

**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. W-1146, SUB 13
DOCKET NO. W-1328, SUB 10

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of)
Application by Red Bird Utility Operating)
Company, LLC, 1650 Des Peres Road,)
Suite 303, St. Louis, Missouri 63131, and)
Total Environmental Solutions, Inc., Post)
Office Box 14056, Baton Rouge, Louisiana)
70898, for Authority to Transfer the Lake)
Royale Subdivision Water and Wastewater)
Utility Systems and Public Utility Franchise)
in Franklin and Nash Counties, North Carolina,)
and for Approval of Rates)

**REBUTTAL TESTIMONY OF TODD THOMAS
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 Todd Thomas. My business address is 1630 Des Peres Road, Suite 140,
3 St. Louis, Missouri, 63131. I am Senior Vice President of t of CSWR, LLC, (“CSWR”) a
4 Missouri limited liability company that has operational and managerial oversight over all
5 its affiliated utility operating companies, including Red Bird Utility Operating Company,
6 LLC (“Red Bird”).

7 **Q. WHAT ARE YOUR JOB RESPONSIBILITIES AT CSWR?**

8 A. I am responsible for engaging and overseeing operations and maintenance
9 (“O&M”) service providers including those contractors responsible for day-to-day
10 operations of CSWR operating affiliates like Red Bird. In addition, I am responsible for

1 engaging and overseeing customer service providers. At the present time, I oversee such
2 activities for all affiliated operating companies providing water or wastewater utility
3 services to customers in Kentucky, Missouri, Arkansas, Tennessee, Louisiana, Mississippi,
4 Texas, North Carolina, South Carolina, Arizona, and Florida.

5 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
6 **EXPERIENCE.**

7 A. My education includes a Bachelor of Science in Civil Engineering from the
8 Missouri University of Science and Technology, and a Master of Business Administration
9 from Washington University in St. Louis.

10 Before joining CSWR, I was President of Brotcke Well and Pump (the second largest
11 well driller and service provider in the Midwest); Vice President of Operations and
12 Business Development of the Midwest for American Water Contract Operations; and
13 General Manager of Midwest Operations for Environmental Management Corporation. I
14 currently serve on the East Central Missouri Board of Directors and am an Advisory Board
15 member for Public Water Supply District 2 of St. Charles County, Missouri which is the
16 largest water and sewer district in the State of Missouri serving approximately 60,000
17 connections.

18 Brotcke Well and Pump serves municipal potable, regulated potable, and industrial
19 ground water suppliers in the states of Missouri, Illinois, Kansas, Tennessee, Kentucky,
20 and Arkansas. Its total number of clients exceeds 200 and they range in size from the City
21 of Bloomington, Illinois, with 31,000 water customers, to 230 customers in the City of
22 Eminence, Missouri. Brotcke Well and Pump drills wells, cleans and treats wells, installs
23 pumps, services pumps, rebuilds pumps, tests wells for regulatory compliance, and installs

1 and services well controls. As President of Brotcke Well and Pump, I was involved in the
2 design, maintenance, and repair of all clients' well systems. I have firsthand experience
3 with how much damage can be done by lack of maintenance on a well system and how
4 much money and effort is required to restore a well system after neglect.

5 As Vice President of Operations and Business Development of the Midwest for
6 American Water Contract Operations, I was responsible for the water and wastewater
7 operations and maintenance contracts for municipal and industrial clients. These clients
8 included wastewater systems owned and operated by the City of St. Charles, in Missouri,
9 and the cities of Godfrey, Mount Vernon, Quincy, Litchfield, Lincoln, Pittsfield, and
10 Elwood in Illinois. These clients also included water and wastewater systems owned and
11 operated by the City of Foristell, Missouri, and the Illinois cities of Brighton, and
12 Monmouth. At one time I had responsibility for operating water and wastewater systems
13 serving approximately 64,000 residential connections. My responsibilities included the
14 direction and management of annual budgeting for each plant's operations and
15 maintenance, design and planning of plant upgrades and maintenance projects, regulatory
16 reporting, plant operations, and regulatory compliance of these systems.

17 My position as General Manager of Midwest Operations for Environmental
18 Management Corporation was similar to my position with American Water Contract
19 Operations with regard to the size and scope of the systems the company managed.

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

21 A. The subject of these dockets is the Application for Transfer of Public Utility Franchise
22 and for Approval of Rates ("Joint Application") filed in these dockets by Red Bird and

1 Total Environmental Solutions, Inc. (“TESI”). The Joint Application seeks Commission
2 approval for Red Bird to acquire all utility assets currently used by TESI and to provide
3 water and wastewater utility services to customers in the Lake Royale development, and to
4 adopt TESI’s Commission-approved rates. In testimony filed September 19, Public Staff
5 witness Evan Houser acknowledged Red Bird has the technical and managerial,
6 qualifications required to acquire, own, and operate TESI’s Lake Royale development
7 water and wastewater systems, and appears to have conditionally recommended
8 Commission approval of the Joint Application. However, Mr. Houser expressed Public
9 Staff’s concerns and reservations regarding certain aspects of the proposed transactions.
10 My rebuttal testimony addresses those concerns and reservations.

11 Specifically, my rebuttal testimony addresses the following issues raised in Mr.
12 Houser’s testimony:

- 13 • The contention that the TESI system is not a “troubled” utility;
- 14 • Public Staff’s contention that no “acquisition adjustment” should be allowed in
15 connection with the proposed acquisition;
- 16 • Concerns expressed by Mr. Houser regarding due diligence costs Red Bird will
17 incur in connection with this transaction;
- 18 • Public Staff’s claims regarding the effect approval of this acquisition would have
19 on customer rates;
- 20 • Public Staff’s recommended bond should the Commission approve the sale of
21 TESI’s assets to Red Bird; and

- 1 • The recommendation that Red Bird be required to meet semi-annually with Public
2 Staff to discuss the company’s operations and financial condition.

