Class E	< 250,000	125,000	112,500	250	250	500	1,000

21 Data Request Threshold = Default minimum level of individual expenditures that would be reviewed, e.g. the
22 level above which copies of invoices would be provided.

23 Adjustment = Default minimum amount required to recommend an adjustment to an individual account.

- 24 b. If the adjustment under consideration is the result of a companion adjustment, then
25 capture the smaller adjustment in order to assure consistency and completeness in Staff's
26 overall position. For example, if Staff proposes a \$5,000 adjustment to payroll, it is likely
27 that a companion adjustment will also be needed to applicable payroll taxes. In this
28 instance, the accompanying adjustment may only be \$400. The amount of this

1 accompanying adjustment may be too small to consider making as a separate
2 recommendation, but it is none-the-less important to include the accompanying
3 adjustment to assure consistency and completeness in Staff's overall recommendation.
4 There is a secondary approach to these companion adjustments that warrants discussion.
5 If the companion or synchronizing secondary adjustment is truly immaterial, Staff may
6 elect to omit this secondary adjustment. Under such circumstances, it is crucial that it
7 is noted in testimony or in the Staff Report that Staff is choosing to pass on this
8 adjustment because of the immaterial magnitude of the secondary adjustment.

9 c. If the net calculable dollar value of two or more adjustments is immaterial, but the
10 individual components are by themselves material, then the size of the net value is not
11 the deciding factor. However, it is very important to make it clear in testimony or in the
12 Staff Report, that it is the Commission's consideration of the individual components
13 that is important and that focus should not be on the net dollar value of the adjustments.
14 For example, a net impact of \$300 to repairs and maintenance expense would appear to
15 be an immaterial adjustment; however, if this net value is actually composed of one
16 recommended increase of \$90,000 and a recommended decrease of \$89,700 then the
17 issues being addressed are clearly material.

18 d. Always consider – “would a fact finder or other party (such as the Utilities Division
19 Directors, Administrative Law Judges or Commissioners) to the docket, agree that the
20 Staff decision to pursue or not pursue a recommendation in a particular area was
21 reasonable?” From a discovery perspective was the request for more support from the
22 applicant warranted from a materiality point of view? For example, would the fact finder
23 conclude that **it appears** that Staff chose to ignore possible minor adjustments only
24 when the adjustments went in the filing utility's favor? Perception of the decision and
25 actions must always be considered.

26 *Additional Ratemaking Factors Influencing Materiality Decisions:*

27 50. Staff also has a set of additional ratemaking factors that will have relevance when gauging
28 materiality.

1 *Rate Base:*

2 51. The Staff regulatory auditor should keep in mind that adjustments to a utility's rate base
3 only impact the utility's annual revenue requirement by the utility's ROR multiplied by the rate base
4 adjustment (plus income tax gross up.) For example, a rate base adjustment of \$1,000 will only change
5 revenue requirement by \$100 if the ROR is 10 percent (this example ignores possible income tax
6 considerations).

7 *Operating Income – Revenues and Expenses:*

8 52. Adjustments to revenue and expense have a dollar for dollar impact to the utility's annual
9 revenue requirement, again ignoring any income tax considerations. That is, a proposed adjustment of
10 \$1,000 to salaries expense will change the utility's annual revenue requirement by \$1,000 (up or down).

11 *Policy Considerations:*

12 53. Except in cases when the impact of an adjustment is extremely small, the auditor should
13 always capture adjustments that relate to a general Utilities Division policy.

14 *Responding to Filing Utility Proposed Adjustments:*

15 54. A filing utility often sets the materiality threshold in a case. For example, if a filing utility
16 proposes an adjustment of \$100, Staff must still evaluate this proposal. However, Staff should not feel
17 obligated to make adjustments to such a small amount even if small errors in the Company's supporting
18 calculations are found.

19 *Seek Additional Guidance When Necessary:*

20 55. If Staff has doubts whether or not to pursue an adjustment or issue discovery, due to
21 materiality, it may be best to consider just passing on the adjustment, or at least to discuss the matter
22 with a manager.

23 *Proof of Revenues:*

24 56. When it comes to ensuring that the rate design either proposed by the filing utility or by
25 Staff, in fact, generates the annual revenue target, materiality considerations must be approached
26 judiciously. While input from the Staff Manager may be needed in certain cases, Staff generally requires
27 the proof of revenues (associated with existing or proposed rate designs) to be very close to targeted

28

1 revenues. The reason for this is simple. Annual revenues recorded are a mathematical function of the
2 ACC-approved billing rates and the utility's billing determinants⁴.

3 57. Staff should give proper consideration to any reconciling evidence provided by the utility
4 (such as meter reading problems which required manual corrections to customer bills, or even possible
5 cycle billing considerations). But, generally as noted, it should be possible to reconcile a rate design to
6 within 1 percent of targeted revenues.

7 *Rate Filing Sufficiency Reviews:*

8 58. Except for materiality considerations related to Staff's proof of revenue analysis, Staff
9 should not spend time trying to work through either the reasonableness of proposed adjustments or the
10 materiality of company proposed adjustments during Staff's rate filing sufficiency reviews. The focus
11 of such reviews is on the completeness of the filing (does the rate filing meet the ACC's minimum filing
12 requirements for this utility?)

13 *Conclusion:*

14 59. Staff is to present a balanced and reasonably developed financial picture. Staff's
15 recommendations should reflect a balanced consideration of the filing and the recommendations should
16 position the filing utility where it can have a reasonable opportunity to pay its ongoing expenses while
17 also earning a reasonable rate-of-return and income.

18 60. The Work Group has recommended that the Commission adopt the Standard of
19 Materiality as put forth in the Status Report.

20 **DEFINE VIABLE AND NON-VIABLE**

21 61. Prior to implementing the Commission "Policy Regarding Direct Incentives for
22 Acquisitions" or the "Policy Regarding the Acquisition of Viable Systems", the Commission directed
23 the Work Group to define "viable" and "non-viable". The Work Group was also asked to evaluate and
24 define "a demonstrated record of acquiring and improving the service provided to the customers of
25 non-viable water systems" and couple those metrics with recommended ROE adders.

26

27

28 4 Billing determinants would include the monthly number of customers and the respective monthly usage levels for each customer class.

1 62. To meet this mandate the industry members of the Work Group created draft
2 documents of the definitions that served as the genesis for future revisions and guided the various
3 meetings where these definitions were discussed. The Work Group diligently and collaboratively
4 worked together to develop the following definitions on which all parties agree. The following
5 information is the result of this process.

6 *Definitions of Viable and Non-Viable Pertaining to Small Water and Wastewater Utilities:*

7 63. The United States Environmental Protection Agency (EPA) has defined viable water
8 systems as systems that have, “the technical, financial, and managerial capability to consistently comply
9 with current and prospective performance requirements.”⁵ The Arizona Corporation Commission used
10 a similar definition in its Policy Statement No. 5 of Decision No. 75626, dated July 25, 2016, concerning
11 the consolidation of small water and wastewater utilities.

12 **A viable water and/or wastewater utility is defined as one that:**

- 13 1. Maintains the managerial, technical and financial capabilities to safely and
- 14 adequately operate; and
- 15 2. Is currently in compliance with all Arizona Department of Environmental
- 16 Quality, Arizona Department of Water Resources, and Arizona Corporation
- 17 Commission rules and orders; and
- 18 3. Will be able to meet other requisite regulatory requirements on a short and long-
- 19 term basis.⁶

20 ...

