March 6, 2023

Via Electronic Filing

Shonta Dunston
Chief Clerk
North Carolina Utilities Commission
4325 Mail Service Center
Raleigh, North Carolina. 27699-4300

Re: **Docket A-41, Sub 22** -- ***In the Matter of Joint Application of Bald Head Island Transportation, Inc., and Bald Head Island Ferry Transportation, LLC, for Approval of Transfer of Common Carrier Certificate to Bald Head Island Ferry Transportation, LLC, and Permission to Pledge Assets***

Dear Ms. Dunston:

Attached is a *Consumer Statement of Position* in Docket A-41 Sub 22. Should you have any questions, please do not hesitate to contact us.

Respectfully yours,

Robert T. Blau
5 Starrush Trail
Bald Head Island, NC 28461

J. Paul Carey
611 Currituck Way
Bald Head Island, NC 28461

Attachment

March 6, 2023

***Consumer Statement of Position***
**Re: Docket A-41, Sub 22**

On December 30, 2022, the NC Utility Commission issued an order in Docket A-41 Sub 21 asserting jurisdiction over the entire Bald Head Island transportation system (System) including its parking and barge operations. It did so out of concern that because the System is a commercially owned local monopoly, System users need to be protected from excessive profiteering. The December 30 order held further that current user rates for passenger ferry/tram, parking and barge services would be presumed reasonable until a new rate case for the entire System is resolved by the Commission, and that the System's current owner Bald Head Island Limited (BHIL) cannot sell its transportation assets to a new owner/operator without prior Commission approval.

On February 13, 2023, the Commission ruled that it would proceed with Docket A-41 Sub 22, an application for approval 1) to transfer the System's Common Carrier Certificate from BHIL to Bald Head Island Ferry Transportation (BHIFT), a wholly owned subsidiary of Pelican Legacy Holdings (Pelican) which, in turn, apparently would be managed and financed by SharpVue Capital (SV); and 2) for BHIFT to pledge the System's assets as collateral for purposes of raising debt capital needed to acquire the System.

On February 20, 2023, the Public Staff filed amended supplemental testimony in Docket A-41 Sub 22. In that testimony, the Staff notes that Commission approval of the transfer application (hereafter Transfer) would be subject to showing that the Transfer would serve the public convenience and necessity, based on a three-part test. That test is: 1) whether the Transfer would have an adverse impact on the rates and services provided by the System; 2) whether System users would be protected as much as possible from potential costs and risks of the Transfer; and 3) whether the Transfer would result in sufficient benefits to offset potential costs and risks. Finally, the Public Staff recommends that the Commission approve the Transfer contingent on BHIFT and BHIFT's eventual owner, whoever that turns out to be, complying with a set of Regulatory Conditions detailed in Exhibit 1 of the Staff's amended testimony.

The purpose of this Statement is to critique the Public Staff's analysis, including the adequacy of its proposed Regulatory Conditions, as well as its recommendation that the Commission approve the Transfer application, with those Conditions. We also propose two possible options for resolving this matter short of the Commission accepting or rejecting SV's amended application.

**Q. Please summarize your Statement.**

SV's proposal to acquire the System for $56M, using high-cost private equity capital, would clearly subject captive System users and the community of Bald Head Island to an excessive and unreasonable amount of cost and financial risk. For these reasons, which are documented below, SV's amended application fails all elements of the Commission's three-test for determining whether the proposed change in ownership would serve the public interest. It clearly would not. The application should be substantially overhauled or rejected.

Our concerns with the current transfer application (hereafter Transfer) mirror concerns that the NC Local Government Commission (LGC) had about a $56M revenue bond issue that the Bald Head Island Transportation Authority (BHITA) proposed to issue for the purposes of acquiring the System from BHIL in 2021 for $47.75M. Because SV's proposed purchase price is significantly higher than BHITA's offer, financing SV's deal would necessarily be considerably more costly, and carry more risk, than BHITA's proposed $56M bond issue.

We also believe that the Regulatory Conditions proposed by the Public Staff, while a step in the right direction, would not significantly mitigate the cost and risks that the Transfer, if approved, would impose on ratepayers. In addition, since the Commission's December 30 order was intended, in large part, to protect captive System users from being forced to pay excessive acquisition costs -- that would result from an inflated purchase price -- through unilateral increases in unregulated monopoly parking and barge rates, the Commission should defer acting on the Transfer application as long as BHIL and SV pursue their court appeal of the December 30 order.

Finally, because the System's current owner, the George P. Mitchell family estate, is no longer interested in owning the System or spending capital on much needed System improvements, a new owner/operator clearly needs to be found. We do not believe, however, that the Mitchell family's interests should compel the Commission to approve a Transfer application that ultimately will harm ratepayers, and the community of BHI. We also understand that it is not the Commission's job to dictate the terms of an acquisition such as this. The buyer and seller need to do that through real and meaningful negotiations, and in a manner that will <u>not</u> subject System users to undue costs, risk, and economic harm. To date, the latter considerations have been missing in action.

In our view, a reasonable Transfer deal could be worked out in one of two ways. Needed changes to the BHIL/SV Transfer application could be negotiated by the System's owner, buyer and the three intervenors in this proceeding (i.e., the Village of BHI, the BHI Club and the Bald Head Association) with the help of an independent arbiter, overseen by the Commission but paid for by the parties of interests. Alternatively, designated state officials could appoint a new board for the BHITA and provide requisite funding needed to <u>independently</u> determine how much BHITA could pay for the System and finance with public debt (e.g., revenue bonds)

without subjecting System users, the BHI community, and the state to unreasonable costs and financial risk.