3 I also will reiterate the many benefits Red Bird’s proposed acquisition would bring
4 to customers served by the TESI water and wastewater systems both immediately and long-
5 term.

6 In addition, I will address questions and concerns expressed in the testimony of
7 Public Staff’s witness John Hinton regarding CSWR’s ability to provide capital necessary
8 to acquire, make required upgrades and improvements, and operate the TESI systems after
9 closing.

10 In separate rebuttal testimony filed by CSWR’s Regulatory Accounting Manager,
11 Caitlin O’Reilly, Red Bird addresses accounting issues raised in the testimony of Public
12 Staff’s witness Lynn Feasel.

13 **II. IS THE TESI SYSTEM A “TROUBLED” UTILITY?**

14 **Q. WHAT IS MR. HOUSER’S ASSESSMENT OF THE OVERALL**
15 **CONDITION OF TESI AND ITS UTILITY FACILITIES?**

16 A. Mr. Houser testifies that TESI provides “safe, albeit intermittently unreliable
17 service to its customers.” (Houser p. 13, lines 8 – 12). The “intermittently reliable service”
18 standard Mr. Houser and Public Staff seem to believe is sufficient is a much lower bar than
19 regulators outside North Carolina have been willing to accept, and I find it hard to believe
20 it’s a standard this Commission would view as satisfactory to TESI’s customers. Customer
21 comments received at the September 25 public hearing strongly support that conclusion.

22 Mr. Houser strains to avoid conceding the obvious – that the TESI system is
23 troubled both from a regulatory compliance perspective and from a quality-of-service

1 perspective. He appears to base his assessment on an investigation that included a visual
2 inspection of TESI's facilities conducted August 23, 2023. Accompanying Mr. Houser on
3 this inspection were representatives of the North Carolina Department of Environmental
4 Quality ("NCDEQ"). Mr. Houser describes his observations regarding the current
5 condition of TESI's facilities, including that the sand filters in TESI's wastewater treatment
6 plant were covered with weeds to the point that they "obscured inspection of the sand filter
7 media." (Houser p. 6, lines 2-3). He states TESI has no current or recent Notices of
8 Violation ("NOV") from the NCDEQ, but also notes that between July 1, 2020, and June
9 30, 2023, the Public Staff Consumer Services Division received 28 customer complaints
10 about TESI. Based on these factors, Mr. Houser concludes TESI is not a troubled utility
11 even though it is currently and apparently, based on the testimony at the public hearing,
12 has for years been providing "intermittently unreliable service" to its customers – meaning
13 the water service provided by TESI is and has only been intermittently reliable.

14 **Q. DO YOU CONCUR WITH MR. HOUSER'S ASSESSMENT?**

15 A. I do not concur with Mr. Houser's assessment. Indeed, his observation that during
16 his visit the sand filters in TESI's wastewater treatment facility obscured inspection of the
17 sand filter media is evidence that TESI has failed to maintain its facilities appropriately.
18 Simply stated, a competent operator would not allow vegetation around a sand filter to
19 grow to the point it obscures inspection of the facility. Furthermore, if Mr. Houser was
20 unable to inspect the sand filters, how can he have any confidence they are working as
21 designed?

1 **Q. DO YOU HAVE INFORMATION TO SUPPORT YOUR OPINION THAT**
2 **TESI AND ITS UTILITY SYSTEMS ARE “TROUBLED”?**

3 A. Yes, I do. I also want to caution the Commission on relying too heavily on Mr.
4 Houser’s assessment of the condition of TESI’s water and wastewater systems based on a
5 single visit to those facilities. That single visit provides a “snapshot” of what was observed
6 on that one day and may not – especially in the face of contrary historical evidence –
7 provide an accurate picture of the true condition of TESI’s systems or how TESI has
8 operated those systems over time. Therefore, in assessing whether TESI and its systems
9 are “troubled” the Commission should take a longer-term, more wholistic view. The water
10 service quality concerns expressed at the public hearing aside, just because TESI’s systems
11 currently comply with applicable regulations does not mean they will be in compliance in
12 the future. And as I will discuss later in my testimony, TESI has itself admitted it lacks the
13 resources to ensure such future compliance.

14 **Q. WHAT EVIDENCE HAS RED BIRD IDENTIFIED IN ITS DUE**
15 **DILIGENCE ANALYSIS THAT SUGGESTS CONTINUED COMPLIANCE WILL**
16 **BE DIFFICULT, IF NOT IMPOSSIBLE, FOR TESI TO ACHIEVE?**

17 A. In Mr. Cox’s direct testimony in this case (pages 24-27) he described the
18 preliminary engineering assessment of Red Bird’s consulting engineer as to TESI’s water
19 and wastewater systems as part of its due diligence and the recommendations developed
20 for repairs and upgrades required after closing. That report, which was prepared by a third-
21 party engineering firm in May-June 2021 identified necessary water system repairs and
22 upgrades totaling almost \$200,000 and sewer system repairs and upgrades totaling more
23 than \$250,000. Because of the effects of inflation in the more than two years since those

1 recommendations and cost estimates were prepared, I would expect current cost estimates
2 of the recommended projects to be substantially greater.

3 As noted in Mr. Cox's direct testimony, the engineer's inspection revealed that
4 TESI's lift stations do not meet the state minimum design criteria, which require that sewer
5 pump stations with greater than 600 gallons per day of flow be equipped with duplex
6 pumps. Additionally, the engineers determined the water tank is in poor condition and
7 various abnormalities were identified. Well run and managed water and wastewater
8 systems do not allow their facilities to deteriorate to the degree described in the due
9 diligence engineering report.