21 ...

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23

24 ⁵ EPA, Methods for Assessing the Viability of Small Water Systems: A review of Current Techniques and Approaches, August, 1995. Located at:
25 <http://nepis.epa.gov/Exe/ZyNET.exe/20001RR9.TXT?ZyActionD=ZyDocument&Client=EPA&Index=1995+Thru+1999&Docs=&Query=&Time=&EndTime=&SearchMethod=1&TocRestrict=n&Toc=&TocEntry=&QField=&QFieldYear=&QFieldMonth=&QFieldDay=&IntQFieldOp=0&ExtQFieldOp=0&XmlQuery=&File=D%3A%5Czyfiles%5CIndex%20Data%5C95thru99%5CTxt%5C00000001%5C20001RR9.txt&User=ANONYMOUS&Password=anonymous&SortMethod=h%7C->
26 <http://nepis.epa.gov/Exe/ZyNET.exe/20001RR9.TXT?ZyActionD=ZyDocument&Client=EPA&Index=1995+Thru+1999&Docs=&Query=&Time=&EndTime=&SearchMethod=1&TocRestrict=n&Toc=&TocEntry=&QField=&QFieldYear=&QFieldMonth=&QFieldDay=&IntQFieldOp=0&ExtQFieldOp=0&XmlQuery=&File=D%3A%5Czyfiles%5CIndex%20Data%5C95thru99%5CTxt%5C00000001%5C20001RR9.txt&User=ANONYMOUS&Password=anonymous&SortMethod=h%7C-&MaximumDocuments=1&FuzzyDegree=0&ImageQuality=r75g8/r75g8/x150y150g16/i425&Display=p%7Cf&DefSeekPage=x&SearchBack=Zy.ActionL&Back=Zy.ActionS&BackDesc=Results%20page&MaximumPages=1&ZyEntry=1&SeekPage=x&ZyPURL#>
27
28

⁶ W-00000C-16-0151, Decision No. 75626, at page 19 of Attachment No. 1, lines 6-11.

1 **A non-viable water or wastewater utility is defined as one that:**

- 2 1. Lacks and is unable to acquire the managerial, technical and/or financial
- 3 capabilities to safely and adequately operate; or
- 4 2. Is currently not in compliance or is unable to achieve compliance with Arizona
- 5 Department of Environmental Quality, Arizona Department of Water
- 6 Resources, and/or Arizona Corporation Commission rules or orders or is
- 7 unable to achieve such compliance without managerial, technical, or financial
- 8 assistance; or
- 9 3. Will not be able to meet other requisite regulatory requirements on a short- or
- 10 long-term basis.

11 64. When making the determination of viability or non-viability, the Commission will

12 consider all of the relevant circumstances of the case and will determine the question of viability or non-

13 viability based on all of the circumstances at the time of the CC&N transfer.

14 65. Non-viability in the short or long-term is different from failure where a utility has

15 deteriorated to the point where it presents a danger to public health and safety, but the same types of

16 facts may indicate a utility has become non-viable before it reaches a failed state. Dockets in which 1)

17 the ACC Staff has filed for the appointment of an interim manager and/or operator or 2) water or

18 wastewater utilities have filed for emergency rate relief, are indicative of a water or wastewater utility

19 that is susceptible to failure.

20 66. The following is not an exhaustive list, but are examples of factors that may be present

21 when a utility is non-viable. Any one of these factors, or any combination of factors could be sufficient

22 to show that a utility is non-viable.

- 23 • The utility lacks and is unable to acquire the managerial, technical and/or financial
- 24 capabilities to:
- 25 ○ Perform necessary operations and maintenance to assure an adequate, safe, and
- 26 permanent water supply and/or adequate, safe treatment of wastewater which
- 27 may include:
- 28 ▪ Maintaining and improving essential equipment.

- 1 ○ The owner and/or operator have walked away from the utility.
- 2 ○ There isn't a clear plan in place in the event of an owner passing away or
- 3 becoming unable to continue running the utility.
- 4 ○ Inability or unwillingness to respond to complaints or requests for service.
- 5 ● Is not in compliance with Arizona Department of Environmental Quality, Arizona
- 6 Department of Water Resources, and/or Arizona Corporation Commission rules or
- 7 orders such as:
- 8 ○ Outstanding violations, a history of violations; and/or the inability or
- 9 unwillingness to correct violations.
- 10 ○ Existing mandates for significant capital improvements such as new treatment
- 11 systems and an inability to meet the mandates.
- 12 ○ Failure to obtain approvals to construct, approvals of construction, discharge
- 13 authorizations or other required permits.
- 14 ○ The utility is not current on sales and/or property taxes.
- 15 ● Will not be able to meet other requisite regulatory requirements on a short or long-term
- 16 basis:
- 17 ○ The utility's Certificate of Convenience and Necessity has been revoked.
- 18 ○ Accounting systems are not kept in accordance with required standards.
- 19 ○ There is a failure to properly complete and/or submit annual reports to the
- 20 Utilities Division.
- 21 ○ Appointment of an interim manager or operator.
- 22 ○ The utility has filed an application for interim rates or emergency rates.
- 23 ○ The setting of adequate rates would be unduly burdensome with the existing
- 24 customer base.

25 67. Class C, D, and E utilities have fewer customers and consequently lower revenues than
26 Class A and B utilities do, yet they generally must meet all the same financial, managerial and technical
27 requirements as the larger companies. As a result, Class C, D and E utilities may be particularly
28 susceptible to being non-viable for either the short or long term.

1 68. A determination that a utility is non-viable shall be used only in the assessment of
2 whether acquisition incentives are appropriate should that utility be acquired. A non-viable
3 determination is not intended to create new compliance burdens on a utility that otherwise would not
4 exist. The intent here is to help non-viable utilities (and their customers), not to punish these companies
5 simply because they have been designated as non-viable.

6 69. The Work Group has recommended that the Commission adopt the definitions of
7 Viability and Non-Viability as put forth in the Status Update.

8 *Demonstrated Track Record*

9 70. Another key factor in the acquisition process is the established demonstrated track
10 record. While the Work Group agrees on the definitions of viable and non-viable, there are valid yet
11 differing points of view as to whether the definition of a non-viable utility can be applied retroactively.
12 Ultimately the Work Group agreed that this was a policy decision best left to the Commission, and
13 presents the following two options for the Commission's consideration.

14 71. A demonstrated track record of acquiring and improving the service provided to
15 customers of non-viable water systems is defined as:

16 Option 1 – No time restriction

17 A utility that has acquired multiple non-viable water and/or wastewater utilities and that
18 has made reasonable, prudent and timely investments, which resulted in the acquired
19 utility becoming viable. The acquiring utility shall bear the burden of demonstrating a
20 track record. In each case, the Commission will consider all of the relevant circumstances
21 in determining whether a track record of acquiring and improving the service provided
22 to customers of non-viable water and/or wastewater utilities has been demonstrated.

23 Option 2 – Limited to acquisitions post decision

24 A utility that has acquired multiple non-viable water and/or wastewater utilities since
25 the ACC issued Decision No. 75626⁷, and that has made reasonable, prudent and timely
26 investments, which resulted in the acquired utility becoming viable. The acquiring utility
27

28 ⁷ Effective date of Decision No. 75626 is July 25, 2016.