**Q. Please describe your interest in this matter, your background, and any relevant expertise you bring to this proceeding.**

We are long-time property owners and part-time residents of Bald Head Island. We are both retired business executives and have considerable professional experience in evaluating the financial aspects of corporate mergers and acquisitions, including those involving business entities overseen by Federal and state regulatory commissions.

We actively participated in the LGC's evaluation of the Bald Head Island Transportation Authority's proposal to acquire the System in 2021 for $47.75M, and to finance that deal through a $56M revenue bond issue that was tentatively rated BBB- by S&P Global, or one notch above junk. We did so out of concern that BHITA's market valuation of the System, as well as its $56M bond application, were excessive and would have subjected System users, and the community of Bald Head Island, to an unreasonable amount of unnecessary costs and financial risk.

In the course of reviewing BHITA's bond application to the LGC, we familiarized ourselves with the System's financial and operational performance. We expressed concerns based on that analysis (see Exhibit 1) to the LGC. The LGC did not approve BHITA's $56M BBB- rated revenue bond issue. In our view, these same concerns should now give the Commission pause in approving SV's proposal to acquire the System from BHIL, for $56M, using high-cost private equity investment capital.

**Q. Please describe why the amended Transfer application, if approved by the Commission with the Regulatory Conditions recommended by the Public Staff, would subject System users and the BHI community to unreasonable costs.**

Whatever SV, or any would-be owner/operator, ends up paying for the System, the cost of that acquisition, including financings charges, will eventually fall on captive System users in one form or another, but usually through higher user rates. Second, from the standpoint of System users and how much of these acquisition costs they will be asked to pay for through higher rates, SV's proposal to acquire the System for $56M would be considerably more costly than BHITA's offer to purchase the same set of assets in 2021 for $47.75M and finance the deal, in its entirety, with a $56M revenue bond issue. Those bonds were expected to carry a 4.75 percent interest rate, and would have been amortized over 30 years.

Because the bulk of the financial information underlying SV's deal with BHIL has been deemed "confidential" it is difficult, for us at least, to estimate just how much more costs SV's acquisition would impose on System users than BHITA's $56M revenue bond issue would have entailed. However, since SV would finance a significantly larger purchase price (i.e., $56M vs. BHITA's $47.75M offer) with a much higher weighted average cost of capital (e.g., 8-9 percent

vs a 4.75 percent interest rate on BHITA's bond issue), the effective annual cost of carrying SV's debt and equity capital would necessarily be an order of magnitude greater than annual debt service charges on BHITA's proposed $56M revenue bond. That is just the simple arithmetic of the matter.

We believe this comparison is very relevant to the three-part test that the Commission will use to determine whether approving the BHIL/SV Transfer application will serve the public interest. In our view, the application will not satisfy that test for precisely the same reasons that gave the LGC pause in approving BHITA's (less costly) bond application. Moreover, since SV apparently relied on data contained in BHITA's bond application for its own "due diligence" in arriving at its proposed $56M purchase price, the LGC's consideration of BHITA's bond proposal is clearly very relevant to the Commission's evaluation of the Transfer application and whether it satisfies the three-part test.

**Q. Please explain how BHITA arrived at its $47.75M offer price and its $56M bond proposal, and why that is pertinent to this proceeding.**

We believe that the LGC did not approve BHITA's bond application out of concern that BHITA's proposed $47.75M acquisition price was based on two highly flawed real estate appraisal which BHIL paid for, and that approving a $56M bond issue rated BBB- that BHITA needed to finance its proposed $47.75 acquisition price would have subjected System users, the community of Bald Head Island, and the state to an unreasonable amount of unnecessary cost and financial/default risk. For reasons highlighted in the attached November 17, 2021 letter to the LGC (Exhibit 1), the LGC's assessment of BHITA's bond application, in our view, was entirely correct.

As that letter notes, and what its bond application clearly demonstrated, BHITA's $47.75M offer price for the System was determined by how much BHITA could borrow through an investment grade revenue bond issue (i.e., rated BBB- or higher). A bond rated below investment grade would very likely have been rejected by the LGC out of concern that if BHITA borrowed more public debt than the System could reasonably handle and subsequently defaulted on its bond payments, the LGC and the state would have had to step in and pick up the pieces.[1]

Based on various studies and financial analyses conducted by consultants on behalf of BHITA, but paid for by BHIL, Mercator International and S&P Global, which rates bonds, determined that BHITA could borrow up to $56M and maintain an investment grade BBB- bond rating – **provided BHITA unilaterally raised ferry, parking and barge rates by roughly 20 percent immediately after acquiring the System**. BHITA could have done so since under the terms of its

[1] This is precisely why any bond issue that a public or state entity in North Carolina proposes to issue for any reason must be approved by the LGC. It is the LGC's job to protect the state's credit rating and, in doing so, to keep interest rates that state entities pay on public debt that they issue as low as possible.

enabling legislation (which BHIL crafted), the System would no longer have been regulated in any fashion by this Commission.

Also, because $8.3M of the $56M in bond proceeds would have been needed to pay bond issuance cost and cover debt service reserve requirements, the balance of $47.75M turned out to be the **most** BHITA could pay BHIL for its transportation assets and finance through an investment grade bond issue that, again, the LGC almost certainly would have insisted on.

BHITA's $56M bond proposal as well as SV's proposal to acquire the System for $56M also reflects a 2017 study that Mercator International conducted for BHIL which estimated the System's market value at $56M. That figure, in turn, became BHIL's initial price "offer" which BHITA and BHIL subsequently "whittled down" to the $47.75M purchase price that S&P Global told BHITA it could finance through a $56M bond issue rated BBB-, or one notch above junk. Presumably, the 2017 Mercator International market valuation study as well as BHITA's bond application, including a detailed *Bond Feasibility Study* also done by Mercator International on BHITA's behalf in 2020 but paid for by BHIL, provided the basis for the $56M purchase price that the Commission is now being asked to approve as part of the BHIL/SV Transfer application. All of these studies and data have since been introduced into the record in Docket A-41 Sub 21 and Sub 22 and, thus, are readily available to the Commission and the Public Staff for their use in evaluating the Transfer application at hand.