10 **Q. DO YOU AGREE WITH MR. HOUSER'S ASSESSMENT OF TESI'S**
11 **RECORD OF COMPLYING WITH HEALTH, SAFETY, AND**
12 **ENVIRONMENTAL REGULATIONS?**

13 A. No, I do not agree. Mr. Houser seems to conclude that because TESI has no recent
14 "enforcement actions" its record of compliance with applicable health, safety, and
15 environmental regulations is satisfactory. (Houser pp. 6-10). But just because TESI's
16 actions – or inactions – didn't result in formal enforcement actions does not mean either its
17 water or wastewater operations have a satisfactory compliance record. According to the
18 U.S. Environmental Protection Agency's ECHO database, TESI's compliance record over
19 the last five years is as follows:

20 Wastewater:

- 21 • Thirteen informal enforcement actions in the last 5 years, including base program
22 violations related to late and missing DMRs, effluent exceedances, and violations
23 for unapproved operation of the facility from 2017 and 2019 which have not been
24 resolved (though a new permit was secured in 2019)
25

- 1 • Six formal enforcement actions in the last 5 years, resulting in \$1,501 in fines
2 related to these actions (Cases NC-LV-2020-0222, NC-LV-2020-0074, NC-LV-
3 2019-0375, NC-LV-2019-0267, NC-LV-2019-0169, and NC-LV-2019-0078).
4
- 5 • Twelve effluent exceedances in the last 5 years, which represent 187 days of testing
6 periods with exceedances and 9 months with exceedances. Those violations
7 included exceeding limits for BOD (daily max and monthly average exceedances),
8 ammonia, fecal coliform, and total residual chlorine.
9
- 10 • TESI's facilities were out of compliance for all 12 of the most recent quarters due
11 to effluent exceedances, unresolved violations, and missing DMR measurements in
12 all submitted DMRs over that period. In two of those quarters TESI's facilities were
13 cited for "Significant Noncompliance" for complete failure to submit DMRs.

14 Water:

- 15
- 16 • Four violations in the last 5 years, including three violations for "Revised Total
17 Coliform Rule: Report Sample Result/Fail Monitor (RTCR)" (failing to complete
18 or submit required bacteriological sampling by the due date for the reporting) and
19 one violation for "Total Haloacetic Acids (HAA5): Monitoring and Reporting
20 (DBP)" (failure to complete or submit required disinfection byproduct sampling by
21 the due date for the reporting).
22
- 23 • Twenty-six additional violations marked as "open" or "known." Violations were
24 primarily for metals and radionuclide testing, which was not completed when
25 required. Other violations were cited for failing to complete Total Coliform Rule
26 and Lead and Copper Rule testing.
27

28 I have attached as **Thomas Rebuttal Exhibit 1** copies of facilities reports taken from the
29 EPA's ECHO database documenting the violations I described above.

30 **Q. WHY DO YOU BELIEVE INCIDENCES OF NON-COMPLIANCE THAT**
31 **DON'T RESULT IN ENFORCEMENT ACTIONS ARE SIGNIFICANT?**

32 A. For TESI's water system, most of the violations cited above involve actual or
33 potential human health hazards. These include total coliform, haloacetic acids, metals, and
34 radionuclides. Testing standards and requirements were established to ensure the presence
35 of these harmful substances does not exceed levels considered to be safe for humans.
36 Failing to perform required tests defeats the purpose of those testing requirements and

1 denies customers the assurance the water they consume is safe for drinking, cooking, and
2 other intended uses. Just because TESI's failure to comply with testing standards did not
3 result in a formal enforcement action does not mean those failures were inconsequential.
4 On the wastewater side, TESI has been chronically non-compliant, as its record of
5 consistent non-compliance over the last 12 calendar quarters demonstrates. It's hard to
6 imagine a less satisfactory compliance history regardless of whether TESI's non-
7 compliance resulted in formal enforcement actions.

8 **Q. WHAT ARE THE PROSPECTS TESI'S COMPLIANCE RECORD WOULD**
9 **IMPROVE IF THE COMMISSION DENIES RED BIRD'S ACQUISITION**
10 **APPLICATION?**

11 A. I believe there are no prospects for improvement in TESI's compliance record or
12 its record more generally with respect to the operation of its water and wastewater systems
13 serving Lake Royale in a manner that ensures its customers receive safe and reliable utility
14 services. As described in Mr. Cox's direct testimony, in 2021 TESI decided it needed or
15 wanted to exit the water and wastewater utility business and as a result agreed to sell its
16 systems in Louisiana, South Carolina, and North Carolina to CSWR-affiliated utilities
17 operating in each of those states. (Cox Direct, pp 21-24) The Louisiana portion of the
18 transaction – by far the largest, involving approximately 18,000 connections – closed in
19 2021 and the South Carolina portion closed earlier this year. All that remains are the
20 systems at issue in this case.

21 Testimony TESI filed in the South Carolina transfer case, which is attached to this
22 testimony as **Thomas Rebuttal Exhibit 2**, explains why there is no prospect for
23 improvement in TESI's North Carolina compliance record. Indeed, that testimony clearly

1 establishes that there is no reason to believe TESI can continue to operate as a stand-alone
2 utility. In his testimony to the South Carolina Commission, Wayne Owens, TESI's Chief
3 Executive Officer, expressly stated "TESI is in the process of selling its water and
4 wastewater business entirely." (**Thomas Rebuttal Exhibit 2**, page 2) He explained the
5 reasons for that decision as follows:

6 The costs of maintaining the sewer and wastewater systems and
7 implementing the requirements of the Federal Consent Decree for those
8 Louisiana sewer systems still subject to that Decree have made continued
9 ownership and operation of those systems exceedingly difficult for TESI.
10 The catastrophic losses suffered because of Hurricane Ida make the need to
11 sell the two Carolina operations even more critical . . . After the sale of
12 Louisiana Assets, the North and South Carolina operations don't justify
13 maintaining management and administrative staff for these two remote
14 operations.

15
16 **Thomas Rebuttal Exhibit 2**, page 3.

17
18 Mr. Owens went on to state:

19 TESI does not possess the capital resources or the access to capital
20 necessary to invest in, maintain, and improve its systems in South Carolina,
21 Louisiana, or North Carolina. Similarly, TESI does not have the
22 wherewithal to seek to adjust its rates with this [South Carolina]
23 Commission, even though TESI's current rates have been in place since
24 2006.