1 shall bear the burden of demonstrating a track record. In each case, the Commission will
2 consider all of the relevant circumstances in determining whether a track record of
3 acquiring and improving the service provided to customers of non-viable water and/or
4 wastewater utilities has been demonstrated.

5 72. The Work Group did not attempt to couple these metrics with the recommended ROE
6 adders; instead, it recommended that the chosen definition be coupled with ROE adders as part of the
7 Cost of Capital reform that the Work Group is still in the process of completing.

8 **RULEMAKING**

9 73. The Decision orders Staff to commence a rulemaking to consider the following
10 amendment to Arizona Administrative Code (“A.A.C.”) R14-2-803.D: “A notice of intent under this
11 section is not required when the reorganization of an existing Arizona water or wastewater public utility
12 holding company is due to the purchase of the shares (or merger of) a Class D or E water or wastewater
13 utility.” On August 31, 2016, Staff opened docket RU-00000A-16-0300, to initiate the process.

14 **STATUS SUMMARY**

15 74. Following are recommendations:

- 16 1. Staff should be directed to post the Emergency Rate Case Application (set forth
17 in Attachment A) on the Commission’s website to make it available for use by
18 utilities. Staff should also be directed to continue to look for ways of improving
19 the efficiency of the emergency surcharge process.
- 20 2. Staff should be directed to post the Short Form Rate Case Application (as
21 discussed in this report) on the Commission’s website to make it available for
22 use by utilities. Staff should also be directed to continue to look for ways of
23 improving the Short Form Rate Case Application.
- 24 3. The Commission could adopt the “Materiality Guidelines” and the definitions
25 of “viable” and “non-viable”, as set forth herein, as Commission policies in
26 order to provide guidance to Staff and to stakeholders.
- 27 4. As discussed on pages 18-19, the Commission should determine which of the
28 two options for the definition of “demonstrated track record” it prefers, and

1 should then adopt that choice as a Commission policy in order to provide
2 guidance to Staff and to stakeholders.

3 75. Regarding the proposed definitions for “Demonstrated Track Record,” we adopt the
4 No time restriction option as our policy on this issue. Although both options have their respective
5 merits, we believe that the No time restriction proposed option best reflects our objectives as set forth
6 in Decision No. 75626.

7 76. Under the guidance of Decision No. 75626, the Work Group has taken steps to define,
8 refine, propose, and implement actions which will significantly improve the regulatory process
9 surrounding small water companies in Arizona. The Work Group should continue forward with making
10 improvements.

11 77. The purpose of establishing acquisition premiums for non-viable companies and “giving
12 credit” to viable companies that purchase them is to incentivize water system consolidation across the
13 state. We know that when a viable company provides service to customers, customers benefit from that
14 company’s financial, managerial, and technical competence. The last thing we want to do is be an
15 impediment to that goal. The Arizona Department of Environmental Quality (“ADEQ”) has also
16 expressed similar sentiments for all water systems (including those regulated by the ACC). Some
17 industry stakeholders, however, have expressed concern that certain regulatory enforcement actions
18 against a prospective new owner of a non-viable water system may actually discourage or inhibit that
19 acquisition due to potential negative perceptions in the financial community that some regulatory
20 actions, both formal and informal, may cause.

21 78. These Stakeholders raise legitimate concern, yet they must be balanced with the
22 Commission and ADEQ’s primary obligation: the health and welfare of Arizonans. We possess
23 enforcement authority to assure that the new owner is:

- 24 a. Making reasonable progress with identifying system deficiencies;
- 25 b. Making reasonable progress with correcting identified deficiencies; and
- 26 c. Is regularly communicating findings/updates with pertinent regulatory agencies
27 (e.g., ACC, ADEQ, etc.)

28

1 We direct ACC Staff to engage with ADEQ and develop a Joint Policy Statement and/or a
2 Memorandum of Understanding dealing with the acquisition of small troubled water utilities. The Joint
3 Policy Statement and/or Memorandum of Understanding should lay out a process that assures the
4 health and safety of the acquired company on a reasonable schedule. The process should be designed
5 to minimize regulatory actions that might exacerbate the financial risk associated with purchasing small
6 companies with compliance issues. Staff is directed to provide the Joint Policy Statement and/or a
7 Memorandum of Understanding for Commission review (or to report on the state of discussion with
8 ADEQ) by October 30, 2016.

9 CONCLUSIONS OF LAW

10 1) The Commission has jurisdiction over the matters discussed herein pursuant to Article
11 XV of the Arizona Constitution and Title 40 of the Arizona Revised Statutes.

12 2) The recommendations set forth in Finding of Fact no. 74 are reasonable, and we adopt
13 them.

14 3) The Commission, having reviewed the Status Update dated September 1, 2016,
15 concludes that it is in the public interest to adopt the policies as discussed herein.

16 4) We adopt Findings of Fact nos. 48 through 60 as our policy statement regarding
17 "Materiality Guidelines."

18 5) We adopt Findings of Fact nos. 63 through 68 as our policy statement regarding the
19 definitions of "viable" and "non-viable."

20 6) We adopt Findings of Fact nos. 70 through 72, and 75 as our policy statement regarding
21 the definition of "Demonstrated Track Record."

22 7) Our policy statements, as discussed herein, are intended to provide helpful information
23 and guidance to Staff and stakeholders, and are not intended as generally applicable requirements.

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ORDER

IT IS THEREFORE ORDERED that Staff shall post the Emergency Rate Case Application (set forth in Attachment A to the Status Update) on the Commission’s website to make it available for use by utilities.

IT IS FURTHER ORDERED that Staff shall continue to look for ways to improve the efficiency of the emergency surcharge process.

IT IS FURTHER ORDERED that Staff shall post the Short Form Rate Case Application (as discussed in this report) on the Commission’s website to make it available for use by utilities.

IT IS FURTHER ORDERED that Staff shall continue to look for ways to improve the Short Form Rate Case Application process.

IT IS FURTHER ORDERED that the “Materiality Guidelines”, as set forth herein, is adopted as a Commission policy.

IT IS FURTHER ORDERED that the definitions of “viable” and “non-viable”, as set forth herein, is adopted as a Commission policy.

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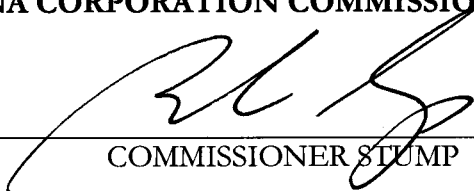
IT IS FURTHER ORDERED that the definition of "demonstrated track record" as set forth in Findings of Fact nos. 70 through 72 and 75 is adopted as a Commission policy.

IT IS FURTHER ORDERED that this Order shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION



CHAIRMAN LITTLE



COMMISSIONER STUMP



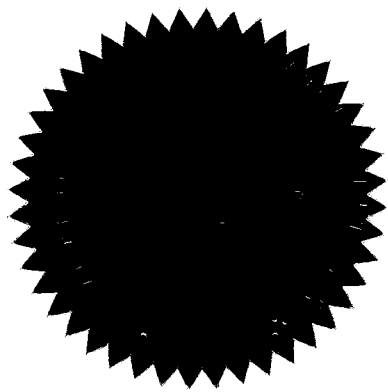
COMMISSIONER FORESE



COMMISSIONER TOBIN



COMMISSIONER BURNS



IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 19th day of September, 2016.