The bottom line to all of this is that BHITA would have had to raise ferry, parking, and barge rates by **20 percent** in order to pay debt service costs on its proposed $56M bond issue had it acquired the System in 2021. Since then, BHIL has raised parking and barge rates which has increased the System's operating income (e.g., EBITDA). According to 2021 audited financial statements for the System's ferry/tram, parking and barge operations, its total operating income appears to be on the order of $4.3M, or 34.8 percent of its annual revenue.

Even assuming that the Commission would allow the System to operate with a 34.8 percent EBITDA margin following a new rate case, it is highly doubt that $4.3M in operating income would be sufficient to compensate SV investors who put up the $56M, given 1) the System's weighted average cost of capital, and 2) the time frame over which those investors would want to recoup their investment (e.g., 3 to 5 years, but certainly not 30 as was the case with BHITA's bonds).

Notwithstanding BHIL's and SV's assertions to the contrary, user rates would have to be increased significantly in order to generate the added operating income needed to produce favorable returns that individual SV debt and equity investors no doubt believe they will earn on the deal. These financing costs also would be on top of other capital spending that the System will very likely have to undertake in order to keep service quality where it minimally needs to be. Again, given the level of detail that went into BHITA's bond application, coupled with the fact that acquisition costs associated with the BHIL/SV application will be substantially higher than BHITA's bond issue would have been, we do not see how the Commission could come to a different conclusion.

Based on its testimony filed in this proceeding, the Public Staff did not analyze BHITA's bond application as a basis for judging the likely impact of approving SV's proposed $56M acquisition on the System's user rates. Had it done so, it very likely would have concluded the Transfer application would not satisfy the Commission's three-part test, and the Staff would not have recommended that the application be approved even with the recommended Regulatory Conditions.

The Public Staff, no doubt, discussed those Conditions with BHIL and SV in some detail. Yet, BHIL and SV did not make any significant changes to the terms of its amended application on the basis of the Staff's Regulatory Conditions, or, for that matter, the Commission's December 30 order. This certainly suggests that SV, and presumably whoever ends up owning BHIFT, believe they can get around any significant constraints that the Commission might place on the System's future operating income and SV's ability to produce the returns on the System that SV has represented to its investors. In our view, this presents the Commission with some glaring incongruities that certainly need to be addressed before the Commission acts on the Transfer application.

**Q. Please explain why Commission approval of the Transfer application, with the proposed Regulatory conditions, would not protect System users "as much as possible from potential costs and risks" that could result from the Transfer.**

One concern we have expressed both before the LGC and this Commission is that if a buyer pays too high of a price for the System, it may be unable to raise additional capital needed to finance unforeseen but essential capital outlays (e.g., the cost of repairing damage caused by a hurricane or some other calamity). In the case of BHITA's bond application, the fact that BHITA proposed borrow as much as it could through a BBB- bond issue ($56M) in order to pay BHIL as much as possible ($47.75M) would have effectively tapped out BHITA's ability to raise additional debt, at least through a second, subordinated (I.e., lower rated, junk) bond issue that the LGC would have been remiss to approve.

While BHITA may have been able to raise additional capital near term through a bridge loan with a bank, its inability to do so for whatever reason (e.g., carrying too much debt) could have forced the System into default. In that event, the LGC would have been required to step in and keep the System afloat until new ownership and financing arrangements could be worked out. The LGC, which is responsible for maintaining the state's creditworthiness and keeping the cost of public debt borrowed by state entities as low as possible, no doubt understood this and was reticent to approve BHITA's bond application for this reason among others.

These same costs, risks, and public policy concerns are <u>amplified</u> in this proceeding simply because SV is proposing to pay a higher price for the System and finance the deal with a much higher weighted average cost of capital. If, for instance, the Transfer application were approved, particularly in view of the Commission's December 30 order and the uncertainty surrounding the likely outcome of a new rate case, could SV raise more capital in a pinch from

its existing or new investors? We do not know, but given the degree of leverage that the current deal contemplates, it may not be able to do that. And if it couldn't, and if BHIFT were forced into bankruptcy, exactly who would be responsible for keeping the System operating until new ownership and financing were worked out? Because the BHI community is totally dependent on the System for moving people and goods between the island and the mainland daily, shutting it down for any length of time is not be an option.

In the case of BHITA's bond application, the LGC and the state, would have backstopped the System and kept it going. In the event that SV acquires the System, at a much higher cost than BHITA would have paid, and subsequently is forced into receivership, the LGC backstop obviously would not be available. Who, then, would step in and keep the System up and running? We have no idea, but we do know that the higher the price SV might pay for the System, the less financial flexibility it will have to raise additional capital in a pinch, and the greater the risk of default.

These are not academic or purely hypothetical issues. Hurricanes happen on Bald Head Island. Many users also believe that the System has been undercapitalized in recent years in part to boost its operating income and market valuation. Whether that's true or not begs the question of whether SV's individual investors (who apparently will actually own BHIFT) will be willing and able to meet unanticipated but significant capital requirements should they arise, which they very easily could.

**Q. Please explain how these risks could be mitigated.**

As was true of BHITA's bond application, the risks underlying the Transfer application now before the Commission can best be mitigated by lowering the price that SV investors pay for the System. This would reduce the amount of debt and equity capital needed to finance the deal along with the amount of acquisition costs that captive System users would be required to pay. A lower purchase price also would give SV more flexibility to raise additional capital necessitated by a storm or some other calamity, or to simply fund much needed capital improvements to the System.

