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January 11, 2023

Ms. A. Shonta Dunston
Chief Clerk
North Carolina Utilities Commission
430 N. Salisbury Street
Raleigh, NC 27603

RE: *In the Matter of Application of Old North State Water Company, Inc. for Authority to Adjust and Increase Rates for Water Utility Service in All Its Service Areas in NC*
Docket No. W-1300, Sub 60
Old North State Water Company, Inc.'s (ONSWC) Public (Redacted) Response to Public Staff Report filed on December 12, 2022

Dear Ms. Dunston:

In accordance with the Commission's June 13, 2022, Order in the above-referenced docket, and specifically in compliance with ordering paragraph number 12 thereof:

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

A Pennsylvania Limited Liability Partnership

California Colorado Delaware District of Columbia Florida Georgia Illinois Minnesota
Nevada New Jersey New York North Carolina Pennsylvania South Carolina Texas Washington

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together to create a plan to improve the capitalization of the Company, and the parties shall make a report to the Commission within six months of the date of this Order regarding the recapitalization plan.

Public Staff filed its Report with the Commission, in the above referenced docket, on December 12, 2022. In further compliance with ordering paragraph 12 of the Commission's Order, ONSWC herewith provides its Public (Redacted) Response to Public Staff's Report. A Confidential version of ONSWC's Response is also being filed in the docket under separate cover.

Thank you in advance for your assistance with this filing. If you should have any questions, please do not hesitate to contact me.

Very truly yours,

/s/ David T. Drooz

David T. Drooz

Attachments

pbb

cc: Parties and Counsel of Record
Christopher J. Ayers, Executive Director, NC Public Staff
Lucy E. Edmondson, Chief Counsel, NC Public Staff
Reita D. Coxton, Staff Attorney, NC Public Staff
Charles M. Junis, PE, NC Public Staff
Jessica Heironimus, NC Public Staff

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. W-1300, SUB 60

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of:

Application by Old North)	
State Water Company, Inc.,)	
3212 6th Avenue South,)	
Suite 200, Birmingham,)	ONSWC RESPONSE TO
Alabama 35222, for)	PUBLIC STAFF REPORT
Authority to Adjust and)	
Increase Rates for Water)	
Utility Service in All of Its)	
Service Areas in North)	
Carolina)	

NOW COMES Old North State Water Company, Inc. (ONSWC or Company), through undersigned counsel, and responds to the Public Staff Report on ONSWC's Compliance with Laws and Recapitalization (Public Staff Report) filed on December 12, 2022. ONSWC requests that the Commission reject the recommendations of the Public Staff – North Carolina (Public Staff) for the reasons set out below.

1. On June 13, 2022, the Commission issued its Order Approving Settlement Agreement and Stipulation, Granting Partial Rate Increase, and Requiring Customer Notice in the above-captioned docket. Ordering paragraph 12 states:

That pursuant to N.C.G.S. § 62-34, the Public Staff shall thoroughly review the various sources of funding utilized by ONSWC for its capital and operational needs, the funds disbursed by ONSWC to Chatham North Holdings, Inc., and the relationships, operating agreements, and contracts between and among the Company, Integra, the Integra affiliates, and Chatham North Holdings, Inc.; including whether they are reasonable, appropriate, and in conformity with North Carolina law and Commission Rules, including

but not limited to N.C.G.S. §§ 62-153, 62-160, and 62-167. Within six months of the date of this Order, the Public Staff shall make a report to this Commission regarding the Company's compliance with applicable North Carolina law. ONSWC shall have the opportunity to respond to the Public Staff's report within 30 days of the filing of such report. Additionally, the parties shall work together to create a plan to improve the capitalization of the Company, and the parties shall make a report to the Commission within six months of the date of this Order regarding the recapitalization plan

2. The Public Staff Report has a section entitled "Legal Compliance" that reviews the relationships and contracts among ONSWC and other companies. The Public Staff identifies two items of noncompliance. First is that ONSWC did not obtain advance approval from the Commission, as provided in N.C.G.S. § 62-161(a), for the promissory note it issued to Chatham North Holdings, Inc. (CNH) in the amount of \$5 million on December 4, 2020.