JODI JERICH
EXECUTIVE DIRECTOR

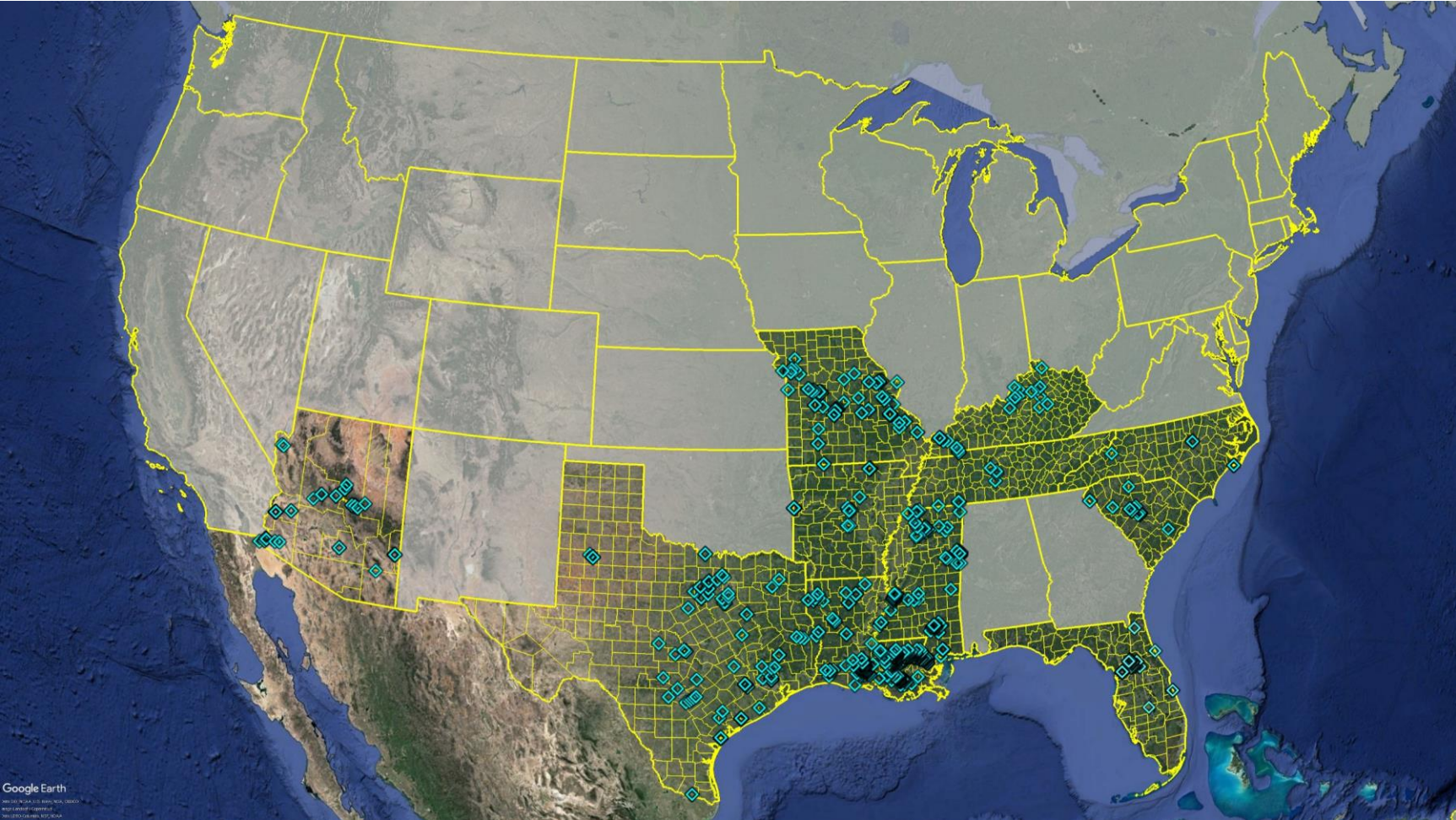
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CSWR Holdings



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**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. W-933, SUB 12
DOCKET NO. W-1328, SUB 0

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of
Application by Red Bird Utility Operating
Company, LLC, and Etowah Sewer
Company, Inc., for Transfer of Public
Utility Franchise and for Approval of Rates

**REBUTTAL TESTIMONY OF BRENT G. THIES
ON BEHALF OF REDBIRD UTILITY OPERATING COMPANY, LLC**

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Brent G. Thies, and my business address is 1630 Des Peres Rd., Suite 140,
St. Louis, MO 63131.

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

A. I am employed by CSWR, LLC (“CSWR”). My current position is Vice President and
Corporate Controller.

Q. ON WHOSE BEHALF ARE YOU FILING THIS DIRECT TESTIMONY?

A. I am filing on behalf of Red Bird Utility Operating Company, LLC (“Red Bird” or the
“Company”), which is a subsidiary of CSWR.

**Q. HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE THIS
COMMISSION?**

1 A. Yes. I filed testimony in Docket Nos. W-922, Sub 8 and W-1328, Sub 9 in support of
2 Red Bird's Joint Transfer Application to acquire Crosby Utilities Inc's water and
3 wastewater systems.

4 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
5 **BACKGROUND.**

6 A. I hold a Bachelor of Arts in Communications/Public Relations from Missouri Baptist
7 University in St. Louis, Missouri and a Bachelor of Science in Accounting from Liberty
8 University in Virginia. I also hold a Master of Divinity degree from Midwestern Baptist
9 Theological Seminary in Kansas City, Missouri and a Master of Business
10 Administration degree from the University of Missouri-St. Louis. I am licensed as a
11 Certified Public Accountant in the state of Missouri, and during my time at CSWR, I
12 have completed the Fundamentals, Intermediate and Advanced Regulatory Studies
13 Programs through the Institute of Public Utilities at Michigan State University.

14 I have been employed in the Accounting and Finance department of CSWR
15 since July 2017. I started at CSWR as the Senior Accountant and was responsible for
16 monthly accounting work for CSWR and its regulated utility subsidiaries. My
17 responsibilities as a Senior Accountant included analysis and reporting related to state
18 regulatory requirements. I was promoted to the position of Controller in October 2018
19 and then Vice President and Corporate Controller in February 2022.

20 Prior to CSWR, I was employed as the Controller of a multi-entity non-profit
21 in St. Louis, Missouri.

1 **Q. WHAT ARE YOUR DUTIES AS VICE PRESIDENT AND CORPORATE**
2 **CONTROLLER?**

3 A. As Vice President and Corporate Controller I am responsible for maintaining the
4 accounting books and records of CSWR and its regulated utility subsidiaries. This
5 includes setting financial controls and accounting policy and having responsibility for
6 the accurate recording of revenues, expenses and capital expenditures. My team also is
7 responsible for preparing and filing regulatory annual reports and responding to certain
8 data requests for the regulated utility subsidiaries of CSWR. In addition, my
9 responsibilities include preparation of monthly and quarterly management reports and
10 interfacing with external auditors and tax professionals.

11 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS**
12 **PROCEEDING?**

13 A. My rebuttal testimony responds to the testimony filed by Public Staff witnesses Lynn
14 Feasel and Michael Franklin. Specifically, I respond to Public Staff witness Feasel's
15 rate base and Contributions in Aid of Construction ("CIAC") calculations along with
16 her estimate of the impacts the Company's acquisition adjustment and due diligence
17 costs would have on a future revenue requirement. I also provide a brief response to
18 the depreciation rates used in the testimony of Public Staff witness Franklin. Lastly,
19 my testimony discusses some particulars of Public Staff's calculations and how the
20 Company views the underlying assumptions and calculations.