**Q. Please comment on other aspects of the Transfer application that pertain to the level of risk underlying SV's deal with BHIL.**

One very possible, and potentially important aspect of the application that relates to risk underlying the deal concerns who would actually own and control BHIFT if the Commission approved the Transfer. If the Public Staff's supplemental testimony is any indication, these issues remain very much "up in the air" notwithstanding that the Commission is being ask to act on the application soon. Questions surrounding the System's ownership and control structure also will need to be nailed down, with finality, before the Commission can determine whether the application satisfies its three-part test for serving the public interest.

On pages 12-14 of its February 20, 2023 testimony, the Public Staff notes:

> As part of its investigation, the Public Staff learned that, at transaction closing, SharpVue will no longer be a member of Partners, and therefore, will no longer be the ultimate parent company of Partners, Holdings and BHIFT. Additionally, the Public Staff learned that at closing, Partners [**redacted**]. As a result, BHIFT indicated in discovery to the Public Staff that it does not consider either SharpVue or Partners to be the ultimate parent company of BHIFT. Rather, while BHIFT will still be wholly owned by Holdings, Holdings will be comprised of various investors that include Partners [**redacted**]. The Public Staff learned that Partners is (and will continue to be after closing), along with Lee Roberts and Chad Paul, one of the three initial managers on the Board of Managers of Holdings, such that Partners will be the sole owner and manager of Holdings and BHIFT after closing. However, pursuant to the IMA, Partner's management rights in Holdings will be assigned for the term of the IMA to SharpVue. This arrangement results in Lee Roberts and Douglas Vaughn, the Managing Partners of SharpVue owning or controlling over 50% of the equity ownership interest in Holdings, and therefore, a controlling interest in BHIFT's regulated parking, ferry, tram, barge and tug operations.
>
> **However, BHIFT indicated that, beyond the unexecuted IMA and key employee agreements, various closing related documents are not yet complete, such that the Public Staff cannot confirm all proposed aspects of the transfer.** [**emphasis added**][2]

Similarly, and certainly of consequence, on page 22 of its testimony, the Public Staff goes on to note:

> In the Transfer, it is not yet clear that the regulated utility (BHIFT) will own the real property upon which the regulated parking, barge or tug operations are located; **instead, it appears that the land will be owned by Pelican Real Property, LLC, an unregulated entity** [**emphasis added**].[3]

All said, the Public Staff seems content in recommending that the Commission approve the Transfer without really knowing what entity will actually own the System and, thus, presumably control its key capital spending and other operating decisions. Instead, the Public Staff 's testimony seems to suggest that long as SV, Partners, Holdings, BHIFT, Pelican Real Property, or any other affiliate of any of those entities are subject to the Public Staff's recommended Regulatory Conditions, it should not matter which of those entities ends up owning and controlling the System, including the land on which the System sits.

We respectfully disagree. While we do not know for sure, we expect that the on-going machinations surrounding SV's ownership and control structure may well have to do with SV, or its individual investors, including lenders that put up the debt capital, wanting more protection in the event of a default. We are not private equity investors and do not profess to understand

[2] See Public Staff, Supplemental Joint Testimony, February 20, 2023, pp. 12-14.
[3] Ibid, pp. 22-23

the "ins and outs" of SV's financing arrangements. By its own admission, the Public Staff apparently doesn't understand them either.

We do know, however, for risk related reasons described above, the Commission needs to understand exactly where the buck would stop in SV's ownership arrangement if the System got into financial trouble (e.g., due to its very heavy and costly debt load) and BHIFT went into receivership. If a private equity company, like SV, with no experience in operating a power generation facility, proposed to acquire Duke Energy's nuclear power plant in Southport NC with a seemingly "tentative" and convoluted ownership and control structure that even remotely resembled what the Public Staff outlined above, we question whether the Commission, or the Public Staff, would even entertain that proposal, much less approve it.

For SV and BHIL to ask the Commission to approve this Transfer with this much uncertainty surrounding how the System, a public utility, will be owned, controlled and managed does not show a lot of respect for the integrity of Commission's regulatory processes, or its responsibility to ratepayers of the System. In addition, if, as the Public Staff's analysis suggests, SV intends to place the System's real property into an unregulated affiliate, that intent would represent a very material change to its Transfer application which, to our knowledge, the applicants have yet to disclose, at least publicly. For these reasons alone, the Commission would be entirely justified to dismiss the application with or without prejudice.

**Q. Please explain why the Commission should be concerned about SV's apparent intend to move the System's real property out of BHIFT into an unregulated affiliate.**

In our view, this ninth inning "wrinkle" in SV's gameplan likely represents an effort on SV's part to circumvent the Commission's December 30 order. It also could be intended to mitigate perceived regulatory risks or concerns that SV investors may have about the deal. In either case, for SV to raise this possibility at this juncture in the Commission's review process does not speak well for the veracity of "commitments" that SV and BHIL have made to the Commission, or the Public Staff, to date.

If, for instance, SV moved ownership of the land on which the System sits into an unregulated subsidiary (e.g., Pelican Real Property, LLC) after the deal closed, what would prevent that subsidiary from unilaterally raising rent that it charges BHIFT, the regulated entity, for using that land? And what impact might that have on the regulated System's costs, rates, service quality, capital spending, and underlying financial and operating risks going forward?