3. ONSWC takes seriously the compliance requirements of Chapter 62 and Commission orders and rules. The ONSWC failure to seek advance approval for the promissory note to CNH was an unintentional oversight. ONSWC did file a copy of the promissory note from CNH on March 31, 2022, as a late-filed rate case exhibit per Commission request. ONSWC also filed on April 14, 2022, a copy of the Guaranty Agreement, dated December 4, 2020, in which ONSWC – Chatham North, LLC (ONSWC – CN) became the guarantor of the CNH promissory note to ONSWC. The promissory note from CNH and the guaranty from ONSWC – CN have been in place for over two years now, and disclosed to and filed with the Commission for about three-quarters of a year.

4. ONSWC proposes to address its failure to obtain advance approval under N.C.G.S. § 62-161(a) for the promissory note to CNH as follows:

a. ONSWC is in the process of acquiring ownership of assets of ONSWC – CN in satisfaction of the promissory note from CNH and the Guaranty Agreement from ONSWC-CN. This transfer of assets and cancellation of the promissory note are expected to take place in January of 2023. ONSWC will notify the Commission in the present docket when that transfer and cancellation have occurred.

b. The Company now understands that the definition of "security" under Chapter 62 is broader than publicly traded securities subject to regulation by the U.S. Securities and Exchange Commission, and will seek approval for new securities, obligations, or liabilities as required by N.C.G.S. § 62-161 and other sections of Chapter 62.

5. The second noncompliance identified by the Public Staff is that ONSWC did not obtain advance Commission approval for five loans in which ONSWC pledged its assets as security, where advance approval is required under N.C.G.S. § 62-

160. The loans were provided by Integra Water, LLC, and its subsidiaries Integra Water Madison County, LLC, Integra Water Creola, LLC, Integra Water Vinemont, LLC (Integra and the Integra Affiliates, respectively). As with the CNH note, the ONSWC failure to seek advance approval for the promissory notes to Integra and the Integra Affiliates is an unintentional oversight. ONSWC did file a copy of those five loan agreements on March 31, 2022, as a late-filed rate case exhibit per Commission request. The loans from Integra and the Integra Affiliates have been in place for over three years now, and disclosed to and filed with the Commission for about three-quarters of a year.

6. Given that the loan agreements were executed in 2019 and 2020, it does not appear there is any cure for the earlier noncompliance other than future compliance. If these loans had materially impaired the ability of ONSWC to function as a public utility, additional Commission action would be warranted, but that is not the case. As discussed below, the loans from Integra and the Integra Affiliates have provided necessary financing for ONSWC. The owner of Integra has promised in sworn testimony that Integra will continue to provide necessary financing for ONSWC, which as the Commission noted in its June 13, 2022, rate case order was sufficient assurance for the Public Staff's witness and for the Public Staff's agreement to settle:

In settlement testimony, Public Staff witness Hinton revised his concerns about the high debt ratio and financial viability of ONSWC articulated in his direct testimony. He stated that further discussions with the Company during settlement talks and his review of the consolidated financial statements of Integra led him to withdraw his prior recommendations that the Company change its actual capital structure and be required to submit audited financial statements. An essential part of the changes to Public Staff witness Hinton's position is the settlement commitment of ONSWC witness McDonald, as the authorized representative of Integra, for Integra to continue to finance the capital needs of ONSWC at sufficient levels to permit ONSWC to fund its capital needs and operational expenses such that ONSWC can provide good quality, reliable water service to its customers consistent with environmental and regulatory requirements.


ONSWC submits that the commitment made by Mr. McDonald in the rate case demonstrates that the failure to obtain advance approval for the loan agreements will not be harmful to the financial viability or operational needs of ONSWC. To the contrary, those loan agreements are helpful to ONSWC and have provided funding to cover the continued operating losses of ONSWC. It is fair to say that Integra is and would be the only willing lender under these conditions. Integra's willingness to continue to fund ONSWC allows ONSWC to fulfill its capital requirements and fund operating losses until ONSWC can adjust rates to achieve its authorized return or close to it.

7. The next part of the Public Staff Report is entitled "Recapitalization Plan" and includes several Public Staff suggestions. ONSWC does not believe the options suggested by the Public Staff are reasonable. The Public Staff Report does not mention the options that ONSWC offered to the Public Staff.