21 **Q. DO YOU HAVE ANY EXHIBITS TO YOUR REBUTTAL TESTIMONY?**

22 A. Yes. **Thies Rebuttal Exhibit 1** details the adjustments to Tap-Ins that the Company
23 used to arrive at its rate base calculation.

1 **Q. WAS THIS EXHIBIT PREPARED OR PROVIDED BY YOU OR UNDER**
2 **YOUR DIRECTION AND SUPERVISION?**

3 A. Yes.

4 **II. ACCOUNTING ISSUES**

5 **Q. HOW DID THE PUBLIC STAFF CALCULATE ETOWAH'S RATE BASE?**

6 A. Public Staff calculated Etowah's rate base beginning with the approved amounts in
7 Etowah's last rate case in Docket No. W-933, Sub 9 for Utility Plant in Service
8 ("UPIS"), accumulated depreciation, and CIAC. The UPIS approved as part of Docket
9 No. W-933, Sub 9 was \$951,285. Public Staff analyzed invoices provided by Etowah
10 to calculate UPIS additions of \$22,645, and then totaled these amounts to arrive at its
11 UPIS value of \$973,930.

12 Public Staff calculated Etowah's accumulated depreciation value in a similar
13 fashion. Public Staff began with the approved amount of accumulated depreciation in
14 Etowah's last rate case in Docket No. W-933, Sub 9—\$547,706—and then brought this
15 figure forward to December 31, 2023. Public Staff then calculated the additional
16 accumulated depreciation from the UPIS additions to arrive at \$825,156 for its final
17 amount of accumulated depreciation.

18 Public Staff also updated the CIAC balance used in its rate base calculation.
19 Public Staff updated the value approved in Docket No. W-933, Sub 9 for tap-in fees
20 received since that time and brought forward the accumulated amortization to
21 December 31, 2023. This process resulted in an adjusted net CIAC value of \$430,981.

1 The Public Staff's resulting total rate base after the adjustments noted above is
2 \$(282,207).¹

3 **Q. DO YOU AGREE WITH PUBLIC STAFF'S CALCULATIONS?**

4 A. The Company believes that the approach taken by Public Staff is reasonable but the
5 Company disagrees with some of the depreciation assumptions used by Public Staff
6 and believes Public Staff should have included a UPIS value that corresponds to the
7 CIAC amount that was added. These differences in UPIS and accumulated depreciation
8 result in a different rate base value than that calculated by Public Staff, as displayed in
9 the table below. Later in my testimony, I explain the Company's divergent
10 assumptions.

	Red Bird	Per Staff
Purchase Price	██████████	██████████
Plant in Service	\$2,159,338	\$973,930
Accumulated Depr	\$(1,585,928)	\$(825,156)
CIAC	\$(430,981)	\$(430,981)
Rate Base	\$142,429	\$(282,207)

11 **Q. WHAT DEPRECIATION RATES DID THE PUBLIC STAFF USE TO**
12 **CALCULATE RATE BASE?**

13 A. In his testimony, Public Staff witness Franklin uses depreciation lives and rates that
14 differ from those approved in Etowah's last rate case. Mr. Franklin used an adjusted
15 depreciable life for generators of 3 years as opposed to 20 years; 20 years as opposed

¹ This calculation is derived by starting with UPIS and subtracting accumulated depreciation and CIAC to arrive at the final net plant in service, or the rate base.

1 to 50 years for lift stations; and a life of 7 years instead of the approved 20 years for
2 check valves.

3 **Q. DOES RED BIRD AGREE WITH THE PUBLIC STAFF'S ADJUSTED**
4 **DEPRECIATION LIVES?**

5 A. No. While the Company respects Mr. Franklin's qualifications to assess depreciable
6 lives, an acquisition case is not the appropriate forum to make adjustments to
7 depreciation lives; rather, depreciation changes should be addressed in a future rate
8 case after further evaluation and depreciation studies have been completed.

9 **Q. PLEASE DESCRIBE THE PUBLIC STAFF'S UPIS VALUES AND THEIR**
10 **RELATION TO THE ADDITION OF CIAC.**

11 A. On the bottom of page 9 on the North Carolina Annual Report template, CIAC is
12 defined as follows:

13 Contributions in aid of construction (CIAC) are generally defined in
14 the NARUC Uniform System of Accounts as money, services, or
15 property received by the utility company from customers,
16 developers, or any other source at no cost to the utility company
17 which offsets the acquisition, improvement, or construction cost of
18 the utility's property, facilities, or equipment to be used to provide
19 utility service. Tap-on fees and meter installation fees are forms of
20 CIAC.

21 Thus, according to the Commission's own Annual Report template, CIAC is a payment
22 of cash or property that results in an additional component of UPIS. In its analysis,
23 Public Staff recognized that Etowah had received tap-on fees that it properly booked
24 as CIAC. However, Etowah's annual reports show no increase in UPIS that
25 corresponds to the plant assets that should have been purchased or constructed as a
26 direct result of the receipt of the tap-on fees. Public Staff made no other adjustment to

1 UPIS to reflect the fact that new taps were added. The effect of this omission is to
2 understate UPIS, resulting in an artificially low rate base value.

3 In order to adjust for the UPIS values associated with the new tap-on fees, the
4 Company added \$1,180,645 to UPIS. This number is equal to the value of CIAC that
5 Public Staff used in its rate base calculation. The Company also calculated the
6 accumulated depreciation that should be associated with the addition UPIS of \$753,559
7 to arrive at a total of \$427,086 as of December 31, 2023. **Thies Rebuttal Exhibit 1**
8 details the adjustments the Company made to arrive at its rate base calculation.

9 **Q. SHOULD THE COMMISSION CONSIDER THE IMPACT OF THE**
10 **PROPOSED ACQUISITION ON FUTURE RATES IN THIS PROCEEDING?**

11 A. No, it should not. As described in more detail in the rebuttal testimony of Red Bird
12 witness and CSWR's President Josiah Cox, the rate impacts included in the testimonies
13 of Public Staff's witnesses are nothing more than estimates based on numerous
14 assumptions that may or may not reflect the elements of the revenue requirement the
15 Commission would use to set future rates. As such, those rate estimates cannot be relied
16 on for assessing the rate impact of the proposed transaction.

17 In addition, Public Staff's rate impact estimates assumes that rates for the
18 Etowah system would be set on a stand-alone basis despite Red Bird stating its intention
19 to seek consolidated, statewide rates for its North Carolina water and wastewater
20 systems. Based on the experience of our affiliate group in states like Kentucky,
21 Missouri and Louisiana, there can be a significant difference between rates set on a
22 stand-alone basis and those set on a consolidated basis.

1 Finally, because Red Bird proposes to adopt at closing the rates that are
2 currently in effect for the Etowah system, the Commission need not consider rates in
3 this proceeding. As I understand applicable law in North Carolina, the focus of this
4 proceeding is to determine if Red Bird has the technical, managerial, and financial
5 qualifications to own and operate as a public utility and to also determine if the
6 proposed acquisition is in the public interest. Issues related to future rates can (and
7 should) be deferred to a future rate case proceeding, where necessary evidence is
8 available to determine Red Bird's revenue requirement and establish the appropriate
9 rate design.