Higher rents would clearly increase the System's operating expenses but not necessarily user rates unless and until: 1) SV elected to file a rate case seeking to recover higher costs, including BHIFT's rent increases, or 2) a state court overturned the Commission's December 30 order. Failing either, user rates would not increase since the Commission, in its December 30 order, held that current rates would be presumed reasonable (and not increased) pending the completion of a new rate case for the entire System. In addition, having extended its regulatory oversight to include the System's parking and barge operations, the Commission presumably

would have to review and approve any lease or rental agreements between BHIFT and Pelican Real Properties or its successor. However, in this instance, shifting revenue and operating income from SV's regulated entity (e.g., BHIFT) to an unregulated affiliate (e.g., Pelican Real Property) would still have the practical effect of increasing the profitability and market value of the unregulated entity at the expense of the regulated System and its users.

In time, if rent increases where large enough, SV presumably would file a rate case, requesting higher user rates for regulated ferry, parking and barge service (needed to recoup rent increases), sooner than it would if the land on which the System sits were treated as a regulated asset, as it is today. While the Commission could potentially mitigate that harm by imputing revenue from the unregulated Pelican Real Property affiliate to BHIFT, doing so would only further complicate an already unnecessarily complicated set of regulatory policy issues that the Commission is being asked to resolve. Imputing rental income also would no doubt add to the contentiousness and cost of litigating new rate cases, not to mention how frequently those cases might be filed.

Similarly, if SV elected to sell either BHIFT or its unregulated Pelican Real Property affiliate to a third party in order to further complicate the revenue imputation process (in an effort to enhance the System's overall profitability and its market value) moving the System's real property into an unregulated affiliate immediately after closing would likely make it easier to execute either of those ownership changes. We do not know that this is what SV has in mind, in part because several key documents underlying its transfer application continue to be treated as confidential "trade secrets" which, in our view, they are not. What we do know, based largely on the Public Staff's February 20 supplemental testimony, is that: 1) several facets of SV's proposed ownership and control of the System's assets remain "up in the air," and 2) how those ownership and control issues are eventually resolved will have a direct bearing on the regulated System's financial performance, including its user rates as well as the System's operating risks, and, thus, the Commission's ability to use its three-part test to judge whether the Transfer will serve the public interest.

The Commission can and should "pierce this veil" by simply reminding SV that the Commission has determined that the System, including the land on which it sits, is a local monopoly and will be regulated in its entirety as a public utility, as long as it remains commercially owned and operated, or until a state court decides otherwise. If SV can't accept that it should withdraw the Transfer application, or the Commission should reject it.

**Q. Please comment on the Public Staff's recommended Regulatory Conditions, and whether they are adequate.**

As noted, we believe the Public Staff's recommended Regulatory Conditions are a step in the right direction but do not really address changes in the Transfer application that would need to be made in order to satisfy the Commission's three-part test. The basic problem with the Transfer application, like the BHITA's bond application, has been the purchase price and, thus, how much acquisition costs captive System users would be asked to pay, and how much

financial risk the System and the community of BHI would be asked to bear once a deal is approved. While the recommended Regulatory Conditions provide some comfort along these lines, they are far from dispositive in terms of ensuring that the Transfer application somehow satisfies the Commission's three-part test.

If that were the objective, for instance, the Public Staff should recommend that the Commission tell BHIL and SV that if they want the Transfer application reviewed, the applicants' appeal of the Commission's December 30 order must be dropped. Failing that there is no way the Commission could judge whether the Transfer would satisfy the Commission's three-part test since that evaluation would be predicated on the December 30 order remaining in place indefinitely and in its entirety. Indeed, the whole point of the December 30 order was to provide assurance that if SV or another owner/operator paid too much for the System, captive users of System's parking and barge monopolies could not be forced to pay for excessive acquisition costs, necessitated by an inflated purchase price.

**Q. Please comment on potential benefits that could result from the Commission approving the Transfer application, and how those benefits compare with the costs and risks to System users that also could result from the Transfer.**

We agree that the System is in need of a new owner/operator since the current owner, the Mitchell family estate, has said it is no longer interested in owning or investing in the System. Notwithstanding a considerable amount of good that the Mitchell family has done for BHI since acquiring much of the island in 1983, we also believe that the only thing the Mitchell family estate is "owed" in this proceeding is a fair and reasonable price for its transportation assets. Since the Deep Point ferry terminal was opened in 2009, financial data compiled as part of BHITA's bond application pretty clearly indicates that even if the System were donated to a non-profit organization today at no cost, BHIL, and by extension the Mitchell family, would have recouped all of its costs, including a healthy annual return (e.g., 12%) on capital invested in the System. We have no qualms about this whatsoever. Successful developers, like the Mitchells, develop properties at a profit much to the benefit of property owners like ourselves.

As to SV's plans to retain BHIL's current management team to continue running the System as it has in recent years, we certainly understand the need/benefit of doing so since SV has absolutely no experience (and presumably no interest) in managing the System's day-to-day operations. We also are concerned, however, that BHIL's current management team may have allowed the quality of passenger ferry service to decline in recent years in an effort to boost the System's operating income (e.g., EBITDA) and market value.

Concerns about declining service quality are very evident in several individual comments made by BHI property owners in responding to the two surveys that the Bald Head Association conducted regarding issues raised in Docket A-41 Sub 21 and Sub 22. Also, in his December 14, 2022 testimony filed in Docket A-41 Sub 21, BHI Mayor Pro Temp, Scott Gardner compiled data from BHIT's quarterly reports to the Commission that indicate the average annual percentage of on-time ferry runs has deteriorated since 2014, the last year during which the System's on-

time ferry runs exceeded 90 percent. By 2021, on-time runs had dropped to a monthly average of 66% for the full year, and to 48% during the peak use vacation months of June-August. Conversely, according to financial data compiled by BHITA, the System's operating profit margins (i.e., EBITDA/Revenue) rose from 32 percent in 2014 to 45 percent in 2021.