25 **Thomas Rebuttal Exhibit 2**, page 3. And when asked whether TESI's current compliance
26 with the South Carolina Commission's rules suggested such performance would continue,
27 Mr. Owens responded, "[w]hile TESI may be so operating at this point in time, because of
28 the difficulties described above [i.e., TESI's decision to leave the water and wastewater
29 business and its lack of access to capital], TESI is unlikely to be able to maintain regulatory
30 compliance on a going-forward basis." (**Thomas Rebuttal Exhibit 2**, page 5)

1 Because the sales of TESI's Louisiana and South Carolina systems have already
2 been completed, the factors causing Mr. Owen to conclude TESI could not achieve
3 regulatory compliance in the future have significantly increased. Consequently, whatever
4 this Commission concludes regarding TESI's current or past compliance record in North
5 Carolina, there is no basis to believe that its service quality or compliance record can be
6 either maintained or improved upon by TESI in the future.

7 **Q. MR. HOUSER SUGGESTS TESI CAN OBTAIN LOW-COST FINANCING,**
8 **WHICH INCLUDES THE POTENTIAL FOR PRINCIPAL FORGIVENESS,**
9 **FROM THE NORTH CAROLINA DIVISION OF ENVIRONMENTAL**
10 **QUALITY'S WATER INFRASTRUCTURE FUND. DO YOU AGREE?**

11 A. No, I do not. For one thing, as Mr. Owen made clear in his South Carolina
12 testimony, TESI has decided to exit the water and wastewater business entirely. Therefore,
13 there is no reason to believe TESI is interested in pursuing and potentially borrowing
14 funding to operate its sole remaining water and wastewater operation, which is the North
15 Carolina utility business serving Lake Royale. Even if TESI were interested in such
16 funding, it appears loans or other capital from the Water Infrastructure Fund is not available
17 to investor-owned utilities. Although it appears the Water Infrastructure Fund was designed
18 to make funds available to a range of entities including investor-owned utilities, as stated
19 on its website ([https://www.deq.nc.gov/about/divisions/water-infrastructure/i-need-](https://www.deq.nc.gov/about/divisions/water-infrastructure/i-need-funding)
20 [funding](https://www.deq.nc.gov/about/divisions/water-infrastructure/i-need-funding)), for 2023 the Fund's low-interest loans and grants are only available to "local
21 governments and certain other non-profit entities." TESI doesn't qualify under either of
22 those categories.

23 Even if TESI could find a source of capital necessary to maintain and improve its
24 sole remaining system, the Commission should note that, at TESI's request, Red Bird

1 recently assumed responsibility, as a contract operator, for day-to-day operations and
2 maintenance of TESI's North Carolina water and wastewater systems. If the proposed
3 acquisition by Red Bird is not approved, it is unclear how TESI can maintain its operations
4 in this state on a stand-alone basis because TESI no longer has the operational or
5 managerial personnel necessary to do so.

III. ACQUISITION ADJUSTMENT

6 **Q. MR. HOUSER STATES IN HIS TESTIMONY THAT PUBLIC STAFF**
7 **DOES NOT SUPPORT RED BIRD RECEIVING AN ACQUISITION**
8 **ADJUSTMENT IN THIS PROCEEDING. HOW DO YOU RESPOND?**

9 A. I agree with Mr. Houser to an extent. For reasons I will further explain later in my
10 testimony, I believe the Commission *need not* authorize an acquisition adjustment for Red
11 Bird in this proceeding. Instead, the Commission can and should defer to Red Bird's initial
12 rate case involving the TESI systems any decision regarding whether an acquisition
13 adjustment should be granted. There are three primary reasons for my deferral proposal.

14 First, based on changes to the law applicable to water and wastewater acquisitions
15 that were discussed in Mr. Cox's direct testimony, the Commission's focus in these system
16 transfer dockets is limited to determining (1) whether the party seeking to acquire a system
17 possesses the technical, managerial, and financial capabilities necessary to provide public
18 utility services, and (2) whether the transaction is in the public interest. And insofar as the
19 public interest determination is concerned, that assessment is to be based on rates that will
20 be in effect immediately after closing. Because any acquisition adjustment deemed
21 appropriate in this case would affect none of the factors the Commission is to consider

1 here, it is neither necessary nor appropriate to decide that issue in a transfer / acquisition
2 case.

3 Second, there is no need for the Commission to address the acquisition adjustment
4 in this case at this time because after closing Red Bird plans to adopt and charge customers
5 TESI's currently approved rates. Therefore, any decision regarding whether an acquisition
6 adjustment should be authorized can be deferred to the initial rate case involving the TESI
7 systems when that issue and its potential impact on rates will be fully considered.

8 Finally, by deferring the acquisition adjustment issue to Red Bird's initial rate case
9 involving the TESI systems more and better information would be available regarding the
10 circumstances and factors that govern whether such an adjustment should be included in
11 rate base. As stated in the Commission's decision in the *Order Approving Transfer and*
12 *Denying Acquisition Adjustment*, issued in Socket No. W-100, Sub 5 (N.C.U.C. January 6,
13 2000) ("*North Topsail*"):

14 Although the number of relevant considerations seems virtually unlimited,
15 all of them apparently relate to the question of whether the acquiring utility
16 paid too much for the acquired utility and whether the customers of both the
17 acquired and acquiring utilities are better off after the transfer than they
18 were before that time . . . [T]he Commission should refrain from allowing
19 rate base treatment of an acquisition adjustment unless the purchasing utility
20 establishes, by the greater weight of the evidence, that the price the
21 purchaser agreed to pay for the acquired utility was prudent and that both
22 the existing customers of the acquiring utility and the customers of the
23 acquired utility would be better off [or at least no worse off] with the
24 proposed transfer, including rate base treatment of any acquisition
25 adjustment, than would otherwise be the case.

26 *North Topsail* at page 27.