10 **Q. PLEASE DESCRIBE THE ASSUMPTIONS PUBLIC STAFF USED IN**
11 **ARRIVING AT THEIR CALCULATION OF THE ESTIMATED REVENUE**
12 **IMPACT.**

13 A. Public Staff witnesses Feasel and Franklin utilized assumptions for capital structure,
14 rate of return, and amortization period to arrive at the revenue and rate impact of certain
15 items that are a part of Red Bird's filing in this docket. Since Red Bird is not currently
16 in a rate case proceeding, there is no way to know whether the assumptions the Public
17 Staff made to arrive at these estimated rate impacts are realistic or reasonable. As the
18 Commission knows, capital structure, return on equity, and amortization periods are
19 some of the most heavily contested issues in a rate case. While Public Staff's witnesses
20 properly characterize their work as estimations, it is not proper to consider their
21 estimated revenue requirement impacts when (a) they are not relevant to an acquisition
22 proceeding, and (b) they are based on hypothetical assumptions that require the

1 development of a complete record in a future general rate case and are likely to be the
2 subject of dispute in that case.

3 **Q. WHAT CONCERNS OR OBJECTIONS DOES THE COMPANY HAVE**
4 **REGARDING THE AMORTIZATION PERIOD PUBLIC STAFF USED TO**
5 **ESTIMATE THE RATE IMPACTS INCLUDED IN ITS TESTIMONY?**

6 A. Public Staff witness Feasel assumes the amortization periods below for her rate impact
7 estimates based on the values of plant in service.

<u>Proposed Amortization Period (Staff)</u>	
Acquisition Adjustments	27.74 Years
Due Diligence Cost	27.74 Years

8 While it may be reasonable to calculating an amortization period that incorporates the
9 useful lives of utility plant assets, this calculation results in an unnecessarily short
10 amortization period. The Company proposes to amortize acquisition adjustments and
11 due diligence costs over a longer amortization period as demonstrated in the table
12 below.

<u>Proposed Amortization Period (Company)</u>	
Acquisition Adjustments	50 Years
Due Diligence Cost	50 Years

13 In accordance with the Depreciation Practices for Small Water Utilities published by
14 the National Association of Regulatory Utility Commissioners, the proposed 50-year
15 amortization is based on the average useful lives of assets comprising water distribution
16 systems and sewer collection systems.

1 **Q. WHY IS THE LONGER AMORTIZATION PERIOD YOU JUST DISCUSSED**
2 **MORE REASONABLE THAN THE PERIOD USED BY PUBLIC STAFF IN ITS**
3 **RATE IMPACT ESTIMATES?**

4 A. The Company's amortization period is more reasonable for at least two reasons. First,
5 as mentioned above, fifty years is a common estimate for the useful lives of the pipes
6 and similar assets comprising water distribution systems and sewer collection systems.
7 Second, the majority of the costs associated with the Company's due diligence efforts
8 relate to mapping, surveying and title and easement research related to the distribution
9 and collection systems. Due diligence costs associated with hard assets, such as those
10 mentioned above, are typically amortized over a period equal to the depreciation period
11 associated with those assets. Therefore, the amortization period for the due diligence
12 related costs should also be fifty years.

13 **III. CONCLUSION**

14 **Q. DOES THIS CONCLUDE YOUR PRE-FILED REBUTTAL TESTIMONY?**

15 A. Yes.

Red Bird Utility Operating Company
 Tap Ons through 12/31/2023

Date	Amount	Rate	Accumulated Depr 12/31/2023
Pre 1998	361,800	3.30%	361,800
12/31/1998	9,000	3.30%	7,430
12/31/1999	86,400	3.30%	68,476
12/31/2001	5,400	3.30%	3,923
12/31/2002	19,800	3.30%	13,730
12/31/2003	59,800	3.30%	39,495
12/31/2004	99,268	3.30%	62,277
12/31/2004	24,357	3.30%	15,281
12/31/2005	66,700	3.30%	39,644
12/31/2006	149,362	3.30%	83,846
12/31/2007	43,700	3.30%	23,089
12/31/2010	6,900	3.30%	2,962
12/31/2012	6,900	3.30%	2,506
12/31/2013	11,500	3.30%	3,797
12/31/2014	4,600	3.30%	1,367
12/31/2015	11,500	3.30%	3,038
12/31/2016	6,900	3.30%	1,595
12/31/2017	32,200	3.30%	6,379
12/31/2018	6,900	3.30%	1,139
12/31/2019	9,200	3.30%	1,215
12/31/2020	27,600	3.30%	2,732
12/31/2021	106,673	3.30%	7,040
12/31/2022	24,185	3.30%	798
Total	1,180,645		753,559

**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. W-933, SUB 12
DOCKET NO. W-1328, SUB 0

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of
Application by Red Bird Utility Operating
Company, LLC, and Etowah Sewer
Company, Inc., for Transfer of Public
Utility Franchise and for Approval of Rates

**REBUTTAL TESTIMONY OF JAMES A. BECKEMEIER
ON BEHALF OF RED BIRD UTILITY OPERATING COMPANY, LLC**

I. INTRODUCTION

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

2 A. My name is James A. Beckemeier, and my business address is 13421 Manchester Road,
3 Suite 103, St. Louis, MO 63131.

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

5 A. I am a Managing Member of BL-STL, LLC (dba Beckemeier LeMoine Law).

6 **Q. ON WHOSE BEHALF ARE YOU FILING THIS REBUTTAL TESTIMONY?**

7 A. I am filing rebuttal testimony on behalf of Red Bird Utility Operating Company, LLC
8 (“Red Bird” or the “Company”), which is a subsidiary of CSWR, LLC (“CSWR”).
9 Beckemeier LeMoine Law is a vendor of Red Bird, and we oversee and facilitate all of
10 its utility system acquisitions throughout the United States.

11 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE THIS**
12 **COMMISSION?**

13 A. No.

1 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
2 **BACKGROUND.**

3 A. I have a B.S./B.A. in Business Marketing and a Juris Doctorate from the University of
4 Missouri, Columbia. I have been a licensed attorney in the States of Missouri and
5 Illinois for 21 years focusing on business and real estate law.

6 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS**
7 **PROCEEDING?**

8 A. The purpose of my rebuttal testimony is to clarify and provide this Commission
9 additional information on the scope and purpose of the due diligence performed on this
10 acquisition and other similar projects prior to closing on the purchase.

11 **Q. DO YOU HAVE ANY EXHIBITS TO YOUR REBUTTAL TESTIMONY?**

12 A. No.

13 **II. DUE DILIGENCE COSTS**

14 **Q. WHAT IS YOUR EXPERIENCE WITH REGARD TO DUE DILIGENCE**
15 **ACTIVITIES FOR A TRANSACTION SUCH AS THE PROPOSED ETOWAH**
16 **SEWER COMPANY ACQUISITION?**

17 A. My law firm has closed over 200 utility company acquisitions since 2017 and has
18 extensive experience with acquiring systems similar to the Etowah Sewer Company,
19 Inc. (“Etowah”).