Are both data trends coincidental? Possibly, but it's also possible that BHIL purposefully cut back on maintenance and capital improvement expenditures in an effort to increase the System's operating profit margins and, hence, its market valuation. If the latter proved to be true, retaining current key managers of the System may prove to be less than beneficial to System users. In any case, given these considerations, it is clear that any potential "benefits" that might result from the acquisition in question would pale in comparison to its potential costs and risks to System users and the community of Bald Head Island.

**Q. Please explain whether you have been paid for any Consumer Statements that you have filed with the Commission or any letters that you wrote to the LGC.**

We have not been paid for providing input into the Commission's proceedings in Dockets A-41 Sub 21 or Sub 22, or for various letters that we submitted to the LGC regarding BHITA's bond application. Indeed, we expect we are the only parties who have filled expert testimony in any of these proceedings who have not been paid. We decided to get involved because, as BHI property owners, we feel we have an obligation to help protect the integrity and viability of the BHI community. In our view, Bald Head Island is a fragile place, both environmentally and economically.

As is reflected in the results of the Bald Head Association's two recent surveys relating to Docket A-41 Sub 21 and 22, a substantial majority of BHI property owners share our belief that because the System is vital to the island's wellbeing and because it operates as a commercially owned monopoly, the System needs to be regulated. Also, because the System's current owner, the Mitchell family estate, no longer wants to own the System or spend the capital needed to keep it in good working order, BHI property owners generally believe the System needs to be sold to a new owner/operator -- albeit at a price that is fair to both the System's users and the current owner. Unfortunately, because the acquisition price for the System proposed by BHITA or SV would subject System users and the BHI community to an unreasonable and unnecessary amount of cost and risk, nether application was/is fair or, if approved, would serve the public interest.

**Q. Please discuss what you believe it will take to get to the price paid for the System that is fair and acceptable to all the parties in this proceeding.**

We believe the BHIL/SV Transfer application should fail for the same reasons that the BHITA's bond application failed: either application would saddle the System, and its captive users, with far too much cost and financial risk. This occurred largely because both BHITA and SV allowed BHIL, the seller, to structure both deals which BHIL gladly did in a manner that would maximize

benefits to the Mitchell family estate, albeit at considerable expense to System users, and the BHI community.

This obviously needs to change if a deal is to be reached that is acceptable to all of the parties in this proceeding. In our view there are two avenues for accomplishing this. One is that all parties could agree to work out a settlement, prior to filing a new rate case, possibly with help of a professional independent arbitrator. That arbitration, if successful, also could provide the basis for a new owner/operator, the Village of BHI, the BHI Club and the Bald Head Association to assume primary responsibility for negotiating an annual revenue requirement and rate schedules for the System which the parties would submit annually to the Commission for its review and approval.

A second possible avenue, which admittedly would be outside the Commission's purview, would be for designated state officials to: 1) restructure the BHITA board with a view toward assuring that all intervenors in this proceeding would be adequately represented on that board, and 2) the cost of crafting a new bond application would be paid for with state funding or, failing that, divided equally between the owner/operator and the three intervenors who would represent the interests of captive System users who, to date, have been ignored or pretty much completely disregarded.

**Q. Please discuss any other issues or concerns that the Commission should weigh in resolving this proceeding**.

We believe that far too much of the factual record underlying the BHIL/SV Transfer application has been improperly labeled "confidential," no doubt in an effort to limit effective public input. Even SV's modified organizational chart has been "redacted" and Exhibit 1 (Recommended Regulatory Conditions) of the Public Staff's February 20 testimony is labeled "confidential." Fortunately, for us at least, the latter made it past the "gate keepers" and into the public version of the Public Staff's testimony.

In our view, this lack of transparency is both unnecessary and has added greatly to the legal costs of litigating Docket A-41 Sub 22. More importantly, similar games that BHIL and BHITA played in withholding financial information that went into BHITA's bond application, and only changed at the LGC's insistence, very likely precluded BHITA for coming up with a more modest revenue bond application that the LGC might well have approved. The Commission need not and should not make this same mistake in adjudicating this proceeding. The Commission and its Public Staff have an obligation and, no doubt, a strong desire to protect the integrity and effectiveness of the Commission's decision-making processes. This can't be accomplished by allowing parties to unilaterally and arbitrarily restrict access to information that is not confidential, yet is necessary to arrive at reasonably well-informed and efficient decisions.

**Q. Does that conclude your Statement?**

Yes, and we appreciate this opportunity to present our views on this matter.

Exhibit One

November 17, 2021

Dale R. Folwell, CPA
North Carolina State Treasurer

Beth A. Wood, CPA
North Carolina State Auditor

Dear Treasurer Folwell and Auditor Wood:

It is our understanding that the NC Local Government Commission (LGC) may consider the Bald Head Island Transportation Authority's (BHITA) $56.1M revenue bond application at its December 7 meeting. We are writing to urge the LGC to reject BHITA's application on the grounds that borrowing $56.1M in order to pay Bald Head Limited (BHL) $47.75M for the BHI transportation system (System) would impose **unreasonable** costs on System users, and subject Bald Head Island and the State to a considerable amount of **unnecessary** financial risk.

We detailed reasons for this in our July 21, 2021 letter to you in which we explained that BHITA's $47.75M offer represents the **highest** price that it could possibly pay BHL and finance through a $56.1M investment-grade bond issue that S&P Global has tentatively rated BBB-, or just one notch above junk. Mercator International, BHITA's lead financial consultant, further estimates that borrowing $56.1M would require BHITA to immediately raise user rates for BHI ferry, parking and barge services by **20 percent** just to pay for debt service costs associated with its bonds. BHITA could do so because under the terms of the Ferry Transportation Authority Act, which BHL conceived, wrote and persuaded the NC legislature to enact in 2017, the BHI transportation System, which is a local monopoly, would no longer be regulated by the NC Utilities Commission once it is acquired by BHITA.