27 Evidence regarding the purchase price presented by both Red Bird and Public Staff
28 in this case does not focus on whether the purchase price Red Bird will pay for TESI's

1 assets is “reasonable.” Red Bird knows that the purchase price was the lowest that could
2 be agreed upon through arms-length negotiations between two non-affiliated parties.
3 Public Staff merely notes the purchase price exceeds the net book value of the assets Red
4 Bird proposes to acquire and expresses no opinion regarding whether such a price is
5 “reasonable.” Because the transaction has not yet been completed, there is not – and cannot
6 be – any tangible evidence regarding how the proposed acquisition would affect either
7 TESI’s current customers or Red Bird’s current and future customers. Public Staff’s
8 projections regarding estimated future rate impacts of the proposed acquisition are purely
9 speculative and are unreliable for that reason. However, deficiencies in the current record
10 regarding both the reasonableness of the purchase price and the effect of the proposed
11 acquisition on customers can be cured if the acquisition adjustment issue is deferred to a
12 future rate case. And customers would not be harmed by such a deferral, because rates
13 charged to Red Bird’s and TESI’s customers will not change until the Commission decides
14 a future rate case, if the acquisition proposed in this case is approved.

15 For all the reasons just stated, I believe it makes sense to defer any decision on an
16 acquisition adjustment to Red Bird’s initial North Carolina rate case for the TESI systems.
17 As I previously noted, such a deferral will harm no one. Moreover, such a deferral is more
18 consistent with recent changes to Chapter 62 governing transfer of water and wastewater
19 utilities, which define the scope of the Commission’s inquiry in such cases.

20 **IV. DUE DILIGENCE COSTS**

21 **Q. PUBLIC STAFF RECOMMENDS THE COMMISSION APPLY A \$10,000**
22 **CAP ON DUE DILIGENCE COSTS INCURRED BY RED BIRD IN CONNECTION**
23 **WITH THE TESI ACQUISITION. HOW DO YOU RESPOND?**

1 A. I disagree with Public Staff's recommendation for at least two reasons. First, as
2 stated elsewhere in my testimony and reiterated here, changes to G.S. § 62-111 limit the
3 issues the Commission is to consider in water and wastewater transfer / acquisition cases.
4 Because the amount of due diligence costs Red Bird incurred does not reflect on its
5 technical, managerial, or financial capabilities to own and operate the TESI systems, the
6 amount of due diligence costs that should be included in rate base is an issue that should
7 be deferred to Red Bird's initial rate case involving the TESI systems. Second, because
8 Red Bird is not proposing to change rates currently in effect for the TESI systems, there is
9 no need for the Commission to deal with any issue related to transaction costs in this
10 proceeding. Deferring that issue will harm or disadvantage no one. Moreover, deferring the
11 issue to a future rate case, when the full amount of transaction-related costs is known, will
12 enable all parties to provide evidence regarding the prudence of those costs and whether
13 they should be included in the rate base to be used to set future rates.

14 In addition, I find many of the arguments Mr. Houser makes regarding due
15 diligence costs to be unreasonable. For example, at page 32 of his testimony Mr. Houser
16 claims due diligence costs "should be absorbed by Red Bird as a cost of doing business
17 and not be included in rate base." While I certainly agree due diligence costs are a cost of
18 doing business, like all such costs a utility is entitled to recover them if they were prudently
19 incurred and are reasonable in amount. And although both those issues should be deferred
20 to a future rate case, I will briefly explain why I believe our due diligence costs satisfy both
21 those standards.

1 As part of the due diligence inquiry we conduct for all acquisitions made by our
2 affiliate group, we routinely engage a third-party engineering firm to assess the condition
3 of assets we propose to purchase and to project what capital improvements will be
4 necessary during the first few years we own and operate those assets. While these results
5 are preliminary – because we have found the true condition and needs of systems we
6 acquire can only truly be determined after we actually own and operate those systems –
7 these preliminary assessments are invaluable for many reasons. Among those is the need
8 to respond to questions raised by regulators in acquisition cases regarding future capital
9 plans. The Commission’s application form is a perfect example of why information
10 gathered during our engineering due diligence activities is essential to the process for
11 obtaining regulatory approval for acquisitions we seek to make. Questions 1 and 2 of the
12 Commission’s *Application for Transfer of Public Utility Franchise and for Approval of*
13 *Rates* require applicants, like Red Bird, to provide the following information:

14 1. Are there any major improvements/additions required in the next
15 five years and the next ten years? Indicate the estimated cost of each
16 improvement/addition, the year it will be made, and how it will be financed
17 (long-term debt, short-term debt, common stock, retained earnings, and
18 other (please explain)).
19

20 2. Are there any major replacements required in the next five years
21 and the next ten years? Indicate the estimated cost of each replacement, the
22 year it will be made, and how it will be financed (long-term debt, short-term
23 debt, common stock, retained earnings, and other (please explain)).
24

25 Providing such information, which is required in order for an acquisition application to be
26 deemed “complete,” would not be possible without the information gathered from the
27 engineering studies prepared as part of our acquisition due diligence. So, while the cost of
28 that due diligence is, as Mr. Houser testifies, “a cost of doing business,” it is a reasonable

1 cost that not only gives a prospective purchaser meaningful insight into the conditions and
2 issues in a system but also is necessary to complete the acquisition application and provide
3 information required by regulators.

4 **Q. DOESN'T MR. HOUSER ALSO CLAIM RED BIRD'S DUE DILIGENCE**
5 **COSTS ARE EXCESSIVE?**

6 A. Although he doesn't use the word "excessive," at page 31 of his testimony he states,
7 "[t]hese costs are significantly higher than due diligence costs requested by many previous
8 applicants." He cites two such cases as examples – Docket No. W-354, Sub 396 and Docket
9 No. W-2018, Sub 527 – but doesn't explain how applicants in those cases were able to
10 provide the kinds of capital improvement estimates required by the Commission's transfer
11 application form. The lack of such evidence – which isn't material to issues the
12 Commission must decide in an acquisition / transfer case – lends support to my contention
13 that this is an issue that need not be dealt with or decided in this docket but should, instead,
14 be deferred to Red Bird's initial rate case relating to the TESI system.