20 **Q. HOW AND TO WHAT EXTENT ARE YOU AND YOUR LAW FIRM**
21 **INVOLVED IN DUE DILIGENCE ACTIVITIES RELATED TO ETOWAH?**

22 A. My law firm works with and/or oversees title companies and surveyors to determine
23 what title review is necessary for title due diligence, what surveys are required, which

1 title defects are material and necessary to cure prior to the closing date vs. those that
2 should not impact the closing. Our firm also manages all curative matters that arise
3 after the closing that are necessary to obtain proper rights to operate the system going
4 forward.

5 In states such as North Carolina, where the attorneys in our law firm are not
6 licensed, we work with local, licensed attorneys' who have similar expertise and
7 delegate the state-specific aspects of this due diligence and curative work to our local
8 partners. In North Carolina, we work with the Law Firm Carolinas for such work. We
9 endeavor to avoid duplicative efforts and to assign tasks accordingly.

10 **Q. WHY DOES A COMPANY SUCH AS RED BIRD CONDUCT DUE**
11 **DILIGENCE IN AN ACQUISITION TRANSACTION AND WHAT BENEFITS**
12 **DO SUCH ACTIVITIES PROVIDE?**

13 A. The primary benefit to conducting extensive due diligence prior to closing on a
14 transaction is to identify any defects in the system assets in order to plan for the capital
15 improvements that will be needed to properly operate the system. In addition,
16 conducting due diligence enables potential purchasers to identify any deficient real
17 property rights that could inhibit the ability to properly operate the system. Identifying
18 such deficiencies allows a purchaser such as Red Bird to take steps to cure such defects
19 and deficiencies as soon as practicable, either prior to or after the closing to avoid
20 disruptions in the proper operations of the system.

1 **Q. PLEASE DESCRIBE AND PROVIDE EXAMPLES OF DUE DILIGENCE**
2 **ACTIVITIES THAT HAVE BEEN PERFORMED BY, AND FOR, RED BIRD**
3 **IN CONNECTION WITH THE PROPOSED ETOWAH ACQUISITION.**

4 A. We obtained a Title Commitment for the tracts of land and easement rights being
5 transferred by Etowah and reviewed the referenced title documents related to the
6 acquisition to identify title deficiencies. We also obtained a detailed title summary of
7 the potential recorded documents within Etowah's service area that could have an
8 impact on the rights of the utility system. This report identified 28 potential easement
9 agreements, 54 plats, numerous deeds and other recorded legal instruments that we
10 reviewed to determine to what extent such instruments would impact an owner's ability
11 to operate the Etowah wastewater system.

12 In addition, the survey team completed five American Land Title Association
13 ("ALTA") surveys of real property that will be transferred as part of the purchase and
14 also has prepared numerous service area maps to set forth the relevant title findings in
15 a unified document.

16 Based on the foregoing activities, we determined that there are material defects
17 in the title rights impacting Etowah that need to be cured prior to the closing or shortly
18 thereafter.

1 **Q. WHAT CONCERNS DOES PUBLIC STAFF WITNESS FRANKLIN EXPRESS**
2 **REGARDING THE DUE DILIGENCE EXPENSES RED BIRD HAS**
3 **INCURRED IN CONNECTION WITH ITS PROPOSED ACQUISITION OF**
4 **THE ETOWAH SYSTEM?**

5 A. Mr. Franklin states that Red Bird's due diligence expenses are excessive and that he is
6 unclear as to the scope or substance of the due diligence work.

7 **Q. HOW DO YOU RESPOND TO MR. FRANKLIN'S CONCERNS?**

8 A. For a potential purchaser to properly assess the feasibility of acquiring a utility system
9 it is incumbent upon the purchasing utility company to perform due diligence. The
10 scope of due diligence generally consists of the following areas:

11 (1) engineering review of the current operational integrity and deferred
12 maintenance needs of the system;

13 (2) valuation of the system assets; and

14 (3) determination of real property rights for the fee simple acquired land as well
15 as the easement rights necessary to operate the system.

16 The proposition that due diligence could be completed at a price of \$10,000.00 for a
17 utility system with 440 residential customers and 485 total customers, consisting of a
18 treatment facility, six pump stations, a force main and sewer lines throughout the
19 service area suggests that Mr. Franklin does not appreciate the work involved in
20 conducting reasonable due diligence required for a transaction of this type.

1 **Q. PLEASE DESCRIBE THE PURPOSE OF CONDUCTING ENGINEERING**
2 **DUE DILIGENCE FOR A TRANSACTION SUCH AS THE ONE AT ISSUE IN**
3 **THIS CASE.**

4 A. The scope of the operational engineering due diligence is demonstrated in the McGill
5 Associates, P.A. (“McGill”) engineering memorandum, Appendices A-1 and A-2, filed
6 as Confidential Attachment L to Red Bird’s Application, in which McGill summarized
7 their assessment of the system and their recommendations to cure the numerous
8 deficiencies set forth in the memorandum. The operational engineering costs incurred
9 by Red Bird are in line with due diligence costs associated with deals of this size, type,
10 and complexity. It is also our understanding that the information developed through the
11 type of due diligence performed by McGill is required to complete part of the
12 Commission’s acquisition application. Therefore, even if engineering due diligence
13 were not standard practice in a deal like this, which we think it is, at least part of the
14 expense associated with McGill’s report was required to be incurred in order for Red
15 Bird to complete its acquisition application.

16 **Q. WHY IS AN APPRAISAL REQUIRED AND WHAT IS THE PROCESS USED**
17 **TO OBTAIN AN APPRAISAL?**

18 A. As part of its due diligence, Red Bird engaged a qualified appraiser to determine the
19 value of the assets being acquired in order to determine the fair value of the assets being
20 acquired. Based upon my experience, the cost of the appraisal for the Etowah system –
21 approximately \$2,500 – is reasonable.

1 **Q. PLEASE DESCRIBE THE PURPOSE OF CONDUCTING SURVEY**
2 **ENGINEERING DUE DILIGENCE FOR A TRANSACTION SUCH AS THE**
3 **ONE AT ISSUE IN THIS CASE.**

4 A. As part of its due diligence, Red Bird engaged 21 Design Group, Inc. to provide survey
5 work and GIS mapping work throughout Etowah's service area, which covers more
6 than 700 acres. In order to perform proper due diligence related to the real property
7 rights that are necessary to operate the utility system, ALTA level surveys needed to
8 be performed for all of the parcels of property where major components of the utility
9 system are located. The ALTA surveys are required by the Title Company to obtain
10 title insurance over the purchased property without exceptions set forth in the title
11 coverage related to matters that would be discovered by an ALTA level survey.

12 In addition to the ALTA level surveys, 21 Design Group performed boundary
13 survey work for each pump station to determine the proper boundaries and legal access
14 to the pump stations. 21 Design Group also conducted and generated GIS mapping for
15 the entire service area to create maps locating the service lines and other components
16 of the system both for pre-closing due diligence and also to use for the benefit of post-
17 closing maintenance and operations of the system. All of the work performed by 21
18 Design Group on this project is necessary for proper due diligence for a purchase of
19 this scope, and the associated fee, is consistent with other projects with a similar scope
20 of work.

1 **Q. PLEASE DESCRIBE THE PURPOSE OF CONDUCTING LEGAL DUE**
2 **DILIGENCE FOR A TRANSACTION SUCH AS THE ONE AT ISSUE IN THIS**
3 **PROCEEDING.**

4 A. In addition to the engineering due diligence I just described, it is standard practice to
5 conduct a legal due diligence review of a proposed transaction. As part of this process,
6 it is necessary to determine if the selling utility company has legal and transferable
7 rights in the real property necessary to operate the utility system. This review consists
8 of ordering a title commitment from a Title Company as to the real property owned by
9 the selling utility company, reviewing all of the referenced documents set forth in the
10 title commitment, and reviewing the ALTA surveys that are generated by the surveyors
11 that 21 Design Group engaged to create the surveys.