8. According to the Public Staff, "Recapitalization options include (1) Integra acquiring ONSWC; (2) Integra and the Integra Affiliates forgiving a portion of ONSWC's outstanding debt; or (3) an equity infusion from Mr. McDonald." The Public Staff also states that the Commission can declare Mr. McDonald to be a public utility based on his status as ONSWC's sole shareholder. These options are inappropriate for the following reasons.

a. Since the source of ONSWC financing is entirely Integra, the distinction between debt and equity is irrelevant. It is an illusory concern. Normally a high level of debt in the capital structure increases risk for equity holders (and thus increases the investor-required return) because debt creditors have a higher priority for payment, and if the company is in poor financial condition the equity holders are more likely than debt holders to receive lower returns or even lose some or all of their investment. Thus a balance between debt and equity is normally important. That is not the case with ONSWC because with just one entity (and its subsidiaries) providing all the financing, the risk of nonpayment by ONSWC is the same regardless of whether the financing is labeled debt or equity. If half or all the loan dollars from Integra and the Integra Affiliates were converted to equity, there would be no decrease in risk to the equity holder. In the case of ONSWC, recapitalization would not improve financial viability and would not serve any useful regulatory purpose.

b. [BEGIN CONFIDENTIAL]





[END CONFIDENTIAL]

c. The Public Staff proposal for Integra to acquire ONSWC would result in costs but not benefits. The costs include transaction costs and the time and resources needed for a proceeding under N.C.G.S. § 62-111. There is no apparent benefit. Integra has already committed in the sworn testimony of Mr. McDonald to providing whatever financing ONSWC needs, and as ONSWC's owner he has tremendous incentive to follow through as needed to protect the significant investment in ONSWC. The underlying assets and liabilities of ONSWC would remain the same whether acquired by Integra or not.

The Public Staff may want Integra to acquire ONSWC so that there is Commission regulatory authority over Integra; however, Integra oversees utility operations in Alabama and Texas, not North Carolina.¹ Given that Mr. McDonald has already promised financing support to ONSWC from Integra, and Mr. McDonald controls Integra, there is nothing to be gained from requiring an acquisition that would bring the Alabama- and Texas-focused company under the Commission's jurisdiction.

As a company that provides back office services to ONSWC, Integra has provided discovery responses to the Public Staff in connection with ONSWC proceedings, and this will continue without the need for Integra to purchase ONSWC. [BEGIN CONFIDENTIAL]



[END CONFIDENTIAL]

¹ Integra does allocate some resources and time to support ONSWC. If the time is directly attributable then the cost is billed directly (and at cost). If the ONSWC share of a cost is more difficult to determine (office rent, insurance, etc.) then the cost is allocated via customer count. The direct assignments and the allocations of Integra costs to ONSWC have been reviewed at great length and in great detail by the Public Staff.

It is not appropriate to force an unaffiliated company (Integra) to acquire a North Carolina utility that the unaffiliated company does not want to acquire. Integra and ONSWC have a common owner, but that owner wants to keep his Alabama/Texas companies separate from his North Carolina company, and should have the right to so as long as Integra is not controlling or owning any part of ONSWC.

d. The next Public Staff proposal is for Integra and the Integra Affiliates to forgive a portion of ONSWC's outstanding debt. This is entirely unreasonable, as the Public Staff is asking for Integra and the Integra Affiliates to write off the loans and take a multi-million dollar loss. It also may be a taxable transaction for ONSWC, resulting in additional cost to the utility. The legality of this proposal is questionable at best, given that the Commission has no jurisdiction over Integra and the Integra Affiliates and given that it raises an issue of unconstitutional taking even if there were jurisdiction.

e. The third Public Staff proposal is for Mr. McDonald to make an equity infusion to ONSWC. The Public Staff does not say the size of the infusion, but it would have to be several million dollars to achieve a capital structure ratio in the range approved in recent North Carolina utility rate cases. This proposal is unjustified. ONSWC is not in need of a massive amount of new capital financing. It is not a "troubled" company, it is conducting utility operations reasonably well, and it has a commitment that Integra will provide additional financing if and when needed. To ask Mr. McDonald to invest several million dollars of his own money is to dictate an individual's personal spending purely to elevate form (capital structure) over substance (any financing needs of ONSWC). Mr. McDonald should be able to choose where and how to invest his personal funds without being forced to infuse equity into a company that presently does not need the equity.