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

16 **Q. TWO OF PUBLIC STAFF'S WITNESSES INCLUDE ESTIMATES**
17 **REGARDING THE EFFECT ON CUSTOMER RATES OF VARIOUS ASPECTS**
18 **OF THE JOINT APPLICATION. HOW DO YOU RESPOND?**

19 A. My response to Mr. Houser's and Ms. Feasel's projections regarding the proposed
20 acquisition of TESI's systems on future rates is twofold. First, because of recent changes
21 to G.S. § 62-111, which governs the Commission's consideration of water and wastewater
22 transfer / acquisitions, the only rates the Commission should consider are those the
23 purchasing utility proposes - which in this case are TESI's current Commission-approved

1 rates. Future rates – *i.e.*, those that would be set in a future rate case – are irrelevant to the
2 determination of whether an acquisition application should be granted.

3 As we made clear in the Joint Application and as reiterated in Mr. Cox’s direct
4 testimony, if Red Bird is authorized to acquire TESI’s water and wastewater systems the
5 customer rates currently in effect will continue to be charged until the Commission
6 authorizes a change in rates in a future Red Bird rate case. Accordingly, approval of the
7 Joint Application will have no impact on customer rates. Therefore, the Commission
8 should disregard the rate impact estimates included in the testimonies of both Mr. Houser
9 and Ms. Feasel. Those estimates have no relevance to the issues the Commission must
10 decide in this case – *i.e.*, whether Red Bird is technically, managerially, and financially
11 qualified to own and operate the TESI systems as a regulated public utility and whether the
12 proposed transaction is in the public interest.

13 There is another reason Public Staff’s rate impact testimony should be disregarded:
14 their projected rate impacts are just estimates. What’s more, they are estimates made based
15 on assumptions regarding all elements of ratemaking – revenue, expenses, rate base, capital
16 structure, rate of return, rate design, etc. – that may or may not be valid. For example, Red
17 Bird has made clear it intends to request in its first North Carolina rate case approval of
18 consolidated, statewide rates for both water and wastewater services. Based on the
19 experience of our affiliate group in states outside North Carolina, where such rates have
20 been approved, consolidated rates are an effective mechanism to mitigate “rate shock” that
21 otherwise would result when small, undercapitalized, and mismanaged systems are taken
22 over by experienced and technically competent owners that invest the capital required to

1 address the needs in those systems. Consolidated rates allow all customers within a state to
2 share the benefits of economies of scale our affiliated group is able to achieve, and also
3 helps to spread out the rate impact of required capital investments that have greater impacts
4 on some systems in the short term but that will affect all systems in the long run. Despite
5 Red Bird's announced intent to seek approval of consolidated rates, Public Staff's
6 estimated rate impacts, in addition to being based on estimates and assumptions, also are
7 calculated as if rates for the TESI systems would always be set on a stand-alone basis.

8 **Q. BECAUSE OF THE FACTORS YOU JUST DESCRIBED, DO YOU THINK**
9 **THE COMMISSION SHOULD CONSIDER FUTURE RATE IMPACTS IN**
10 **REACHING A DECISION IN THESE DOCKETS?**

11 A. No, I do not. The impact on future rates of Red Bird's acquisition of the TESI
12 systems will not and cannot be known at the present time, so it would be inappropriate and
13 unnecessary for the Commission to consider that issue in the current case. As a regulated
14 utility, Red Bird is prohibited by law from changing rates unless and until such a change is
15 authorized by the Commission. Under applicable law, no change in rates can be approved
16 by the Commission without a thorough consideration of a utility's rate change request, with
17 full opportunity for interested parties – like Public Staff – to present evidence and
18 arguments regarding that request. Also, as provided in Chapter 62, all rates set by the
19 Commission must be fair and reasonable. For all these reasons, it is neither necessary nor
20 appropriate for the Commission to consider possible future rate impacts in this case.
21 Consideration of rate related issues can and should be deferred to future rate cases where
22 all parties have the ability to present evidence on all factors relevant to ratemaking.
23 Following such consideration, both the utility and its customers can be assured that
24 whatever decision the Commission makes regarding rates will be based on facts – instead

1 of estimates and assumptions – and that the resulting rates are fair and reasonable to all
2 affected parties.

3 **VI. AMOUNT OF BOND REQUIRED BY N.C.G.S. § 62-110.3**

4 **Q. IF THE COMMISSION APPROVES THE PROPOSED TRANSFER OF**
5 **ASSETS, WHAT BONDS DO PUBLIC STAFF RECOMMEND THAT RED BIRD**
6 **BE REQUIRED TO POST TO SATISFY THE REQUIREMENTS OF N.C.G.S. § 62-**
7 **110.3?**

8 A, As stated in his testimony at page 33, should the Commission approve Red Bird's
9 proposed acquisition of TESI's assets Mr. Houser recommends Red Bird be required to
10 post a \$50,000 bond for the water system and a \$50,000 bond for the wastewater system.

11 **Q. DO YOU AGREE WITH PUBLIC STAFF'S RECOMMENDATIONS?**

12 A. No, I do not. In response to data requests Red Bird submitted regarding Mr.
13 Houser's bond recommendations, Public Staff stated the bond currently in effect for the
14 TESI water and wastewater system totals \$20,000. Public Staff's recommendation thus
15 represents a 400% increase in the bond required for the TESI systems. Absent a compelling
16 justification – which is not provided in Mr. Houser's testimony – the Commission should
17 reject Public Staff's recommendation.

18 **Q. DID RED BIRD ATTEMPT TO IDENTIFY THE BASIS FOR THE**
19 **SIGNIFICANT BOND INCREASE RECOMMENDED BY PUBLIC STAFF?**

20 A. Yes, Red Bird did seek such information. However, the information provided in
21 response to the company's inquiries wasn't very helpful. Following the filing of Mr.
22 Houser's testimony, Red Bird submitted several data requests seeking information
23 regarding the basis for Public Staff's bond recommendation. Those data requests and the
24 responses received were as follows:

1 26. Explain how and to what extent each of the following factors affected
2 Public Staff's bond recommendations in this case: (a) the systems Red Bird
3 currently owns and operates in North Carolina, and (b) the capital
4 improvements recommended in Red Bird's preliminary engineering study
5 of the TESI systems.