Even more problematic, the **entire** $56.1M that BHITA is proposing to borrow through its BBB- revenue bond issue would be needed to pay BHL $47.75M with the remaining $8.35M used to cover reserve requirements and related bond issuance costs. Thus, **none of BHITA's debt capital – or the added cash flow that results from a permanent 20 percent rate hike needed to service that debt -- would be available to spend on the transportation System itself**.

Therein lies a considerable amount of default risk. If unanticipated capital spending requirements were to arise in the next few years (e.g., due to damage caused by a hurricane, some other calamity, or chronic neglect), BHITA may be unable to raise additional capital needed to keep the System up and running. Given the amount of debt BHITA would already be carrying, a second (subordinated) revenue bond issue would necessarily be rated well below investment-grade which the LGC may be remiss to approve. Should that occur, BHITA could easily be forced to default on its bond payments, in which case the LGC would have to step in and oversee the System's operation until new ownership and related financing could be worked out. Because the community of Bald Head Island is completely dependent on the transportation System for moving people, goods and service vehicles to and from the island **daily**, shutting the System down even temporarily due to BHITA defaulting on its bonds would not be an option.

On November 2, in view of all of this, a clear majority of voters on Bald Head Island (i.e., 58%) registered their objections to BHITA's proposed deal with BHL by approving a general obligation (GO) bond referendum that would allow the Village of Bald Head Island to borrow up to $54M to purchase the transportation System and operate it as a municipally owned utility. They did so despite the fact that BHL, and the Mitchell Family Corporation which owns BHL, have said that they will not sell the System to Village of Bald Head Island, and that if the LGC does not approve BHITA's bond application in December, the System's ferry, parking and barge operations may be sold separately to other commercial operators (e.g., private equity investors).

In our view, the favorable outcome of the Village of Bald Head Island's bond referendum reflects a growing and widely held view among BHI stakeholders that BHITA has failed to do what it was purportedly created for; namely, to represent and protect the interests of those users who completely depend on the BHI transportation System. Instead, by proposing to borrow $56.1M though a revenue bond issue rated BBB-, thereby maxing out its borrowing capacity, in order to pay BHL $47.75M, BHITA has spent the last 4+ years working out a revenue bond application that **maximizes** the sales price of BHL's transportation assets -- all at a considerable cost to System users (e.g., an immediate 20% rate hike needed to pay debt service costs), and considerable risk to BHI and the State. Needless to say, none of this has inspired confidence, at least among BHI stakeholders, that BHITA can or should be trusted to manage the System going forward.

The question remains why BHITA put itself, and the LGC, in this position. BHITA asserts that the terms of the Ferry Transportation Authority Act and its two highly flawed real estate appraisals that formed the basis of BHITA's $50.9M "due diligence" valuation of BHL's transportation assets made them do it. Like the real estate appraisals themselves, we believe that explanation is incomplete to the point of being disingenuous.

In our July 21 letter, we noted BHITA's initial real estate appraisal done by the Worsley Real Estate Company purposefully excluded using the Income Approach which is widely regarded to be the best, and most accurate method of valuing income producing property. Worsley was explicitly instructed by BHITA's business valuation consultant, whoever that was, to exclude the Income Approach presumably because its use would have required BHITA to disclose BHL's prior-year financial statements for the transportation System. Members of the BHITA Board of Trustees were permitted to see those statements but only after signing a binding non-disclosure agreement (NDA).

Even so, by signing the NDA, BHITA, and its consultants, were effectively precluded from using these data to independently value the transportation System based on its **actual** financial performance. Had they done so, BHL's financial statements would have had to be released to the public, thereby violating the NDA. The fact that BHITA had no budget with which to hire its own independent financial and engineering experts also didn't help. Nor did the fact that none of the eleven political appointees to the BHITA Board of Trustees had the relevant expertise or prior experience needed to negotiate an acquisition such as this.

Instead, for its initial valuation, BHITA relied on a 2017 study **done for BHL** by Mercator International which estimated the enterprise value of the System at $55.8M. Apparently, that study was shared with Worsley in 2019 prior to his conducting BHITA's first real estate appraisal which, of course, turned out to be **two and a half times** what the Brunswick County tax assessor believes BHL's transportation related real estate assets are worth. Mercator's 2017 enterprise valuation also provided the basis for the *Bond Feasibility Study* that Mercator International **did for BHITA** in 2020. That study, in turn, determined how much public debt BHITA could potentially raise through an investment grade bond issue (i.e., $56.1M, assuming an across-the-board 20 percent permanent rate increase) and, thus, how much it could pay BHL (i.e., $47.75M).

On October 22, 2021, BHITA finally released the 2017 Mercator study in response to a July 9, 2021 Public Record Request filed by a resident and business owner on BHI. Since the 2017 study obviously had an important bearing on BHITA's "due diligence" valuation, as well as its bond application, and because it may not have been disclosed to the LGC, we are attaching a copy to this letter.

In the interest of brevity, we will not dissect the 2017 Mercator study. We will simply note that its $55.8M valuation of the BHI transportation system was 26 times the System's EBITDA for 2016, 19 times EDITDA for 2017, and was based on a series of **assumptions** that BHL, or another commercial operator, could raise **unregulated** parking and barge rates enough to generate the cash flows and terminal values needed to produce a valuation that high.

Of the $55.8M aggregate valuation, Mercator's 2017 study attributed only $3.5M (6%) to the regulated BHI passenger ferry -- despite the fact that the passenger ferry in 2017 accounted for 61 percent of the System's total operating revenue. BHL's **unregulated parking monopoly** at the Deep Point ferry terminal site was valued at $38.2M (69% of the total), while its **unregulated barge monopoly** which hauls all goods and service vehicles between BHI and the mainland, was valued at $14M (25%). Mercator's 2017 valuation also was predicated on operating income (EBITDA) margins of BHL's parking monopoly increasing from 71.7% of revenues in 2017 to **86.1%** in 2040, while EBITDA margins on its barge monopoly were projected to increase from 71.3% of revenues in 2017 to **83.2%** of revenues in 2040.