f. The Public Staff also suggests that the Commission can "declare Mr. McDonald a *de facto* public utility under the definition of a public utility set forth in N.C.G.S. § 62-3(23)(a) based on his status as ONSWC's sole shareholder." ONSWC respectfully disagrees. If Mr. McDonald were acting as a *de facto* public utility, the Commission could declare him to be a *de jure* public utility. However, the facts do not support such action. Mr. McDonald has created Integra and ONSWC as lawful corporate entities, with their own staff and own financial statements and own tax and legal liabilities. When an individual is the majority or sole owner of a company, there should be a presumption that the company is a separate legal entity. An individual's ownership does not default to a merged identity with the corporation he owns. The alter ego doctrine applies only if there is a showing that the individual controls the company and uses that control to cause a fraud or wrong to another party.² No such showing has been made

² Piercing the corporate veil is an extraordinary remedy, as "[d]isregarding the corporate form is not to be

with respect to Mr. McDonald, particularly given that ONSWC utilizes a staff who conduct the day-to-day operations of the utility business.

g. The Public Staff's list of options does not include a proposal that ONSWC suggested to them. Namely, that some of the loans from Integra and/or the Integra Affiliates to ONSWC could be converted into equity upon the expiration of the term of the loans in December 2024. ONSWC does not believe recapitalization would benefit utility customers or improve financial viability for reasons stated above, and therefore does not recommend that a portion of the loans be converted to equity at the end of 2024. However, if the Commission disagrees and for reasons within its lawful authority decides recapitalization is required, then ONSWC believes the best path toward that goal is to convert enough of the loans to equity such that the capital structure reaches approximately 45% equity at the end of calendar 2024.

9. The Public Staff Report includes a section entitled "Other Issues" that are in addition to the topics identified in the Commission's ordering paragraph 12. The Public Staff notes that ONSWC has been slow to provide financial statements requested by the Public Staff, and that there are inconsistencies in the financial statements.

ONSWC accepts the accuracy of those allegations. Integra provides some back office support to ONSWC, including accounting services. Integra is well aware that it needs more staffing for this function, and is taking action in that regard. The rapid growth of Integra and ONSWC in recent years caused the companies to outgrow their accounting staff. The lead accountant at Integra was overworked, particularly under the pressure of a high volume of data requests during the rate case in addition to her regular work, and resigned from Integra this month. Integra has hired a new chief financial officer as of January 3, 2023. His

done lightly." *Green v. Freeman*, 367 N.C. 136, 145, 749 S.E.2d 262 (2013); see also *State ex rel. Cooper v. Ridgeway Brands Mfg., LLC*, 362 N.C. 431, 442, 666 S.E.2d 107 (2008)

However, liability may be imposed on an individual who is operating a corporation as a mere instrumentality when the individual has:

Control, not mere majority or complete stock control, but complete domination, not only of finances, but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and

Such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or dishonest and unjust act in contravention of plaintiff's legal rights; and

The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.

Glenn v. Wagner, 313 N.C. 450, 455, 329 S.E.2d 326, ____ (1985). (citation omitted; emphasis added)

resume is attached as confidential Attachment 1. Integra is also in the process of hiring another person to increase the accounting staff, and hopes to complete that process within 45 days.

It is also noteworthy that until late in 2020 much ONSWC business was handled by the Myers' owned contractor Envirolink, Inc. Now that Envirolink is no longer working for ONSWC, Mr. McDonald is taking steps to improve the accounting function that serves ONSWC. The contractor was supposed to have responsibility for providing guidance on regulatory accounting, including regulatory relations and compliance with Commission rules. When Mr. McDonald was forced to terminate the relationship with Envirolink, ONSWC struggled to find the regulatory accounting experience necessary to properly comply with rate case data requests and other Public Staff inquiries.