6 **Response: Both contribute to the bond recommended by Mr. Houser.**
7 **Witness Cox testified in his prefiled direct testimony that Red Bird**
8 **plans to pursue small systems which are out of compliance with**
9 **environmental regulations. Red Bird also plans for substantial capital**
10 **investment in the systems it pursues. If significant capital investment is**
11 **indeed required in these systems, the bond should be increased.**
12 **Additionally, Red Bird's other water and sewer franchises in North**
13 **Carolina have not yet established a record of operation.**

14 . . .

15 27. At page 33 of his testimony Mr. Houser indicates Public Staff's bond
16 recommendation was based, in part, on "Red Bird's limited operating
17 experience in North Carolina." If operating experience is relevant to the
18 determination of an appropriate bond amount, should the operating
19 experience of Red Bird's affiliates outside North Carolina be taken into
20 consideration? Explain all reasons for Public Staff's response.

21 **Response: N.C.G.S § 62-110.3(a)(1) requires the Commission to**
22 **consider "Whether the applicant holds other water or sewer franchises**
23 **in this State, and if so its record of operation." Based on § 62-110.3(a)(1)**
24 **and the fact that other jurisdictions in which Red Bird operates have**
25 **different regulations than those that apply to systems operated in North**
26 **Carolina, the Commission should not consider the operating experience**
27 **of Red Bird's affiliates outside North Carolina, but rather Red Bird's**
28 **record of operation in North Carolina.**

29 . . .

30 28. Provide all calculations and workpapers supporting Public Staff's
31 recommendation that Red Bird be required to post a \$50,000 bond for the
32 Lake Royale water system and a \$50,000 bond for the Lake Royale
33 wastewater system. Your response should explain the bond value Public
34 Staff attributed to each of the factors in N.C.G.S. § 62-110.3(a).

35 **Response: Bond recommendations are not determined by a**
36 **mathematical formula and as such do not have workpapers or specific**
37 **values associated with each component.**

1 **Q. HOW DO YOU RESPOND TO THE EXPLANATIONS PUBLIC STAFF**
2 **PROVIDED FOR ITS PROPOSED INCREASE IN THE BOND APPLICABLE TO**
3 **THE TESI SYSTEMS AT ISSUE IN THIS CASE?**

4 A. My overall response is that based on Public Staff's responses to Red Bird's data
5 requests there is no justification for any increase in the bond for the TESI systems and most
6 certainly not the 400% increase Public Staff proposes. To date Red Bird has acquired three
7 water and wastewater acquisitions in North Carolina and has been required to post bonds
8 totaling \$475,000 in connection with those acquisitions. If the Commission authorizes Red
9 Bird to acquire the TESI systems, although that acquisition would increase the total number
10 of customers the company serves Public Staff has provided no explanation as to why the
11 addition of TESI's systems warrants a \$80,000 increase in that bond total – especially when
12 \$20,000 is currently deemed adequate for those same systems. Looking at the other
13 bonding criteria listed in G.S. § 62-110.3(a), the extent to which the age, condition, and
14 type of equipment will change is unknown at this point, the number of customers won't
15 change, and there is no evidence customer growth in TESI's service area would require
16 expansion of either the water or wastewater system.

17 As for Red Bird's "record of operation," although that company has a limited
18 operating history in North Carolina, CSWR – which is responsible for providing technical,
19 managerial, and financial support for all its utility operating affiliates – has demonstrated
20 its capabilities and competencies in each of the other 10 states where those affiliates
21 operate. Mr. Cox's direct testimony documents accolades CSWR has earned from
22 environmental regulators in Missouri and Mississippi, and the fact utility regulators in all

1 states where CSWR’s affiliates operate continue to authorize and approve additional
2 acquisitions is testament to their satisfaction with the group’s performance.

3 But perhaps the most compelling evidence of why Public Staff’s bond
4 recommendation cannot be justified is its response to data request 28: “Bond
5 recommendations are not determined by a mathematical formula and as such do not have
6 workpapers or specific values associated with each component [identified in G.S. 62-
7 1103(a)].” This exposes Public Staff’s bond recommendation process as arbitrary and
8 therefore unworthy of the Commission’s endorsement or approval.

9 After considering all factors I believe are relevant to setting bonds for the water and
10 wastewater systems Red Bird proposes to acquire, I believe the appropriate bond amounts
11 are those currently in place. Public Staff has not provided any justification for the increases
12 it proposes.

13 **VII. PROPOSED ANNUAL REVIEW OF OPERATIONS AND**
14 **FINANCIAL CONDITION**

15 **Q. PUBLIC STAFF WITNESS HINTON PROPOSES RED BIRD BE**
16 **REQUIRED TO MEET ANNUALLY WITH PUBLIC STAFF TO DISCUSS THE**
17 **COMPANY’S WATER AND WASTEWATER OPERATIONS AND TO REVIEW**
18 **ITS FINANCIAL CONDITION. HOW DO YOU RESPOND?**

19 A. Although Red Bird is not opposed to an annual meeting with Public Staff to discuss
20 the company’s operations and financial conditions, it seems to me Public Staff’s efforts in
21 this area are misplaced. In response to Mr. Hinton’s recommendation, Red Bird submitted
22 a data request asking Public Staff to, in part, “[i]dentify each water and/or wastewater
23 utility operating in North Carolina that currently is subject to the same or similar
24 requirement.” In its response to that request, Public Staff stated, “no water/wastewater

1 utility is currently subject to the requirement to meet annually with the Public Staff.” That
2 response went on to identify four North Carolina utilities that are subject to such a
3 requirement and the cases in which that requirement was imposed. Three of those cases
4 involved mergers or corporate restructurings and the fourth involved the transfer of a
5 transportation certificate to Bald Head Island Ferry Transportation, LLC.