We would encourage the LGC and its staff to review Mercator's 2017 study carefully, particularly pages 62-75, and make its own judgement about the validity and reasonableness of its valuation. We also would urge the LGC to consider the **propriety** of BHITA hiring Mercator to conduct its *Bond Feasibility Study* shortly after Mercator had completed its $55.8M enterprise valuation of the System for BHL, the seller. BHITA's use of Mercator also is indicative of why BHITA should have disclosed publicly all documents that had a bearing on its appraisal and its bond application as soon as they were available rather than keeping those documents confidential until after the LGC was initially expected to consider and approve BHITA's application last February. Very much to its credit, the LGC did not let that happen, and here we are.

In our opinion, Mercator's 2017 study, like the 2019 Worsley real estate appraisal and the second real estate appraisal that BHITA had done by Newmark Knight and Frank earlier this year in response to concerns about the validity of the Worsley appraisal, were all set up to exceed, or more accurately, **not constrain** the maximum amount of public debt that BHITA could raise through an investment grade revenue bond issue (i.e., $56.1M) and, thus, how much it could pay BHL (i.e., $47.75M) and arguably comply with the Ferry Transportation Authority Act.

As we noted in our July 21 letter, all of this was corroborated by BHITA itself in its July 6 response to the LGC's "must answer" Question 10. Question 10 asked why BHITA dismissed concerns that its proposed purchase price was well in excess of what Limited's transportation System might actually be worth (i.e., to a buyer other than BHITA) based on its actual operating income (EBITDA). BHITA responded:

> There is no standardized approach to valuation to this type of asset, as governmental acquisitions of privately held infrastructure assets are very rare. Furthermore, the Authority is operating under a statute that requires it to acquire assets rather than a business. EBITDA is a measure of profits that also takes into account variable tax rates and depreciation policies. **Because the Authority is not a for-profit entity, … the Authority did not focus on EBITDA as a valuation tool for either (market) value or (bond) feasibility…. [S]ince the Authority will be operating as a public entity rather than a private enterprise; its financial analysis and financial projections are all based on operating cash flows …. Rather than using a simple projection of the seller's historical net income to measure financial performance (and fair market value), the Authority worked with a feasibility consultant (Mercator International) to develop cash flow models as part of its due diligence of the transaction**. (**Emphasis added**)

In closing, we do not fault BHL for trying to maximize the sales price of its transportation assets in the manner in which it did. Using political processes to enhance, or attempt to enhance, the profitability of commercially owned monopolies is not a new or uncommon practice. We do fault BHITA, however, for agreeing to a deal with BHL that clearly would unfairly and unreasonably penalize users of the BHI transportation System (who BHITA purportedly represents), while subjecting Bald Head Island and the State to unnecessary financial risk.

As the 2017 Mercator study suggests, it is conceivable that BHL, or another commercial operator, could increase unregulated BHI parking and barge rates enough to "justify" an excessively high valuation. BHL's parking and barge operations, after all, are currently **unregulated local monopolies** that can be and, in our view, already are being exploited by BHL. EBITDA margins in the range of 80% of operating revenue are by definition excessive and, in this instance, clearly indicative of monopoly pricing abuse.

Yet, BHITA apparently accepted Mercator's 2017 valuation as reasonable and a "given," and proceeded to come up with its own inflated appraisal. As a result, after 4+ years of BHITA

deliberating, the fair market value of the System remains a mystery. And the LGC is now being asked to approve a revenue bond issue that would: 1) privatize and monetize the transportation System's future unregulated monopoly profits which would immediately accrue to BHL through the payment of BHITA's $47.75M offer price, and 2) socialize the default risk that would result from BHITA issuing $56.1M in revenue bonds rated BBB-, thereby tapping out its ability to raise more debt capital should unanticipated capital spending requirements arise which they very easily could.

**Many BHI stakeholders believe the latter outcome is offensive, particularly in view of the fact that: 1) current unregulated parking and barge rates are already unreasonably high and subject to monopoly pricing abuse; 2) the quality of regulated passenger ferry service during periods of peak use is deteriorating and will require additional expenditures to fix; and 3) Mercator International's projected cash flow increases that would result from an additional, and wholly unnecessary 20 percent rate hike should not be used by BHITA as a rationale for overpaying BHL and borrowing more debt capital than the transportation System can comfortably afford.** Given the importance of the BHI transportation System to the community of Bald Head Island, we hope the LGC will see through this subterfuge and reject BHITA's bond application.

Respectfully yours,

Robert T. Blau, CFA
5 Starrush Trail, Bald Head Island

J. Paul Carey
611 Currituck Way, Bald Head Island

cc: Honorable Ronald Penny, NC Secretary of Revenue
Honorable Elaine Marshall, NC Secretary of State
Mr. Paul Butler, Jr.
Mr. Mike Philbeck
Mr. John Burns
Ms. Vida Harvey
Ms. Nancy Hoffman
Ms. Sharon Edmundson, Deputy State Treasurer and Director NC State and Local Government Finance Division
Mr. Timothy Romocki, Director, Debt Management, NC Department of State Treasurer
Ms. Charlotte Mitchell, Chair, NC Utilities Commission
Ms. Susan Rabon, Chair, Bald Head Island Transportation Authority
Mr. J. Andrew Sayre, Mayor, Village of Bald Head Island
Mr. Peter Quinn, Mayor Elect, Village of Bald Head Island