As part of improving the accounting capabilities at Integra, and therefore the accounting service provided to ONSWC, Mr. McDonald plans to hire an outside firm in the spring of 2023 to thoroughly review the accounting needs and processes and to perform an accounting review of ONSWC and its financial statements. This is intended as a cost-efficient way, without the expense, diversion of resources, and disruption of a full scale audit, to identify where improvements are needed. The timing is meant to allow new accounting staff first to be retained and learn a bit about the Integra and ONSWC books and processes, so they can work with the reviewers. ONSWC will provide a copy of this outside accounting review to the Public Staff and Commission upon request.

However, ONSWC does not agree that the difficulty with producing timely and consistent financial statements has a bearing on the recapitalization issue. It is obvious that the financing of ONSWC is mostly through debt instruments, and not equity, regardless of which financial statement one reviews. Recapitalization is not going to address the problems with timing and accuracy of financial statements – those problems are an independent issue and can only be remedied by hiring new accounting staff, which Integra is working on.

Meanwhile, the Public Staff has declined to move contiguous extension filings of ONSWC to Staff Conference until updated financial statements are provided. That is, the Public Staff is exerting its own leverage to pressure ONSWC for updated financials, and of course Integra is striving to provide ONSWC with updated and accurate financials as soon as appropriate staff can be hired and have time to make the needed corrections.

Finally, the Public Staff Report states “The Public Staff also finds ONSWC’s failure to seek Commission approval of debt issuances totaling over \$13,000,000 alarming.” This comment would appear to repeat the legal compliance concerns discussed above, but it also appears that the Public Staff is alarmed because Mr. McDonald owns both Integra and ONSWC. Yet Mr. McDonald owned Integra and 95% of ONSWC during the rate case. He now owns 100% of ONSWC, so if

anything his interest in not having Integra foreclose on the loans has increased. In the rate case, Public Staff witness Hinton accepted the loan financing arrangement as acceptable, particularly in light of Mr. McDonald's commitment to have Integra continue to provide sufficient financing for ONSWC. In the rate case, the ratio of debt in the capital structure and the amount of debt did not preclude the Public Staff from entering a settlement with ONSWC. It should be emphasized that as the owner of ONSWC, Mr. McDonald has a strong interest in the financial success of ONSWC. It would not serve his interest to allow insolvency or abandon the millions of dollars of assets he has invested in the ONSWC North Carolina utility operations. And since the debt of ONSWC is owed to Integra and the Integra affiliates, which are owned by Mr. McDonald, there would be no purpose or advantage for Integra to attempt to make claims against ONSWC assets. In sum, ONSWC does not understand why the Public Staff is alarmed by the level of ONSWC debt. What matters is that ONSWC is adequately funded and is providing adequate service to customers.

For the reasons stated above, ONSWC asks the Commission to deny the recommendations in the Public Staff Report. ONSWC will provide updated financial statements and a reconciliation of the inconsistencies in past statements when it has the staff to do so (through accounting services provided by Integra). The forensic and management audits recommended by the Public Staff will not expedite that process; if anything, they will slow it down and be an additional drag on ONSWC finances. Nor will changing the ownership of ONSWC or declaring Mr. McDonald to be a utility achieve anything useful in this situation. The Public Staff has identified a non-problem – the debt ratio for ONSWC. It has also identified a real problem – the late and inconsistent financial statements. The Public Staff has not proposed a meaningful remedy. ONSWC, with accounting services from Integra, understands the financial reporting problem and is already working to address it.

This the 11th day of January, 2023.

FOX ROTHSCHILD LLP

/s/ David T. Drooz

David T. Drooz

North Carolina State Bar No. 10310

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Attorney for Old North State Water Company,
Inc.

VERIFICATION

John McDonald, being duly sworn, deposes and says: that he is the President of Old North State Water Company, Inc., that he is familiar with the facts set out in the attached ONSWC Response to Public Staff Report; and that the same is true to the best of his knowledge.



John McDonald

State of Alabama
County of Jefferson

Sworn to and subscribed before me this

the 11th day of January, 2023.



Notary Public



My Commission Expires: July 14, 2024

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the foregoing ONSWC Response to Public Staff Report upon each of the parties of record in this proceeding or their attorneys of record by emailing them an electronic copy or by causing a paper copy of the same to be hand-delivered or deposited in the United States Mail, postage prepaid, properly addressed to each.

This the 11th day of January, 2023.

Electronically submitted
/s/ David Drooz