6 I found the list of companies required to meet annually with Public Staff puzzling
7 because I know three of those companies to be well run, well-capitalized, and profitable
8 utilities. I’m not familiar with the ferry company and therefore can’t comment on its
9 operations or financial conditions. But nowhere on the list was a small water and
10 wastewater company like TESI or the numerous other companies in North Carolina that
11 Red Bird has acquired or is seeking Commission approval to acquire. Yet those are the
12 types of utilities that warrant the kind of scrutiny Public Staff now proposes to impose on
13 Red Bird.

14 Focusing on TESI, I have attached to my testimony as **Thomas Rebuttal Exhibit**
15 **3**, excerpts from TESI’s annual reports for the years 2019 through 2022. Those excerpts
16 show TESI experienced negative net income in each of those years – ranging from a loss
17 of \$4,661 in 2020 to a loss of more than a quarter million dollars in 2022. Had Public Staff
18 required TESI to meet annually to discuss operations and finances those discussions would
19 have disclosed problems with both the company’s operations (as I described earlier in my
20 testimony) and its precarious financial situation. And there are numerous other small
21 systems in North Carolina whose operations and financial conditions are as bad or worse

1 than TESI's. Despite this fact, Public Staff seems only to require annual meetings with well
2 run and well-capitalized utilities who don't really need Public Staff's oversight.

3 **Q. WHAT ABOUT THE CONCERNS MR. HINTON EXPRESSED**
4 **REGARDING "THE ONGOING VIABILITY OF CSWR, LLC, BECAUSE IT**
5 **CONTINUES TO REPORT SIGNIFICANT LOSSES ON ITS CONSOLIDATED**
6 **INCOME STATEMENT." ARE THOSE CONCERNS VALID?**

7 A. No, they are not valid. If you focus solely on profit and loss from utility operations,
8 it's true CSWR has lost money each year the company has been in existence. But the picture
9 Mr. Hinton paints is focused too narrowly because it fails to acknowledge that neither
10 CSWR nor its utility affiliates fund day-to-day operations exclusively from revenues
11 derived from utility operations. Instead, those revenues are substantially supplemented by
12 working capital provided by investments from U.S. Water Systems, LLC (U.S. Water) –
13 the affiliate group's ultimate corporate parent.

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

1 be adjusted to compensatory levels is something our company – and our investors – expect
2 and plan for. That is another reason why CSWR and its affiliates have been so successful
3 at turning around environmentally and financially distressed utilities like TESI.
4 Consequently, the financial metrics that concern Mr. Hinton need not concern the
5 Commission, especially in light of the fact current customers are being served by a utility
6 that not only is losing money but is failing to provide compliant or reliable service.

7 Since it began operations, CSWR has invested more than \$450 million to acquire,
8 improve, and operate water and wastewater systems. Of that total, approximately \$205
9 million was paid to sellers to acquire the utility assets and approximately \$195 million has
10 been invested to make capital improvements. The remaining approximately \$50 million
11 has provided working capital necessary to keep those operations going until rates can be
12 adjusted. Regulators in all other states where our affiliates operate agree this arrangement
13 satisfies the requirement that a party seeking to acquire utility assets demonstrate the
14 financial wherewithal necessary to own and operate those assets. This approach will work
15 as well in North Carolina as it does elsewhere.

16 CSWR has access to the equity capital necessary to purchase, improve, and operate
17 the water and wastewater systems our affiliates acquire. Our commitment to regulators has
18 been to invest equity sufficient to fund purchases, make necessary and prudent capital
19 improvements, and provide working capital. And because those commitments have been
20 kept, those same regulators continue to entertain and approve our acquisitions.

21 Red Bird plans to add debt to its capital structure at the appropriate time, but that
22 time is not now. Red Bird's systems in North Carolina currently have negative net income
23 and, as I have previously testified, TESI's North Carolina operations currently operate at a

1 loss. No commercial lender would lend money to a company with that kind of balance
2 sheet and income statement. That's why only three state operating companies in our
3 affiliate group – those in Missouri, Louisiana, and Mississippi – have been able to obtain
4 debt financing. But until debt funding is available, equity provided by CSWR will be
5 sufficient to fund and sustain utility operations, as Red Bird's affiliates conclusively have
6 demonstrated in other states.

VIII. CONCLUSION

7 **Q. DO YOU HAVE ANY CONCLUDING THOUGHTS YOU WANT TO**
8 **EXPRESS TO THE COMMISSION REGARDING THIS JOINT APPLICATION?**

9 A. Yes. I would like to reiterate what was said at the conclusion of Mr. Cox's direct
10 testimony in this case. Red Bird's proposed acquisition of the water and wastewater
11 systems currently owned and operated by TESI would be consistent with and would
12 promote the public interest. Transfer of these systems to a well-capitalized enterprise that
13 is a professional utility would be in the best interest of the TESI customers who are
14 currently being provided "intermittently" reliable service, potential on-going exposure to
15 human health threats, years of environmental violations and have no hope for
16 improvements from TESI. Red Bird and CSWR are fully qualified, in all respects, to own
17 and operate those systems and to otherwise provide safe and adequate service.
18 Accordingly, I respectfully ask the Commission to grant the authority sought in the Joint
19 Application.

20 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY AT THIS TIME?**

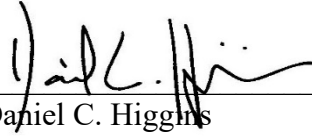
21 A. Yes, it does.

CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing document, has been served on the Public Staff, by either depositing same in a depository of the United States Postal Service, first-class postage prepaid and mailed by the means specified below, or by electronic delivery.

This the 3rd day of October, 2023.

BURNS, DAY & PRESNELL, P.A.



Daniel C. Higgins
Post Office Box 10867
Raleigh, NC 27605
Tel: (919) 782-1441
Email: dhiggins@bdppa.com
Attorneys for Red Bird