12 Real property due diligence also consists of a review of any real property rights
13 necessary to operate the system that the selling utility company does not own and/or is
14 not able to transfer. In order to determine the transferable rights of the selling utility
15 company and the additional rights that are necessary to properly operate the utility
16 system, all of the recorded plats as well as the covenants, restrictions and indentures in
17 the service area need to be located and reviewed to determine if there are any granted
18 easement rights for access to the service lines, if there are any developer rights available
19 for a utility company for operations, or if there are any other publicly dedicated rights
20 to rights of way or other easement areas in which the service lines or components of
21 the system are located.

22 Generally, when developers entitle real property for small communities that
23 have a utility system similar to the Etowah system, the developers fail to properly grant

1 the necessary utility easement rights to access all of the service lines and/or other
2 components of the system. Red Bird deems it prudent to determine these rights prior to
3 closing in order to have clarity as to which parts of the system components and/or
4 service rights are being transferred with clear titled access, and which part of the system
5 exist upon land that does not contain express legal rights for the components to be
6 located thereon. This process involves significant title search fees, survey work and
7 legal fees in order to determine the potential deficiencies in such rights. Once such
8 deficiencies are determined, then Red Bird can take reasonable steps prior to the closing
9 to attempt to cure some or all of these deficiencies; or, if they are not able to cure all
10 such deficiencies prior to closing, to have clarity on how to address the deficiencies
11 after the closing. This process ensures Red Bird will have enforceable title to the real
12 property assets it acquires, and any defects will be remedied as part of the title
13 company's obligations under its title insurance policy that is issued at the closing
14 related to the property listed in the title policy.

15 **Q. BASED ON YOUR EXPERIENCE, WOULD YOU CHARACTERIZE RED**
16 **BIRD'S DUE DILIGENCE ACTIVITIES AS REASONABLE FOR AN**
17 **ACQUISITION TRANSACTION SUCH AS THE ONE UNDER**
18 **CONSIDERATION IN THIS CASE? PLEASE EXPLAIN.**

19 A. Yes. The due diligence activities conducted to date for this transaction are reasonable
20 and consistent with prior North Carolina transactions conducted by Red Bird.
21 Moreover, the due diligence activities that have taken place for this transaction are
22 consistent with the due diligence Red Bird's affiliates have performed for similar
23 transactions in other states.

1 **Q. HAS RED BIRD COMPLETED ALL OF THE REQUIRED DUE DILIGENCE**
2 **FOR THIS TRANSACTION? IF NOT, WHAT ADDITIONAL DUE**
3 **DILIGENCE ACTIVITIES ARE REQUIRED?**

4 A. While most of the due diligence for the Etowah system has been completed, due to the
5 significant delay of the approval process of this transaction, much of the title review
6 and certain parts of the engineering due diligence will need to be updated to current
7 conditions prior to the closing in order to finalize the due diligence. Whereas CSWR's
8 affiliates outside North Carolina are accustomed to a closing time frame that generally
9 lasts anywhere from nine months to one-year, the delay in the regulatory approval
10 process in North Carolina has impacted transactions like Etowah, resulting in Red Bird
11 incurring significant additional due diligence costs.

12 **Q. PUBLIC STAFF WITNESS FRANKLIN STATES IN HIS TESTIMONY THAT**
13 **SEVEN DIFFERENT BUSINESS ENTITIES – TWO ENGINEERING FIRMS**
14 **AND FIVE LAW FIRMS – WERE ENGAGED IN DUE DILIGENCE FOR THIS**
15 **PROPOSED TRANSACTION. HOW DO YOU RESPOND?**

16 A. Mr. Franklin is mistaken. The following companies were engaged to assist with due
17 diligence for this matter:

- 18 1. McGill Associates, P.A. - McGill has provided engineering services to
19 determine the current condition of the physical assets of the system and has
20 made recommendations on curative work necessary to properly operate the
21 system after closing.
- 22 2. 21 Design Group, Inc. – 21 Design provided survey engineering and related
23 title review for the entire service area.

- 1 3. Beckemeier LeMoine Law – I previously explained the scope of services
2 undertaken by my law firm.
- 3 4. Black, Slaughter & Black, PA & Law Firm Carolinas – These two entities are
4 the same law firm (Law Firm Carolinas is the successor to the prior named law
5 firm), and this law firm has provided state-specific title due diligence as well as
6 title company services for this project.
- 7 5. Burns, Day & Presnell, P.A. – Burns has provided legal services related to the
8 regulatory approval process for this matter.
- 9 6. Valbridge Property Advisors – Valbridge provided an appraisal for the utility
10 assets being purchased.

11 **Q. WHY WERE THREE DIFFERENT LAW FIRMS REQUIRED FOR DUE**
12 **DILIGENCE IN THIS TRANSACTION?**

- 13 A. Burns, Day & Presnell, P.A. provided the necessary legal services to assist Red Bird
14 with meeting its obligations to properly comply with the regulatory approval process
15 for the purchase of the Etowah system. Beckemeier LeMoine Law provided the
16 necessary legal services to oversee and conduct legal due diligence related to the real
17 and personal property being purchased as part of this transaction as well as to determine
18 what (if any) additional property is necessary to obtain ownership or other rights in
19 order to properly operate the Etowah system after the closing. To the extent Beckemeier
20 LeMoine Law is not able to provide state-specific legal services, Law Firm Carolinas
21 provides the state-specific legal services. In addition, Law Firm Carolinas is a title
22 company agent that works with the underwriting title company to obtain and issue the
23 title commitment and title policy for the covered property.

1 **Q. DO YOU AGREE WITH PUBLIC STAFF WITNESS FRANKLIN'S**
2 **SUGGESTION THAT DUE DILIGENCE COSTS FOR THIS TRANSACTION**
3 **ARE EXCESSIVE BASED ON THE PURCHASE PRICE RED BIRD**
4 **PROPOSES TO PAY FOR THE ETOWAH SYSTEM?**

5 A. No. The purchase price has no correlation to due diligence costs. Red Bird's affiliate
6 group has had systems with purchase prices that are five times higher than the Etowah
7 price that have similar due diligence costs and have had systems that sold for as little
8 as \$1.00 that also have similar due diligence costs. The true driver of due diligence
9 costs is the assets being reviewed and the number of defects or deficiencies that are
10 discovered.

11 **III. CONCLUSION**

12 **Q. DOES THIS CONCLUDE YOUR PRE-FILED REBUTTAL TESTIMONY?**

13 A. Yes.

CERTIFICATE OF SERVICE

DOCKET NO. W-933, SUB 12

DOCKET NO. W-1328 SUB 0

I hereby certify that a copy of the Rebuttal Testimony of Josiah Cox, Brent Thies and James Beckemeier on behalf of Red Bird was served electronically or by depositing a copy of the same in the United States Mail, first class postage prepaid, at the addresses contained in the official service lists in these proceedings.

This the 13th day of November 2023.

RED BIRD WATER

/s/ Mindy McGrath

Mindy McGrath (NC Bar No. 35628)

Molly M. Jagannathan (NC Bar No. 36931)

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